



Interim Report

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

VOLUME 1

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Letter of Transmittal

28 September 2018

His Excellency General the Honourable Sir Peter Cosgrove AK MC (Retd)
Governor-General of the Commonwealth of Australia
Government House
CANBERRA ACT 2600

Your Excellency

In accordance with the Letters Patent issued to me on 14 December 2017,
I have made inquiries and prepared an Interim Report of the
Royal Commission into Misconduct in the Banking, Superannuation
and Financial Services Industry.

Yours sincerely

[Signed]

Kenneth M Hayne
Commissioner

Contents

Volume 1

Executive summary	xix
Glossary	xxi
Abbreviations	xxv
Legislation	xxvii

1. Introduction	1
1 Establishment	4
2 The first steps	6
3 Initial inquiries	7
4 Public engagement	10
5 Proceeding by case study	12
6 Work outside hearings	14
6.1 Research	14
6.2 Public engagement	16
6.3 Choosing case studies	17
6.4 Moving targets	17

2. Consumer lending	19
Introduction	19
1 Purposes of consumer protection	20
2 Responsible lending	22
2.1 ‘Unsuitable’	22
2.2 Necessary steps	23
2.2.1 Reasonable inquiries: Requirements and objectives	23
2.2.2 Reasonable inquiries: Financial situation	24
2.2.3 Reasonable steps to verify	24
<i>The HEM</i>	27
2.2.4 ‘Reasonable’ inquiries: Scalable	28
2.3 Non-delegable obligations	30
3 Background information	30
3.1 Home loans	30
3.1.1 Average home loan size	31
3.1.2 Number of mortgage defaults per year	31
3.1.3 Home loans and intermediaries	32
3.2 Car loans	33
3.3 Credit cards	33
3.4 Add-on insurance	34
4 Magnitude and prevalence	35
4.1 Past remediation programs	35
4.1.1 Home loans	35
4.1.2 Car loans	36
4.1.3 Credit cards	36
4.1.4 Add-on insurance	37
4.1.5 Processing and administrative errors	37
4.2 Summary of the remediation programs	37
4.3 How widespread?	38

4.4 Responses to the Commission's initial inquiries	38
4.4.1 ANZ	39
4.4.2 CBA	39
4.4.3 NAB	41
4.4.4 Westpac	42
4.5 Conduct acknowledged by the entities	42
4.5.1 Home loans	42
ANZ	42
CBA and Aussie Home Loans	43
NAB	43
Westpac	44
4.5.2 Car loans	45
ANZ	45
Westpac	46
4.5.3 Credit cards	46
ANZ	46
CBA	46
NAB	47
Westpac	47
4.5.4 Overdrafts	48
ANZ	48
CBA	48
4.5.5 Add-on insurance	48
CBA	48
Westpac	49
4.5.6 Processing errors	49
CBA	49
ANZ	49
NAB	50
Westpac	50
4.5.7 Other consumer lending issues	51
ANZ	51
CBA	51
Other entities	52
5 Consequences of the conduct	52

6 Four kinds of issue	54
6.1 Intermediaries	56
6.1.1 For whom does the intermediary act?	56
6.1.2 Remuneration	59
6.1.3 Other intermediaries	63
6.2 Customer ‘needs’	64
6.3 Credit risk or unsuitable lending?	65
6.4 Processing errors	66
7 Regulatory compliance	67
8 Issues that have emerged	70
3. Financial advice	73
Introduction	73
1 History	74
1.1 How did the financial advice industry emerge?	74
1.2 Vertical integration	78
1.3 Early scandals	82
1.3.1 Storm Financial	82
1.3.2 Commonwealth Financial Planning (CFPL)	84
1.3.3 ‘Isolated pockets of poor culture’	86
2 Financial advice and FoFA	88
2.1 Conflicts of interest	89
2.2 Conflicted remuneration	91
2.3 Grandfathered remuneration	93
2.4 Change grandfathering?	94
2.5 Conflicted remuneration: Related issues	97
2.6 Fee disclosure statements	99
2.7 Norms of behaviour in general law	99

3 Financial advice industry today	101
3.1 Overview of the industry	101
3.2 Licensing regime	101
3.3 The subjects of advice	103
4 Pending changes in the law	104
4.1 Professional standards	104
4.2 Design and distribution obligations on issuers and distributors	105
4.3 Product intervention power	105
4.4 Further changes to industry funding model for ASIC	106
4.5 ASIC Enforcement Review	107
5 Conduct acknowledged by the entities	108
5.1 Fees for no service	108
5.1.1 AMP	108
5.1.2 ANZ	109
5.1.3 CBA	110
5.1.4 NAB	111
5.1.5 Westpac	111
5.2 Inappropriate advice	112
5.2.1 AMP	112
5.2.2 ANZ	113
5.2.3 CBA	113
5.2.4 NAB	114
5.2.5 Westpac	115
5.3 Improper conduct by advisers	117
5.3.1 AMP	117
5.3.2 ANZ	118
5.3.3 CBA	119
5.3.4 NAB	119
5.3.5 Westpac	121

6 What the case studies show	121
7 Fees for no service	126
7.1 Causes	126
7.2 Prevention and detection	131
7.3 Remediation	133
8 Platform fees	134
9 Inappropriate advice	138
9.1 Causes	139
10 Post-hearing responses	142
11 Improper conduct and discipline	143
11.1 Prevention	143
11.2 Detection	145
11.3 Consequences: Regulatory	145
11.3.1 Civil penalty	145
11.3.2 Notice of breach	146
11.3.3 Banning orders	148
11.4 Consequences: Industry	149
11.5 Operation of the disciplinary system	151
11.6 The new regulatory provisions	153
12 Issues that have emerged	155

4. Small and medium enterprises	159
Introduction	159
1 What is an SME?	159
1.1 Harmonise the definitions?	161
1.2 Why treat small businesses differently?	162
2 The current framework	162
2.1 The Code of Banking Practice	165
3 Conduct acknowledged by the entities	170
3.1 ANZ	170
3.2 BOQ	171
3.3 CBA	173
3.4 Macquarie Bank	175
3.5 NAB	175
3.6 Suncorp	177
3.7 Westpac	177
4 The voluntary guarantor	178
5 Responsible lending	179
6 More general issues	180
7 Issues that have emerged	182
7.1 Code of Banking Practice	183
7.2 Guarantees	184
7.3 External dispute resolution	184

5. Bankwest and CBA	185
Introduction	185
1 The complainants' conundrum	185
2 The Bankwest acquisition	187
3 Previous inquiries	190
4 Analysis of the various theories	193
5 Further submissions	210
6. Agricultural lending	225
Introduction	225
1 Legal and regulatory framework	228
1.1 General	228
1.2 Farm debt mediation and rural financial counsellors	229
1.3 Who are the principal lenders to agricultural businesses?	230
2 Conduct acknowledged by the entities	232
2.1 ANZ	232
2.2 Bendigo	233
2.3 CBA	234
2.4 NAB	235
2.5 Rabobank	236
2.6 Other inquiries	237

3 Issues identified	237
3.1 Receivers and other external administrators	238
4 Analysing the issues	241
4.1 An overarching problem?	242
4.2 Lending against ‘market value’	244
4.3 Who values the land?	245
4.4 Dealing with distressed loans	247
4.4.1 Farm debt mediation	251
4.4.2 Hardship	252
4.4.3 Default interest and the enforcement of securities	253
5 Issues that have emerged	254
7. Remote communities	257
Introduction	257
1 Remote area issues	259
1.1 Basic accounts	260
1.2 Informal overdrafts	260
1.3 Dishonour fees	261
1.4 Identification issues	262
2 Funeral insurance	262
2.1 Funeral insurance issues	263
3 Issues that have emerged	264

8. Regulation and the regulators	267
Introduction	267
1 Why were breaches so many and so widespread?	268
2 ASIC	270
2.1 ASIC's remit	270
2.2 ASIC's response to misconduct	271
2.3 Infringement notices	274
2.4 Other regulatory responses	275
2.5 Responding to misconduct: The proper starting point	277
2.6 Implementing new provisions	281
2.7 Limited powers	285
2.8 Litigation and regulation	285
3 The future: Regulation	290
3.1 Change the law?	290
3.2 The place of the Banking Code of Practice	291
4 The future: The regulators	294
4.1 ASIC	294
4.1.1 Size of remit	294
4.1.2 Negotiated outcomes	295
4.1.3 Remediation	296
4.1.4 Remedy less than profit	296
4.1.5 Congruence between policies and the needs of the economy	296
4.2 APRA	297

5 Issues that have emerged	299
5.1 The present regulatory regime	299
5.2 Accountability of the regulators	299
5.2.1 ASIC	299
5.2.2 APRA	300
9. Entities: Causes of misconduct	301
1 Culture, governance and remuneration	301
2 Management by measurement	302
3 Some matters of history	303
3.1 The GFC and remuneration	303
3.2 Future of Financial Advice reforms	305
3.3 International developments	305
3.4 The Sedgwick Review	306
4 Responses to the Sedgwick Review: Changing remuneration and changing culture	308
4.1 ANZ	309
4.2 Westpac	314
4.3 Other banks	315
5 Changed remuneration and changed culture?	316
6 What can or should be done about remuneration practices and policies?	317
6.1 Is incentive remuneration necessary?	317
6.2 Would better disclosure help?	318
6.3 Regulatory intervention?	318
6.4 Meeting the dangers of conduct risk	320
6.5 The BEAR	321

6.6 Intermediaries	322
6.7 Business structures	323
7 Issues that have emerged	324
7.1 Conduct risk	324
7.2 Remuneration	324
7.3 The BEAR	325
7.4 Intermediaries	325
7.5 Business structures	326
10. Issues that have emerged	327
Introduction	327
1 Consumer lending	327
2 Financial advice	329
3 Small and medium enterprises	333
3.1 Code of Banking Practice	334
3.2 Guarantees	334
3.3 External dispute resolution	335
4 Agricultural lending	335
5 Remote communities	337
6 Regulation and the regulators	339
7 Entities: Causes of misconduct	340
7.1 Conduct risk	341
7.2 Remuneration	341
7.3 The BEAR	341

7.4 Intermediaries	341
7.5 Business structures	342
8 Restating the issues	343
8.1 Issues	343
8.1.1 Access	343
8.1.2 Intermediaries	343
8.1.3 Responsible lending	344
8.1.4 Regulation and the regulators	345
8.2 Causes	345
8.3 Responses	345

Executive summary

The Commission's work, so far, has shown conduct by financial services entities that has brought public attention and condemnation. Some conduct was already known to regulators and the public generally; some was not.

Why did it happen? What can be done to avoid it happening again? These are now the key questions.

In this Interim Report these questions – 'why' and 'what now' – are asked with particular reference to banks, loan intermediaries and financial advice, with a view to provoking informed debate about both questions.

Why did it happen?

Too often, the answer seems to be greed – the pursuit of short term profit at the expense of basic standards of honesty. How else is charging continuing advice fees to the dead to be explained? But it is necessary then to go behind the particular events and ask how and why they came about.

Banks, and all financial services entities recognised that they sold services and products. Selling became their focus of attention. Too often it became the sole focus of attention. Products and services multiplied. Banks searched for their 'share of the customer's wallet'. From the executive suite to the front line, staff were measured and rewarded by reference to profit and sales.

When misconduct was revealed, it either went unpunished or the consequences did not meet the seriousness of what had been done. The conduct regulator, ASIC, rarely went to court to seek public denunciation of and punishment for misconduct. The prudential regulator, APRA, never went to court. Much more often than not, when misconduct was revealed, little happened beyond apology from the entity, a drawn out remediation program and protracted negotiation with ASIC of a media release, an infringement notice, or an enforceable undertaking that acknowledged no more than that ASIC had reasonable 'concerns' about the entity's conduct. Infringement notices imposed penalties that were immaterial for the large banks. Enforceable undertakings might require a 'community benefit payment', but the amount was far less than the penalty that ASIC could properly have asked a court to impose.

What can be done to prevent the conduct happening again?

As the Commission's work has gone on, entities and regulators have increasingly sought to anticipate what will come out, or respond to what has been revealed, with a range of announcements. These include announcements about new programs for refunds to and remediation for consumers affected by the entity's conduct, about the abandonment of products or practices, about the sale of whole divisions of the business, about new and more intense regulatory focus on particular activities, and even about the institution of enforcement proceedings of a kind seldom previously brought. There have been changes in industry structure and industry remuneration.

The law already requires entities to 'do all things necessary to ensure' that the services they are licensed to provide are provided 'efficiently, honestly and fairly'. Much more often than not, the conduct now condemned was contrary to law. Passing some new law to say, again, 'Do not do that', would add an extra layer of legal complexity to an already complex regulatory regime. What would that gain?

Should the existing law be administered or enforced differently? Is different enforcement what is needed to have entities apply basic standards of fairness and honesty: by obeying the law; not misleading or deceiving; acting fairly; providing services that are fit for purpose; delivering services with reasonable care and skill; and, when acting for another, acting in the best interests of that other? The basic ideas are very simple. Should the law be simplified to reflect those ideas better?

This Interim Report seeks to identify, and gather together in Chapter 10, the questions that have come out of the Commission's work so far. There will be a further round of public hearings to consider these and other questions that must be dealt with in the Commission's Final Report.

Glossary

Term	Definition
anti-hawking provisions	Provisions set out in Sections 736, 992AA and 992A of the <i>Corporations Act 2001</i> (Cth) that prohibit offering financial products for issue or sale during, or because of, an unsolicited meeting or telephone call with a retail client.
authorised deposit-taking institution (ADI)	A body corporate authorised under the <i>Banking Act 1959</i> (Cth) to carry on a banking business in Australia.
Australian Credit Licence (ACL)	A licence issued under the <i>National Consumer Credit Protection Act 2009</i> (Cth) that authorises a licensee to engage in particular credit activities.
Australian financial services licence (AFSL), Australian financial services licensee	A licence under the <i>Corporations Act 2001</i> (Cth) that authorises a person who carries on a financial services business to provide financial services. A licensee is the person who provides the services.
Bank Bill Swap Rate (BBSY)	An interest rate used as a benchmark when pricing financial products.
buyer of last resort (BOLR)	Arrangements whereby a licensee or an authorised representative acquires the business of another representative. The purchase price is determined using a specific formula.
conflicted remuneration	Any benefit, whether monetary or non-monetary, given to a financial services licensee , or their representatives, who provides financial product advice to retail clients that, because of the nature

Term	Definition
	of the benefit or the circumstances in which it is given could reasonably be expected to influence the choice of financial product recommended by the licensee or representative or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative: see Section 963A of the <i>Corporations Act 2001</i> (Cth).
enforceable undertaking	An undertaking enforceable in a court. Issued under the <i>Australian Securities and Investments Commission Act 2001</i> (Cth) and the <i>National Consumer Credit Protection Act 2009</i> .
external dispute resolution (EDR)	An independent service for resolving disputes between consumers and providers of financial products and services, as an alternative to the court system.
financial product	Under the <i>Corporations Act 2001</i> (Cth), a facility through which, or through the acquisition of which, a person makes a financial investment, manages financial risk and/or makes non-cash payments.
financial services entity	Defined by the Letters Patent as (among other things) ‘an ADI (authorised deposit-taking institution) within the meaning of the <i>Banking Act 1959</i> ’, ‘a person or entity required by section 911A of the <i>Corporations Act 2001</i> to hold an Australian financial services licence , or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative’, and ‘a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders’.

Term	Definition
Financial Services Guide (FSG)	A guide that contains information about the entity providing financial advice, and explains the services offered, the fees charged and how the person or company providing the service will deal with complaints.
financial services licensee	An individual or business that has been granted an Australian financial services licence (AFSL) by ASIC.
Future of Financial Advice (FoFA)	A 2012 package of legislation intended to improve the trust and confidence of Australian retail investors in the financial services sector and ensure the availability, accessibility and affordability of high quality financial advice.
Household Expenditure Measure (HEM)	A measure of what families spend on different types of household items, calculated quarterly by the Melbourne Institute of Applied Economic and Social Research.
mortgage aggregator	An intermediary between mortgage brokers and lenders. Mortgage aggregators have contractual arrangements with lenders that allow brokers operating under the aggregator to arrange loans from those lenders.
mortgage broker	An intermediary between borrowers and lenders of home loans.
third party guarantor	A person or business other than the borrower who guarantees to pay back a loan if the borrower does not.

Term	Definition
Tier 1 Capital	Capital against which losses can be written off while an authorised deposit-taking institution (ADI) continues to operate and can absorb losses should the ADI ultimately fail.
trail commission	A regularly recurring commission to an intermediary, such as a broker, based on a proportion of the current or average loan balance and payable periodically after the loan is made/drawn. Distinct from a commission that is paid up front.
vertical integration	A description of the relationship between entities where financial advice, platforms and funds management are controlled by a single entity.

Abbreviations

ABA	Australian Bankers' Association (now Australian Banking Association)
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ACBF	Aboriginal Community Benefit Fund
ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ADI	authorised deposit-taking institution
AFCA	Australian Financial Complaints Authority
AFA	Association of Financial Advisers
AFSL	Australian financial services licence
APRA	Australian Prudential Regulation Authority
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
BOLR	buyer of last resort
EDR	external dispute resolution

FASEA	Financial Adviser Standards and Ethics Authority
FoFA	Future of Financial Advice (legislation reforms)
FOS	Financial Ombudsman Service
FPA	Financial Planning Association of Australia
FSG	Financial Services Guide
HEM	Household Expenditure Measure
KPI	Key Performance Indicator
LVR	loan-to-value ratio
PDS	product disclosure statement
SME	small and medium enterprises
SMSF	self managed superannuation fund

Legislation

Australian Securities and Investments Commission Act 2001 (Cth)
(The ASIC Act)

Australian Small Business and Family Enterprise Ombudsman
Act 2015 (Cth)

Banking Act 1959 (Cth)

Competition and Consumer Act 2010 (Cth)

Corporations Act 2001 (Cth) (the Corporations Act)

Fair Work Act 2009 (Cth)

Farm Business Debt Mediation Act 2017 (Qld)

Farm Debt Mediation Act 1994 (NSW)

Farm Debt Mediation Act 2011 (Vic)

Financial Services Reform Act 2001 (Cth)

Income Tax Assessment Act 1997 (Cth)

Insurance Contracts Act 1984 (Cth)

National Consumer Credit Protection Act 2009 (Cth) (the NCCP Act)

Privacy Act 1988 (Cth)

Royal Commissions Act 1902 (Cth)

1. Introduction

The Letters Patent establishing the Commission authorise, but do not require, me to submit an interim report. I have decided that it is important that I provide an interim report and that I explain why that is so.

The Commission has now conducted six rounds of public hearings. The first four rounds of hearings related to issues that focused principally on the provision of banking services to consumers, to small enterprises, and to rural and remote communities. Those first four rounds of hearings also looked at issues arising from the use of intermediaries between borrowers and lenders and from the provision of financial advice to retail customers.

Taken together, those first four rounds of hearings, coupled with the very large amount of work undertaken outside the hearing room by counsel assisting, by the solicitors assisting and by the Office of the Royal Commission allow me to identify issues about conduct by banks and their associated entities that call for further debate and consideration before I make my final report.

The Letters Patent record that 'Australia has one of the strongest and most stable banking, superannuation and financial services industries in the world, which performs a critical role in underpinning the Australian economy'. And, as the Letters Patent also record, 'Australia's banking system is systemically strong with internationally recognised and world's best prudential regulation and oversight'.

The Letters Patent require me to inquire into, and report on, whether any conduct by financial services entities, including banks and their associated entities, might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fall below community standards and expectations. I must execute those tasks conscious of the fact that the banking system is a central artery in the body of the economy. Defects and obstructions in the artery can have very large effects. Likewise, prolonged injections of doubt and uncertainty can affect performance. Therefore, I must execute my tasks promptly, and I must execute those tasks in ways that will achieve two related purposes.

First, as far as reasonably possible, I must seek to identify properly the underlying causes of conduct of the kinds referred to in the Terms of Reference: conduct that might amount to misconduct and conduct falling short of community standards and expectations. As the Terms of Reference say, I must inquire whether the relevant conduct is 'attributable to the particular culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant subsector' and whether the conduct 'result[s] from other practices, including risk management, recruitment and remuneration practices of a financial services entity, or in the relevant industry or relevant subsector'. The second purpose must be to conduct the inquiry in ways that will prompt proper consideration of how best to avoid recurrence of conduct that might amount to misconduct or conduct falling short of community standards and expectations.

To these ends, this interim report records the conclusions reached about the particular case studies that were examined in the first four rounds of hearings. This interim report seeks to identify the issues about banking, loan intermediaries and provision of financial advice that I consider arise out of the matters examined in those hearings. This interim report poses a series of questions, directing attention to considerations that may bear upon what conclusions I should reach, and what recommendations I should make, about banking, lending intermediaries, and financial advice in response to the more particular issues identified in the Terms of Reference namely:

- the adequacy of the existing laws and policies of the Commonwealth relating to the provision of banking and related financial services;
- the adequacy of the internal systems of financial services entities;
- the adequacy of existing forms of industry self-regulation, including industry codes of conduct, to identify, regulate and address misconduct and conduct falling short of community expectations and to provide appropriate redress to consumers;
- the effectiveness and ability of regulators to identify and address misconduct;
- whether any further changes to the legal framework, practices within entities, or the financial regulators are necessary to minimise the likelihood of misconduct in the future; and

- the effectiveness of mechanisms for redress for consumers of financial services who suffer detriment as a result of misconduct.

Before the Commission was appointed, all four major banks had publicly recognised that their conduct, or the conduct of associated entities, had fallen short of what the community expected. Regulators and others had examined particular aspects of the conduct of banks and their associated entities and had sometimes levelled sharp criticism at those who had engaged in the conduct that was the subject of inquiry. Thus, when the Commission began its work, as many as 70 public inquiries concerning the conduct of banks and their associated entities had been or were being conducted. Regulatory authorities had conducted and were continuing to conduct numerous investigations into allegations of misconduct.

The Commission therefore began its work from the established premise that some banks and their associated entities had engaged in conduct during the preceding 10 years that was conduct that might amount to misconduct or was conduct that fell short of community standards and expectations.

In these circumstances, I thought it right to begin my enquiry by asking financial services entities, including banks and their associated entities, to tell me what conduct over the previous 10 years they had identified as amounting to misconduct or conduct falling short of community standards and expectations. In light of both the responses to those requests and what had been established before the Commission was appointed, I determined that the Commission's hearings should proceed by examining case studies, rather than by seeking to investigate every separate case in which it was said that a financial services entity had or might have engaged in misconduct, or had or might have engaged in conduct falling short of community standards and expectations.

Nevertheless it remained, and it remains, vitally important to the work of the Commission to find out not only what complaints had been made and investigated but also what other complaints members of the public wanted to make. And, as later explained, many thousands of members of the public have made submissions to the Commission. Many of the consumers who have given evidence, or whose cases have been considered in the course of deciding which cases should be the subject of hearings have been identified because they made a submission to the Commission.

Before I deal with the particular case studies that were undertaken in the first four rounds of hearings, the issues that arise from those case studies and the questions that those case studies provoke, I should say something about the establishment of the Commission and the steps that were taken to set it up to do its work.

1 Establishment

By Letters Patent dated 14 December 2017, I was appointed to be a Commission of Inquiry and required and authorised to inquire into the matters stated in the Letters Patent. Ten subjects of inquiry were identified:

- (a) whether any conduct by financial services entities (including by directors, officers or employees of, or by anyone acting on behalf of, those entities) might have amounted to misconduct and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency;
- (b) whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and expectations;
- (c) whether the use by financial services entities of superannuation members' retirement savings, for any purpose, does not meet community standards and expectations or is otherwise not in the best interests of those members;
- (d) whether any findings in respect of the matters mentioned in paragraphs (a), (b) and (c):
 - (i) are attributable to the particular culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant subsector; or
 - (ii) result from other practices, including risk management, recruitment and remuneration practices, of a financial services entity, or in the relevant industry or relevant subsector;
- (e) the effectiveness of mechanisms for redress for consumers of financial services who suffer detriment as a result of misconduct by financial services entities;

- (f) the adequacy of:
 - (i) existing laws and policies of the Commonwealth (taking into account law reforms announced by the Commonwealth Government) relating to the provision of banking, superannuation and financial services; and
 - (ii) the internal systems of financial services entities; and
 - (iii) forms of industry self-regulation, including industry codes of conduct;

to identify, regulate and address misconduct in the relevant industry, to meet community standards and expectations and to provide appropriate redress to consumers;
- (g) the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities;
- (h) whether any further changes to any of the following are necessary to minimise the likelihood of misconduct by financial services entities in future (taking into account any law reforms announced by the Commonwealth Government):
 - (i) the legal framework;
 - (ii) practices within financial services entities;
 - (iii) the financial regulators;
- (i) any matter that has occurred or is occurring overseas, to the extent the matter is relevant to a matter mentioned in paragraphs (a) to (h);
- (j) any matter reasonably incidental to a matter mentioned in paragraphs (a) to (i).

The Letters Patent directed me to have regard to the implications of any change to laws that I proposed to recommend ‘for the economy generally, for access to and the cost of financial services for consumers, for competition in the financial sector and for financial system stability’. The Letters Patent further directed me to ‘give priority to matters that in [my] opinion, have greater potential for harm if not addressed expeditiously’.

The Letters Patent defined ‘financial services entity’ as meaning (among other things) ‘an ADI (authorised deposit taking institution) within the meaning of the *Banking Act 1959*’, ‘a person or entity required by

Section 911A of the *Corporations Act 2001* [the Corporations Act] to hold an **Australian financial services licence**, or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative', and 'a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders'. (Bolded terms like Australian financial services licence are defined in the Glossary at the start of this volume.) Banks, financial advisers and loan intermediaries are all relevant 'financial services entities'.

The Letters Patent defined 'misconduct' as including four kinds of conduct:

- conduct that 'constitutes an offence against a Commonwealth, State or Territory law, as in force at the time of the alleged misconduct';
- conduct that 'is misleading, deceptive or both';
- conduct that 'is a breach of trust, breach of duty or unconscionable conduct'; and
- conduct that 'breaches a professional standard of a recognised and widely accepted benchmark for conduct'.

2 The first steps

Before the Letters Patent were issued, Ms Toni Pirani of the Attorney General's Department was nominated to act as the Chief Executive Officer of the Office of the Royal Commission (ORC). Again, before the Letters Patent were issued, I nominated some counsel to assist me. Pursuant to the *Royal Commissions Act 1902* (Cth)¹ the Attorney-General appointed Ms Rowena Orr QC, Ms Eloise Dias and Mr Mark Costello as counsel assisting the Commission. Subsequently, Mr Michael Hodge QC and Mr Albert Dinelli were also appointed as counsel assisting. As the work of the Commission proceeded, the Australian Government Solicitor retained additional counsel to prosecute the work of the Commission: Ms Claire Schneider, Ms Sarah Zeleznikow, Mr Mark Hosking and Mr Tim Farhall.

¹ *Royal Commissions Act 1902* (Cth) s 6FA.

On 7 December 2017, expressions of interest were sought from 27 firms of solicitors to act as solicitors assisting the Commission. Eight bids were received by the deadline of 14 December 2017. The Australian Government Solicitor was selected and on 18 December 2017 commenced in that role.

The Commission's CEO set about the tasks of assembling the staff of the ORC and finding premises from which the staff, counsel and solicitors could work. Those (very large) tasks were substantially completed by 2 March 2018. In the meantime, with the assistance of the Attorney-General's Department, the Commission established its website. On 22 January 2018, with the assistance of document management contractor Law In Order, the Commission established the means by which members of the public could make submissions to the Commission electronically by completing a form available through the Commission's website.

3 Initial inquiries

On the day after the Letters Patent were issued, I wrote to 61 financial services entities inviting each to answer three (or, in the case of superannuation entities, four) questions.²

- First, each entity was asked, in effect, whether it had identified any misconduct by the entity that had occurred at any time since 1 January 2008 and, if it had, to state 'the nature, extent and effect of that misconduct'.
- Second, each entity was asked whether it had identified 'any conduct, practice, behaviour or business activity' in which it had engaged since 1 January 2008 that it considered had fallen below community standards and expectations and again, if it had, to state the nature and effect of that conduct, practice, behaviour or activity.
- Third, each entity that identified misconduct or conduct falling short of community standards and expectations was asked a number of other questions about that conduct including:

² The text of the letters is set out in Appendix 2.

- whether the conduct was the subject of another inquiry, investigation or legal proceeding;
- whether the entity attributed any of the conduct to the culture or governance practices of the entity or the industry or to other practices;
- what steps the entity had taken to remedy the consequences of the conduct; and
- what steps the entity had taken to prevent recurrence of conduct of the kind reported.

The additional question asked of superannuation entities need not be noticed here.

At the same time, I wrote to industry associations and to the Australian Competition and Consumer Commission, the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission (ACCC, APRA and ASIC) asking each of them the same kinds of question I had asked of financial services entities.

I gave the financial services entities six weeks to make their responses, asking each to make its response by 29 January 2018.

All of the entities, associations and regulators to which I wrote provided written responses to the questions I asked. As will be seen from what is said later in this report about individual case studies, each of the larger financial services entities acknowledged that, since 1 January 2008, it had engaged in conduct that fell short of community standards and expectations. Some acknowledged that some conduct might have amounted to misconduct. But none of the submissions by the four largest banks (ANZ, CBA, NAB or Westpac) or by AMP suggested that the submission that it made in answer to the questions I had asked in my letter of 15 December 2017 set out a comprehensive and detailed list of all conduct of the kinds that the letter had asked them to provide. In several cases, the submission said expressly that it set out ‘examples’ of conduct that the entity had identified.

This being so, on 2 February 2018, I wrote again to a number of entities, including the four largest banks and AMP asking each to provide me with a detailed and comprehensive list of all conduct occurring in the previous five years that the entity considered amounted to ‘misconduct’ as defined in the

Terms of Reference. CBA and NAB protested that the task was too large and could not be completed within the time allowed. Instead, each provided the Commission with printouts produced by risk management programs that those entities maintained as a record of every incident that any employee of the entity considered might constitute a breach of law. After Senior Counsel Assisting noted, during the first round of hearings, that the answer that CBA had made to my 2 February letter was unhelpful, CBA provided a further submission on 22 March 2018 (the last day of that round of hearings). This further submission set out in two tables conduct that it had identified as misconduct occurring in the preceding five years. Two tables were provided: one relating to Aussie Home Loans and the other relating to other entities in the CBA group. The Aussie Home Loans table had 139 entries, the other table had 309 entries.

The point to be made about the course of events is that at least CBA and NAB found it difficult to comply with the requests that I made. Each explained the difficulty by pointing to the need to assemble information from many separate sources. NAB said that, to make its response to the 15 December requests, it had examined 'NAB's significant litigation reports, reported Australian court judgments, NAB's breach registers and underlying reports to ASIC, APRA and AUSTRAC, adverse FOS determinations relating to "systemic issues", significant breaches of the Code of Banking Practice reported in NAB's Annual Statements of Compliance, and reports to the Australian Information Commissioner'.³ NAB said that to provide details of misconduct that had occurred over the preceding five years it would have to look at, among other things, the Annual Compliance Statements it had made under the Code of Banking Practice (which recorded 1,914 breaches of the Code in the last five full financial years), 300 events reported as significant breaches to ASIC or APRA occurring during that period, 370 FOS determinations, 375 determinations by the Credit and Investments Ombudsman, 246 significant litigation matters and five different databases recording customer complaints.⁴

³ Letter dated 13 February 2018 from John Sharpe, General Manager, Dispute Resolution & Regulatory Investigations, NAB, to Simon Sherwood, AGS, [5(a)]. AUSTRAC is the Australian Transaction Reports and Analysis Centre and FOS is the Financial Ombudsman Service.

⁴ Letter dated 13 February 2018 from John Sharpe, General Manager, Dispute Resolution & Regulatory Investigations, NAB, to Simon Sherwood, AGS, [15]–[31].

Taken together, the course of events and the explanations proffered can lead only to the conclusion that neither CBA nor NAB could readily identify how, or to what extent, the entity as a whole was failing to comply with the law. And if that is right, neither the senior management nor the board of the entity could be given any single coherent picture of the nature or extent of failures of compliance; they could be given only a disjointed series of bits of information framed by reference to particular events. Information presented in that way points too easily towards explaining what has happened as ‘a small number of people choosing to behave unethically’⁵ or as the product of ‘people, policies and processes that existed with a pocket of poor culture in that area at that time’.⁶

The extent to which these issues extend beyond CBA and NAB remains to be explored.

4 Public engagement

As already mentioned, the Commission invited members of the public to make submissions to the Commission using the form available on the Commission’s website. I sought to emphasise the importance of public submissions at every public hearing conducted by the Commission, including the first, formal sitting that was held on 12 February 2018.⁷

At that first sitting I noted that there had been some public discussion about the effects on the work of the Commission of contractual provisions about confidentiality in settlement agreements and non-disparagement clauses in employment, settlement or severance agreements. I said:

This Royal Commission, like every Federal Royal Commission, has extensive compulsory powers. A confidentiality or non-disparagement clause in an agreement will not act as a reasonable excuse against production in answer to a notice to produce or a summons. It would not be

⁵ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group’s Response dated 29 January 2018 to the Commission’s Letter dated 15 December 2017*, 29 January 2018, 5 [3.1].

⁶ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 9 [27].

⁷ Transcript, Commissioner Hayne, 12 February 2018, 11.

a reasonable excuse not to answer a question in a hearing. It seems to me to follow that answering a notice or summons would not amount to a breach of any confidentiality or non-disparagement clause. Further – and this is very important – under section 6M of the Royal Commissions Act, if a witness gives evidence or produces a document under a notice or summons, no injury can be done to that person. Suing the person would almost certainly fall within that prohibition.

In many cases where a dispute had been settled on confidential terms, the most immediate fact for the Commission will be that the dispute was settled, not the particular terms on which it was settled, and the fact of the settlement of the dispute will not be within any confidentiality provision. But whether or not that is so, any institution which sought any form of legal redress against a member of the public or a whistleblower seeking to volunteer information to the Commission in anticipation of the possible exercise of the Commission's coercive powers would be taking a step which would very likely provoke two immediate consequences. First, the Commission would be very likely indeed to exercise its compulsory powers to secure the information in question. Second, the very fact that an institution sought to inhibit or prevent the disclosure of the information would excite the closest attention not only to the lawfulness of that conduct by the institution, but also to what were the institution's motives for seeking to prevent the Commission having that information.⁸

Thereafter many financial services entities, including most if not all banks, said publicly that they would not seek to enforce or rely upon any confidentiality provision to prevent anyone making a complaint to the Commission. And, nothing in the later work of the Commission, its lawyers or its staff has so far suggested that confidentiality or non-disparagement provisions have inhibited in any way any communication with the Commission.

Many members of the public have submitted complaints about financial services entities by using the Commission's web-form. By 31 August 2018, more than 8,646 forms had been submitted. In addition, there had been more than 5,500 emails and 3,200 telephone calls to the Office of the Royal Commission, some asking for help in making a complaint, some asking about the work of the Commission, some offering comments on the work that had been done.

⁸ Transcript, Commissioner Hayne, 12 February 2018, 11–12.

All of the complaints made by the public are read. Many of the case studies examined in public hearings have come to the attention of the Commission only because a member of the public submitted a web-form complaint. Some information about the nature of the complaints that have been received is set out in Appendix 8. As that information shows, roughly two out of three of the complaints that have been made are complaints about banking. And most of the complaints have been made by persons who give an address in the three eastern mainland states.

Why did the Commission proceed by case study?

5 Proceeding by case study

Consideration of what had been the subject of earlier inquiries and investigations showed that it would be impossible for the Commission to investigate every instance of conduct that it was alleged might have amounted to misconduct or was conduct falling short of community standards and expectations. Before the establishment of the Commission, banks and their associated entities had paid hundreds of millions of dollars of compensation to thousands of consumers to remedy the consequences of things that the entities had done or not done. Hundreds, soon thousands, of members of the public made submissions to the Commission complaining about the conduct of banks or their associated entities.

Evidently, then, not every case could be investigated or examined in the course of public hearings. Choices had to be made. What criteria could be applied in making those choices?

The main criterion applied in choosing case studies was whether the cases chosen were likely to permit identification and useful exploration of issues having a wider application than the particular case. Were the cases particular examples of widespread or frequently occurring conduct? Did the cases raise issues that may be systemic?

The Commission's Terms of Reference require it not only to investigate conduct but also to identify the causes of conduct of the relevant kinds. As already noted, the Commission began its work knowing that there had been conduct of the relevant kinds. In those cases, the focus fell upon why rather than what. What had happened was known. Why it had happened required further investigation and consideration. Accordingly, when selecting the

cases that were to be examined in the course of public hearings it was important to identify cases that might give some understanding of why the conduct had occurred. And it also followed that sometimes it would be desirable to look at more than one case to see what, together, they might show about causes.

Finally, regard had to be paid, and significance given, to the importance of the Commission conducting a public inquiry into conduct that might amount to misconduct or was conduct falling below community standards and expectations. Public exposure of misconduct and the vindication that those affected by that conduct derive from its exposure is an important consequence of conducting a public inquiry into misconduct. The cases that were chosen had to be selected as reasonably illustrative of the kinds of conduct about which members of the public had complained.

Some considerations were irrelevant to choosing the case studies that were undertaken. Neither the continuing existence of a dispute between entity and customer, nor the customer's desire to start or reopen a dispute, could bear upon whether the Commission would look at the conduct. This Commission, like every federal Royal Commission, exercises executive power. It does not, and cannot, exercise judicial power. The Commission cannot decide disputes between parties. It cannot award damages or any other form of relief to a person who complains that a financial services entity engaged in conduct of a kind that falls within the Terms of Reference. It cannot decide whether there *has been* misconduct. That is a task for a court. The most that the Commission can do is decide whether conduct 'might have amounted to misconduct and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency'.⁹ (I say more about this subject under the heading 'The Commission's tasks' when dealing with the case studies.)

It is then necessary to recognise some possible consequences of pursuing particular case studies.

Because the Commission was required to examine whether conduct might amount to misconduct or was conduct falling short of community standards and expectations, the Commission's work focused upon bad behaviour. Like

⁹ *Letters Patent*, 14 December 2017, (a).

any inquiry that is required to investigate whether there has been wrongdoing, and if there has, to identify its causes, there is always a risk that the resulting picture of the industry is distorted. There is always a risk of losing sight of the fact that, in any industry as large as the financial services industry (or any of the chief subsectors of the industry) there will always be cases where participants do the wrong thing. Sometimes participants will act from base motives; sometimes participants will act thoughtlessly or will be careless of whether their actions are morally or legally justifiable.

In addition it is important not to be dazzled by the amounts of money financial services entities have spent in compensating customers for the harm done by conduct that is now recognised to have been misconduct or, at least, conduct falling short of community standards and expectations. Large financial entities engage in very many dealings with very many people. The entity's conduct will often affect thousands of customers. If it does, the total amount that must be paid to remedy damage done to customers as a result of the conduct may be very large. Often that reflects the scale of the entity's enterprise. It may say little or nothing about how or why the conduct occurred. And *for the entity*, the amount, though large, may not materially affect the entity's financial results.

Those observations may be important. They may be relevant when considering what entities have done in response to identifying conduct if a relevant kind. But, it remains important to recognise that, *for the individual customer*, the effect of an entity's conduct may be very large, regardless of what effect it may have on the entity. Some of the case studies examined concerned amounts that may look to be small. The figure appearing after the dollar sign is not always an accurate measure of the effect that conduct may have had.

6 Work outside hearings

Much of the work of the Commission has been undertaken outside the hearing room.

6.1 Research

First, considerable research has been undertaken both by staff of the Commission and by consultants. Their research has been recorded in a series of substantial papers published by the Commission. At the

Commission's request, several other papers have been provided to the Commission by Commonwealth authorities and published by the Commission.

The papers that relate to the subjects dealt with in this report and had been published by the Commission before the completion of the report are listed and reproduced in Appendix 9.

As can be seen from the list, the papers describe:

- features of the banking industry;¹⁰
- features of the financial planning industry;¹¹
- features of the mortgage broking industry;¹²
- matters bearing upon financial services and small and medium sized enterprises;¹³ and
- features of car financing in Australia.¹⁴

The papers also provide essential information about the existing legal framework governing a number of different aspects of the provision of financial services:

¹⁰ FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018.

¹¹ FSRC, *FSRC Background Paper No. 6 (Part A): Some Features of the Australian Financial Planning Industry*, 5 April 2018; FSRC, *FSRC Background Paper No. 6 (Part B): Education and Training Requirements for Financial Advisers*, 5 April 2018; FSRC, *FSRC Background Paper No. 6 (Part C): Financial Products Available to Retail Investors*, 5 April 2018.

¹² FSRC, *FSRC Background Paper No. 2: Some Features of the Australian Mortgage Broking Industry*, 22 February 2018.

¹³ FSRC, *FSRC Background Paper No. 12: Financial Services and Small and Medium-Sized Enterprises*, 14 May 2018.

¹⁴ FSRC, *FSRC Background Paper No. 3: Some Features of Car Financing in Australia*, 9 March 2018.

- consumer credit;¹⁵
- financial advice and sale of **financial products**;¹⁶ and
- credit for small business.¹⁷

Two other papers consider more specific issues about the regulatory capital framework for ADIs¹⁸ and the relationship between the regulatory capital framework and impairment of loans, provisioning for impaired loans and enforcing security for loans.¹⁹

All of these papers provide information that is important to a proper understanding of the work of the Commission. The work of the Commission, in its public hearings and the work that has been done outside the hearing room is necessarily shaped by reference to the nature and characteristics of the industry with which it is dealing and the legal and regulatory framework within which the industry has been working during the times that are relevant to the conduct being examined.

6.2 Public engagement

Second, as has already been noted, staff of the Office of the Royal Commission have spoken to and communicated with many members of the public in the course of their work.

¹⁵ Jeannie Marie Paterson and Nicola Howell, *FSRC Background Paper No. 4: Everyday Consumer Credit – Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans*, 12 March 2018; Treasury, *FSRC Background Paper No. 5: Request for Information Reforms to Consumer Lending*, 19 March 2018.

¹⁶ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018; Treasury, *FSRC Background Paper No. 8: Key Reforms in the Regulation of Financial Advice*, 13 April 2018.

¹⁷ Andrew Godwin, Jeannie Marie Paterson and Nicola Howell, *FSRC Background Paper No. 10: Credit for Small Business – An Overview of Australian Law Regulating Small Business Loans*, 7 May 2018; Treasury, *FSRC Background Paper No. 11: Request for Information – Reforms to Small Business Lending*, 9 May 2018.

¹⁸ APRA, *FSRC Background Paper No. 9: The Regulatory Capital Framework for Authorised Deposit-Taking Institutions (ADIs)*, 27 April 2018.

¹⁹ APRA, *FSRC Background Paper No. 13: The Regulatory Capital Framework – Impairment Provisioning and Enforcing Security*, 18 May 2018.

6.3 Choosing case studies

Third, solicitors and counsel assisting have considered many more cases of alleged relevant conduct than those taken as case studies in hearings. To do that, Notices to Produce have been prepared and served and witness statements sought and examined to see whether the case concerned is one that the Commission should examine in public hearings.

As later explained in more detail when dealing with the four case studies in the third round of hearings that concerned loans made by Bankwest, solicitors and counsel examined thousands of pages of documents relating to dozens of loans before the four that were examined in evidence were chosen as illustrating issues that should be examined in public hearings.

For the fourth round of hearings concerning dealings with customers in rural and remote areas, there were extensive consultations with financial counselling services and legal aid providers. Close attention was given to the web-form complaints. Cases were identified. Complainants were contacted and interviewed, often more than once. Entities were required to produce relevant documents and, more often than not, statements of evidence. Then counsel and solicitors reviewed what had been assembled to decide whether it should be pursued in public hearings.

6.4 Moving targets

As the Commission went on with its work, entities and regulators went on about theirs.

More than once, the Commission's announcement of its intention to hold public hearings into particular kinds of conduct was followed soon after by an entity announcing some change in its products, processes or procedures or by an entity and a regulator announcing that some agreement had been made about the regulatory response to some past conduct. Two examples of that kind of conduct will illustrate the point. Further examples are noted elsewhere in this report.

A few days before the Commission was to hear evidence about CBA's conduct in connection with the sale of 'add-on insurances' (including consumer credit insurance) CBA announced that it would no longer offer those products and would implement a refund program for those who had been sold unsuitable consumer credit insurance.

Shortly before the Commission was to embark on its hearings about financial advisers charging clients for ongoing services that had not been provided, ASIC reached agreement, first with ANZ and then with CBA, for the relevant entities to provide **enforceable undertakings** as a consequence of the conduct in question.

Further, after the Commission had conducted public hearings about some kinds of conduct, entities announced changes in products, processes or procedures that had been the subject of inquiry. Not only were there changes in products, processes and procedures and new regulatory steps, some entities announced plans to dispose of parts of their business. Some, but by no means all of these changes are noted elsewhere in this report.

2. Consumer lending

Introduction

The Commission's first round of hearings explored issues that have arisen for consumers in their dealings with financial services entities about:

- home loans;
- car loans;
- credit cards;
- forms of 'add-on' insurance sold with home loans, car loans and credit cards;
- offers of pre-approved overdrafts and credit cards; and
- 'processing' and 'administrative' errors.

The Commission took these issues as subjects for its first round of hearings for two reasons. First, dealings about home loans, car loans and credit cards are important to both consumers and financial services entities. Second, the information that the Commission obtained from members of the public making submissions, from regulators, from consumer advocacy groups and from financial services entities, all pointed to the occurrence in connection with these kinds of dealings of conduct that might amount to misconduct and conduct falling below community standards and expectations. Information from all four sources (public submissions, regulators, consumer advocates and financial services entities) pointed towards consumers not always having been 'treated honestly and fairly' in their dealings.¹

¹ The Letters Patent establishing the Commission recited that: '[A]ll Australians have the right to be treated honestly and fairly in their dealings with banking, superannuation and financial services providers. The highest standards of conduct are critical to the good governance and corporate culture of those providers.' *Letters Patent*, 14 December 2017.

The issues described affected hundreds of thousands of consumers. Financial services entities paid hundreds of millions of dollars to remedy what had happened.

This chapter deals with the issues in seven sections:

- 1 The purposes of consumer protection.
- 2 The responsible lending provisions.
- 3 Some background information about
 - home loans and car loans;
 - credit cards; and
 - add-on insurance.
- 4 The magnitude and prevalence of the issues.
- 5 The consequences of the conduct.
- 6 The issues that arise:
 - intermediaries – the confusion of roles and responsibilities;
 - customer needs – you ‘need’ what we have to sell;
 - credit risk or unsuitable lending? Lending is not unsuitable if the consumer is unlikely to default; and
 - processing errors – failure to deliver promised features of products sold.
- 7 Regulatory compliance.

1 Purposes of consumer protection

Consumers of financial services cannot expect to be insulated from loss, but they can properly expect to be treated fairly and honestly.

As the Murray Inquiry said, ‘fair’ treatment requires that **financial products** and services perform in the way that consumers expect or are led to

believe.² What a consumer is led to believe about a product's performance depends upon what that consumer is told or not told about its performance, and that can be measured against the standard of honesty reflected in the basic command of 'do not mislead or deceive'. What a consumer can or should expect about performance of a product may present more difficult issues.

Treating consumers fairly and honestly has important economic consequences.

In its 2008 report, the *Review of Australia's Consumer Policy Framework*, the Productivity Commission identified respects in which it thought that Australia's consumer policy framework needed an overhaul. The Productivity Commission said that 'addressing these problems will have significant direct benefits for consumers' and that 'by better engaging and empowering consumers and furthering the development of nationally competitive markets, reform will enhance productivity and innovation.'³ The Productivity Commission concluded that '[t]he overarching objective should be to improve consumer wellbeing by fostering effective competition and enabling the confident participation of consumers in markets in which both consumers and suppliers can trade fairly and in good faith.'⁴

The laws that now regulate the financial industry and dealings in financial products, and make specific provisions affecting dealings with consumers, must be understood and applied in light of these considerations. They are considerations that find direct expression in the overarching, and fundamental, requirements of the *Corporations Act 2001* (Cth) (the Corporations Act) and the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act) that a financial services licensee must do *all* things necessary to *ensure* that the financial services provided by the licensee are provided 'efficiently, honestly and fairly'⁵ and that the holder of an **Australian Credit Licence** (ACL) must do *all* things necessary to ensure

² Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report, 193.

³ Productivity Commission, *Review of Australia's Consumer Policy Framework*, 30 April 2008, vol 1, 2.

⁴ Productivity Commission, *Review of Australia's Consumer Policy Framework*, 30 April 2008, vol 1, 2.

⁵ Corporations Act s 912A(1)(a).

that the credit activities authorised by the licence are engaged in ‘efficiently, honestly and fairly’.⁶

2 Responsible lending

A critical legislative step towards fostering effective competition in the consumer lending market, and enabling the confident participation of consumers in a lending market in which both consumers and lenders trade fairly and in good faith, has been the introduction of the responsible lending provisions of the NCCP Act. More precisely, it is the requirements imposed by Division 3 of Part 3-2 of the NCCP Act on credit licensees to assess ‘unsuitability’. The licensee must assess whether the credit contract will be *unsuitable* for the consumer if the contract is made or (in the case of a credit limit increase) the limit is increased.⁷

2.1 ‘Unsuitable’

A credit licensee *must* assess that the credit contract (or the proposed credit limit increase) is unsuitable if certain conditions are met.⁸ The most important of those conditions is that a contract will be unsuitable for the consumer if, at the time of the assessment, it is likely that the consumer will be unable to comply with the consumer’s financial obligations under the contract, or could only comply with substantial hardship.⁹ And the NCCP Act further provides that it is to be presumed that, if the consumer could only comply with the consumer’s financial obligations under the contract by selling the consumer’s principal place of residence, the consumer could only comply with those obligations with substantial hardship, unless the contrary is proved.¹⁰

⁶ NCCP Act s 47(1)(a).

⁷ NCCP Act s 129.

⁸ NCCP Act s 131(1).

⁹ NCCP Act s 131(2)(a).

¹⁰ NCCP Act s 131(3).

2.2 Necessary steps

Before making the assessment of whether the loan is unsuitable, the licensee *must* take a number of steps. Those steps include:

- making reasonable inquiries about the consumer's *requirements* and *objectives* in relation to the credit contract;¹¹
- making reasonable inquiries about the consumer's *financial situation*;¹² and
- taking reasonable steps to *verify* the consumer's financial situation.¹³

The content of these three steps is important. The first two require reasonable *inquiries*; the third requires reasonable steps to *verify*.

2.2.1 Reasonable inquiries: Requirements and objectives

The consumer's requirements and objectives in relation to the credit contract are personal to the consumer. The NCCP Act requires the credit licensee to make reasonable inquiries about them. In many cases, perhaps most, identifying the consumer's requirements and objectives will require some identification of what the consumer proposes to do with the facility that is provided or the amount that is to be borrowed under the credit contract. Whether, in the case of a revolving credit facility like a credit card, the consumer's requirements and objectives are sufficiently identified as being simply to make the proposed credit contract is an issue to which further attention is given in connection with credit card lending.

One negative proposition, however, may be made with a degree of certainty. The consumer's requirements and objectives are not identified if all that the credit licensee looks at is whether the consumer may be expected not to default under the credit contract. And as the case studies examined in the first round of hearings show, credit licensees too often have focused, and too often continue to focus, only on 'serviceability' (which is to

¹¹ NCCP Act s 130(1)(a).

¹² NCCP Act s 130(1)(b).

¹³ NCCP Act s 130(1)(c).

say credit risk) rather than making the inquiries and verification required by law.

2.2.2 Reasonable inquiries: Financial situation

In determining a consumer's financial situation it will always be necessary to consider both sides of the ledger – income *and* expenditure. That is, the credit licensee must make reasonable inquiries about what income the consumer has had in recent times and whether the consumer can reasonably expect to enjoy that level of income for a reasonable time in the future. But the credit licensee must also make reasonable inquiries about the consumer's expenditures – both what expenditures the consumer has had, and what level of expenditures the consumer can reasonably be expected to have in the future.

These inquiries are more than an inquiry about whether the credit licensee thinks that the consumer is unlikely to default in performance of the loan. Credit risk is an inquiry that prudent lenders have always made. The responsible lending provisions of the NCCP Act introduced new and additional requirements. They require more than the lender being satisfied that the loan is an acceptable credit risk.

More particularly, identifying that the consumer's income is larger than a general statistical benchmark for expenditures by consumers whose domestic circumstances are generally similar to those of the person seeking the loan does not reveal the particular consumer's financial situation. All it does is convey information to the credit licensee that it may judge sufficient for it to decide that the risk of the consumer failing to service the loan is acceptable.

2.2.3 Reasonable steps to verify

Verification calls for more than taking the consumer at his or her word. If the consumer claims to have regular income, what step has the credit licensee taken to verify the claim? Verification is often not difficult. Most persons have income deposited to a bank account and there is, therefore, a bank statement showing receipt of the income claimed that will be readily available to the consumer (and readily available to the credit licensee if it is the **authorised deposit-taking institution** (ADI) at which the consumer maintains the account). And many of a consumer's main outgoings will be recorded (or at least reflected) in the same bank statement.

The evidence showed that, more often than not, each of ANZ, CBA, NAB and Westpac took some steps to verify the income of an applicant for a home loan. But the evidence also showed that much more often than not none of them took any step to verify the applicant's outgoings. The general tenor of the evidence was that a lender satisfied responsible lending obligations to verify a borrower's financial position if the lender assessed the suitability of the loan by reference to the higher of a borrower's declared household expenses and the **Household Expenditure Measure** (HEM) published by The Melbourne Institute (or some equivalent measure) and that verifying outgoings was 'too hard'.

But what was meant by verifying outgoings being 'too hard' was that the benefit *to the bank* of doing this work was not worth the bank's cost of doing it.

This understanding of the position emerged from the evidence given in the fourth case study. There a borrower supplied ANZ a copy of his bank statement (with another ADI) as verification of his income. The outgoings recorded in that statement were obviously inconsistent with what the borrower recorded as his outgoings. But ANZ's procedures did not require consideration of, and in fact the relevant bank employees did not look at, the bank statement for any purpose other than verifying income.

During the same case study, Mr William Ranken, the leader of the 'Homeowners team' for ANZ, was asked about some recommendations that KPMG had made to ANZ as a consequence of KPMG's conduct of the Australian Prudential Regulation Authority (APRA) targeted review. KPMG had recommended, first, that ANZ ask customers to provide a more detailed breakdown of their expenses that would provide 'greater insight and assist customers in ensuring stated expenses are complete and accurate'; second, that ANZ could ask customers to supply bank statements for their main transaction accounts as well as credit card statements; third, that asking customers to supply these statements would 'address the risk that customers fail to disclose major items of expenditure; and fourth, that bank statements could also be reviewed for general account conduct to identify whether 'there are any obvious inconsistencies between a customer's stated expenses and transaction history, or any general indicators of financial

stress.’¹⁴ Mr Ranken said that ANZ was trialling the first three proposals in its proprietary channel, but not the fourth.¹⁵ Of that he said, in effect, that the cost for the benefit was not sufficient, or as he put it, ‘we don’t think that that’s a material uplift’.¹⁶ Tellingly, Mr Ranken made no reference to whether the responsible lending requirements suggested or required otherwise.

Since March 2018, Westpac has expanded the number of expense categories included in its home loan application process from six to 13, and made some mandatory. Categories now include ‘telephone, internet, pay TV and media streaming subscriptions’, ‘medical and health’, and ‘childcare’. Any category given a value of \$0 must be accompanied by an explanation.¹⁷ A separate set of expense categories termed ‘commitments’, being fixed outgoings, is also collected.¹⁸ Westpac policies require that staff scrutinise all transaction accounts provided by the customer for inconsistencies with these declared amounts. But in most cases Westpac does not require customers to provide regular transaction statements for non-Westpac accounts, and the ‘verification’, as distinct from the ‘inquiry’, of the customer’s expenses remains largely with the customer.¹⁹

In as many as three out of every four home loans examined in the course of APRA’s 2016/2017 targeted review into home lending practices, the banks assumed that the borrower’s household expenditures were equal to the relevant HEM – amounts published by The Melbourne Institute as the Household Expenditure Measure – ‘a measure that reflects a modest level

¹⁴ Exhibit 1.87, 28 April 2017, KPMG Targeted Review 2016/2017, 9–10; Transcript, William Andrew Ranken, 19 March 2018, 474.

¹⁵ Transcript, William Andrew Ranken, 19 March 2018, 475.

¹⁶ He continued: ‘And that’s the one where, as I’ve previously stated, the complexity, the time, the cost for the benefit, we don’t think that that’s a material uplift to having the detailed, you know, in combination with the first one, having the detailed conversation with the customer, then attesting to that, and signing that’s the correct statement of position and us referencing that to an independent statistical benchmark.’ Transcript, William Andrew Ranken, 19 March 2018, 475.

¹⁷ Witness statement of William Malcolm 2 August 2018, 26 [133]–[134].

¹⁸ Witness statement of William Malcolm 2 August 2018, 18 [95]–[97].

¹⁹ Witness statement of William Malcolm 2 August 2018, Exhibit WDM1-58.

of weekly household expenditure for various types of families'.²⁰ (Some of the banks subject to the targeted review were found to use a HEM figure for a borrower's household expenditure less frequently than others. Even so, a significant number of the files inspected by the external accountants who conducted the targeted review showed reliance on HEM.)

The HEM

As The Melbourne Institute explains:

[The HEM] report examines household expenditure in Australia. Using local survey data linked to the Consumer Price Index, the HEM looks at what families actually spend in relation to different types of household.

The HEM classifies more than 600 items in the Australian Bureau of Statistics' *Household Expenditure Survey* as absolute basics, discretionary basics or non-basics. These items are then used to calculate modest expenditure for eight types of household.

Notes

- The HEM is defined as the median spend on absolute basics plus the 25th percentile spend on discretionary basics.
- *Absolute basics* are most food items, children's clothing, utilities, transport costs and communications.
- *Discretionary basics* include take-away food, restaurants, confectionery, alcohol and tobacco, adult clothing, childcare and entertainment.
- *Non-basics* include luxury services such as gardeners and overseas holidays.
- Rents and mortgage payments are not included, as the HEM is a net-of-housing costs measure.²¹

As the first of the notes just quoted records, HEM represents the median spend on absolute basics, but only the 25th percentile spend on discretionary basics. Three out of four households spend more on things

²⁰ The Melbourne Institute, *Publications 2018* (undated) The Melbourne Institute <https://melbourneinstitute.unimelb.edu.au/__data/assets/pdf_file/0003/2162550/MI-Publications-Brochure-2018.pdf>.

²¹ The Melbourne Institute, *Social Indicators Report* (undated) The Melbourne Institute <<https://melbourneinstitute.unimelb.edu.au/publications/social-indicator-reports>>.

like alcohol and tobacco, adult clothing and childcare than HEM includes in its result. And, HEM takes no account of spending on 'non-basics'. Together, these considerations show why it is right to describe HEM as being used to calculate only '*modest* expenditure'.

Further, and obviously, HEM takes no account of whether a particular borrower has unusual household expenditures as may well be the case, for example, if a member of the household has special needs or an aged parent lives with, or is otherwise cared for, by the family.

It follows that using HEM as the default measure of household expenditure does not constitute any *verification* of a borrower's expenditure. On the contrary, much more often than not it will mask the fact that no sufficient inquiry has been made about the borrower's financial position. And that will be the case much more often than not because three out of four households spend more on discretionary basics than is allowed in HEM and there will be some households that spend some amounts on 'non-basics'. Using HEM as the default measure of household expenditure assumes, often wrongly, that the household does not spend more on discretionary basics than allowed in HEM and does not spend anything on 'non-basics'.

The practice described in connection with home loans extended, and continues to extend, well beyond that area of lending. Evidence led in the first round of hearings showed that entities making car loans have taken, and continue to take a generally similar approach of taking some steps to verify borrower income but none to verify borrower household expenditures. Instead the entity considers whether the customer can service the debt by determining an amount of uncommitted monthly income by deducting from income the higher of a borrower's declared household expenses and either the HEM measure, or a sum derived from a HEM measure. And entities considering whether to allow a credit limit increase on a credit card account have followed substantially the same approach in those cases where they made any inquiry about a customer's financial position.

2.2.4 'Reasonable' inquiries: Scalable

The Australian Securities and Investment Commission's (ASIC's) Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct explains how ASIC interprets the law relating to responsible lending and sets out ASIC's 'expectations for compliance with the responsible lending

obligations'.²² The Guide says that the obligation to make reasonable inquiries, and to take reasonable steps to verify information 'is scalable', an expression it amplifies by saying that 'what you need to do to meet these obligations will vary according to the circumstances'.²³

Understood in this way, the proposition that the obligations are 'scalable' is undeniable. What the Act requires is *reasonable* inquiries and *reasonable* steps. And what is reasonable will often be affected by the particular nature and amount of the credit contract in issue.

The Guide gives four examples of factors that may bear upon performing the obligations of inquiry and verification:

- the potential impact on the consumer of entering an unsuitable credit contract;
- complexity of the credit contract;
- capacity of the consumer to understand the credit contract; and
- whether the consumer is an existing customer or a new customer.²⁴

As the Guide makes plain, the first of these factors requires consideration of the *particular* consumer's position. It does not depend upon whether the loan can be described as 'large' or 'small'. '[E]ven a small loan can cause financial difficulties for a consumer on a low income'.²⁵ Often enough for a customer with little leeway between income and expenditure, it is the small additional loan that may tip the balance.²⁶

²² ASIC, Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct, November 2014, reg 209.14.

²³ ASIC, Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct, November 2014, reg 209.19.

²⁴ ASIC, Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct, November 2014, reg 209.22, Table 3.

²⁵ ASIC, Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct, November 2014, reg 209.22, Table 3.

²⁶ As Dickens wrote in *David Copperfield*, "My other piece of advice, Copperfield," said Mr. Micawber, "you know. Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds nought and six, result misery."

2.3 Non-delegable obligations

The legislation imposes the obligations described on the licensee. It is for the licensee to satisfy them. Of course the licensee can engage others to do some or all of the work, but the responsibility remains that of the licensee. Hence, if the licensee agrees with a third party that the third party will make relevant inquiries and verify relevant information, the third party's failure to perform those obligations presents the question whether the licensee has failed in performing its obligations. The question is not answered by observing that the licensee had made a contract obliging the third party to take the necessary steps and that the third party had breached its contract with the licensee.

3 Background information

3.1 Home loans

Almost every person buying a house in Australia will borrow a large part of the cost. Many Australians have home loans with one of the major lenders.

In its first published Background Paper, the Commission set out information showing the size and importance of the home loan market to ADIs and to the economy generally.²⁷ That paper recorded the following information.

Home loans are the largest asset on the books of ADIs, comprising around 42% of assets as at the September quarter 2017.

As at November 2017, there was a total of \$1.07 trillion in finance for owner-occupied housing provided by ADIs and a further \$560 billion in investment housing finance provided by ADIs (a total of around \$1.6 trillion in housing finance provided by ADIs). The vast majority of housing finance is provided by banks (around 98%), with the remainder provided by permanent building societies and credit co-operatives.²⁸

²⁷ FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018.

²⁸ ABS data cited in: FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 19 [4.2].

As at the September quarter 2017, there were around 5.8 million residential term loans provided to households by an ADI, with greater than \$1 billion of term loans. Of these, around 1.6 million (27%) were interest-only loans, 2.2 million (38%) were loans with offset facilities and 4.1 million (71%) were loans with redraw facilities.²⁹

3.1.1 Average home loan size

The average balance of residential term loans to households was \$264,000 as at the September quarter 2017. The average home loan balance is significantly higher for interest-only loans (\$347,000) and loans with offset facilities (\$314,000).

3.1.2 Number of mortgage defaults per year

At the time of Background Paper 1 (February 2018), there were only a small number of mortgages in arrears in Australia, according to Standard & Poor's, which estimates the value of residential mortgages in arrears (that is, mortgages with late repayments) using residential mortgage-backed securities (RMBS) data.

According to Standard & Poor's, only 1% of the total value of Australian 'prime'³⁰ mortgages (where borrowers have a high likelihood of repaying their debt) were in arrears of 31 days or more. Of the total value of Australian 'non-conforming' mortgages (where borrowers have a lower likelihood of repaying their debt – often referred to as 'sub-prime'), 3.4% were in arrears of 31 days or more. This figure had dropped substantially since 2007.³¹

These values dropped further when considering loans that were 90+ days in arrears. Only 0.6% of Australian 'prime' mortgages were 90+ days in arrears, and around 1.5% of Australian 'non-conforming' mortgages were

²⁹ See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 19 [4.2].

³⁰ For a detailed explanation of prime and non-conforming loan definitions, see Guy Debelle, 'A Comparison of the US and Australian Housing Markets' (Speech delivered at the Sub-prime Mortgage Meltdown Symposium, Adelaide, 16 May 2008) <www.rba.gov.au/speeches/2008/sp-ag-160508.html>.

³¹ See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 20.

90+ days in arrears.³² The data, when split by type of ADI, showed that the proportion of Australian prime mortgages 90+ days in arrears had generally increased for major banks and regional banks, although they remained low as a proportion of total balances.³³

3.1.3 Home loans and intermediaries

Intermediaries play important roles in the home loan industry. The exact role each form of intermediary fulfils at various stages of a home loan transaction is not always clear. Those issues are considered separately.

In its second Background Paper, the Commission set out some features of the Australian Mortgage Broking Industry.³⁴ The paper made five points:

- The mortgage broking industry is a key distribution channel for residential mortgage financing in Australia, settling 55.7% of all residential home loans in the September quarter 2017.
- **Mortgage aggregators** act as intermediaries between **mortgage brokers** and lenders, by providing brokers with access to lenders on their aggregator's panel.
- Residential property investors and residential owner-occupiers are the main customers of mortgage brokers, collectively accounting for over 75% of the customers of mortgage brokers.
- Banks still finance the majority of the loans originated through mortgage brokers, although there is a modest increase in the volume of loans financed by non-bank lenders.
- Mortgage brokers and mortgage aggregators do not charge borrowers directly for their services. Instead, they typically receive upfront and **trail commissions** from the lender.

³² See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 20.

³³ See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 21.

³⁴ FSRC, *FSRC Background Paper No. 2: Some Features of the Australian Mortgage Broking Industry*, 22 February 2018.

3.2 Car loans

In its third Background Paper, the Commission described some features of car financing in Australia.³⁵ That paper made seven points:

- Indicatively, 90% of all car sales are arranged through finance, of which around 39% are financed through a dealership and around 61% are financed from other sources.
- In the December quarter 2017, car loan payments were the largest vehicle-related expense for the 'hypothetical household' in both capital cities and regional areas, with repayments larger than weekly fuel costs.
- In 2017, new finance commitments for motor vehicles were around \$35.7 billion, equivalent to around 4.2% of all new finance commitments in 2017.
- In 2017, finance commitments for motor vehicles were the equivalent of around 2.0% of nominal GDP, similar to its share in 2007.
- Over the past 10 years there has been an increase in financing for new motor vehicles and a decrease in financing for used motor vehicles.
- Profit margins for car dealers rely not only on car sales, but on ancillary services, including the sale of finance and insurance.
- Delinquency rates for motor vehicle loans have increased since 2012, but remain at low levels.

3.3 Credit cards

Credit cards are a common feature of everyday life in Australia. In its first Background Paper, the Commission made three observations about credit cards:³⁶

³⁵ FSRC, *FSRC Background Paper No. 3: Some Features of Car Financing in Australia*, 9 March 2018.

³⁶ FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018.

- Credit card debt comprises a very small amount of the overall assets of ADIs – around 1% (\$51.4 billion of the \$4.6 trillion in assets held by ADIs), as at the end of the September quarter 2017.³⁷
- As at November 2017, there were around 16.7 million credit and charge card accounts in existence in Australia, with total balances of around \$52.2 billion. The average balance per account (total balance divided by number of accounts) was around \$3,128.³⁸
- Credit card debt has declined over the past 10 years. In financial year terms, total balances have reduced from a peak of 3.6% of nominal GDP in 2007/2008 to 3% of GDP in 2016/2017.³⁹

Credit cards are used as a means of payment and as a revolving credit facility. Those holders who use the card as a means of payment and pay the whole balance of the account when due are known as ‘transactors’. Those who pay less than the balance due are known as ‘revolvers’. Obviously, holders may act as transactors for a time and then as revolvers for a time.

3.4 Add-on insurance

Consumer credit insurance has been a common form of insurance sold in connection with different forms of credit arrangements, including credit cards, personal loans, car loans and home loans. The policies are sold as insurance that will respond to some events that may prevent or hinder the borrower meeting the obligations undertaken to the lender. The principal events are death, disability or unemployment.

In addition, other forms of ‘add-on’ insurance have been sold in connection with the financing and sale of motor vehicles. Those other forms of insurance include comprehensive motor vehicle insurance (covering loss or damage to the vehicle), ‘tyre and rim’ insurance (sold as covering the cost of replacing tyres or wheel rims damaged by accident), ‘gap’ insurance (sold as covering the gap between the value of the vehicle and the amount owed

³⁷ See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 23 [4.4].

³⁸ See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 23 [4.4].

³⁹ See FSRC, *FSRC Background Paper No. 1: Some Features of the Australian Banking Industry*, 9 February 2018, 23 [4.4].

on the loan used to buy it) and ‘mechanical’ insurance (sold as providing cover for the consequences of mechanical breakdown).

Entities that sell add-on insurance commonly receive a commission on the sale fixed by reference to the amount of premium charged. Since the NCCP Act, the commission that may be paid for has been capped at 20%.⁴⁰

In 2011, ASIC reported that the net loss ratio for consumer credit insurance (calculated as the net incurred claims divided by the net premium revenue) for the years 2008 to 2010 had varied from 18% in 2008 to 34% in 2010.⁴¹ For more recent years, figures published by APRA in its *General Insurance Claims Development Statistics* recorded an ultimate net loss ratio⁴² for consumer credit insurance of about 20%.⁴³ Consumer credit insurance has been, and remains, a very profitable form of insurance.

4 Magnitude and prevalence

4.1 Past remediation programs

4.1.1 Home loans

In recent years, banks have acknowledged that aspects of their conduct in connection with home loans have been unacceptable and have caused detriment to consumers. As a result, a number of banks have provided refunds to customers as part of significant remediation programs, generally overseen by ASIC. Information provided to the Commission by ASIC indicated that between 1 July 2010 and 28 February 2018, financial services entities paid almost \$250 million in remediation to almost 540,000

⁴⁰ NCCP Act sch 1 s 145.

⁴¹ ASIC, *Report 256: Consumer Credit Insurance: A Review of Sales Practices by Authorised Deposit Taking Institutions*, October 2011, 15 [47], Table 3.

⁴² APRA defines ‘ultimate net loss ratio’ as ‘Net ultimate cost of claims (inflated and undiscounted) divided by Net earned premium’. See APRA, *General Insurance Claims Development Statistics* (28 June 2018) APRA, Glossary <www.apra.gov.au/sites/default/files/GICDS%2520Glossary.pdf>.

⁴³ APRA, *General Insurance Claims Development Statistics* (28 June 2018) APRA, Table 13 <www.apra.gov.au/publications/general-insurance-claims-development-statistics>.

consumers as a result of three particular forms of conduct in connection with home loans. The three forms of conduct were:

- reliance on fraudulent documentation;
- processing or administration errors; and
- breaches of responsible lending obligations.

During the same period (1 July 2010 to 28 February 2018), ASIC banned and suspended from providing credit services or placed conditions on the licences of 51 individuals or companies for engaging in home loan application fraud. Through the Commonwealth Director of Public Prosecutions, ASIC brought criminal prosecutions against 13 credit providers for conduct in relation to home loan applications, 12 of whom were convicted of fraud or dishonesty offences. ASIC also banned one person from providing credit services and cancelled the credit licence of two entities on the basis of breaches of responsible lending obligations in connection with home loan applications.

4.1.2 Car loans

ASIC told the Commission that, between 1 July 2010 and 28 February 2018, financial services entities paid almost \$90 million to almost 17,000 consumers as a result of two forms of conduct in connection with car loans, being reliance on fraudulent documentation and breaches of responsible lending obligations.

During the same period, ASIC banned or cancelled or suspended or placed conditions on the licences of 19 individuals or companies in the car financing industry. Through the Commonwealth Director of Public Prosecutions, four car loan credit service providers were convicted of criminal offences. As a result of action taken by ASIC in the car financing industry, over \$5.7 million has also been paid in civil penalties.

4.1.3 Credit cards

Between 1 July 2010 and 28 February 2018, over \$11 million in remediation was paid to over 34,000 consumers by financial services entities in response to breaches of responsible lending obligations in connection with credit cards. During the same period, ASIC obtained four outcomes against three credit card providers for breaches of responsible lending obligations in

connection with credit cards. And, as a result, \$1.5 million was paid in civil penalties.

4.1.4 Add-on insurance

Between 1 July 2010 and 28 February 2018, more than \$128 million has been paid in remediation to consumers by financial services entities as a result of particular conduct in connection with add-on insurance.

Approximately \$900,000 of this sum related to home loan add-on insurance remediation programs, affecting over 10,500 consumers. Approximately \$117 million related to car loan add-on insurance remediation programs, affecting over 212,000 consumers. Approximately \$10 million related to credit card add-on insurance, affecting approximately 65,000 consumers.

4.1.5 Processing and administrative errors

Information from both regulators and entities showed that there had been various forms of ‘processing error’ that resulted in consumers being charged more under their home loan contracts than the loan contract provided.

Those errors included failures to link offset accounts and failures to apply the correct interest rate. Between 1 July 2010 and 28 February 2018, approximately \$239 million was repaid to almost 540,000 consumers who had been affected by account administration and processing errors in connection with home loans.

4.2 Summary of the remediation programs

The figures set out in the preceding paragraphs, which are tabulated below, were given to the Commission by ASIC immediately before the first round of hearings. They reflected information of which ASIC had been made aware and cases and circumstances that had then been brought to a final outcome.

Between 1 June 2010 and 28 February 2018, nearly 900,000 consumers were identified as having been affected. That number comprised:

- home loans – 540,000;
- car loans – 17,000;
- credit cards – 34,000;
- add-on insurance – home loan – 10,500;

- add-on insurance – motor vehicle – 212,000; and
- add-on insurance – credit card – 65,000.

The monetary effects of the conduct were significant.

Treating the administration and processing errors identified in connection with home loans as subsumed in the total figures given in respect of issues about home loans, the various forms of conduct that have been described yielded remediation payments totalling more than \$470 million comprising:

- home loans – \$250 million;
- car loans – \$90 million;
- credit cards – \$11 million; and
- add-on insurance – \$128 million.

4.3 How widespread?

The prevalence of the issues that have been identified can be gauged by reference to the responses that the four largest banks (ANZ, CBA, NAB and Westpac) made to the inquiries that the Commission made immediately after its establishment about what events of misconduct, or conduct falling short of community standards and expectations, the entities had identified.

Before referring to what was revealed by those responses it is necessary to say something first about the approaches that each of the four largest banks took to answering the inquiries that were made.

4.4 Responses to the Commission's initial inquiries

As is explained in Chapter 1, on the day after the grant of the Letters Patent establishing the Commission, I wrote to a number of entities asking them what misconduct and conduct falling short of community standards and expectations they had identified as occurring during the previous 10 years. After receiving the responses made to the initial inquiries, I asked a number of entities (including ANZ, CBA, NAB and Westpac) to supply more specific information about events of misconduct (as distinct from conduct falling short of community standards and expectations) that the entities had identified over the last five years. These further inquiries were made on 2 February 2018.

How did the four largest banks respond?

4.4.1 ANZ

In its two responses to the Commission's inquiries, ANZ acknowledged that it had engaged in misconduct and conduct falling short of community standards and expectations in connection with home loans, credit cards, processing errors and car finance. On their face, ANZ's responses appeared to be detailed and comprehensive.

4.4.2 CBA

CBA's first submission in response to the Commission's initial inquiries was made on behalf of the whole CBA group including, in particular, Aussie Home Loans (by then a wholly owned subsidiary of CBA).⁴⁴ The first submission was cast at a general level. It did not disclose with any particularity the conduct that CBA, or entities within the CBA group, had engaged in in relation to consumer lending over the last 10 years that CBA identified as having constituted misconduct or conduct that falls below community standards and expectations.

In its first submission, CBA acknowledged that it had engaged in misconduct in limited respects. So, for example, it acknowledged that it had been involved in legal proceedings in which an adverse comment or finding had been made against one or more of the entities of the group. And, in that first submission, it also acknowledged that it had engaged in conduct that fell short of community standards and expectations in relation to add-on insurance, responsible lending and offers of credit. But the first submission gave very little detail about the conduct to which it referred. And at least in respect of what was said in that response about Aussie Home Loans, the

⁴⁴ The CBA Group acquired a 33% interest in Aussie Home Loans in August 2008 and increased that investment to 80% in December 2012. On 9 August 2017, the Group announced that it had acquired the remaining 20%, giving it 100% ownership. Exhibit 1.80, 29 January 2018, Paragraphs 170 to 177 of CBA Submission, 31 [170].

response was cast in terms suggesting, wrongly, that there had been few if any problems identified in that business.⁴⁵

When the Commission asked CBA (and others) to specify more precisely what misconduct it had identified over the previous five years, CBA protested that it could not do this within the time allowed and instead proffered spreadsheets derived from its risk management system recording events that had been thought appropriate to record in that system during the relevant period.

In her opening address to the Commission at the commencement of the first round of hearings, Senior Counsel Assisting the Commission criticised the adequacy of CBA's responses to the Commission's inquiries of 15 December 2017 and 2 February 2018. Within 10 days, the solicitors for CBA provided to the Commission tables answering the inquiries made on 2 February 2018; one related to CBA and companies in the group other than Aussie Home Loans; the other related to Aussie Home Loans. Why the first two responses CBA made were deficient and why the tables produced on 22 March 2018 had not been prepared and made available earlier was not explained.

The table that related to the conduct of Aussie Home Loans contained 182 entries, organised under three headings:

⁴⁵ What was said was that: 'During the relevant period, Aussie has identified isolated and unauthorised incidents of conduct issues and some technical breaches of the law, in relation to the credit assistance services provided by Aussie brokers and in interactions between employees and Aussie brokers. There have also been isolated issues which required customer remediation in relation to Aussie's white label products. Examples of the nature of isolated and unauthorised conduct issues that Aussie has identified include former brokers using customer information and seeking to contact Aussie customers in contravention of their contractual and privacy obligations; provision or facilitation by brokers of false or misleading information and false declarations from customers in the process of applying for loans; [and] behavioural conduct such as offensive or otherwise unprofessional behaviour directed towards or amongst employees and/or brokers. Aussie also identified some minor system or process errors resulting in incorrect calculation of interest, fees or charges by the credit provider(s) on Aussie white label products and a small number of self-identified contraventions of the *National Consumer Credit Protection Act 2009* (Cth) ...'. Exhibit 1.80, 29 January 2018, Paragraphs 170 to 177 of CBA Submission, 31–2 [173]–[174].

- False Documents and/or Declarations and/or Misleading Information;
- NCCP Act Breaches; and
- Breach of Broker Agreement/Franchise Agreement/Policy/Operations Manual.

The contrast between the information supplied after the first hearings had begun and the information about Aussie Home Loans supplied by CBA in response to the Commission's first inquiry is evident.

4.4.3 NAB

NAB provided two submissions to the Commission in which it acknowledged it had engaged in misconduct and conduct falling below community standards and expectations in relation to home lending, credit cards, personal loans and processing or administration errors.

NAB's second submission elaborated on a number of aspects of its first submission and provided some further detail. But the submission did not provide detailed or comprehensive information about instances of misconduct, including instances of possible misconduct still under investigation of which the bank had become aware at any time since 1 January 2013 and NAB protested that it could not perform such a task within the time fixed. Like CBA, NAB provided the Commission with spreadsheets derived from its risk management system recording events that had been thought appropriate to record in that system during the relevant period.

NAB's apparent inability to draw together information about instances of misconduct identified during the immediately preceding five years shows that it was then unable to identify promptly, whether for its own internal purposes or for any external purpose, a single, reasonably comprehensive and accurate picture of whether and how it had failed to comply with applicable financial services laws. On the face of it, information of that kind would be important not only for managing compliance with those laws but also for identifying whether separate events stemmed from similar causes.

The difficulties raised by NAB, and by others, about meeting the Commission's requests suggest that those entities deal with regulatory compliance piecemeal rather than comprehensively. Approaching compliance piecemeal does not readily permit identification of underlying

causes. Particular events are too readily seen as isolated departures from an assumed norm caused only by aberrant behaviour of individuals. Deeper causes and connections remain unconsidered and unidentified.

4.4.4 Westpac

Westpac also made two submissions to the Commission. Westpac has a number of brands, including St George Bank, Bank of Melbourne, Bank of South Australia and RAMS, which it uses in its dealings with consumers. In its initial submissions Westpac acknowledged that across these brands it had engaged in actual or potential misconduct and conduct falling below community standards and expectations relating to home lending, credit cards, car loans, add-on insurance, processing or administration errors and unsolicited offers of credit.

Shortly before the first round of hearings began, however, Westpac told the Commission that the information it had provided in those submissions did not take account of some categories of data and that further acknowledgments may be provided. Westpac thereafter made a number of further acknowledgments of conduct amounting either to misconduct or conduct falling short of community standards and expectations. Again, this course of events points towards a disjointed, piecemeal approach to monitoring compliance with applicable laws.

4.5 Conduct acknowledged by the entities

The four major banks disclosed that they had identified a range of misconduct and conduct falling short of community standards and expectations in connection with home loans, car loans, credit cards, add-on insurance and so-called ‘processing errors’.

4.5.1 Home loans

ANZ

ANZ acknowledged that between 2013 and 2018 it had engaged in at least 20 events of misconduct or conduct falling below community standards and expectations in relation to home lending and residential mortgages. (In this context, of course, a single ‘event’ may affect many consumers.) By way of example, during 2015 and 2016, ASIC conducted an industry-wide review into interest-only home loans. ASIC, after calling for a sample of 25 customer files from ANZ, queried whether ANZ had made genuine inquiries

into customers' living expenses. ANZ recognised that there were instances where it lacked evidence to show that genuine inquiries had been made, but it did not accept that it had not made those inquiries.

CBA and Aussie Home Loans

CBA's first and second responses to the Commission's inquiries did not distinctly acknowledge any significant relevant conduct in connection with home loans. By contrast, the table of Aussie Home Loans conduct that CBA provided in the course of the first round of hearings acknowledged various forms of relevant conduct.

No less importantly, the other table that CBA provided in the course of that first round disclosed 10 events of relevant conduct by CBA in relation to home loans. Three related to responsible lending; three related to the charging of incorrect interest, or interest-only charges; one related to the incorrect charging of fees; and the other three raised other issues. Some of the events had been reported to ASIC; some had not. Some could be seen as having been embraced by what had been said in the first response to the Commission's inquiries; some could not. Some had resulted in remediation programs; some had not.

In the Aussie Home Loans table, under the 'False Documents' heading, the first four entries related to the four brokers whose activities were the subject of the evidence led in the course of the Aussie Home Loans case study. As later explained, each of those brokers was convicted of several counts of offences of fraud. The remaining 25 entries made under this heading were described as providing false or misleading information to either a lender or to customers.

Nineteen entries in the Aussie Home Loans table were listed under the heading 'NCCP Act Breaches'. All were said to relate to responsible lending. The third and most numerous category of events in the Aussie Home Loans table embraced such matters as the misuse of data and 'inappropriate professional and personal conduct'.

NAB

In its response to the Commission's initial inquiry, NAB acknowledged misconduct in connection with NABs 'Introducer program' and said that it had by then identified about 2,480 customers who may have been affected

by this misconduct. It said that investigations were continuing. These events were the subject of the first case study.

NAB also acknowledged misconduct in the advertising of variable interest rates in October 2014, when it incorrectly advertised that it was offering the lowest standard variable rate for more than five years, a statement that should have been qualified to make clear that it was only correct insofar as it applied to rates offered by the four major banks.

In addition, NAB provided examples of conduct that it considered fell below community standards and expectations in relation to home lending. These included that, before June 2013, NAB may not have been carrying out further inquiries into the declared living expenses of home loan applicants when the declared expenses were below the relevant benchmark used by NAB to assess home applications.

The examples also included an acknowledgment that NAB had identified an issue in relation to UBank, a division of NAB, and its offer of an EFTPOS gift card to customers who took out a home loan with UBank in a four-month period between December 2013 and March 2014. ASIC had raised concerns that some details of UBank's offer were not disclosed in some of the advertisements or were not disclosed sufficiently clearly.

Westpac

Westpac acknowledged that, at the time of the first round of hearings, it was the subject of ASIC enforcement action in relation to alleged breaches of responsible lending obligations.⁴⁶ In those proceedings, ASIC alleged that Westpac failed to properly assess whether borrowers could meet their repayment obligations before entering into home loan contracts. Westpac defended the proceedings. On 4 September 2018, ASIC and Westpac announced that they would join in seeking orders of the Federal Court of Australia that Westpac had contravened its responsible lending obligations and should pay a civil penalty of \$35 million.⁴⁷

⁴⁶ Westpac, *Response of Westpac Banking Corporation Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* 29 January 2018, 29 January 2018, 23.

⁴⁷ ASIC, 'Westpac Admits to Breaching Responsible Lending Obligations when Providing Home Loans and a \$35 Million Civil Penalty' (Media Release, 18-255MR, 4 September

Westpac also acknowledged that, in 2016, it had identified that some of its authorised home lending bankers were not correctly completing customer income and expense verification activities at the point of sale.

Westpac further acknowledged that, over a seven-year period, customers with Westpac, St George, Bank of South Australia and Bank of Melbourne did not receive benefits for which they were eligible in relation to a home loan package they held. Approximately 175,000 Westpac customers were affected. The number of affected customers with St George, Bank of South Australia and Bank of Melbourne had not been determined when Westpac made its initial submissions to the Commission.

Westpac also acknowledged a number of other events of misconduct in relation to home lending. In one instance Westpac approved a loan referral from a third party broker for a home loan of over \$529,000 to an 80-year-old man who spoke poor English. A credit card debt approved at the same time was later written off.

4.5.2 Car loans

ANZ

ANZ acknowledged at least seven events of misconduct or conduct falling below community standards and expectations in relation to car loans and car finance, including failures to take reasonable steps to verify income stated in car finance applications.

ANZ identified a number of issues relating to the Esanda dealer finance portfolio that was owned by ANZ until April 2016. Between 2011 and 2014, a car finance broker had arranged loans for customers that did not meet Esanda's lending criteria by writing the application in the name of an individual who did not own or have possession of the vehicle, but who agreed to guarantee the loan. ANZ accepted that the systems that Esanda had in place at the time were ineffective to detect this and therefore failed to meet community standards and expectations.

ANZ has also accepted, in litigation brought by ASIC, that it failed to take reasonable steps to verify the income figures in relation to 12 car finance

2018) <<https://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-255mr-westpac-admits-to-breaching-responsible-lending-obligations-when-providing-home-loans-and-a-35-million-civil-penalty/>>.

applications introduced to Esanda by third party intermediaries.⁴⁸ These matters were considered in the 10th case study in the first round of hearings.

Westpac

Westpac acknowledged at least four events of misconduct or conduct falling below community standards and expectations in relation to car loans, primarily comprising breaches of the responsible lending obligations. Westpac also identified issues relating to the unsuitable sale of insurance and the use of flex commissions which, as Westpac noted, ASIC considered could operate unfairly by providing an incentive for intermediaries to increase the price of a credit contract to a consumer.

4.5.3 Credit cards

ANZ

ANZ acknowledged at least nine events of misconduct or conduct falling below community standards and expectations in relation to credit cards, including the lack of disclosure of overseas transaction fees in the terms and conditions of consumer credit card products. By way of example, ANZ acknowledged that between 2009 and February 2016 there were inconsistencies between interest rates contained in customers' original letters of offer for certain commercial credit cards and those charged by ANZ systems to some customers. This affected 52,135 customer accounts, and customers were ultimately refunded approximately \$10.4 million last year.

CBA

Similarly, CBA acknowledged that it had engaged in misconduct, in late 2011 or early 2012, in its approach to seeking consent from credit card customers to receive credit limit increases, which resulted in CBA giving an **enforceable undertaking** to ASIC. CBA also referred to a further event in 2014 relating to a failure to correctly follow scripts when processing credit limit increases. (Some further detail was provided on this issue in CBAs second submission of 13 February 2018.)

⁴⁸ *ASIC v Australia and New Zealand Banking Group Ltd* [2018] FCA 155.

NAB

NAB acknowledged that it had engaged in conduct in connection with credit cards that fell below community standards and expectations. By way of example, NAB acknowledged that 10 NAB employees had deviated from NABs policies and processes by failing to contact credit card customers to confirm their needs and objectives, or to make it clear that they were not obliged to accept a NAB credit card. The number of customers potentially affected was 215, and the number confirmed to have been affected was 18.

Similarly, NAB also told the Commission that between February and May 2009, NAB migrated customers with NAB Gold Reward accounts to NAB Qantas Gold accounts and sent these customers an American Express credit card without being requested to do so by the customers. The number of customers affected by this conduct was not disclosed by NAB.

In addition, NAB acknowledged that it had engaged in misconduct between 2008 and 2013, arising from the erroneous recording of 16,288 credit defaults against customers with NAB credit cards or personal loan accounts. NAB noted that some of this conduct also involved contraventions of the *Privacy Act 1988* (Cth).

Westpac

Westpac acknowledged at least 12 events of misconduct or conduct falling below community standards and expectations in relation to credit cards, including a practice of proactively selling credit cards with limits exceeding the levels advised under lending policy rules to clients over the phone.

In addition, Westpac acknowledged that, between 2012 and 2014, approximately 6,600 accounts may have been affected by an automated approval process that did not adequately take income and employment factors into account. These matters were explored further in the 12th case study about credit card credit limit increases.

Westpac also acknowledged that, between 2012 and 2015, it had applied higher interest rates to credit cards than required by an enforceable undertaking Westpac had given to ASIC. This issue affected 67,000 customers.

Finally, Westpac acknowledged that it had sent a message to at least 3,700 customers that was deemed by ASIC to be misleading, because it created

the impression that a customer had to consent to receive invitations for credit limit increases in order to receive the full benefits of their credit card.

4.5.4 Overdrafts

ANZ

In relation to overdrafts, ANZ's responses to the Commission recorded that, between November 2014 and January 2015, ANZ sent letters to a group of existing customers offering them an overdraft facility with limits of \$500, or \$1,000, in circumstances where ANZ had not made any inquiries of the customer before sending the letter. In February 2016 ASIC issued five infringement notices totalling \$212,500 for these alleged failures. These events were examined in the seventh case study.

CBA

Similarly, in CBA's first submission, CBA acknowledged that ASIC had issued four infringement notices to CBA in 2016, totalling \$180,000. The infringement notices related to breaches of responsible lending laws when providing personal overdraft facilities. (Further detail on this event was provided in CBAs second submission, dated 13 February 2018.)

4.5.5 Add-on insurance

CBA

In its first submission, CBA acknowledged that approximately 65,000 of its customers had purchased 'CreditCard Plus' insurance in circumstances where they may not have met the employment eligibility criteria in the product terms and therefore may not have been able to claim certain benefits under the policy. CBA acknowledged that refunds of approximately \$10 million, including interest, had been made to those customers as at the date of the 29 January 2018 submission. This was described by CBA not as misconduct, but as conduct falling below community standards and expectations.

CBA also acknowledged that a further 20,000 consumers had purchased their 'Loan Protection' product, another insurance product sold in connection with a home or personal loan, in circumstances where those consumers may not have met the employment eligibility criteria that would permit the consumer to claim benefits under the policy. CBA indicated that its

investigation into this conduct was at an early stage, but that it estimated that about \$3.4 million of refunds would need to be made to consumers. This conduct was again not described by CBA as misconduct, but as conduct falling below community standards and expectations.

About one week before the beginning of the first round of hearings, CBA announced that it would stop selling CreditCard Plus insurance and Personal Loan protection insurance.

Westpac

Westpac also acknowledged at least three events of misconduct or conduct falling short of community standards and expectations in relation to add-on insurance products.

4.5.6 Processing errors

CBA

In its 29 January response to the Commission's initial inquiries, CBA referred to a number of 'other issues of community interest or concern'. One example it gave of those matters was of its having told ASIC, in 2015, of 'errors in its serviceability calculator that applied to some personal overdraft applications'.⁴⁹ But CBA in that submission did not deal with any of the processing and administration errors that were later examined in the course of the Commission's hearings. And the tables of identified misconduct that CBA provided on 22 March did not distinctly identify matters of that kind.

ANZ

In relation to processing errors, ANZ acknowledged that between 2003 and July 2013, some ANZ home loan customers were charged a higher interest rate than they should have been according to the terms and conditions of their loan contracts. In addition, some offset accounts were not properly linked to home loans, resulting in customers being charged excess interest. This affected approximately 400,000 customer accounts, and ANZ ultimately refunded customers approximately \$69.3 million. ANZ has also identified other home loan processing or administration errors. These issues

⁴⁹ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 34 [192].

are described further in what is said about the eighth case study undertaken in the first round of hearings.

NAB

NAB also acknowledged processing or administration errors in relation to consumer lending during the relevant period. For example, NAB acknowledged that on 24 November 2010 and 15 April 2011 two separate failures of the customer account processing systems occurred, with the 2011 incident resulting in approximately 70,000 customers not receiving expected payments into their accounts.

NAB acknowledged that between 2007 and 2010 customers with NAB Visa debit cards were being incorrectly charged reference or overdraft fees, resulting in approximately \$1.8 million in fees being refunded.

In addition, NAB acknowledged offset account failures, whereby it overcharged interest on certain home loans in the period between 2010 and 2017, because it had not linked some offset accounts to broker-originated home loans. This resulted in approximately 178,000 customers overpaying interest on their home loans.

Westpac

Westpac acknowledged at least 16 events of misconduct or conduct falling below community standards and expectations in relation to processing or administration errors for home loans and credit cards.

By way of example, Westpac acknowledged that processing failures resulted in approximately 69,000 home loan customers being required to pay more interest over the life of their loan, because their interest-only loan was not switched to principal interest and fees, at the conclusion of the agreed interest-only term. Remediation to customers was expected (at the time of the initial submissions) to cost Westpac \$11 million.

In addition, Westpac acknowledged that 133,000 accounts held by customers under the age of 21 did not have the correct fee waivers applied to their accounts, and a further 28,000 St George accounts were also affected. In consequence, Westpac paid about \$9.2 million to customers to remedy the errors.

4.5.7 Other consumer lending issues

ANZ

ANZ acknowledged at least 22 events of other misconduct and conduct falling below community standards and expectations in connection with consumer lending, including customers being charged incorrect fees or interest amounts, customers accessing inflated redraw balances and redrawing amounts in excess of the amount of principal they paid in advance, and failures to send hardship notices to applicable customers within the 21-day period required by the National Credit Code.

In addition, ANZ acknowledged that in the last seven years approximately 120 cases had been brought against it in the Financial Ombudsman Service that related to consumer and small business responsible lending issues. Approximately 50 of these cases were decided against ANZ.

CBA

In its first submission, CBA acknowledged a number of issues in relation to responsible lending. CBA described what it referred to as operational incidents that it said had impacted upon its responsible lending practices, including in relation to inaccuracies in calculations, insufficient documentation and verification, failure to correctly follow scripting, employee and third party misconduct and deficiencies in controls around manual loan approval processing. These events were not categorised by CBA as misconduct but, rather, as conduct that had fallen below community standards and expectations.

CBA acknowledged that it had remediated customers in respect of product administration and disclosure, credit decisions and responsible lending, systems controls and processes failures, sales practices and fraud or misconduct issues. CBA's submission did not show whether the remediation programs in relation to some of these categories of conduct pertained to consumer credit products.

Other entities

The four largest banks were not the only entities that acknowledged that they had engaged in conduct of the kinds described. Other entities made submissions to the Commission acknowledging generally similar kinds of conduct.

5 Consequences of the conduct

Observing that those affected by the conduct described were ‘consumers’ does not fully reveal the nature and extent of the effects of the conduct. Those effects are best understood by considering what can and does happen when the problems become acute.

When financial problems become acute, consumers can and do seek financial counselling. As ASIC records, on its ‘MoneySmart’ website, financial counselling is a free service offered by community organisations, community legal centres and some government agencies.⁵⁰ And assistance is offered through a ‘National Debt Hotline’ available throughout Australia.

In New South Wales, the National Debt Hotline is operated by the Financial Rights Legal Centre. The Financial Rights Legal Centre is a community legal centre established in the late 1980s. The Centre’s Co-ordinator, Ms Karen Cox, described it as specialising in ‘helping people understand and enforce their financial rights, especially people on low incomes or who are otherwise marginalised or vulnerable’.

Ms Cox gave evidence that the Centre took close to 25,000 calls for advice or assistance during the 2015/2016 financial year. Of those, about 7,500 related to insurance and the remaining 17,000 or so calls related to credit and debt problems. She said that the most common cause of debt problems for callers were credit cards, followed by home loans, personal loans (including pay day lending), car loans and energy debts.

⁵⁰ See ASIC, *Financial Counselling* (8 August 2018) ASIC’s Money Smart <www.moneysmart.gov.au/managing-your-money/managing-debts/financial-counselling>.

Ms Cox said that credit cards ‘top the list of consumer finance motivating calls to the National Debt Hotline’. As she said, credit cards can help to smooth the irregularities of income and expenditure. But, as she also pointed out, it is not unusual for a person with a credit card ‘to become caught in a harmful debt spiral’. And those who have persistent credit card debt are likely to experience harm, both financial (paying high interest and fees) and non-financial (such as forgoing essential expenditure or experiencing personal distress). The consequence, as Ms Cox pointed out, is that consumers can be paying interest on everyday expenditure for years, sometimes decades.

Persistent credit card debt affects the overall financial position of the holder. Sometimes consumers re-finance their credit card debt into their home loans. And, if that is done, the consumer’s equity in the home is diluted and the servicing requirements for the home loan will likely be changed.

The evidence that Ms Cox gave in connection with home loans and car loans identified the issues that were the subject of closer attention in the case studies relating to those matters. She spoke of credit providers not making adequate inquiries about a consumer’s expenses when deciding whether to make the loan but instead relying on benchmarks such as the Henderson Poverty Index or the HEM. In that regard, she said that the Centre’s experience was that mortgage brokers were more likely to say to a client that ‘this is the estimated monthly expenditure for a family your size; does that sound right to you’ than ask open-ended questions designed to identify actual expenses or consider bills and bank statements to test the reality of the client’s estimates.

More particularly, Ms Cox identified the kinds of complaints made to the Centre about mortgage brokers and said that a common feature of many of the complaints was ‘the inherent conflict of interest in the broker remuneration model and the imperative for the broker to sign the customer up to a loan in order to receive a remuneration benefit’.

In connection with car loans, Ms Cox said that those loans, and re-possession, were a common reason for consumers to call the National Debt Hotline. She spoke of ‘motor vehicle finance churn’ where consumers with older cars still under finance, or with a balloon payment due at the end of the loan term, being ‘upgraded or re-financed with increased finance’ resulting in large debts, far greater than the value of the vehicle being acquired.

As the evidence given by Ms Cox showed, the conduct identified by entities as misconduct or conduct falling short of community standards and expectations affects individuals. As the evidence adduced in the first round of hearings showed, the effects can be profound. The consumers who gave evidence in those hearings all explained the effects that the conduct in issue had had on them. One (Mr Robert Regan) spoke of coming to depend on charity for food. Another (Ms Nalini Thiruvangadam) spoke of being forced to borrow from her family and of having to sell her jewellery. A third (Mr David Harris) spoke of the consequences he had suffered when, despite admitting to his bank that he had a gambling problem and reaching out to his bank for help, he was offered more credit.

6 Four kinds of issue

The inquiries that the Commission made into conduct in connection with consumer dealings with financial services entities raised many issues. The most important of those issues were illustrated by the case studies undertaken in the first round of hearings. The issues can be gathered in various ways but it is useful to identify four kinds of issue:

- **intermediaries – the confusion of roles and responsibilities;**
- **customer needs – you ‘need’ what we have to sell;**
- **credit risk or unsuitable lending? Lending is not unsuitable if the consumer is unlikely to default; and**
- **processing errors – failure to deliver promised features of products sold.**

Each will be considered separately. But it is important to recognise that, behind or beneath these issues may lie a deeper observation about unifying causes.

Much if not all of the conduct identified in the first round of hearings can be traced to entities preferring pursuit of profit to pursuit of any other purpose.

As commercial enterprises, each of the entities whose conduct was considered in the first round of hearings rightly pursues profit. Directors and

other officers of the entities owe duties to shareholders to do that. But the duty to pursue profit is one that has a significant temporal dimension. The duty is to pursue the long-term advantage of the enterprise. Pursuit of long-term advantage (as distinct from short-term gain) entails preserving and enhancing the reputation of the enterprise as engaging in the activities it pursues efficiently, honestly and fairly. And, lest there be any doubt, it also entails obeying the law. But to preserve and enhance a reputation for engaging in the enterprise's activities efficiently, honestly and fairly, the enterprise must do more than not break the law. It must seek to do 'the right thing'.

The evidence that was led in the first round of hearings suggested that the entities examined had done, and were doing, as little as they thought they have needed to do to meet their legal obligations, offering no (or at best, next to no) encouragement to or reward for staff or third parties to pursue the interests of the consumer. Compliance appeared to have been relegated to a cost of doing business. And, the case studies undertaken in the first round of hearings showed, that there had been occasions when profit has been allowed to trump compliance with the law, and many more occasions where profit trumped doing the right thing by customers.

The importance that entities give to profit is reflected most clearly in their remuneration policies for staff and for third parties such as brokers, introducers and aggregators. Those policies have two kinds of effect.

First, staff and others engaged by an entity will treat as important what they believe that the entity values. Rewarding volume and amount of sales is the clearest signal that selling is what the entity values. What staff and others believe that the entity values informs what they do. It is a critical element in forming the culture of the entity.

Second, the importance that entities give to profit is shown also by their allowing third parties whom they authorise to deal with consumers to prefer the interests of the third parties to those of the consumer. Remuneration and similar arrangements (most notably the 'flex-commission' arrangements in relation to car loans, which are considered later) have encouraged those third parties to pursue their own profit interests (and thus the profit of the entity) at the expense of the consumers' interests.

6.1 Intermediaries

As noted earlier, mortgage brokers act in relation to more than half of all residential home loans settled in Australia. Mortgage aggregators act as intermediaries between mortgage brokers and lenders. Neither mortgage brokers nor mortgage aggregators charge borrowers directly. Typically they receive loan-value based commission from the lender – part ‘upfront’ and part ‘trail’ commission. Upfront commission is calculated as a percentage of the amount drawn down; **trail commission** is calculated as a percentage of the amount outstanding. The rate of commission varies but it is convenient to indicate their general level by noting that CBA’s standard broker commission provided for an upfront commission of 65 basis points (0.65%) with a trail commission of 15 basis points (0.15%) for three years and 20 basis points (0.2%) for the fourth and subsequent years.⁵¹

Some lenders have used and continue to use ‘introducers’ to refer potential home loan borrowers to the lender. It is described as a ‘spot and refer system’. That is, the introducer tells the potential borrower that the lender lends money, tells the lender that a named person is seeking a loan and gives the lender the contact details for the potential borrower. The introducer is paid a commission if the person introduced takes a loan. In the case study examined in evidence, NAB paid introducers a commission of 0.4% of the amount of the loan drawn down. Between 2013 and 2016, NAB paid introducers nearly \$100 million.

To understand what misconduct has occurred in connection with home loans, and why it occurred, it is necessary to consider two matters: first, for whom do intermediaries in the home loan market act, and second, what are the effects of value-based remuneration for intermediaries?

6.1.1 For whom does the intermediary act?

There is no simple legal answer to this question. At a practical level, however, the intermediary is paid only by the lender. The intermediary may hope to deal with a borrower more than once but may never do so. A broker expects to deal with lenders repeatedly and must be accredited by the lender to whom a loan proposal is made or by the aggregator through whom the proposal is made. And the relationship between broker, aggregator and lender will be regulated by contract. Broker, aggregator and lender may all

⁵¹ Transcript, Daniel James Huggins, 15 March 2018, 250.

see the broker as ‘the face of the lender’, not as ‘the face of the borrower’. And again, at a practical level, ‘introducers’ are even more clearly the face of the lender and not the face of the borrower.

The contracts made between broker and aggregator and between aggregator and lender may contain ‘no agency’ provisions. So, for example, the Template Head Group Agreement produced by CBA provided that the ‘Head Group’ (the aggregator) was CBA’s ‘agent’ only in relation to the collection of customer identification, tax file number disclosure, privacy protection of information forms, and any bank account opening application form.⁵² And when a broker submits a loan application to a lender, the lender may assert (as CBA did in its submissions) that the broker takes this step as the agent of the borrower.⁵³

Five further points may then be made about the question for whom does the intermediary act.

First, **notions of ‘agency’ are apt to mislead**. To ask only whether the intermediary is ‘agent’ for the borrower or for the lender is to ask too broad a question. Instead, it is more useful to ask two questions. First, for whom does the borrower *believe* that the intermediary is acting? That is, what is it that the borrower expects of the intermediary? Second, are those beliefs and expectations well-founded? What (if any) duties does the intermediary owe the borrower at any of the several stages between a borrower approaching a broker and the borrower drawing the loan? And how do those duties fit with whatever duties the broker may owe to the lender? (As already noted, the intermediary’s duties to the lender are almost always to be found in contracts between intermediary and lender or, where there is a further level of intermediary – for example an aggregator – in the web formed by the separate contracts between lender, broker and aggregator.)

The second point to be made in respect of the question – ‘For whom does the intermediary act?’ – is that, **in most cases, even if an intending borrower believes or expects the intermediary to be acting in the interests of the borrower, the intermediary owes no general duty to the**

⁵² Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-4 [CBA.0001.0028.0344 at .0367]; Transcript, Daniel James Huggins, 15 March 2018, 237.

⁵³ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 3 [11].

borrower to seek out the best and most appropriate deal for the borrower. The intermediary will have told the borrower that he or she deals with a limited group of lenders. Generally, if the intermediary owes a duty to the borrower it will be the statutory obligation to determine only whether the proposed loan is 'unsuitable'.

Third, there may be cases where the intermediary expressly assumes some more specific role with respect to the borrower. This may be the case, for example, if the broker were to agree (or assert) that he or she would act in the borrower's best interests or if the broker were to assert that the loan proposed was the 'best' available. In the first of these cases the broker might be found to have assumed an obligation to act only in the interests of the borrower; in the latter case, the statement made would be measured against the law of misleading and deceptive conduct.

But very often, the relationship between broker and would-be borrower will either be obscure or a relationship in which the broker owes the borrower no duty larger than not to negotiate an unsuitable loan.

Fourth, different considerations may arise when the broker assembles material necessary to submit an application for a loan. In performing those tasks, does the broker owe the lender or the borrower any obligation to inquire about or verify the accuracy of the personal information that the borrower supplies? If the intermediary does owe a duty of that kind to either the borrower or the lender, it is a duty that is often not performed. The fact that so many home loan applications proceed by the lender assuming that the borrower's living expenses are equal to the HEM measure, not as the borrower declares them to be, can lead only to the conclusion that in many of those cases the broker has not taken any effective steps to inquire into, or verify, the expense information supplied by the borrower.

Fifth, **there is no doubt that in the eyes of at least some lenders, the broker's task is to sell that lender's products.** As later explained in connection with the evidence about CBA's broker accreditation program, CBA's broker 'Authority to Act' form records that, to maintain accreditation by CBA, a broker must submit a minimum of four home loan applications and settle a minimum of three home loans every six months.⁵⁴ Mr Huggins

⁵⁴ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-11 [CBA.0001.0027.4036 at .4038].

said in evidence that CBA did not enforce this requirement ‘systematically’ but the fact is that this was what it told its accredited brokers.⁵⁵

6.1.2 Remuneration

How, if at all, is the remuneration of intermediaries associated with misconduct in connection with home loans?

In 2017, on the instructions of the ABA, Mr Stephen Sedgwick AO conducted a review of retail banking remuneration. He published his report in April 2017 and made 21 recommendations. Some of those recommendations have been adopted, some not. The recommendations and the extent to which they have been adopted are considered elsewhere in this report.

For present purposes, it is convenient to focus on only one submission made to Mr Sedgwick: the submission made by CBA on 10 February 2017. One paragraph of the covering letter for that submission captures the essence of the issue that underlies much of the conduct about home loans examined in the first round of hearings.

The covering letter, signed by the then CEO of CBA (Mr Ian Narev), said that:

We agree with the Reviewer’s observations that while brokers provide a service that many potential mortgagees value, the use of loan-size linked with upfront and trailing commissions for third-parties, can potentially lead to poor customer outcomes. Mortgages also sit outside the financial advice framework, even though buying a home and taking out a mortgage is one of the most important financial decisions an Australian consumer will make. We would support elevated controls and measures on incentives related to mortgages that are consistent with their importance and the nature of the guidance that is provided. For example, the de-linking of incentives from the value of the loan across the industry; and the potential extension of regulations such as Future of Financial Advice (FoFA) to mortgages in retail banking.

Three points emerge from that one paragraph:

⁵⁵ Transcript, Daniel James Huggins, 15 March 2018, 267–8.

- **First, remuneration can affect outcome.** (CBA recognised and accepted that ‘the use of loan-size linked with upfront and trail commissions for third-parties, can potentially lead to poor customer outcomes.’)
- **Second, advice about mortgages matters.** (CBA recognised and accepted that mortgages ‘sit outside the financial advice framework’ and supported ‘the potential extension of regulations such as ... FoFA to mortgages in retail banking.’)
- Third, CBA would not move first, or alone, to meet the issues.

Further content was given to these points in the Issues Paper Submission that accompanied CBA’s letter to Mr Sedgwick. In considering ‘Issues specific to remuneration of third parties’ the submission identified three findings that were ‘consistent with the hypothesis that differences in remuneration ... are driving different customer outcomes and lends some support to the case for discontinuing the practice of volume-based commissions for third parties,’ Those findings were that:

- **Broker loans were reliably associated with higher leverage, even for customers with an identical estimate of risk;**
- **Loans written through brokers have a higher incidence of interest-only repayments, have higher debt-to-income levels, higher loan-to-value ratios (LVRs) and higher incurred interest costs compared with loans negotiated directly with the bank; and**
- **Over time, higher leverage means broker customers have an increased likelihood of falling into arrears, pay down their loans more slowly and on average pay more interest than customers who dealt directly with the bank.**

There is no reason to doubt the accuracy of these findings. They were the findings that ASIC recorded in its *Review of Mortgage Broker Remuneration* published in March 2017.⁵⁶ ASIC concluded that, even after controlling for differences between those who deal directly with a lender and those who used a broker, consumers going through broker channels obtained loans with higher LVRs (typically between 1% and 4%, depending on the lender)

⁵⁶ ASIC, *Report 516: Review of Mortgage Broker Remuneration*, March 2017.

and larger loans in dollar terms.⁵⁷ ASIC further concluded that, again controlling for differences, consumers going through broker channels ‘obtained significantly more interest-only loans: for all eight lenders reviewed, brokers arranged at least 50% more interest-only loans, and up to four times as many interest-only loans in the case of one lender’.⁵⁸

Nor is there any reason to doubt that **value-based upfront and trail commissions to third parties contribute to those outcomes**. CBA, the largest home lender in Australia, acknowledges this to be so. ASIC found it to be so. The assertions by Aussie Home Loans and Smartline Home Loans Pty Ltd, that the present remuneration structures for intermediaries are not shown to lead to any consequence that calls for alteration of the system are not to be accepted.

What does require closer consideration, however, is the proposition advanced throughout the CBA submission to Mr Sedgwick that the way in which bank staff are paid does not lead to poor customer outcomes. Two reasons were given. First, the submission pointed to differences in the ways in which staff remuneration structures differed from the value-based remuneration of brokers. Second, it was said that the banks have enough checks and balances to avoid those outcomes: ‘[r]egardless of the channel in which a customer purchases a Commonwealth Bank product or service, we have strong processes and controls to ensure that we meet our responsible lending obligations and that customers can afford the loan that is being provided to them.’ And it is this last assertion, in one form or another, that underpinned the submissions by NAB, Westpac and Aussie Home Loans that no change should be made to broker remuneration arrangements.

Whether, and to what extent, staff incentive schemes and structures contribute to misconduct or conduct falling short of community standards and expectations in connection with home loans is better considered as part of a more general examination in Chapter 8 of the contribution that staff remuneration structures have made to the ways in which ADIs deal with their customers. What is plain, however, is that **value- and volume-based remuneration for intermediaries in the home loan industry has been an**

⁵⁷ ASIC, *Report 516: Review of Mortgage Broker Remuneration*, March 2017, 14 [51].

⁵⁸ ASIC, *Report 516: Review of Mortgage Broker Remuneration*, March 2017, 14 [53].

important contributor to misconduct and conduct falling short of community standards and expectations and poor customer outcomes.

The conduct to which value-based remuneration has contributed is exemplified by the case studies examined in the first round of hearings. And both CBA and ASIC rightly identified the consequences of value-based remuneration of brokers:

- higher leverage;
- higher incidence of interest-only loans;
- higher total debt-to-income ratios;
- higher LVRs;
- higher incurred interest costs; and,
- over time, an increased likelihood of borrowers falling into arrears, borrowers paying their loans more slowly and paying more interest than other borrowers.

In these circumstances, it will be important to consider whether value- and volume-based remuneration of intermediaries should be forbidden.

In December 2017 the Combined Industry Forum (CIF), composed of industry bodies and financial services entities, released a report setting out reforms to broker remuneration agreed upon by its members. The changes included paying commissions based on the amount of funds actually drawn down by a customer (rather than the size of the loan approved), ceasing volume and campaign-based commissions, limiting the value and availability of rewards such as entertainment and overseas trips, and the development of a mortgage broking industry code. In late August 2018, the CIF reported that its members had eliminated volume-based commissions and mooted the adoption of a 'customer first' duty.

The reforms announced are limited. While the perverse incentives created by volume-based commissions, which reward brokers for the number of customers placed with a lender, are to be removed, upfront and trail commissions based on loan value remain. While basing those commissions on funds drawn down removes an incentive for brokers procuring a loan larger than the borrower will use, the change does not deal with the more basic problem of borrowers being encouraged to borrow more than they

need. As noted elsewhere in this report, value-based remuneration conflicts directly with customers' interests.

It is not immediately clear what would be the content of a 'customer first' duty. In particular, it is not clear how this form of duty is intended to differ from the duty to act in the best interests of the client that the Corporations Act imposes on financial advisers. Nor is it clear, if the two forms of duty are to be given different content, why the duty a mortgage broker owes to a borrower should differ from the duty a financial adviser owes a retail client.

6.1.3 Other intermediaries

One other form of intermediary calls for special consideration – retail dealers, especially car dealers, who are entitled to, and do, act as agents for lenders without holding an **Australian Credit Licence**. Under the point-of-sale exceptions to the NCCP Act, many car dealers (and some retailers), without holding an ACL, have offered to consumers loans to be provided by a lender.⁵⁹ It has been common for lenders to allow car dealers what are called 'flex-commissions'. Under that kind of arrangement, the lender fixes a base rate of interest that will be charged under the loan agreement. If the dealer can persuade the borrower to agree to pay a higher rate, the dealer receives a large part of interest payable over and above the base rate. In more recent times, lenders have provided that the agreed rate must not exceed a rate fixed by the lender but, below that cap, the dealer is free to offer a loan on behalf of the lender at a rate greater than the base rate fixed by the lender.

Many borrowers know nothing of these arrangements. Lenders do not publicise them; dealers do not reveal them. The dealer's interest in securing the highest rate possible is obvious. It is the consumer that bears the cost. To the borrower, the dealer may appear to be acting for the borrower by submitting a loan proposal to the lender on behalf of the borrower. If the borrower thinks that the dealer is acting for the lender, the borrower is given no indication that in fact the dealer is looking after its own interests rather than as a mere conduit between lender and borrower. For all the borrower knows, the interest rate the dealer quotes as the applicable rate is fixed by

⁵⁹ Exhibit 1.158, Witness statement of Michael Saadat, 5 March 2018, 2 [11], 23 [128]; Jeannie Marie Paterson and Nicola Howell, *FSRC Background Paper No. 4: Everyday Consumer Credit – An Overview of the Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans*, 12 March 2018, 23.

the lender. In fact, however, whenever the dealer quotes a rate larger than the base rate fixed by the lender, the dealer is acting in its own interests.

When a consumer negotiates a loan at point of sale there may be as much confusion about the roles and responsibilities of an intermediary as there is in connection with brokers and aggregators dealing with home loans.

6.2 Customer ‘needs’

Unsurprisingly, those employed by the large banks used similar forms of expression when describing dealings between the entity and its customers. There was repeated reference to ‘conversations’ with the customer and to meeting the customer’s ‘needs’. The second kind of issue that emerged from the first round of hearings relates to this notion of a customer’s ‘needs’.

The use of words like ‘conversations’ and ‘needs’ must not be permitted to obscure what was being described. A ‘conversation’ with a customer is treated as an opportunity to sell what the entity has to sell and, for that purpose, to gather some necessary information about the customer.

The customer’s ‘needs’ are formed by reference to what the entity has to sell. And often it is the entity’s representative that tells the customer what he or she ‘needs’. That is why the banks have rewarded and continue to reward staff and intermediaries for ‘cross-selling’ products. The customer who seeks a home loan is sold a transaction account or is sold a credit card. The customer who seeks a credit card is sold ‘add-on insurance’. The examples could be multiplied. The staff member, or intermediary is rewarded for making the cross-sale. It is said that the customer’s ‘unmet needs’ have been met. But the customer is treated as ‘needing’ what the entity has to sell.

A clear illustration of this understanding of customer ‘needs’ is provided by the evidence given about ANZ’s conduct in making unsolicited offers of overdraft facilities to customers and Westpac’s conduct in offering credit limit increases to credit card holders. In neither case had the customer expressed any ‘need’ or desire for this facility.

Unsolicited offers to credit card holders of credit limit increases were common throughout the industry. Since 1 July 2012, they have been regulated under the NCCP Act.⁶⁰

Closely connected with these points about customers' needs is the further point, examined earlier in connection with the responsible lending provisions, that the lending decisions examined in the course of the first round of hearings were dictated by reference to credit risk rather than the statutory requirements about unsuitable lending.

6.3 Credit risk or unsuitable lending?

The point just made about lending decisions being made by reference to credit risk rather than the applicable statutory requirements is readily illustrated by reference to the evidence led in the first round of hearings about credit limit increases for credit card holders and unsolicited offers of overdraft limits.

The evidence showed that a credit limit increase would be offered to a credit card holder, and granted, if the bank judged that the card holder was unlikely to default in meeting the minimum repayment due if the increased limit was fully drawn. So too, ANZ made unsolicited offers of overdraft limits to those whom it judged were unlikely to default. The only criterion applied in either kind of case was whether the customer was likely to default.

Lending was treated as not unsuitable if the customer was unlikely to default.

But that is not what the responsible lending provisions required. Contrary to those provisions, the banks made no inquiry about the customer's circumstances, requirements or objectives. Until ASIC stepped in, in September 2012, none of the banks made any inquiry about the credit card holder's financial situation at the time of the offer. And even after ASIC had sought, in 2012, to have the banks make inquiries about the customer's financial situation at the time of the offer to increase the credit

⁶⁰ NCCP Act s 133BE(1), as amended by *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011* (Cth) sch 1 pt 3-2B div 4 and *Treasury Laws Amendment (Banking Measures No 1) Act 2018* (Cth) sch 5 pt 2; see also Jeannie Marie Paterson and Nicola Howell, *FSRC Background Paper No. 4: Everyday Consumer Credit – An Overview of the Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans*, 12 March 2018, 56.

limit, Westpac continued, for more than two years, to offer and to grant credit limit increases without making any inquiry beyond whether the customer's immediately antecedent history of servicing the existing credit card debt showed that the customer could service an increased debt. Westpac estimated its profit from this conduct as more than \$23 million.

6.4 Processing errors

What entities described in their submissions to the Commission, and their dealings with ASIC, as 'processing errors' in connection with home loans were failures by the entities to make proper provision in their administrative and computer systems to charge customers only the interest and fees that had been agreed with the customer. That is, in breach of what they had promised, the entities charged customers interest at rates higher than had been agreed and charged fees that should not have been charged, either at all or at the rate they were.

Three fundamental, but simple, points must be made about these issues.

First, entities should not offer to sell what they cannot deliver. And that is what has been done when an entity has offered interest rate or fee discounts but has not charged the proper rate or the proper fee because relevant accounts were not linked, or automated systems were not properly programmed to charge the right rate or fee.

Not to charge the contractually stipulated rate or fee is evidently conduct that falls below community standards and expectations. Performing a contract according to its terms must be seen as a standard of behaviour that the community expects to be met.

But not to charge the contractually stipulated rate or fee is also misconduct. It is a breach of duty or it is a breach of a recognised and widely adopted benchmark for conduct or, most probably it is both.

Further, not charging the correct rate or fee might also constitute a contravention of Section 912A of the Corporations Act. That section obliges a financial services licensee to do *all* things necessary to ensure that the financial services covered by the licence are provided efficiently, fairly and honestly. And not charging the right rate or the right fee may be, in at least many cases, not to provide the relevant service 'efficiently, fairly and honestly'. Regardless of whether failing to charge the right rate and right fee is a breach of Section 912A, it is, on its face, a breach of contract. And if it is

a breach of contract, it would breach ‘a widely recognised and widely adopted benchmark for conduct’. It would be misconduct and it would be misconduct that has serious effects on many customers.

Second, the entity that sells a product should have the right systems in place *before* the first sale is made. Selling without knowing that what is sold can be delivered is, at best, careless of the interests of the customers to whom the product is sold. At worst, it is deceptive.

The third, and equally simple observation to make is that, if an entity does not deliver what it has sold, the entity must remedy that default and the consequences of the default as soon as reasonably practicable.

Once this is understood, the so-called processing errors identified by banks called for much quicker responses than exemplified by ANZ’s prolonged processes for identifying and then compensating customers affected by failures first identified in 2003,⁶¹ which were still far from complete when the Commission took evidence on the subject in March 2018.

7 Regulatory compliance

The first round of hearings revealed some common and recurring themes about what importance the entities whose conduct was examined in those hearings give to regulatory compliance. Some have been mentioned already but it is as well to bring them together for the purpose of considering what they show.

The evidence led in the first round of hearings pointed towards:

- the entities concerned preferring profit to pursuit of any other purpose; and
- the entities treating regulatory compliance as a cost of doing business rather as a foundation that informs and underpins how the business must be conducted.

⁶¹ Exhibit 1.127, undated, Extract from Final Table, items 134–8, 151; Transcript, Sarah Mary Stubbings, 20 March 2018, 659–60.

Four aspects of the evidence reveal this to be so.

First, there is the body of evidence about how the four largest banks have dealt with responsible lending obligations. They have seen these obligations as satisfied whenever the bank, as lender, is satisfied that the borrower is unlikely to default. That is, they have each understood, and applied, the law that requires lenders to ascertain and form a view about the *borrower's* requirements and objectives and the *borrower's* financial situation as met by asking only whether the *lender* is taking an acceptable credit risk.

Second, there is the body of evidence about how long it has taken the banks to lodge a written report with ASIC under Section 912D of the Corporations Act that the bank has breached, or is likely to breach, any of the obligations under Section 912A or Section 912B. The evidence called in the first round of hearings suggested that in some of the cases examined the bank concerned had not lodged the necessary written report 'as soon as practicable and in any event within 10 business days after becoming aware of the breach or likely breach'.⁶²

Third, there was the evidence that showed that even if doing business in a particular way was of actual or possible disadvantage to customers, the banks would not alter that way of doing business if unilateral change would bring significant competitive disadvantage.

So, despite CBA recognising that 'the use of loan-size linked with upfront and trail commissions for third parties can potentially lead to poor customer outcomes',⁶³ CBA would not unilaterally change its broker and aggregator remuneration arrangements. And more strikingly, ANZ and Westpac would not cease to allow car dealers to earn 'flex-commissions' with respect to car loans despite powerful reasons to abandon the practice. First, as has been explained, the practice allowed (indeed it encouraged) the dealer to prefer its own commercial gain to the borrower's interests. Second, the banks knew that its car loan borrowers suffered disadvantage from these arrangements and those employees of ANZ and Westpac who gave evidence about these matters appeared not to dispute that the disadvantage

⁶² Corporations Act s 912D(1B).

⁶³ Exhibit 1.37, 10 February 2017, Letter from Mr Narev to Mr Sedgwick dated 10/02/2017 and the Annexed Issues Paper Submission dated 10/02/2017, 2.

arose from the dealer's conflict of interest.⁶⁴ Third, the banks not only did nothing to tell consumers that dealers might seek to negotiate an interest rate above the rate required by the lender, the banks readily accepted that the practice was not generally known. And finally, despite it being announced (in September 2017) that the law was to change to outlaw the practice (with effect from 1 November 2018),⁶⁵ the banks did nothing to modify their business practices for fear of the resulting commercial disadvantage if other lenders did not follow suit.

The fourth aspect of the evidence led in the first round of hearings that shows that the entities concerned preferred profit to pursuit of any other purpose was the evidence given about Westpac and its offering credit limit increases to credit card holders. Despite being told plainly by ASIC that it considered that practices of the kind followed by Westpac did not comply with the responsible lending provisions, Westpac chose to continue those practices until ASIC threatened legal action. And Westpac chose not to seek, at any time in the intervening two years, to tell ASIC that it proposed to continue with its previous practices or to persuade ASIC that ASIC's stated views of the law were wrong.

These four matters must then be assessed in light of the ways in which banks have, until very recently, structured their remuneration arrangements for staff and for third parties. As is explained in Chapter 8, for most of the last decade, **remuneration arrangements for third party intermediaries and for all staff, both frontline staff and senior executives, have rewarded sales and profitability. Doing the 'right thing' has not been rewarded. And even in the more recent past, 'balanced scorecards' and 'conduct gateways' have too often used doing the 'wrong thing' as a disqualifying criterion. But penalising default is not the same as rewarding the right and proper performance of a task. Penalising default encourages hiding mistakes; it does not encourage doing the**

⁶⁴ cf NCCP Act s 47(1)(b) obliging a credit licensee to 'have in place adequate arrangements to ensure that clients of the licensee are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or its representatives'.

⁶⁵ ASIC, 'ASIC Bans Flex Commissions in Car Finance Market' (Media Release, 17-301MR, 7 September 2017); see also ASIC, *ASIC Credit (Flexible Credit Cost Arrangements) Instrument*, 2017/780, 5 September 2017.

‘right thing’. It does not encourage the intermediary or the employee to ask, ‘Should I, should the Bank, do this?’

8 Issues that have emerged

The issues that emerged in connection with consumer lending concerned:

- intermediaries, and confusion of roles;
- communication with customers; and
- responsible lending.

Intermediaries stand between consumers and the providers of financial services. They include **mortgage brokers**, **mortgage aggregators**, introducers, financial advisers, authorised representatives of financial services licensees, and representatives (at point of sale) of credit licensees. Often, intermediaries are given tasks that, done properly, will help to fulfil the entity’s responsible lending obligations. There are, therefore, issues about entities’ oversight of these contractually stipulated tasks, and their responsibility for their own, non-delegable statutory obligations.

Intermediaries are often seen by the customer as the face of the entity. Entities, on the other hand, have given conflicting messages about whether intermediaries represent entities, themselves, or the customer. There are, therefore, questions about intermediaries’ obligations toward customers and entities, and customer expectations of the intermediaries with whom they deal.

Both entities and customers appear to be confused about the roles of intermediaries. Issues then arise about how entities can communicate with customers to create realistic expectations of products bought through intermediaries. And questions of communication arise when considering what obligations an entity owes to clients of an employee or intermediary when the entity suspects that employee or intermediary of misconduct toward at least some of their clients.

Responsible lending raises issues about the interpretation and application of obligations imposed by the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act). A particular issue that arose concerned entities’ interpretation of the requirement to verify a customer’s financial situation.

Later changes to verification processes may suggest some entities have changed their interpretation of the relevant provisions. Examination of responsible lending also directed particular attention to the tension between responsible lending and some products long sold by, and some processes long used by, entities and intermediaries, including add-on insurance, pre-approved credit limit increases and the **Household Expenditure Measure** (HEM).

The particular issues can be identified as including:

- What duties does an intermediary owe to a borrower?
- What duties should an intermediary owe to a borrower?
- How can entities' systems be improved to detect and prevent breaches of responsible lending obligations by intermediaries?
- Are 'introducer' programs compatible with responsible lending obligations?
- Do broker contracts, as they stood at the time of the hearings, meet the statutory requirement imposed by Section 912A of the *Corporations Act 2001* (Cth) to have arrangements in place to manage conflicts of interests? Do broker contracts, as now made, meet those requirements?
- What should be disclosed to borrowers about an intermediary's obligations to the lender and to the borrower?
- What should be disclosed to borrowers about an intermediary's remuneration?
- What steps, consistent with responsible lending obligations, should a lender take to verify a borrower's expenses?
- Do the processes used by lenders, at the time of the hearings, to verify borrowers' expenses meet the requirements of the NCCP Act? Do the processes now used meet those requirements?
- Should the HEM continue to be used as a benchmark for borrowers' living expenses?

- Is the offer of a credit limit increase, where the customer has consented to receive such marketing, consistent with the NCCP Act obligation not to provide credit that is not unsuitable for the customer, having regard to their requirements and objectives?
- Is the offer of a credit limit increase based only on information held by the bank about a customer a breach of the NCCP Act obligation to take reasonable steps to verify the consumer's financial situation?
- When an employee or intermediary is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?
- When an employee or intermediary is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidence of misconduct?
- Are certain types of add-on insurance, by their nature, poor value propositions for customers?

3. Financial advice

Introduction

The Commission's second round of public hearings explored issues relating to the financial advice industry.

The Commission focused on four topics:

- fees for no service, which concerned licensees or advisers charging fees to clients for financial advice that was not provided;
- inappropriate financial advice, which can be broadly described as financial advice that does not comply with the 'best interests' obligation and related obligations in Part 7.7A of the *Corporations Act 2001* (Cth) (the Corporations Act) or advice that does not take proper account of a client's circumstances;
- improper conduct by financial advisers, which included falsifying documents, misappropriating customer funds and engaging in misleading or deceptive conduct in relation to clients; and
- disciplinary matters, which included how disciplinary matters involving financial advisers are now dealt with and whether there are any gaps in the existing system.

These four topics were chosen in light of what the relevant entities told the Commission in their initial submissions and in light of what members of the public told the Commission in their online submissions.

Together the four topics presented issues about conduct and culture which, in turn, raised issues about regulation and about the structure of the financial advice industry. **Two themes recurred: dishonesty and greed.**

- **Charging for doing what you do not do is dishonest.**
- **Giving advice that does not serve the client's interests but profits the adviser is equally dishonest.**

- **No matter whether the motive is called ‘greed’, ‘avarice’ or ‘pursuit of profit’, the conduct ignores basic standards of honesty.**
- **Its prevalence and persistence require consideration of the issues of culture, regulation and structure.**

The discussion of these issues begins by looking at the history of the financial advice industry.

1 History

The issues considered by the Commission are related to the history of the financial advice industry. In particular, the roots of the industry are in sales and that has had a key influence in shaping the culture of the industry. Early scandals, how the industry responded to those scandals and the phenomenon of **vertical integration** (discussed further in Section 1.2, below) also provide an insight into the nature of the industry and why issues persist despite ongoing attempts at legislative reform.

1.1 How did the financial advice industry emerge?

The traditional business of banking comprised lending, deposit-taking and the provision of transaction services.¹ Through the first half of the twentieth century, banking was a regulated, local, low risk business based on a customer’s credit worthiness and yielded returns based on interest.² Much has changed, but the mid-century model persists in the popular consciousness. Bank advertising draws heavily on this historical image.

During the 1950s, banking had little to do with funds management, where an entity pools and invests money on behalf of customers. The funds management sector was composed largely of superannuation and life

¹ Malcolm Edey and Brian Gray, ‘The Evolving Structure of the Australian Financial System’ (Paper presented at The Future of the Financial System Conference, H.C. Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 8–9 <www.rba.gov.au/publications/confs/1996/pdf/conf-vol-1996.pdf>.

² Malcolm Edey and Brian Gray, ‘The Evolving Structure of the Australian Financial System’ (Paper presented at The Future of the Financial System Conference, H.C. Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 7 <www.rba.gov.au/publications/confs/1996/pdf/conf-vol-1996.pdf>.

insurance.³ For reasons discussed below, the reach of this sector was limited until regulatory and financial conditions changed.

In the 1970s, Australia began to deregulate its financial markets. Restrictions on bank interest rates and liability structures were removed; foreign banking was made easier to access; the Australian dollar was floated.⁴ The financial sector expanded. At the same time, growth in the size and liquidity of securities markets allowed more diverse **financial products** to develop.⁵

The next critical steps were the expansion of superannuation, which shifted the responsibility for and control of provision for retirement from employers into the hands of individuals. From 1983, successive changes to the tax treatment of superannuation increased the complexity of superannuation but also established it as a vehicle for compulsory saving. These developments included the incorporation of superannuation into employment awards in 1986 and legislation in 1991 imposing tax penalties where employer contributions were not made.⁶

With greater amounts of savings invested in superannuation funds, Australians now have a far higher exposure to capital markets and since the 1980s Australians have increasingly seen a need for financial advice.

³ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the Financial System Conference, H.C. Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 7 <www.rba.gov.au/publications/confs/1996/pdf/conf-vol-1996.pdf>.

⁴ RBA, *Submission to the Financial System Inquiry*, March 2014, 16 <http://fsi.gov.au/files/2014/04/Reserve_Bank_of_Australia.pdf>.

⁵ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the Financial System Conference, H.C. Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 17–20 <www.rba.gov.au/publications/confs/1996/pdf/conf-vol-1996.pdf>.

⁶ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the financial System Conference, H.C. Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 35 <www.rba.gov.au/publications/confs/1996/pdf/conf-vol-1996.pdf>.

Before the early 1980s, Australians who required financial advice often went to their bankers, accountants and insurance advisers.⁷

As the market for superannuation and investment products grew, the life insurance and other financial institutions that manufactured financial products looked to financial advisers to sell them.⁸ At that time most financial advisers came from a background of life insurance, in which a sales-driven, commission-based culture prevailed and comprehensive advice was not commonly sought or given.⁹ These being the roots of today's financial planning industry, the culture has endured.

The 1990s brought even more of the Australian public into the market for financial products and services, and therefore advice.¹⁰ A series of privatisations (such as CBA, Telstra and Qantas) and demutualisations (such as AMP and NRMA Insurance)¹¹ increased middle class share ownership. Further deregulation of the financial sector contributed to a surge in credit provision and the design of new and more complex financial products. These developments in combination with the prevailing low interest rates raised household indebtedness and increased the value of market-linked financial assets households held.¹² At this time, banks were beginning their expansion into wealth management, which later accelerated and is discussed below.

⁷ Janet Cowan, William Blair and Sharon Taylor, 'Personal Financial Planning Education in Australian Universities' (2006) 15 *Financial Services Review* 43, 46.

⁸ Robert Brown, 'Reinventing financial planning' (2008) 3(1) *Australian Journal of Financial Planning* 17, 20.

⁹ Robert Brown, 'Reinventing financial planning' (2008) 3(1) *Australian Journal of Financial Planning* 17, 20.

¹⁰ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 5.

¹¹ See also ASX, *The Australian Share Ownership Study* (2014) <www.asx.com.au/documents/resources/australian-share-ownership-study-2014.pdf>.

¹² Marianne Gizycki and Philip Lowe, 'The Australian Financial System in the 1990s' (Paper presented at The Australian Economy in the 1990s Conference, H.C. Coombs Centre for Financial Studies, Kirribilli, 24–5 July 2000) 187 <www.rba.gov.au/publications/confs/2000/>.

The regulatory framework that governs financial advice and product sales today was designed in response to, and in the midst of, these changes. A number of design decisions should be noted for their part in shaping the financial advice industry as it is today.

The 1997 Financial System Inquiry chaired by Mr Stan Wallis (the Wallis Inquiry) reviewed the then fragmented regulation of the financial system and recommended that there be a 'consistent and comprehensive disclosure regime' administered by a single regulator. The adoption of this model marked the start of the uniform treatment of traditional intermediary services and financial sales and advice relating to funds management. In 1998, the Australian Securities and Investments Commission (ASIC) was established, combining the responsibilities of the then Australian Securities Commission and the Insurance and Superannuation Commission.¹³

In December 1999, Treasury released its Corporate Law Economic Reform Program Paper No. 6 (CLERP 6). Although extensive amendments have been made to the legislation passed to implement CLERP 6, a number of its underlying principles have endured. One of those principles was to fold sales and advice relating to insurance and superannuation into the regulation of securities. That regulatory framework was premised on independent intermediation and the use of mandatory disclosure as a means of investor protection.¹⁴ It did not take into account that insurance and superannuation decisions were usually made with consumption (a payment in case of injury; an income stream at retirement), rather than investment, in mind, or that those products were usually sold by sales agents and not independent brokers like those who traded in securities.¹⁵

Another key principle in CLERP 6 was to regulate intermediaries (including advisers) at firm level rather than at the individual level, in part to allow ASIC

¹³ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 6.

¹⁴ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 8.

¹⁵ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 8.

to target its resources efficiently.¹⁶ Thus, under the Corporations Act, individual advisers do not hold licences. The licensed entity is commonly the relevant **financial services entity** and individual advisers act as authorised representatives of the licensed entity. Authorised representatives fall under the firm's statutory obligation to ensure they comply with financial services laws.

Importantly, CLERP 6 did not provide that financial advisers were to be independent from product issuers. It is not clear whether the authors considered the possibility that financial advisers may be employed or authorised by issuers of products about which they advise, a situation that is now widespread. Nor did CLERP 6 engage with the fiduciary duties or other general law obligations that may attach to financial advisers but conflict with their employment conditions. The financial advice industry is still caught in this structural link between product issuers and the adviser's legal obligation to act in the best interests of the client.¹⁷

Finally, CLERP 6 established that household access to wholesale markets and complex products would not be restricted.¹⁸ Rather, it relied on mandatory pre-disclosure as the means to inform consumers about risks on the basis that consumers would then make informed and rational choices about the best investment strategies for them. That meant leveraged and complex investments could be marketed and sold in the retail market.¹⁹

1.2 Vertical integration

The Wallis Inquiry reflected the prevailing conditions of deregulation and globalisation, which produced a sense that financial markets would displace

¹⁶ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 9.

¹⁷ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 10.

¹⁸ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 10–11.

¹⁹ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 10–11.

banks from their core functions and cause financial service providers to specialise and disaggregate.²⁰ It expected that this rise in competition would eliminate mispricing of financial products and services, create efficiencies in the system and ultimately produce lower costs for consumers.²¹ The RBA has said that the Wallis Inquiry underestimated banks' capacity to expand and acquire businesses along their supply chains.²²

From the time of the Wallis Inquiry, banks' accumulation of wealth management businesses accelerated. During the late 1990s and early 2000s, each of the major banks acquired or merged with a fund manager. More recently, banks have sold off a number of those acquisitions, the returns on which have proved lower than expected.²³

The vertical integration of product manufacture with product sale and financial advice is a 'one stop shop' vision in which retail customers' investment needs can be provided alongside traditional banking facilities such as loan and deposit services. Vertical integration has seen the acquisition by entities of a number, or all, of the steps in supply of financial products to consumers, starting with designing and creating the product, providing asset management services and investment platforms, and engaging in distribution to customers by way of financial advice or sales.²⁴

Vertical integration promises the virtue of efficiency, which is then passed on to consumers in the form of lower costs and greater access to financial advice. Customers may also enjoy the simplicity of dealing with just one institution. But the internal efficiency of the 'one stop shop' does not necessarily produce efficiency in outcomes for customers. The one-stop

²⁰ Treasury, *Financial System Inquiry Final Report* (Commonwealth of Australia, 1997) Chapter 4; Reserve Bank of Australia, *Submission to the Financial System Inquiry*, March 2014, 14 <http://fsi.gov.au/files/2014/04/Reserve_Bank_of_Australia.pdf>.

²¹ Treasury, *Financial System Inquiry Final Report* (Commonwealth of Australia, 1997) Chapter 4 <<http://fsi.treasury.gov.au/content/FinalReport.asp>>.

²² RBA, *Submission to the Financial System Inquiry*, March 2014, 14 <http://fsi.gov.au/files/2014/04/Reserve_Bank_of_Australia.pdf>.

²³ Productivity Commission, *Competition in the Financial System: Productivity Commission Draft Report*, January 2018, 82.

²⁴ See generally Productivity Commission, *Competition in the Financial System: Productivity Commission Inquiry Report No. 89*, June 2018, Chapter 9.

shop has an incentive to promote the owner's products above others, even where they may not be ideal for the consumer.²⁵

From the perspective of banks, vertical integration always promised the benefit of cross-selling opportunities (the opportunities for cross-selling financial products to existing and new customers).²⁶

In 2000, CBA acquired Colonial Mutual Life Assurance Ltd,²⁷ which conducted life and other insurance business, and a funds management business. In September 2017, CBA announced that it was selling its life insurance business to AIA,²⁸ and, in July 2018, announced that it would seek to sell the remainder of that business.²⁹ In late June 2018, CBA announced that it would demerge its other wealth management and mortgage broking businesses, including Colonial First State, Colonial First State Global Asset Management Count Financial, Financial Wisdom and Aussie Home Loans, into a separately listed entity.³⁰

In 2000, NAB acquired the financial services businesses of Lend Lease, including MLC Holdings Ltd.³¹ In May 2018, NAB announced that it

²⁵ Productivity Commission, *Competition in the Financial System: Productivity Commission Draft Report*, January 2018, 82, quoting Choice, *Competition in the Australian Financial System Submission to the Productivity Commission*, September 2017, 30; ASIC, *Report 562 Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018, 16.

²⁶ See, eg, Theodore Golat, 'Banks' Wealth Management Activities in Australia', *Reserve Bank Bulletin* (2016) September Quarter, 53, 54–6.

²⁷ CBA, 'Intention to Merge with Colonial' (ASX Announcement, 10 March 2000) <www.asx.com.au/asx/statistics/displayAnnouncement.do?display=text&issuerId=1517&announcementId=167694&documentDate=2000-03-10&documentNumber=203643>.

²⁸ CBA, 'Divestment of Australian and New Zealand Life Insurance Businesses' (ASX Announcement, 21 September 2017) <www.asx.com.au/asxpdf/20170921/pdf/43mhnzcfywb1rs.pdf>.

²⁹ CBA, 'Completion of New Zealand Life Insurance Divestment' (ASX Announcement, 2 July 2018) <www.asx.com.au/asxpdf/20180702/pdf/43w71lflx3gb0.pdf>.

³⁰ CBA, 'Intention to Demerge Wealth Management and Mortgage Broking Business' (ASX Announcement, 25 June 2018) <www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/2018-asx/cba-intention-to-demerge-wealth-management-and-mortgage-broking.pdf>.

³¹ Lend Lease, 'LLC Ann: Sale of MLC Businesses to NAB Uncon Settlement 30/6' (ASX Announcement, 27 June 2000).

proposed to sell its MLC advice, platform and superannuation and asset management businesses.³²

In 2002, ANZ entered joint venture arrangements with ING Group in respect of wealth management and life insurance businesses in Australia and New Zealand,³³ and later acquired the full business. ANZ has since sold most of those businesses.

Westpac took a different path. In 1999, Westpac founded Magnitude Group Pty Ltd. In 2008, as part of its merger with St George Bank Ltd, Westpac acquired St George's financial advice business, which included employed advisers as well as Securitator Financial Group Ltd. In 2002, Westpac acquired all of BT Financial Group's asset accumulation businesses.³⁴

By contrast, AMP's structures remain substantially unchanged. AMP has a network of about 2,800 financial planners. About 90% of those are self-employed and act as authorised representatives of one of the various AMP advice licensees, which include AMP Financial Planning Pty Ltd, Charter Financial Planning Pty Ltd and Hillcross Financial Services Ltd (all of which are subsidiaries of AMP).

By the time of the Final Report of the Financial System Inquiry in 2014³⁵ (Murray Inquiry), the 'one stop shop' model was well established in the market. The Murray Inquiry report observed that the high concentration and steadily increasing vertical integration in some sectors had the potential to limit the benefits of competition in the future.³⁶ While the report did not express a view as to the merits of vertical integration, the Murray Inquiry recommended ways in which to make ownership and alignment more transparent.³⁷ It did, however, note that the Global Financial Crisis (GFC) had exposed 'significant numbers of Australian consumers holding financial

³² NAB, '2018 Half Yearly Results – Appendix 4D' (ASX Announcement, 3 May 2018) 15, 53.

³³ ANZ, 'ANZ & ING Complete Funds Management and Life Insurance JV' (ASX Announcement, 30 April 2002).

³⁴ Westpac, 'Westpac Completes BT Financial Group Transaction' (ASX Announcement, 31 October 2002).

³⁵ Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report.

³⁶ Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report, 255–6.

³⁷ Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report, 271–2.

products that did not suit their needs and circumstances’ and that there were ‘significant problems relat[ing] to shortcomings in disclosure and financial advice’.³⁸

1.3 Early scandals

Scandals dating back to the GFC began to shed light on the conflicts and culture in the financial advice industry. **Regulatory responses, however, focused on the remediation of specific instances of poor advice, rather than seeking to identify root causes within institutions and the industry. Those responses largely set the tone for future approaches to misconduct by financial advisers, that is, to compensate customers according to arrangements negotiated with ASIC while requiring few changes to the business itself.**

1.3.1 Storm Financial

Shortly before the second half of 2008, Storm Financial was a profitable company with \$77 million in annual revenue and \$120 million in consolidated gross assets.³⁹ Initially largely conducting its business in north Queensland before its liquidation in 2009, Storm was conducting business throughout most of Queensland and in many other parts of Australia, attracting thousands of customers.⁴⁰ Between 2007 and 2008, Storm Financial had offices in a number of States in Australia and had over 100 employees.⁴¹

The business model of Storm Financial was to provide advice in standard or template form, with minimal tailoring to the investor.⁴² Almost 90% of Storm’s clients were encouraged to take out loans against the equity in their own homes, obtain a margin loan and use the funds from these loans to

³⁸ Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report, 27.

³⁹ *ASIC v Cassimatis [No 8]* [2016] FCA 1023 [1]; see also *ASIC v Cassimatis [No 9]* [2018] FCA 385 [6].

⁴⁰ *ASIC v Cassimatis* [2013] FCA 641 [4].

⁴¹ *ASIC v Cassimatis [No 8]* [2016] FCA 1023 [135].

⁴² *ASIC v Cassimatis [No 8]* [2016] FCA 1023 [9].

invest in the share market via index funds.⁴³ In late 2008 and early 2009, many clients of Storm Financial were in negative equity positions, sustaining significant losses.⁴⁴

This resulted in many investors losing their investment, their homes and their life savings and still having significant debts outstanding. ASIC estimated the total loss suffered by all investors who borrowed from various banks to invest through Storm to be approximately \$832 million.⁴⁵

In December 2008, ASIC commenced an investigation into Storm Financial.⁴⁶ In early 2009, Storm Financial was placed into voluntary administration and liquidators were subsequently appointed.

ASIC commenced a number of legal proceedings in relation to the Storm Financial scandal including proceedings alleging that the directors of Storm Financial had breached their duties as directors and that Storm Financial had provided inappropriate advice.⁴⁷ In March 2018, the Federal Court imposed a penalty of \$70,000 (from a maximum penalty of \$200,000) on each of the directors of Storm Financial and ordered that each be disqualified from managing corporations for seven years.⁴⁸

ASIC also entered into settlement agreements with various institutions to provide compensation for losses suffered:

- In 2012, ASIC entered into a settlement agreement with CBA to make available up to \$136 million as compensation to CBA customers who had

⁴³ See ASIC, 'Directors of Storm Financial Penalised for Breach of Duties' (Media Release, 18-081MR, 22 March 2018); see also *ASIC v Cassimatis [No 9]* [2018] FCA 385 [7]; *ASIC v Cassimatis [No 3]* (2015) ALD 410 [6].

⁴⁴ ASIC, 'Directors of Storm Financial Penalised for Breach of Duties' (Media Release, 18-081MR, 22 March 2018).

⁴⁵ ASIC, 'ASIC and CBA Storm Financial Settlement' (Media Release, 8 March 2013) 3 [1.5].

⁴⁶ ASIC, *ASIC Investigation Background* (28 October 2016) ASIC <<https://storm.asic.gov.au/proceedings/summary-of-asic-actions/asic-investigation-background/>>.

⁴⁷ ASIC, *Summary of ASIC Actions: Civil Penalty Proceedings against the Cassimatises* (28 October 2016) ASIC <<http://storm.asic.gov.au/proceedings/summary-of-asic-actions/>>.

⁴⁸ ASIC, 'Directors of Storm Financial Penalised for Breach of Duties' (Media Release, 18-081MR, 22 March 2018).

borrowed from the bank to invest through Storm Financial.⁴⁹ CBA had already provided approximately \$132 million to Storm Financial investors under its resolution scheme.⁵⁰

- In 2013, ASIC intervened in a class action brought against Macquarie Bank in respect of Storm Financial regarding the fairness of settlement arrangements. The Full Federal Court held that the distribution of the settlement sum was not fair and reasonable to all group members and a revised settlement arrangement was arrived at whereby Macquarie Bank agreed to pay \$82.5 million by way of compensation and costs.⁵¹
- In 2014, ASIC entered into a settlement agreement with the Bank of Queensland to pay approximately \$17 million as compensation for losses suffered on investments made through Storm Financial.⁵²

1.3.2 Commonwealth Financial Planning (CFPL)

In 2010, a whistleblower raised allegations of misconduct by financial advisers employed by CFPL, a subsidiary of CBA.⁵³ The allegations included that certain CBA financial advisers were advising clients to invest in high risk but profit-generating products that were not appropriate for them, switching products without the relevant client's permission and forging clients' signatures on documents.

As a result, when the GFC occurred, thousands of clients of CFPL, many of whom were nearing retirement or had already retired, lost millions of dollars.

⁴⁹ ASIC, 'ASIC and CBA Reach Storm Financial Settlement' (Media Release, 12-227MR, 14 September 2012).

⁵⁰ ASIC, 'ASIC and CBA Reach Storm Financial Settlement' (Media Release, 12-227MR, 14 September 2012).

⁵¹ ASIC, 'ASIC and Bank of Queensland Reach Storm Financial Settlement' (Media Release, 14-244MR, 22 September 2014).

⁵² ASIC, 'ASIC and Bank of Queensland Reach Storm Financial Settlement' (Media Release, 14-244MR, 22 September 2014).

⁵³ Simon Hoyle, 'For CBA He Was the Wrong Guy in the Wrong Place at the Wrong Time', *Professional Planner* (online), 4 July 2014, <www.professionalplanner.com.au/featured-posts/2014/07/04/striking-a-blow-29119/>; Jeff Morris, 'I Gift Wrapped Commonwealth Bank for ASIC and It Did Nothing', *The Sydney Morning Herald* (online), 27 April 2018 <www.smh.com.au/business/banking-and-finance/i-gift-wrapped-commonwealth-bank-for-asic-and-it-did-nothing-20180427-p4zbyk.html>.

CBA paid more than \$20 million in compensation to clients who had received inappropriate financial advice from two CFPL financial advisers (Mr Don Nguyen and Mr Anthony Awkar).⁵⁴

It later became apparent, however, that the misconduct extended beyond these two advisers and CBA subsequently implemented a second compensation program.⁵⁵

In October 2011, ASIC accepted an **enforceable undertaking** from CFPL that required CFPL to review the advice given to clients by an additional 16 advisers, and pay to clients any compensation arising from that review. Three additional CFPL advisers and six advisers from another CBA advice arm, Financial Wisdom Limited, were subsequently identified as also having provided inappropriate advice and CBA paid compensation to those clients.⁵⁶

In 2013, Australian media reported misconduct by financial planners at CFPL, a systematic cover up by management, and inadequate offers of compensation to complaining customers.⁵⁷

In July 2014, CBA commenced the Open Advice Review Program. The program was open to those who had been customers of CFPL and

⁵⁴ Exhibit 2.277, undated, 00. Updated CFP Board Pack – 1900214 [CBA.0503.0002.4443 at .4627]; see also Adele Ferguson and Deb Masters, 'Insider's View to CBA Financial Planning Scandal', *The Sydney Morning Herald* (online), 4 May 2014 <www.smh.com.au/business/banking-and-finance/insiders-view-to-cba-financial-planning-scandal-20140504-zr4dp.html>.

⁵⁵ KordaMentha Forensic, *Compliance Report (Part 3): Commonwealth Financial Planning Limited and Financial Wisdom Limited: Report of Compliance Expert*, 3 November 2017, 6.

⁵⁶ ASIC, *REP 431 Comparison Report: Commonwealth Financial Planning Limited and Financial Wisdom Limited* (23 April 2015) <<http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-431-comparison-report-commonwealth-financial-planning-limited-and-financial-wisdom-limited/>>.

⁵⁷ Adele Ferguson and Chris Vedelago, 'Targets, Bonuses, Trips – Inside the CBA Boiler Room,' *The Sydney Morning Herald* (online), 22 June 2013 <www.smh.com.au/business/banking-and-finance/targets-bonuses-trips-inside-the-cba-boiler-room-20130621-2oo9w.html#ixzz3ls7bmVx0>; quoted in Adam Steen, Dianne McGrath and Alfred Wong, 'Market Failure, Regulation and Education of Financial Advisers' (2016) 10(1) *Australasian Accounting, Business and Finance Journal* 4, 9.

Financial Wisdom between 1 September 2003 and 1 July 2012. The program has offered a total of \$37.6 million in compensation to customers.⁵⁸

1.3.3 'Isolated pockets of poor culture'

Consistent with the regulatory focus on compensation, entities' response to financial advice scandals such as Storm and CFPL has frequently been that the misconduct was caused by 'a few bad apples' and that the issue did not raise broader or systemic concerns.

For example:

- In addressing the CFPL scandal in CBA's 2014 Annual Report, Mr Ian Narev, then CEO of CBA, said that the bank's achievements were 'overshadowed by the ongoing impact of the poor actions of some of our financial planners in past years'.⁵⁹
- In CBA's initial submission to the Commission dated 29 January 2018, CBA said that incidents of misconduct may be attributed to an individual, to a small number of individuals or to 'pockets of poor culture'.⁶⁰ The same submission also referred to 'isolated and unauthorised incidents of conduct issues' in relation to misconduct in Aussie Home Loans.⁶¹
- Westpac's submission to the Commission dated 29 January 2018 identified a number of broad cultural or governance themes that it considered may underpin the relevant conduct issues. Of the five themes, three related to individual conduct (individuals failing to

⁵⁸ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 10 [33]; Transcript, Senior Counsel Assisting, 16 April 2018, 1010.

⁵⁹ CBA, *Annual Report 2014*, 12 August 2014, 6. The CBA Annual Reports made no reference to the Storm Financial scandal other than noting the commencement of proceedings by ASIC against CBA and the settlement of those proceedings. See CBA, *Annual Report 2012*, 15 August 2012, 176; CBA, *Annual Report 2013*, 13 August 2013, 142.

⁶⁰ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 3–4.

⁶¹ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 31–2.

implement policies or processes, as well as human error and individual dishonesty).⁶²

- Following the Commission's hearings into financial advice, AMP's Interim Executive Chairman, Mike Wilkins, addressed the AMP Annual General Meeting on 10 May 2018. In that address, he said that 'a small number of individuals in our advice business made the decision not to follow policy, and inappropriately charged fees to customers where no service was provided'.⁶³

Rhetoric of this kind is common. And responses of this kind to revelations of wrongdoings are generally accompanied by apologies and undertakings to take steps to restore public trust. For example, following the CFPL scandal, Ian Narev, then CEO of CBA, noted that CBA 'must now focus on restoring trust with all our financial planning customers and the community generally'.⁶⁴ Similar commitments were made after the Comminsure scandal in early 2016⁶⁵ and again in 2017 in relation to the Australian Transaction Reports and Analysis Centre (AUSTRAC) investigation into money laundering through CBA ATMs.⁶⁶

That generally similar conduct occurred in all of the major entities suggests that the conduct cannot be explained as 'a few bad apples'. That characterisation serves to contain allegations of misconduct and distance the entity from responsibility. It ignores **the root causes of conduct, which often lie with the systems, processes and culture cultivated by an entity**. It does not contribute to rebuilding public trust in the financial advice industry. The misconduct acknowledged by the major

⁶² Westpac, *Response of Westpac Banking Corporation Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 29 January 2018, 4–5.

⁶³ Mike Wilkins, 'Address by AMP Interim Executive Chairman to the AMP Annual General Meeting' (Speech delivered at the 2018 AMP Annual General Meeting, 10 May 2018).

⁶⁴ CBA, *Annual Report 2014*, 12 August 2014, 6.

⁶⁵ CBA, 'Statement on Comminsure Upgrades and Assurances' (Media Release, 10 March 2016).

⁶⁶ Clancy Yeates, "'I Am Sorry': CBA Boss Ian Narev Apologises for ATM Money Laundering Scandal', *The Sydney Morning Herald* (online), 6 October 2017 <www.smh.com.au/business/banking-and-finance/i-am-sorry-cba-boss-ian-narev-apologises-for-atm-money-laundering-scandal-20171006-gyvild.html>.

entities gives rise to broader questions than those answered by the ‘few bad apples’ response.

2 Financial advice and FoFA

As noted above, several financial product and financial services providers had collapsed during or after the GFC. The losses caused had been large and many consumers had been affected. Reforms, known as the **Future of Financial Advice** (FoFA) reforms, were proposed. The reforms were properly seen as radical alterations to the regulation of the financial advice industry that had emerged and developed in the decade or so that preceded their enactment.

The 2012 FoFA reforms⁶⁷ had three principal elements:

- the imposition of a best interests obligation on financial advisers giving personal advice to clients;
- a ban on **conflicted remuneration**; and
- measures intended to promote greater transparency about charging of fees for advice by requiring consumer agreement to ongoing advice fees, and enhanced disclosure of fees and the services associated with ongoing fees.

Further changes were made in 2014 and 2015.⁶⁸

The content and extent of changes to be made in 2012, and later in 2014 and 2015, were contested. Before the introduction of the legislation that was enacted in 2012, government established a ‘Peak Consultation Group’ drawn from bodies as diverse as the Association of Financial Advisers, the Australian Bankers’ Association, CHOICE, Industry Super Australia and the Property Council of Australia. For about 12 months before the legislation was enacted, this group met each month to discuss the proposals. It is,

⁶⁷ Effected by the *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).

⁶⁸ *Corporations Amendment (Revising Future of Financial Advice) Regulation 2014* (Cth); *Corporations Amendment (Financial Advice) Regulation 2015* (Cth); *Corporations Amendment (Financial Advice Measures) Act 2015* (Cth).

therefore, not surprising that the resulting provisions show signs of compromise and accommodation of widely divergent interests.

For the moment it is useful to focus on two of those compromises. The first was that conflicts of interest between adviser and client should be permitted to remain but be ‘managed’. The second was that some forms of conflicted remuneration were, and still are, allowed to continue.

2.1 Conflicts of interest

Section 912A(1)(aa) of the Corporations Act now provides that a **financial services licensee** must have in place ‘adequate arrangements for the *management* of conflicts of interest’ that may arise in relation to activities undertaken by the licensee *or a representative* of the licensee in the provision of financial services as part of the financial services business of the licensee (emphasis added). Section 961J provides that a provider of advice who knows, or reasonably ought to know, that there is a conflict between the interests of the provider and the client must give priority to the client’s interests when giving the advice. But to treat the client’s interests as foremost is to do no more than comply with the duty that the client is owed. That is, Section 961J is no more than a restatement of the duty imposed by Section 961B to act in the best interests of the client. When taken together, the two provisions presuppose that conflicts of interest can not only be ‘managed’ but are to be (and more importantly, *can be*) resolved by giving priority to the client’s interests.

To speak in the abstract of conflicts between the interests of a financial adviser and the interests of the client does not reveal (and may even obscure) the way in which those interests intersect and conflict. The interests of the client are to obtain the best financial advice reasonably available. More particularly, if the advice is for the client to acquire some financial product, it is in the client’s interests to obtain the best product: best in the sense that it is fit for purpose but best in the sense also that it is the cheapest and (as far as can reasonably be determined) the best performing product available. By contrast, the adviser’s interest is to further his or her career and to maximise financial reward and the licensee’s interest is to maximise profit. Where an adviser is employed by, or aligned with and acts on behalf of, a principal who manufactures or sells financial products, the adviser’s interests (and the principal’s) will be advanced by persuading a client to acquire one of the principal’s products.

Although spoken of as a conflict of ‘interests’, **the conflict may be better seen as a conflict between the financial *interests* of the adviser or licensee and the *duty* that each owes to the client.** (The adviser owes the client a best interests duty⁶⁹ and the licensee must ensure compliance with that duty.)⁷⁰

Understood in that way, the conflict comes into sharper relief. Recognising that the conflict is between duty and interest emphasises the need to focus on the position of the adviser and the licensee. It is their conduct which is in issue, not the client’s.

ASIC’s January 2018 report *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, and the particular cases examined in evidence, show how often the conflict (whether of interests or between duty and interests) is ‘managed’ in a way that aligns with the adviser’s interests. But both the ASIC report and the particular cases show much more than that. They show that advice that benefits the adviser ‘commonly’⁷¹ does not advance the interests of the client and in a significant number of cases does actual harm to the client.

The conclusions recorded in the ASIC report are telling. In 75% of the files that ASIC reviewed for the purposes of its report, the adviser did not demonstrate compliance with the requirements of Section 961G to give ‘appropriate advice’. In 75% of the files reviewed, ASIC found that the adviser appeared to have prioritised the adviser’s own interests (in breach of Section 961J).⁷² And, in 10% of the files reviewed, ASIC had ‘significant concerns about the impact of the non-compliant advice on the customer’s financial situation’.⁷³ More particularly, ASIC found that the clients had switched into new superannuation arrangements that gave less, charged

⁶⁹ Corporations Act s 961B.

⁷⁰ Corporations Act s 961L.

⁷¹ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, 24 January 2018, 35.

⁷² ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, 24 January 2018, 42 [174].

⁷³ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, 24 January 2018, 8 [20].

more, or both gave less and charged more without any countervailing benefit. The detriment to the client is obvious.

The results recorded in ASIC's report were obtained by examining the files of 10 advice licensees associated with the five largest entities: AMP, ANZ, CBA, NAB, and Westpac. They are, therefore, results based on the work of advisers associated with the largest entities that may, because of their size, be assumed to be the best-resourced. **They are results that demonstrate the validity of a basic observation of the world: that the choice between interest and duty is resolved, more often than not, in favour of self-interest. And they are results that, on their face, deny a fundamental premise for the legislative scheme of the FoFA reforms: that conflicts of interest can be 'managed' by saying to advisers, 'prefer the client's interests to your own'.** Experience (too often, hard and bitter experience) shows that conflicts cannot be 'managed' by saying, 'Be good. Do the right thing'. People rapidly persuade themselves that what suits them is what is right. And people can and will do that even when doing so harms the person for whom they are acting.

It may be assumed that the recognition of these basic truths lay behind the provisions of the FoFA reforms that prohibited the payment or acceptance of 'conflicted remuneration'.⁷⁴ But the conflicted remuneration provisions also reflected compromise by allowing for some forms of conflicted remuneration to continue to be received.

2.2 Conflicted remuneration

The FoFA reforms included that a financial services licensee must not accept conflicted remuneration and that it must take reasonable steps to ensure that representatives of the licensee do not accept conflicted remuneration.⁷⁵

Section 963A of the Corporations Act defines conflicted remuneration as 'any benefit (whether monetary or non-monetary) given to a financial services licensee or a representative of the licensee, who provides financial product advice to persons as retail clients, that, because of the nature of the

⁷⁴ Corporations Act s 963E.

⁷⁵ Corporations Act s 963F.

benefit or the circumstances in which it is given, could have either or both of two effects:

- It could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or
- It could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.'

That is, the very hinge about which the conflicted remuneration provisions turn is that the payment is one that 'could reasonably be expected to influence the choice of financial product recommended to retail clients'.

An authorised representative⁷⁶ or other representative⁷⁷ must not accept conflicted remuneration. An employer of a financial services licensee or a representative of a licensee must not give employees conflicted remuneration⁷⁸ and a product issuer or seller must not do so.⁷⁹

Volume-based benefits are presumed to be conflicted remuneration.⁸⁰ A platform operator cannot accept volume-based shelf-space fees.⁸¹ Financial services licensees⁸² and authorised representatives⁸³ are forbidden to charge asset-based fees on borrowed amounts.

From 1 January 2018, conflicted remuneration includes volume-based benefits given to a licensee or representative in relation to information given on, or dealing in, a life risk insurance product.⁸⁴ A monetary benefit relating to a life risk product will not be conflicted remuneration if it is a level

⁷⁶ Corporations Act s 963G.

⁷⁷ Corporations Act s 963H.

⁷⁸ Corporations Act s 963J.

⁷⁹ Corporations Act s 963K.

⁸⁰ Corporations Act s 963L.

⁸¹ Corporations Act ss 964, 964A.

⁸² Corporations Act s 964D.

⁸³ Corporations Act s 964E.

⁸⁴ *Corporation Regulations 2001* (Cth) reg 7.7A.11B.

commission within the applicable cap⁸⁵ and provides a ‘clawback’ arrangement if the policy is cancelled, not continued, or the policy cost is reduced in the first two years of the policy.⁸⁶

Section 965 seeks to prevent avoidance of the conflicted remuneration provisions by forbidding entering into, beginning to carry out or carrying out a scheme if it would be concluded that the sole purpose of the scheme was to avoid the application of any part of the relevant Corporations Act division.

On their face the conflicted remuneration prohibitions may appear to be comprehensive. But there are exceptions⁸⁷ relating to general insurance,⁸⁸ life risk insurance products⁸⁹ and basic banking products,⁹⁰ and there is also power to prescribe benefits or circumstances in which a benefit is given that take the benefit outside the definition of conflicted remuneration.⁹¹

2.3 Grandfathered remuneration

After the commencement of the FoFA reforms, payment and receipt of some forms of conflicted remuneration for financial advice was permitted to continue by ‘grandfathering’ provisions made by Subdivision 5 of Division 4 of Part 7.7A of the Corporations Regulations 2001 (Cth).⁹² It is neither necessary nor profitable to trace the detail or history of those grandfathering provisions. At the risk of some inaccuracy it is enough to note that certain arrangements made before the FoFA reforms came into force in July 2013 that would otherwise have fallen within the ban on conflicted remuneration

⁸⁵ For the calendar year 2018, 80% upfront commission and 20% trail commission, reducing to 70% upfront and 20% trail in 2019 and 60% upfront and 20% trail from 1 January 2020. See ASIC, *ASIC Corporations (Life Insurance Commissions) Instrument*, 2017/510, 31 May 2017, pts 2, 3; Corporations Act s 963B; *Corporations Regulations 2001* (Cth) regs 7.7A.11C(1)(d), 7.7A.11D(1)(b).

⁸⁶ See ASIC, *ASIC Corporations (Life Insurance Commissions) Instrument*, 2017/510, 31 May 2017, s 6.

⁸⁷ ASIC, Regulatory Guide 246: Conflicted and Other Banned Remuneration, December 2017, 72.

⁸⁸ Corporations Act s 963B(1)(a).

⁸⁹ Corporations Act s 963B(1)(b).

⁹⁰ Corporations Act s 963D.

⁹¹ Corporations Act s 963B(1)(e).

⁹² *Corporations Regulations 2001* (Cth) regs 7.7A.15B–7.7A.16F; Corporations Act s 1528.

were, and remain, excluded from the definition of conflicted remuneration. For present purposes, two points are important.

First, despite it being recognised that the grandfathered forms of remuneration are conflicted remuneration (because they could reasonably be expected to influence the choice of financial product recommended by a licensee or representative to retail clients, or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative), charging and receiving these exempted forms of remuneration have been permitted to continue. And even now, five years on, licensees and representatives can, and do, continue to charge and receive these fees.

Second, in 2014, when ASIC looked at the value of 'grandfathered' benefits, it found that, '[o]n average, licensees indicated that grandfathered benefits were worth around one-third of their total income (though substantially more or less than the average in some cases).'⁹³

2.4 Change grandfathering?

If the premise for the conflicted remuneration provisions is accepted (and no-one suggested that it should not be) how can the grandfathering provisions be justified today? At the time the changes were first made, participants in the industry could say that sudden change in remuneration arrangements may bring untoward consequences for countervailing benefits that would not outweigh the harms of disruption. Has that argument now outlived its validity?

It was said in evidence that to outlaw all conflicted remuneration would diminish income that licensees now receive. It would follow, so the argument went, that clients would have to pay more for advice. And more than one witness suggested that no one licensee could afford to be the 'first mover' in this area for fear of suffering a commercial disadvantage in relation to those who chose to maintain the payments.

In its submissions about this matter, the Financial Planning Association of Australia (FPA) recommended that grandfathered commissions on superannuation and investment advice be phased out over a three-year

⁹³ ASIC, *Report 407: Review of the Financial Advice Industry's Implementation of the FoFA Reforms*, September 2014, 30 [96].

period and that a 'long-term timeline' be developed to 'lead to the removal of life risk commissions in the future'.⁹⁴

By contrast, AMP submitted that the grandfathering arrangements provided for in the FoFA arrangements should remain in place and, in effect, should, over time, be allowed to wither on the vine.⁹⁵ Behind the submission lay unexpressed allusions (expressly advanced when grandfathering was introduced and also mentioned by ANZ in its submissions)⁹⁶ suggesting that changing the permitted forms of remuneration may constitute some acquisition of property otherwise than on just terms. Two points may be made about those allusions. First, where would be the 'acquisition'? Who would acquire anything? It is not apparent that any proprietary benefit or interest would accrue to any person.⁹⁷ But second, and no less importantly, if the point is good, it was good when most forms of conflicted remuneration were prohibited. Yet no-one sought then to challenge the validity of the relevant provisions and the FoFA bans on conflicted remuneration have now been operating for five years without challenge.

NAB submitted that 'there is insufficient evidence before the Commission to make a definitive recommendation as to whether each of the statutory carve-outs to the ban on conflicted remuneration ... ought [to] be maintained'.⁹⁸ And ANZ sought to make a generally similar point.⁹⁹ CBA made no submission. But Westpac said that it was 'supportive of any industry wide steps to accelerate the move away from grandfathered commissions and [from] any perception of ongoing conflict associated with

⁹⁴ FPA, *Written Submissions of the Financial Planning Association of Australia to the Royal Commission into Misconduct in the Banking, Superannuation and Insurance Industry* [Part A], undated, 3–4.

⁹⁵ AMP, *AMP Group Submission: Counsel Assisting's General Questions in Closing Submissions*, 7 May 2018, 7–8.

⁹⁶ ANZ, *Submissions by ANZ in Respect of General Questions – Round 2 Hearings*, 7 May 2018, 2–3 [8].

⁹⁷ cf *JT International SA v The Commonwealth* (2012) 250 CLR 1.

⁹⁸ NAB, *Submission in Response to Questions Arising from the Second Round of Public Hearings*, 7 May 2018, 26 [107].

⁹⁹ ANZ, *Submissions by ANZ in Respect of General Questions – Round 2 Hearings*, 7 May 2018, 2–3.

commission based structures'.¹⁰⁰ Westpac submitted that any move to change the grandfathering arrangements must have appropriate regard to the impact that the moves may have on access to advice due to increased costs and to the viability of advisers and advice businesses that are currently affected by those revenue streams.¹⁰¹

Since the hearings about financial advice, Westpac, Macquarie, NAB and ANZ have all announced that they will cease paying grandfathered commissions to the advisers they employ. Westpac's BT Financial Group estimates that up to 140,000 client accounts are subject to commissions that will be removed.¹⁰² Westpac noted it may be disadvantaged by its position as the first mover on this policy.¹⁰³ It estimated a resulting \$40.8 million annual reduction in revenue.¹⁰⁴ But it also noted the countervailing advantage that the products relieved of grandfathered commission will be more attractive to clients and therefore will be more competitive market offerings.¹⁰⁵ Ultimately, Westpac said, it was preferable to make the changes because they were consistent with the intent of the legislation, the interests of customers, and the professionalisation of the financial advice industry.¹⁰⁶ Similarly, in early July 2018, media reported Macquarie had issued a statement that it would turn off commissions paid to its private wealth and private bank advisers, affecting approximately 17,000 client accounts.¹⁰⁷

ANZ Financial Planning has also announced that it will no longer retain grandfathered commissions in relation to the OnePath investment and superannuation platforms. Clients will receive the amount of the commission

¹⁰⁰ Westpac, *General Submissions on Financial Advice*, 7 May 2018, 3 [14].

¹⁰¹ Westpac, *General Submissions on Financial Advice*, 7 May 2018, 3 [18].

¹⁰² Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 5 [27].

¹⁰³ Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 3 [19](d).

¹⁰⁴ Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 6 [33](a).

¹⁰⁵ Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 7 [39].

¹⁰⁶ Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 3 [19].

¹⁰⁷ See, eg, Alice Uribe, 'Macquarie Scraps Grandfathered Commissions', *Financial Review*, 3 July 2018 <www.afr.com/business/banking-and-finance/financial-services/macquarie-scraps-grandfathered-commissions-20180703-h126n8>.

by way of a rebate.¹⁰⁸ Likewise, on 3 September 2018, NAB announced that customers of its Financial Planning and Direct Advice businesses would be rebated grandfathered commissions paid by NAB Wealth product providers from 1 January 2019.¹⁰⁹

Evidently, some entities have overcome the arguments against removing grandfathered commissions, and now consider it advantageous to do so. The first mover problem has been eliminated. The onus now shifts to the entities wishing to continue to pay and accept grandfathered commissions to demonstrate why the calculations made by Westpac, Macquarie and ANZ do not work for them.

Those points will then have to be considered against the point of principle made by ASIC in its submissions. This is that **‘any exception to the ban on conflicted remuneration, by definition, has the ability to create misaligned incentives, which can lead to inappropriate advice’**.¹¹⁰

That is not a point that depends on evidence. It is the unchallenged (and unchallengeable) basic premise for the conflicted remuneration provisions. The grandfathering arrangements were temporary and exceptional measures. Once the legislative premise is accepted (and it was not challenged) the question must be **‘Why should the grandfathering provisions remain?’** The question is not, as AMP, NAB and ANZ suggested, ‘What evidence is there to warrant change?’

2.5 Conflicted remuneration: Related issues

That **misaligned incentives can lead to inappropriate advice** calls attention to two other issues: one concerning the separate treatment of benefits given in relation to life risk products (other than a group life policy for members of a superannuation entity, or a life policy for a member of a

¹⁰⁸ Letter from ANZ to Mr Simon Daley dated 20 August 2018.

¹⁰⁹ NAB, ‘NAB Moves on Grandfathered Commissions’, 3 September 2018 <<https://news.nab.com.au/nab-moves-on-grandfathered-commissions/>>.

¹¹⁰ ASIC, *Submissions of the Australian Securities and Investments Commission: Round 2: Financial Advice*, 7 May 2018, 31 <<https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-2-written-submissions/asic.pdf>>.

default superannuation fund)¹¹¹ and the second concerning the payment of sales-related bonuses (or ‘variable remuneration’) to advisers.

As noted earlier, changes have been made, with effect from 1 January 2018, to the rules that govern the payment of commissions in connection with life risk products.¹¹² But, subject to those changes, selling life insurance products is still rewarded by upfront and **trail commissions**. Why do not these arrangements lead to misalignment of incentives? Why should these provisions remain?

Put shortly, if crudely, **sales staff can be rewarded by commission; advisers should not be.**

If, as seems inevitable, appeals are made to both history and the need to maintain the availability of advice by preserving existing advice business models, **what evidence is there that shows that the costs of doing away with payment by commission will outweigh the benefits of improving the overall quality of advice that is given?**

What answer is there to ASIC’s observations about advice given by representatives of licensees associated with the five largest banking and financial institutions, that **in three out of every four cases examined, the advisers appeared to have preferred their own interests to those of the clients?**¹¹³

Likewise, **if licensees engage representatives as advisers, rather than as sales staff, why should the remuneration of the adviser be tied, to any extent, to the volume or value of sales made?** That is, if a balanced scorecard is used to determine eligibility for and amount of variable remuneration, what place does volume or value have in an adviser’s scorecard? The scorecard reflects what the business values. The scorecard records what the individual will believe that the business values. What answer is made to ANZ’s proposal¹¹⁴ to remove all sales incentives for

¹¹¹ Corporations Act s 963B(1)(b).

¹¹² See ASIC, *ASIC Corporations (Life Insurance Commissions) Instrument*, 2017/510, 31 May 2017.

¹¹³ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018, 42 [174].

¹¹⁴ ANZ, ‘ANZ Unveils Plan to Improve Financial Planning’ (Media Release, 7 May 2018).

bonuses and only assess performance on consumer satisfaction, values and risk and compliance standards? It can no longer be said ‘everyone rewards sales’.

2.6 Fee disclosure statements

The FoFA reforms included a requirement in relation to the provision of personal advice, and sometimes general advice, that the client must be provided with a **Financial Services Guide** before the financial advice is provided.¹¹⁵ The Financial Services Guide is to contain prescribed information, including the kinds of remuneration the adviser will receive from the transactions,¹¹⁶ and information about who the financial services licensee acts for when providing the relevant services.¹¹⁷ A statement of advice must also accompany personal advice, setting out the advice itself and, among other things, the basis on which the advice was given and any interests – whether monetary or not, and whether direct or indirect – that might be reasonably capable of influencing the advising entity or any of its associates in the provision of the advice.¹¹⁸

Where an adviser charges ongoing fees, there is a requirement to provide an annual fee disclosure statement and give clients the option to opt-in to the ongoing fee arrangement every two years.¹¹⁹

As noted above, CLERP 6 and the regulatory framework it instituted relied heavily on disclosure to rationalise customer decision-making and impose transparency on licensees. The potential for complexity and duplication in the documents I have just described may derogate from that aim.

2.7 Norms of behaviour in general law

The FoFA reforms supplemented a number of existing protections and requirements in the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) such as the prohibitions on unconscionable

¹¹⁵ See generally Corporations Act ss 941A and 941B.

¹¹⁶ Corporations Act s 942B(2)(e).

¹¹⁷ Corporations Act s 942B(2)(d).

¹¹⁸ See generally Corporations Act ss 946A–947E.

¹¹⁹ See generally Corporations Act ch 7 pt 7.7A div 3.

conduct and misleading or deceptive conduct in relation to the provision of financial advice.¹²⁰ These prohibitions are not novel ideas.

In addition, the ASIC Act imposes two implied warranties that are also relevant to the provision of financial advice.¹²¹ The first warranty (implied into every contract for the supply of financial services to a consumer) is that the services will be rendered with due care and skill.¹²² The second warranty applies when a consumer makes known to the supplier of a financial service any particular purpose for which the service is required or the result that the consumer wants to achieve.¹²³ In these circumstances the supplier is taken to have warranted that the services supplied will be reasonably fit for that purpose or are of such a nature and quality as to achieve that result.¹²⁴

These prohibitions and warranties are longstanding norms of market conduct. The Chalmers *Sale of Goods Act 1893* (UK) codified implied warranties already established in common law that goods would be reasonably fit for purpose and of merchantable quality. Those provisions were widely adopted in the common law world, including in the Australian colonies.

Depending on the nature of a client's interaction with a financial adviser, a general law duty of care may also arise, as may a fiduciary duty.¹²⁵

¹²⁰ See generally ASIC Act pt 2 div 2 sub-divs C–D.

¹²¹ See ASIC Act s 12ED.

¹²² ASIC Act s 12ED(1)(a).

¹²³ ASIC Act s 12ED(2)(b).

¹²⁴ ASIC Act s 12ED(2).

¹²⁵ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 29–37.

3 Financial advice industry today

3.1 Overview of the industry

In Part A of its sixth published Background Paper (Background Paper 6A), the Commission provided a summary of the size and the structure of the Australian financial planning industry.¹²⁶

The financial advice industry is highly concentrated. As at late 2017, the top five entities (the four major banks and AMP) collectively held a market share of about 48% by industry revenue. About 30% of the total number of financial advisers on ASIC's Financial Advisers Register worked for one of the major banks and 44% of advisers, both aligned and non-aligned, operated under a licence controlled by the largest 10 financial institutions.

3.2 Licensing regime

The Commission's seventh published Background Paper, prepared for the Commission by Professor Pamela Hanrahan, sets out in detail the relevant legal and regulatory framework for the provision of financial advice in Australia (Background Paper 7).¹²⁷ The *Financial Services Reform Act 2001* (Cth) established the current licensing regime for holders of **Australian financial services licences**.¹²⁸ It enacted prescriptive conduct and disclosure obligations for financial advice providers dealing with retail clients and required product disclosure statements for financial product sales.

Under the Corporations Act, a person provides financial product advice when they give a client a recommendation or statement of opinion, or a report of either of those things, that is intended to influence, or could reasonably be regarded as being intended to have such an influence, on

¹²⁶ FSRC, *FSRC Background Paper No. 6 (Part A): Some Features of the Australian Financial Planning Industry*, 5 April 2018.

¹²⁷ Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018.

¹²⁸ Corporations Act ch 7 pt 7.6.

a person in making a decision in relation to a particular financial product or class of financial product.¹²⁹

There are two types of financial product advice: personal advice, which is advice given to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, and general advice, which comprises all other financial product advice.¹³⁰

In most cases, a person may only provide personal advice or general advice if they hold an Australian financial services licence or are a representative of a person who holds such a licence.¹³¹ The regulatory framework for financial advice contemplates that there will usually be two or three separate entities involved in the provision of personal advice to a retail client. Depending on the business structure, these may be:¹³²

- the financial services licensee, which is usually a body corporate, and an individual, who is an officer or employee of the licensee acting as its representative in providing advice;¹³³
- an individual who is an authorised representative of the licensee (not an employee of the licensee); or¹³⁴
- an employee of an authorised representative.¹³⁵

Some financial advisers operate in dealer groups, which are also known as financial advisory networks. Where advisers operate in this structure, a group corporate entity holds the relevant licence, permitting the financial

¹²⁹ Corporations Act sub-s 766B(1); ASIC Act sub-s 12BAB(5).

¹³⁰ Corporations Act sub-ss 766B(2)–(4). This distinction is not used for the purposes of the ASIC Act.

¹³¹ Corporations Act ss 911A and 911B.

¹³² Pamela Hanrahan, *FSRC Background Paper No. 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households*, 5 April 2018, 72–3.

¹³³ Corporations Act para 911B(1)(a).

¹³⁴ Corporations Act para 911B(1)(b).

¹³⁵ Corporations Act para 911B(1)(c).

advisers who are members of the dealer group to operate as its authorised representatives and provide financial advice to consumers on its behalf.

Financial advisers (and dealer groups) can be classified as either independent/non-aligned or as aligned with a financial institution, such as a bank or a wealth management services provider. Financial advisers can only use the terms ‘independent’ or ‘non-aligned’ (or similar words or expressions) in relation to their business if they meet certain legislative requirements. These include:

- not receiving commissions, volume-based payments, other gifts or benefits from an issuer of a financial product; and
- operating without any conflicts of interest arising from their associations or relationships with a product issuer.¹³⁶

3.3 The subjects of advice

As indicated in Background Paper 6A, there are five main topics of financial advice sought by consumers.¹³⁷ Measured as a percentage of the Australian financial advice industry’s revenue for the year 2016–17, those topics represent:

- superannuation and retirement advice (about one third of revenue);
- loan and investment advice (about one quarter of revenue);
- self managed superannuation fund (SMSF) advice (about one fifth of revenue);
- other services such as estate planning (one tenth of revenue); and
- tax advice (one tenth of revenue).

¹³⁶ See also ASIC, ‘ASIC Clarifies Its Position on the Use of “Independently Owned” under s 923A’ (Media Release, 17-206MR, 27 June 2017); ASIC, Regulatory Guide 175: Licensing: Financial Product Advisers – Conduct and Disclosure (March 2017), 20–1.

¹³⁷ FSRC, *FSRC Background Paper No. 6 (Part A): Some Features of the Australian Financial Planning Industry* (5 April 2018), 12–13.

Of the approximately 25,000 financial advisers registered in Australia, 8,704 have told ASIC that they have completed a degree at bachelor level or above, representing 35% of all advisers.¹³⁸

4 Pending changes in the law

A number of further legislative changes relevant to the provision of financial services are either pending or have been recently introduced. Many arise out of recommendations from the Murray Inquiry.

4.1 Professional standards

Proposed changes to lift the professional, education and ethical standards of financial advisers were announced in February 2017.¹³⁹ The changes include compulsory education requirements, supervision for new advisers, a code of ethics for the industry, an industry exam and ongoing annual professional development obligations. Details regarding these changes (as at April 2018) were set out in Part B of the Commission's sixth published Background Paper.¹⁴⁰

A new Commonwealth standard setting body, the Financial Adviser Standards and Ethics Authority (FASEA), was established in 2017 to develop these requirements and govern the professional standing of the financial advice sector.¹⁴¹ FASEA will develop the new code of ethics, and professional organisations will be able to apply to ASIC for approval as code monitoring bodies. All advisers will be required to subscribe to the code of ethics of a monitoring body by 1 January 2020.¹⁴²

¹³⁸ ASIC letter dated 29 March 2018, [93].

¹³⁹ The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Higher Standards for Financial Advisers to Commence' (Media Release, 9 February 2017).

¹⁴⁰ FSRC, *FSRC Background Paper No. 6 (Part B): Education and Training Requirements for Financial Advisers*, 5 April 2018, 8–12.

¹⁴¹ See generally Treasury, *Financial Adviser Standards and Ethics Authority Limited (FASEA)* <<https://treasury.gov.au/programs-and-initiatives-banking-and-finance/financial-adviser-standards-and-ethics-authority-limited-fasea/>>.

¹⁴² Treasury, *Submission: Hearings on Financial Advice*, undated, 15.

Other requirements will commence on 1 January 2019.¹⁴³ From that date, new advisers will be required to hold a relevant degree before they are eligible to sit the exam and commence a year of supervised work and training.¹⁴⁴ Existing advisers will have two years to pass the exam (by 1 January 2021) and five years to reach a standard equivalent to a degree (by 1 January 2024).¹⁴⁵

4.2 Design and distribution obligations on issuers and distributors

The Government accepted the Murray Inquiry's recommendations to introduce design and distribution obligations (DDOs) for financial products to ensure that products are targeted at the right people.¹⁴⁶

The Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth), if enacted, would introduce DDOs intended to promote the provision of suitable financial products to consumers of those products. The reforms recognise that current disclosure requirements are not, on their own, sufficient to fully inform consumers.¹⁴⁷

The obligations revolve around making an appropriate target market determination for products and dealing with the product accordingly.

4.3 Product intervention power

Under the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth), if enacted, ASIC would be granted a new product intervention power. Under the proposed power, ASIC could make an order that a person must not engage in specified conduct in

¹⁴³ See generally ASIC, *Professional Standards for Financial Advisers – Reforms* (17 June 2018) <<http://asic.gov.au/regulatory-resources/financial-services/professional-standards-for-financial-advisers-reforms/>>.

¹⁴⁴ See generally Corporations Act ch 7 pt 7.6 div 8A.

¹⁴⁵ See generally Corporations Act ch 10 pt 10.23A.

¹⁴⁶ Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report, 198–205.

¹⁴⁷ Treasury, *Submission: Hearings on Financial Advice*, undated, 4–5.

relation to a product where ASIC perceives a risk of significant consumer detriment.¹⁴⁸

4.4 Further changes to industry funding model for ASIC

Also pursuant to Murray Inquiry recommendations, an industry funding model was introduced for ASIC commencing 1 July 2017.¹⁴⁹ The stated purpose of the industry funding model is to have industry bear the cost of regulation.¹⁵⁰

The 2017–2018 Budget announced that the industry funding model would be implemented as a levy.¹⁵¹ Legislation to impose and collect the levy commenced on 1 July 2017.¹⁵² At the same time, the existing market supervision cost recovery regime was repealed.¹⁵³

Under the industry funding model, ASIC's regulatory costs are allocated across 48 industry subsectors based on the actual costs of ASIC's regulation of each subsector in the previous financial year.¹⁵⁴

ASIC's estimated budgets for the 2016/2017, 2017/2018 and 2018/2019 years, compared with the budgets for the Australian Competition and

¹⁴⁸ Treasury, *Submission Hearings on Financial Advice*, undated, 4–5; see Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill (Cth) 2017 sch 2 s 102CC, sch 2 s 301C.

¹⁴⁹ Exhibit 2.1.24, November 2014, Financial System Inquiry Final Report, 250–3; *ASIC Supervisory Cost Recovery Levy Act 2017* (Cth).

¹⁵⁰ The Hon Scott Morrison, Treasurer, and The Hon Kelly O'Dwyer, Minister for Small Business and Assistant Treasurer, 'Turnbull Government Bolsters ASIC to Protect Australian Consumers' (Media Release, 20 April 2016).

¹⁵¹ Commonwealth of Australia, *Budget Paper No. 2 2017–18: Budget Measures*, 22.

¹⁵² *ASIC Supervisory Cost Recovery Levy Act 2017* (Cth) s 2; *ASIC Supervisory Cost Recovery Levy (Collection) Act 2017* (Cth) s 2.

¹⁵³ *ASIC Supervisory Cost Recovery Levy (Consequential Amendments) Act 2017* (Cth) sch 1 items 20–7.

¹⁵⁴ ASIC, *ASIC Industry Funding Factsheet* (June 2018) ASIC, 1 <https://download.asic.gov.au/media/4760195/industry-funding_june2018_07.pdf>; see also ASIC, *Report 535: ASIC Cost Recovery Arrangements: 2017–18* (July 2017).

Consumer Commission (ACCC) and the Australian Prudential Regulation Authority (APRA) are:

	2016/2017	2017/2018	2018/2019
	\$'000	\$'000	\$'000
ASIC	\$589,169 (estimated actual) ¹⁵⁵	\$636,969 (estimated actual) ¹⁵⁶	\$617,962 (estimate) ¹⁵⁷
ACCC	\$211,986 (estimated actual) ¹⁵⁸	\$243,363 (estimated actual) ¹⁵⁹	\$261,722 (estimate) ¹⁶⁰
APRA	\$723,856 (estimated actual) ¹⁶¹	\$671,663 (estimated actual) ¹⁶²	\$682,100 (estimate) ¹⁶³

4.5 ASIC Enforcement Review

In October 2016, the government established the ASIC Enforcement Review Taskforce to review ASIC's enforcement regime.¹⁶⁴ The Taskforce issued its report in December 2017.

¹⁵⁵ Treasury, *Portfolio Budget Statements 2017–18: Treasury Portfolio* (Commonwealth of Australia, 9 May 2017) 150.

¹⁵⁶ Treasury, *Portfolio Budget Statements 2018–19: Treasury Portfolio* (Commonwealth of Australia, 8 May 2018) 146.

¹⁵⁷ Treasury, *Portfolio Budget Statements 2018–19: Treasury Portfolio* (Commonwealth of Australia, 8 May 2018) 146.

¹⁵⁸ Treasury, *Portfolio Budget Statements 2017–18: Treasury Portfolio* (Commonwealth of Australia, 9 May 2017) 82.

¹⁵⁹ Treasury, *Portfolio Budget Statements 2018–19: Treasury Portfolio* (Commonwealth of Australia, 8 May 2018) 80.

¹⁶⁰ Treasury, *Portfolio Budget Statements 2018–19: Treasury Portfolio* (Commonwealth of Australia, 8 May 2018) 80.

¹⁶¹ Treasury, *Portfolio Budget Statements 2017–18: Treasury Portfolio* (Commonwealth of Australia, 9 May 2017) 128.

¹⁶² Treasury, *Portfolio Budget Statements 2018–19: Treasury Portfolio* (Commonwealth of Australia, 8 May 2018) 126.

¹⁶³ Treasury, *Portfolio Budget Statements 2018–19: Treasury Portfolio* (Commonwealth of Australia, 8 May 2018) 126.

¹⁶⁴ See generally Treasury, *ASIC Enforcement Review* <<https://treasury.gov.au/review/asic-enforcement-review/>>.

On 16 April 2018, the government published its response to the Taskforce's final recommendations, agreeing or agreeing in principle to all 50 recommendations of the Taskforce.¹⁶⁵ Implementation of the recommendations in chapters 1 and 4 of the report, relating to self-reporting of contraventions by licensees (including Section 912D of the Corporations Act), industry codes, and ASIC's directions powers respectively, have been deferred until this Commission makes its report.¹⁶⁶ Other recommendations of the Enforcement Review, relating to ASIC search warrant powers, access to telecommunications intercepts licensing and banning powers, need not be described here.

5 Conduct acknowledged by the entities

In their submissions to the Commission, financial services entities acknowledged conduct that amounted to misconduct or conduct falling below community standards and expectations in connection with the provision of financial advice. The following is a summary of the conduct acknowledged by the entities in relation to fees for no service, inappropriate advice and improper conduct by advisers.

5.1 Fees for no service

5.1.1 AMP

AMP acknowledged conduct that it described as involving possible contraventions of the Corporations Act and the ASIC Act in relation to 'fees for no service':

- AMP acknowledged 196 events, across 14 AMP Advice Licensees, of advisers failing to provide customers with services for which they had

¹⁶⁵ Australian Government, *Australian Government Response to the ASIC Enforcement Review Taskforce Report* (April 2018).

¹⁶⁶ Australian Government, *Australian Government Response to the ASIC Enforcement Review Taskforce Report* (April 2018) 2–3, 5–6, 13–14.

paid, during the period 1 July 2008 to 30 June 2015.¹⁶⁷ This resulted in \$193,519 having been paid to customers in compensation.¹⁶⁸

- AMP also acknowledged numerous events that involved an AMP licensee continuing to charge a customer fees for services that were not provided¹⁶⁹ during the period from 1 July 2008 to 30 June 2015.¹⁷⁰ These events occurred in the context of AMP's 'Buyer of Last Resort' policy, its 'ringfencing' practice, fees charged to advisers whose authority had been terminated, and movement of customer registers between AMP practices. AMP also acknowledged possible misconduct in its reporting to ASIC of charging fees for no service.

5.1.2 ANZ

ANZ acknowledged that between 2006 and 2013, more than 10,000 Prime Access customers paid fees for documented annual reviews that were never provided by ANZ financial planners. ANZ also acknowledged that it had identified failures by eight of its authorised representatives to provide documented annual reviews to 813 customers between May 2013 and April 2016.

ANZ acknowledged that from 2003 to 2015, certain entities associated with ANZ deducted fees for ongoing services from the accounts of about 2,900 members of managed investment schemes and superannuation funds. None of the members had an allocated financial adviser, and as a result none of the members received any services. The total fees deducted from the accounts of these members were \$931,647.¹⁷¹

ANZ also acknowledged that between June 2007 and August 2016, service fees were deducted from customers' accounts in amounts or at rates in

¹⁶⁷ AMP, *AMP Group Submission*, 29 January 2018, 11 [5.4.5].

¹⁶⁸ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 2 [8].

¹⁶⁹ AMP, *AMP Group Submission*, 29 January 2018, 12 [5.4.16]; AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3].

¹⁷⁰ AMP, *AMP Group Response*, 29 January 2018, 12 [5.4.5]; AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3].

¹⁷¹ ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 12 [5.31].

excess of those quoted in their service agreements. This affected approximately 4,035 customers to a total cost of \$4.5 million. During this period ANZ also continued to deduct ongoing service fees from the accounts of certain customers who had cancelled their services. The total number of customers affected by this event has not, at the time of this report, been determined.¹⁷²

On 29 March 2018 (very soon before the Commission was to begin taking evidence on these matters), ANZ entered into an enforceable undertaking with ASIC in respect of the fees for no service misconduct relating to its Prime Access customers. The enforceable undertaking requires ANZ, among other things, to pay a community benefit payment of \$3 million and provide audited attestations that the bank has since provided annual reviews to the relevant customers and improved its compliance systems.¹⁷³

5.1.3 CBA

CBA identified instances in the period from July 2007 to June 2015 where clients of CFPL, BW Financial Advice and Count Financial were charged ongoing fees for financial advice where no such services were provided. CBA acknowledged that as at 31 December 2017, approximately \$118.5 million in refunds (including interest) has been offered or paid to customers affected by this conduct.¹⁷⁴

Again, very soon before the Commission was to begin taking evidence on these matters, on 9 April 2018, CFPL and BW Financial Advice entered into an enforceable undertaking with ASIC in relation to a failure to provide, or evidence the provision of, annual reviews to approximately 31,500 'Ongoing Service' customers in the period from July 2007 to June 2015 (for Commonwealth Financial Planning) and from November 2010 to June 2015 (for BW Financial Advice).

Like the ANZ enforceable undertaking, CBA's enforceable undertaking requires the entities, among other things, to pay a community benefit

¹⁷² ANZ, *ANZ Submission in Response to the Commission's letters of 15 December 2017*, 29 January 2018, 13 [5.32].

¹⁷³ ASIC, 'ASIC Accepts Enforceable Undertaking from ANZ for Fees for No Service Conduct' (Media Release, 18-092MR, 6 April 2018).

¹⁷⁴ CBA, *Royal Commission into Misconduct into the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 11–12 [39].

payment of \$3 million in total, and provide attestations from senior management demonstrating improvements to their compliance systems and processes.¹⁷⁵

5.1.4 NAB

NAB acknowledged misconduct concerning the charging of Adviser Service Fees between 2008 and 2015, and of Plan Service Fees between September 2012 and January 2017, in circumstances where no adviser was allocated to the client.¹⁷⁶

NAB told the Commission that as at 31 January 2018, it had paid or agreed to pay:

- approximately \$6.6 million in compensation to more than 25,000 clients affected by the misconduct concerning the charging of Adviser Service Fees;¹⁷⁷ and
- approximately \$35 million in compensation to more than 220,000 clients affected by the misconduct concerning the charging of Plan Service Fees.

NAB also told the Commission that it was investigating further circumstances where fees were charged to clients but the relevant services may not have been provided.¹⁷⁸

5.1.5 Westpac

Westpac acknowledged that BT Financial Group commenced an Ongoing Advice Services review program in 2016. This program identified retail clients who, in the period from 1 July 2008 to 31 December 2015, had been

¹⁷⁵ ASIC, 'ASIC Accepts Enforceable Undertaking from Commonwealth Bank Subsidiaries for Fees for No Service Conduct' (Media Release, 18-102MR, 13 April 2018).

¹⁷⁶ NAB, *NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, 12 [11].

¹⁷⁷ ASIC letter of 29 March 2018, 2.

¹⁷⁸ NAB, *NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, 12 [11].

charged fees for ongoing advice, where they had not received the service paid for, or evidence of such service being provided could not located.¹⁷⁹

As at 31 December 2017, BT Financial Group had paid compensation in excess of \$3.2 million to 435 clients as a result of issues identified by the Ongoing Advice Services review program.¹⁸⁰ Westpac also noted that its 2016/2017 annual results provisioned approximately \$24 million (including interest) for refunds of fee payments identified in the Ongoing Advice Services review program.¹⁸¹

5.2 Inappropriate advice

5.2.1 AMP

AMP acknowledged that inappropriate advice by 14 advisers between 1 January 2009 and 30 June 2015 had resulted in compensation to 1,079 customers.¹⁸² The amount of the compensation was not provided.

AMP also acknowledged misconduct that occurred between March 2010 and September 2014, which it described as ‘insurance rewriting’ conduct. This was said to involve instances where an authorised representative recommended to a customer that they cancel their existing AMP life insurance policy and replace it with a new AMP life insurance policy, which enabled the authorised representative to collect the maximum rate of upfront commission payable. That commission was higher than the commission that would have been payable had the policies been transferred using an ‘internal transfer’ function.¹⁸³

AMP acknowledged that one former adviser had engaged in this conduct approximately 57 times in respect of 49 clients, leading to compensation for seven customers of about \$61,000.¹⁸⁴

¹⁷⁹ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 29.

¹⁸⁰ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 29.

¹⁸¹ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 29.

¹⁸² AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 5 [5].

¹⁸³ AMP, *AMP Group Submission*, 29 January 2018, 9 [5.1.15], [5.3.1], [5.3.3].

¹⁸⁴ AMP, *Schedule A to AMP Response to Letter dated 2 February 2018*, 1 [1].

This conduct is the subject of ongoing investigations by ASIC. In the course of those investigations, five other advisers have been identified as having engaged in the same misconduct, with two of those advisers now banned by ASIC.¹⁸⁵

5.2.2 ANZ

Among its notifications to ASIC, ANZ acknowledged there were more than 30 events of misconduct or potential misconduct in relation to the appropriateness of advice.¹⁸⁶ This included advice that had been provided with a lack of a reasonable basis,¹⁸⁷ advice that was of little or no benefit to the customer, but generated fees for the adviser,¹⁸⁸ cases where there was no evidence that sufficient research had been undertaken before advice was given,¹⁸⁹ and cases where advisers had not accurately disclosed fees.¹⁹⁰

5.2.3 CBA

CBA acknowledged that in the period since 1 January 2013:

- It had made 20 breach notifications to ASIC in relation to actual or likely breaches of the Corporations Act by an adviser licensed by CFPL, Financial Wisdom or Count Financial.
- It had made a further five breach notifications in relation to advisers identified through file reviews that were conducted in accordance with the

¹⁸⁵ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 1 [1].

¹⁸⁶ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, items 6–7, 9–15, 18, 20–9, 32, 34–5, 37–9, 43–53, 128.

¹⁸⁷ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, item 22.

¹⁸⁸ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, item 15.

¹⁸⁹ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, item 29.

¹⁹⁰ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, item 45.

Additional Licence Conditions applied to the financial services licences held by CFPL and Financial Wisdom.

- It had made notifications in respect of a further 20 advisers in relation to serious compliance concerns.
- It had made good governance notifications in respect of a further 13 advisers, which largely related to signature irregularities in documents on client files.
- Fifteen former CBA employees or representatives have been the subject of ASIC banning orders or enforceable undertakings since 1 January 2013.
- As at 31 December 2017, it has paid or offered to pay approximately \$96 million to customers relating to the provision of poor financial advice or adviser misconduct.

5.2.4 NAB

In its submissions to the Commission NAB did not always distinguish between adviser misconduct involving inappropriate advice and other improper conduct. NAB acknowledged that, in the period from 1 January 2009 to 29 January 2018, it had notified ASIC or otherwise discussed with ASIC approximately 68 advisers whom NAB had identified as giving rise to serious compliance concerns. This included conduct involving multiple instances of inappropriate advice leading to customer loss, backdating of documents, misleading statements, and repeated compliance breaches.¹⁹¹

NAB acknowledged that, in the period from 1 January 2009 to 29 January 2018, it had identified instances where customers had been provided with inappropriate advice that failed to comply with the requirement to have a reasonable basis for advice and to act in the customer's best interests, including an unspecified number of instances of:

- failing to provide advice tailored to the customers' objectives or appropriate for the customers' risk tolerance;

¹⁹¹ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 5.

- recommending a geared strategy that was inappropriate; and
- failing to recommend withdrawal from a geared financial product during a cooling off period when the customer's circumstances had changed.¹⁹²

NAB also acknowledged that it had identified an unspecified number of other instances where customers had been provided with inappropriate advice about insurance, including:

- failing to give appropriate insurance advice given the customer's individual circumstances, including advice resulting in a customer being uninsured;
- cancelling a customer's insurance policies before new insurance was in place; and
- recommending a switch to new insurance that did not benefit the customer.¹⁹³

5.2.5 Westpac

A significant ASIC review, established in 2015 and known as the 'Advice Compliance Program', identified 22 Westpac financial advisers who had provided inappropriate advice and who were reported to ASIC.¹⁹⁴

BT Financial Group participated in ASIC's Advice Compliance Project, as a result of which a further 11 financial advisers were identified as potentially providing 'problematic advice'.¹⁹⁵ Since 2015, BT Financial Group has identified a further 15 advisers who may have given inappropriate advice.¹⁹⁶

¹⁹² NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 6.

¹⁹³ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 7.

¹⁹⁴ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 29.

¹⁹⁵ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 29.

¹⁹⁶ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 29.

As at 29 January 2017, Westpac had paid a total of \$12.568 million in compensation to 205 clients, with a further \$1.024 million in compensation offered but not yet accepted.

When Westpac made its initial submission to the Commission on 29 January 2018, Westpac had not completed its review of the advice received by 468 customers who had been given advice by the initial 22 advisers.¹⁹⁷

Westpac also provided to the Commission some specific examples of the inappropriate advice of four advisers, being:

- an adviser who provided inappropriate personal advice primarily relating to gearing recommendations, with 116 clients requiring remediation;¹⁹⁸
- an adviser who had provided inappropriate advice relating to establishment of SMSFs and using limited recourse borrowing arrangements to fund the purchase of real property;¹⁹⁹
- two advisers whose conduct gave rise to concerns of inadequate disclosure, charging of ongoing fees without providing the relevant services, inadequate documentation of client goals and objectives, inadequate risk profiling and no documented reasonable basis for advice provided or superannuation switching; and
- an adviser who had provided standardised advice across his client base and recorded identical goals and objectives for many of his clients.²⁰⁰

These four advisers were reported to ASIC, and three have been the subject of banning orders.²⁰¹

¹⁹⁷ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 32.

¹⁹⁸ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 30.

¹⁹⁹ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 30.

²⁰⁰ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 31.

²⁰¹ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 30–1.

5.3 Improper conduct by advisers

5.3.1 AMP

AMP acknowledged that since 2009, it had identified:²⁰²

- 81 advisers with potential 'Serious Compliance Concerns', a phrase defined by ASIC as including circumstances where a person has engaged in conduct that is dishonest, illegal, deceptive and/or fraudulent, or gross incompetence or gross negligence; and
- 440 advisers with potential 'Other Compliance Concerns', a phrase defined by ASIC as including circumstances where a person has engaged in conduct that would be a breach of internal business rules or standards, result in an adverse finding from audits conducted by or for the licensee or result in actual or potential financial loss to clients as a result of advice received.

In February 2018, AMP provided a supplementary submission to the Commission in which it acknowledged further identified possible misconduct including:

- about 126 additional advisers who had engaged in possible misconduct such as charging fees for no service and providing inappropriate advice.²⁰³ Of those advisers, AMP identified only one as currently being in the remediation program;²⁰⁴ and
- 28 advisers who had engaged in conduct that breached a statute, regulation, standard or code.²⁰⁵

²⁰² AMP, *AMP Group Submission*, 29 January 2018, 14 [5.5.7]; AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, Schedule B 7 [6.2].

²⁰³ AMP, *21 February 2018 Submissions to Royal Commission*, 21 February 2018, tables 1–8.

²⁰⁴ AMP, *21 February 2018 Submissions to Royal Commission*, 21 February 2018, Table 1 item 40.

²⁰⁵ AMP, *21 February 2018 Submissions to Royal Commission*, 21 February 2018, items 3, 5, 10–1, 13–22, 24, 26–30, 32–4, 36–7, 39–41.

5.3.2 ANZ

ANZ acknowledged that, in response to a notice issued by ASIC in 2015, it had identified 39 advisers who were employed or authorised by ANZ and who had engaged in improper or non-compliant conduct between 1 January 2009 and 7 July 2015. Between 1 July 2015 and 31 December 2017, ANZ made an additional 40 reports or notifications to ASIC concerning the conduct of a total of 41 financial advisers or authorised representatives.²⁰⁶ The adviser misconduct covered by these notifications included improper use of customer funds, misleading conduct concerning advisers' qualifications or authorisations, falsifying customer or compliance documentation, deliberate overcharging of fees, provision of poor quality advice and failure to comply with disclosure obligations.²⁰⁷

ANZ also acknowledged at least 56 events of misconduct or potential misconduct relating to improper conduct by financial advisers.²⁰⁸ These included circumstances where customer signatures were forged or falsified,²⁰⁹ customers impersonated,²¹⁰ there had been fraudulent uses of powers of attorney,²¹¹ where financial advisors falsely witnessed documents or facilitated documents being falsely witnessed,²¹² or where customer funds had been transferred into a financial adviser's personal bank account.²¹³

²⁰⁶ ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 8–9 [5.18]–[5.20].

²⁰⁷ ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 9–10 [5.21].

²⁰⁸ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, items 6, 8, 9, 12, 16–17, 19, 22, 25, 29, 30–3, 36–8, 40–2, 51, 54–88.

²⁰⁹ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, items 8, 12, 19.

²¹⁰ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, 30.

²¹¹ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, item 31.

²¹² See, eg, ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, items 51, 59, 60.

²¹³ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, items 27, 31.

ANZ also acknowledged that on 14 January 2018, it had notified ASIC that a further 29 advisers had falsely witnessed, or facilitated the false witnessing of, certain forms signed by customers.²¹⁴

Further, ANZ acknowledged misconduct by ANZ Financial Planning in failing to pay agreed rebates on approximately \$8.5 million in trail commissions to approximately 6,800 customers between 2009 and 2017. At the time of the Round 2 hearing, ANZ estimated it would pay affected customers in excess of \$12.5 million in total in remediation in respect of this misconduct, including lost earnings of approximately \$4.8 million.²¹⁵

5.3.3 CBA

In its third submission to the Commission, CBA acknowledged 76 specific events of misconduct over the last five years that related to financial advice. These included instances of problems with customer documentation and signatures, failure to comply with disclosure requirements, and asset allocations that failed to align with customer risk profiles.

5.3.4 NAB

In its January 2018 submission to the Commission, NAB identified instances of improper conduct by employed financial advisers and authorised representatives of NAB Wealth entities, including:

- dishonest or otherwise serious illegal conduct such as misappropriation of funds and the provision of advice to invest in a company in which the authorised representative had a financial interest between at least 2011 and 2016;
- involvement or potential involvement in inappropriate early release schemes between at least 2016 and 2017 allowing members access to superannuation benefits before they became entitled to them; and

²¹⁴ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, items 57–70, 72–9, 81–4, 86–8.

²¹⁵ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, item 90.

- the provision of advice by advisers outside the scope of their Letters of Authority between at least 2009 and October 2016.²¹⁶

In addition, NAB acknowledged that, in the period from 1 January 2009 to 29 January 2018, there were instances where it had failed to prevent the misappropriation of customer funds, including misappropriation by financial advisers.²¹⁷

NAB acknowledged that between 1 January 2010 and 30 September 2017, it had paid approximately \$38 million to customers, which it said included amounts (which were not specified) paid as compensation to customers for financial adviser misconduct.²¹⁸

The acknowledgments of improper conduct by NAB also included an acknowledgment that, as at October 2017, it had identified 353 NAB employees who had been involved in incorrectly witnessing binding beneficiary nomination forms for superannuation funds. This incorrect witnessing potentially affected the validity of beneficiary nomination forms for about 2,520 customers.

NAB also acknowledged a number of issues in relation to the disclosure that it made to its customers, including a number of NAB Group licensees that had failed to disclose relationships between advisers, advice licensees, and other members of the Group that issue investment products from 2008 to March 2016.²¹⁹

NAB also acknowledged that, in the period from 2008 to March 2016, approximately 150,000 customers received deficient disclosure either

²¹⁶ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 8.

²¹⁷ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 9.

²¹⁸ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 5.

²¹⁹ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 21.

in statements of advice or Financial Services Guides in relation to MLC-branded products and other investment manager products.²²⁰

5.3.5 Westpac

Westpac acknowledged that a BT Financial Group adviser had established 72 life insurance policies in the names of clients with no existing accounts, with a view to dishonestly obtaining a benefit through the sale of these policies. Criminal charges were laid by Victoria Police and the adviser was permanently banned by ASIC.²²¹

Westpac also identified that a financial adviser employed by an authorised representative of Magnitude had performed unauthorised transactions in accounts of five of her clients. Three of these clients suffered losses as a result of these transactions. The adviser was criminally prosecuted and sentenced for charges including theft.²²²

Westpac acknowledged that \$2.75 million has been paid to 1,996 impacted customers as a result of advice fees paid between 1998 and 2012 for BT 'Investment Wrap' or 'SuperWrap' products that may have been higher than the maximum fee ranges noted in some disclosure documents.²²³

6 What the case studies show

Clients of financial advisers or financial advice licensees being charged fees for services not provided to them is now rightly recognised to have been a large and endemic problem in the industry.

What is said at the start of this chapter should be repeated. **Charging for doing what you do not do is dishonest. No-one needs legal advice to**

²²⁰ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, item 21.

²²¹ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 32.

²²² Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 31.

²²³ Westpac, *Response of Westpac Banking Corporation*, 29 January 2018, 34.

tell them that. The root cause for what happened was greed; the greed of both licensees and advisers:

- **Licensees treated the *provision* of ongoing services as a matter of no concern to them. Provision of the services was treated as a matter between only the client and the adviser.** At least when an adviser left the licensee, and the client became an ‘orphan client’, the licensee knew that that adviser would *not* be providing ongoing services to that client. But the licensees did nothing in response. They simply continued to take the money that was deducted from the client’s investments in payment of the ongoing service fee.
- **Advisers often treated ongoing service arrangements as though they were nothing but trail commissions for the advice that had already been given.** The fees were both a steady source of income (for little or no effort) and an important element that would contribute to the capital value of the adviser’s business. In some cases, advisers continued to charge ongoing service fees even though the client was dead and had died years earlier.²²⁴ Even in those cases, the licensee did not terminate the adviser’s contract for dishonesty; the licensee simply ‘warned’ the adviser not to continue the conduct.
- **Clients seldom complained about being charged for nothing. They did not complain because the fees they paid were charged invisibly.**
- **Whether the conduct is said to have been moved by ‘greed’, ‘avarice’, or ‘the pursuit of profit’, it is conduct that ignored the most basic standards of honesty.**
- **The licensees did nothing to stop it and they took the proceeds.**
- **The conduct of licensees and advisers was inexcusable and no-one has since tried to excuse it.**
- **No-one has been subjected to any formal public process of investigation, finding and punishment for this conduct. Only at the last minute before the hearings began, did enforceable**

²²⁴ Transcript, Marianne Perkovic, 19 April 2018, 1340–1, describing cases identified in the business of Count Financial Ltd; see also Exhibit 2.90, December 2015, Count Risk & Compliance Forum, 25.

undertakings yield public (and then very limited) formal acknowledgment from entities that ASIC had ‘concerns’ about their conduct and that those concerns were ‘reasonably held’.

- **Even when the Commission was taking evidence about the issue, the licensees had not made good their defaults by compensating all their affected clients.**

As already noted, the four largest banks and AMP all acknowledged in their initial submissions to the Commission that they or their associated entities had charged clients fees for personal financial advice that had not been provided.²²⁵ In most cases, the client had made an ‘ongoing service agreement’ with a licensee for the provision of personal advice and other services and had been allocated an adviser. The adviser did not provide the ongoing service and the licensee did not ensure that the service was provided. Typically, the fees were deducted automatically from the client’s investment account balance.²²⁶

The nature and extent of the ‘fees for no service’ issue was described in the evidence of Mr Kell, Deputy Chair of ASIC. At 31 January 2018, AMP, ANZ, CBA, NAB and Westpac had paid, or agreed to pay, to almost 306,000 customers, combined compensation of more than \$216 million.²²⁷ Three of those entities, ANZ, CBA and NAB, had reported to ASIC that they estimated that further compensation of at least \$2.5 million would be paid;²²⁸

²²⁵ AMP, AMP Group Submission, 29 January 2018, 10–13 [5.4.1]–[5.4.23]; ANZ, ANZ Submission in Response to the Commission’s Letters of 15 December 2017, 29 January 2018, 7–8 [5.8]–[5.17], 12–13 [5.31]–[5.35]; ANZ, ANZ Response to the Commission’s Letter of 2 February 2018, 13 February 2018, items 1, 92–5; CBA, Submission, 29 January 2018, 11–13 [39]–[45]; NAB, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group’s Response dated 29 January 2018 to the Commission’s Letter dated 15 December 2017, 29 January 2018, items 11–12; Westpac, Response of Westpac Banking Corporation, 29 January 2018, 29, 31.

²²⁶ See generally Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, 1–2 [7]–[11].

²²⁷ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK- 3 [ASIC.0902.0001.3370 at .3370].

²²⁸ Being ANZ, CBA and NAB, Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-3 [ASIC.0902.0001.3370 at.3370].

Westpac had told ASIC that the amount of future compensation was not likely to be material;²²⁹ the last, AMP, provided no estimate.²³⁰

In 2014, ASIC started its 'Wealth Management Project', a major project focusing upon the financial advice businesses conducted by ANZ, CBA, NAB, Macquarie, Westpac and AMP. In April 2015, ASIC announced that it was 'investigating multiple instances of licensees charging clients for financial advice, including annual advice reviews, where the advice was not provided'.²³¹ ASIC said that it would 'consider all regulatory options, including enforcement action' where it found evidence of breaches of the law and that it would 'look to ensure that advice licensees follow a proper process of customer remediation and reimbursement of fees where such breaches have occurred'.²³² As events turned out, however, until immediately before the time the Commission began taking evidence about fees for no service, ASIC had undertaken some investigations and had pursued remediation, but had taken no enforcement action.²³³ Rather, as Mr Kell said, '[m]ost of ASIC's work in the [Fees for no Service] project [had] focused on remediation'.²³⁴ And it was not until a few days before the hearings began that ASIC announced first, that it had agreed with ANZ that ANZ would give an enforceable undertaking and then, a few days later, that it had agreed with CBA that two of CBA's financial advice licensees (CFPL and Bankwest Financial Advice [BWFA], a CBA licensee that ceased to provide advice in 2016) would give an enforceable undertaking in relation to the charging of fees for no service.

In October 2016, ASIC reported that AMP, ANZ, CBA and NAB had all identified systemic issues in relation to the charging of ongoing service fees;

²²⁹ Being Westpac, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-3 [ASIC.0902.0001.3370 at .3370]

²³⁰ Being AMP, Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-3 [ASIC.0902.0001.3370 at .3370].

²³¹ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-2 [ASIC.0902.0001.0941].

²³² Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-2 [ASIC.0902.0001.0941].

²³³ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-4 [ASIC.0902.0001.3189].

²³⁴ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, 11 [42].

Westpac had identified a systemic issue ‘in relation to one adviser only’; Macquarie had not identified any systemic failures in respect of fees for no service.²³⁵ ASIC said that ‘[m]ost of the systemic failures identified’ had occurred before the FoFA reforms, which came into effect on 1 July 2013.²³⁶ But the report also revealed that, as at 31 August 2016, compensation arising from fees for no service was estimated to be more than \$178 million in respect of about 200,000 customers,²³⁷ and that, by 31 August 2016, about \$23.7 million had been paid, or agreed to be paid to over 27,000 customers. Between 31 August 2016 and 31 January 2018, the total compensation paid or agreed to be paid and the number of customers affected increased markedly, to the figures given by Mr Kell in his evidence: more than \$216 million and more than 305,000. And, contrary to the tenor of ASIC’s 2016 report, the evidence to the Commission showed that there had been some significant systemic failures after the FoFA reforms. The most notable of those failures examined in evidence related to AMP and its conduct of continuing to charge fees to clients whose advisers had sold their businesses to AMP as the ‘buyer of last resort’.

No doubt the advice licensees would say that undertaking remediation programs for clients who had been charged fees for no services constituted their acknowledgment of wrongdoing. But there has been no formal public condemnation of what occurred. The only formal and public steps that have been taken with respect to this issue, beyond ASIC issuing its reports and Press Releases, was ASIC’s acceptance, very soon before the Commission began its hearings about fees for no service, of the ANZ and CBA enforceable undertakings.²³⁸ The undertakings went no further than to record ASIC’s ‘concerns’ and that the relevant entities acknowledge that those concerns are ‘reasonably held’.

²³⁵ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 5 [7].

²³⁶ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 6 [16].

²³⁷ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 7.

²³⁸ ASIC, *Enforceable Undertaking*, 29 March 2018, 5 pt 3; ASIC, ‘ASIC Accepts Enforceable Undertaking from ANZ for Fees for No Service Conduct’ (Media Release, 18-092MR, 6 April 2018); ASIC, *Enforceable Undertaking*, 9 April 2018, 9 [3.5.5]; ASIC, ‘ASIC Accepts Enforceable Undertaking from Commonwealth Bank Subsidiaries for Fees for No Service Conduct’ (Media Release, 18-102MR, 13 April 2018).

This is well short of a full and frank acknowledgment by the entities that what they had done was wrong. No doubt ANZ and CBA would point to their having each agreed to ‘make a community benefit payment’ of \$3 million. But if paying that negotiated amount is to be understood as some form of penalty marking the public denunciation of the licensees’ conduct, it seems small compared with the amounts of money that the remediation programs show have been needed to make good the damage done to clients: nearly \$90 million in the case of the CBA licensees and nearly \$50 million in ANZ’s case.

Several separate groups of issue arise from clients having been charged for advice services that were not provided.

- **How and why did these events occur?**
- **Why were these events not prevented from occurring?**
- **Why were they not detected sooner?**
- **How effective have been the remediation processes?**

Those issues can be described as issues about: causes, prevention, detection and remediation. As will be explained, issues of prevention and detection are closely connected with the issues about causes.

7 Fees for no service

7.1 Causes

In its 2016 report, ASIC reported that, during the time fees were being charged for no service:

- **The financial advice industry had a culture of reliance on automatic periodic payments such as sales commissions and adviser service fees;**
- **Some advice licensees prioritised advice revenue and fee generation over ensuring that they delivered the required services;**
- **Some licensees and advisers did not keep adequate records to enable monitoring and analysis; and**

- **Some licensees did not develop and enforce effective monitoring and checking procedures to prevent systemic failures.**²³⁹

No doubt these observations were then, and remain, accurate. But, as expressed, they are observations that do not go far beyond the proposition that fees were charged for no service. Several further points must be made.

The first is obvious. As said above, **charging for doing what you do not do is wrong**. No doubt, as Mr Regan, AMP's Group Executive, Advice and New Zealand, pointed out, fees were charged for no service at times that saw great legal and regulatory change. But contrary to Mr Regan's evidence, neither the pace nor the extent of regulatory change made any contribution to the occurrence of these events.²⁴⁰ As Mr Regan himself accepted, charging fees for no service is obviously wrong.²⁴¹

Second, and equally obviously, **making an ongoing service arrangement gives the adviser a financial advantage**. The adviser stands to earn, and to continue to earn, annual amounts from the client. The less the adviser does before the fee is paid, the greater the financial advantage. And, as ASIC noted in its 2016 report, licensees did not have systems in place to ensure that *any* services were provided in return for the fees being charged, but licensees did have systems that recorded incoming revenue.²⁴²

Third, **licensees did nothing to prevent advisers having more customers on their books than they could monitor or advise annually**. Often, the advisers had 'acquired' (or 'inherited') those clients from some other adviser.²⁴³ And licensees, like AMP and its associated entities, that have provided, and continue to provide, 'buyer of last resort' arrangements for advisers who wish to leave the business not only facilitate, but actively encourage, the treatment of client books as a tradeable asset to be valued

²³⁹ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 8 Table 1.

²⁴⁰ cf Exhibit 2.13, Witness statement of Anthony George Regan, 11 April 2018, 54.

²⁴¹ Transcript, Anthony George Regan, 16 April 2018, 1072–3.

²⁴² ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 39–40 [191].

²⁴³ ASIC, *Report 499: Financial advice: Fees for No Service*, October 2016, 40 [191(b)].

as a multiple of annual income earned. Annual income consists of commissions and fees paid by clients.²⁴⁴

Fourth, **the services to be provided under ongoing service arrangements were, and still are, often neither well-defined nor onerous**. Witness evidence showed how the services to be provided under ongoing service arrangements may not only be very loosely defined but also defined in a way that has little or no substantive content beyond a promise to speak with the client once each year. Describing the services (as Mr Michael Wright, the national head of BT Financial Advice did) as 'strategic advice and reassurance' may encourage both adviser and client to see providing the ongoing services as a matter of form rather than substance and as not a matter of any immediate or pressing moment or value. What exactly was, or is, to be provided in an 'annual review'? What is meant when it is said that the client may 'have access' to the adviser? Was (or is) the only promise made to 'offer' an annual review? And some advisers have in the past charged fees for services that ASIC said had 'limited' (I would say no) value such as maintaining records that the law required the advisers to maintain and retain.²⁴⁵

As ASIC pointed out in its submissions, the promised services, even if provided, may not give the client a benefit commensurate with their cost. If, as each of Ms Marianne Perkovic (on behalf of CBA), Mr Regan (on behalf of AMP) and Mr Darren Williams (on behalf of ANZ) said may be the case, the future advice fee is fixed as a percentage of the 'funds under advice' (rather than as a fixed dollar sum), the question of value for money is all the more evident. Ms Perkovic said that the maximum fee charged by CFPL, under its Legacy package, was 0.94% of funds under advice;²⁴⁶ Mr Regan produced an example of an agreement between an adviser at Hillross and a client where the ongoing service fee was fixed at 0.6% of funds under advice;²⁴⁷ Mr Williams said that some ongoing service fees were calculated

²⁴⁴ Transcript, Anthony George Regan, 16 April 2018, 1062.

²⁴⁵ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 40.

²⁴⁶ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 5 [29].

²⁴⁷ Exhibit 2.13, Witness statement of Anthony George Regan, 11 April 2018, Exhibit AGR-1 [AMP.6000.0020.0234]; see also Transcript, Anthony George Regan, 16 April 2018, 1059.

as a percentage of the fees under advice but that other such fees were fixed as a flat dollar amount.²⁴⁸

When asked to describe what was generally provided under ongoing advice arrangements, Mr Wright said, that ‘before FoFA, the conversation was much more around performance.’ Post-FoFA, and particularly now in our business, the conversation is much more around *strategic advice and reassurance*.²⁴⁹ Mr Wright spoke also of now using the ‘conversation’ to reflect on statutory changes, and ensuring that strategic advice was going to meet the client’s goals and aspirations by, if needs be, ‘rebalanc[ing] or reposition[ing]’ to meet those goals.²⁵⁰

Subject to one important qualification, the description that Ms Perkovic, Mr Regan and Mr Williams gave of ongoing services was not substantially different from the description given by Mr Wright. The qualification that must be noted is that Ms Perkovic described the ‘core component of ongoing services’ as an annual review²⁵¹ but, according to Ms Perkovic, at least in the case of BWFA, the mere offer of an annual review was sufficient for the fee to be charged.²⁵²

If done properly, an annual review might require the application of a deal of time, skill and judgment. Whether it did would depend not only upon the skill and diligence of the adviser but also upon what investments the client had, whether the client’s circumstances had changed and whether investment conditions had changed either generally or in relation to one or more of the products in which the client had invested. Absent extraordinary external events or radical change in the client’s personal position, it would be very easy to provide the service with little time and little effort. And, as pointed out above, the less the work that is done, the greater the financial advantage to the adviser.

²⁴⁸ Exhibit 2.92, Witness statement of Darren John Williams, 13 April 2018, 10–11.

²⁴⁹ Transcript, Michael Wright, 20 April 2018, 1450 (emphasis added).

²⁵⁰ Transcript, Michael Wright, 20 April 2018, 1450.

²⁵¹ Provided in the past, by one CBA licensee, BWFA, by telephone. See Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 4 [24], 9 [62].

²⁵² Transcript, Marianne Perkovic, 18 April 2018, 1289–92.

The fifth consideration to notice is that **the fees charged under ongoing service arrangements were, and still are, often charged ‘invisibly’: by being deducted from the client’s investment accounts**. If there is no recognition of a pressing need for the services and the charge is deducted automatically against funds under investment, neither adviser nor client may think about whether the services promised have been or should be provided. A line in a periodic investment statement recording the payment will draw the matter to attention *only* if the client is attentive enough to look beyond the total given at the foot of the statement. And there are many who will not do that. Whether a fee disclosure statement draws the matter to the client’s attention may depend upon what emphasis the adviser gives when presenting the statement to how beneficial the adviser’s past advice has been, and how well the client’s investments have proved or are proving to be.

Sixth, **before the FoFA reforms required advisers to obtain client agreement every two years for the provision of ongoing services, the client may have made the agreement for ongoing services at the time advice was first provided and neither then nor thereafter adverted to, or been reminded of, the adviser’s obligation**.

Seventh, **income from trail commissions was, and remains, an important part of the revenue earned from the provision of financial advice**. This is consistent with ASIC’s observation of an industry culture that relies on automatic periodic payments from customers.²⁵³ The highest source of revenue for financial advisers providing advice on behalf of three out of AMP’s four advice licensees for every year between 2008 and 2018 (for which AMP had records)²⁵⁴ was ongoing or trail commissions.²⁵⁵ And for the fourth of those advice licensees, where fees for service were the largest source of revenue for advisers, the advisers were employees of the licensee.

²⁵³ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 8.

²⁵⁴ AMP did not have records about revenue sources for two entities (Charter and iPac) for 2008–2011 because those entities were not then part of AMP. See Exhibit 2.171, Witness statement of Anthony George Regan, 11 April 2018, 21 [78].

²⁵⁵ Exhibit 2.171, Witness statement of Anthony George Regan, 11 April 2018, 19–21 [77]–[78].

Yet Mr Wright gave evidence that, despite clients not coming to an adviser asking for ongoing advice,²⁵⁶ most clients of authorised representatives of the financial advice businesses conducted by Westpac's advice licensees, (Magnitude and Securitor) would be on an ongoing advice arrangement.²⁵⁷ (He said that fewer clients of Westpac's *employed* financial advisers would have ongoing arrangements. Even so, it is to be noted that one of the case studies showed that Mr Mahadevan, an adviser employed by Westpac, signed Mr and Mrs McDowall up for ongoing advice at a fee of \$3,000 per annum.²⁵⁸ The point not having been explored in evidence, one can only wonder what the purpose of that ongoing advice might have been thought to be.)

Taken together, these considerations, and those identified by ASIC in its 2016 report, point firmly towards the simple conclusions that the root cause of the fees for no service conduct was greed: greed by licensees; greed by advisers.

7.2 Prevention and detection

As the remediation figures show, **the large entities did not prevent fees being charged for no service. They had neither the systems nor the processes to know whether their authorised representatives were delivering what had been promised. Hence the failure to provide services could not be detected. And how and why the events occurred show why they did not come to light sooner.**

As already noted, the licensees did not have systems or processes that allowed the licensee to monitor whether the adviser was delivering whatever services had been promised.²⁵⁹ One of the elements of the ANZ and CBA enforceable undertakings was to have senior management attest that the relevant licensee's compliance systems and processes were (at the time of the undertaking) reasonably adequate to track the licensee's contractual obligations to its ongoing service clients. ANZ's attestation was to be

²⁵⁶ Transcript, Michael Wright, 20 April 2018, 1451.

²⁵⁷ Transcript, Michael Wright, 20 April 2018, 1449–50.

²⁵⁸ Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037 at .0059].

²⁵⁹ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 39–41.

‘audited’;²⁶⁰ the attestation relating to CFPL (BWFA having ceased to carry on advice business) was to be ‘supported by an expert report’.²⁶¹

In its 2016 report, ASIC recorded the changes that some licensees – AMP, ANZ, CBA and NAB – had made to their systems to prevent a recurrence of charging fees for no service. Those changes varied from changing system controls,²⁶² to altering record keeping and oversight.²⁶³

But some at least of the chief causes of the issue remained, not least the enticing call of profit, the uncertain content of what was promised and the capacity to deduct the fees invisibly.

The uncertainty of the content of what is promised is not an issue to be solved by regulation. It is, and must be, a matter for client and adviser to decide what if any services will be provided after the provision of initial advice. It is, and must be, a matter for client and adviser to decide how those services are defined. But it is consistent with the policies that underpinned the FoFA reforms to consider first, how long a contract for future services can be made and second, what responsibility any entity asking for payment of fees for future services should have for verifying that the client has authorised the payment.

Under existing law, advisers cannot charge for the provision of ongoing advice unless the client has positively renewed the instruction to provide ongoing advice during a 30-day renewal period that commences no later than two years after making or renewing the ongoing fees arrangement.²⁶⁴ Should that period be reduced? **Should the adviser and client have to renegotiate an ongoing service arrangement annually?**

²⁶⁰ ASIC, *Enforceable Undertaking*, 29 March 2018, 5 pt 3; see also ASIC, ‘ASIC Accepts Enforceable Undertaking from ANZ for Fees for No Service Conduct’ (Media Release, 18-092MR, 6 April 2018).

²⁶¹ ASIC, *Enforceable Undertaking*, 9 April 2018, 9 [3.5.5]; see also ASIC, ‘ASIC Accepts Enforceable Undertaking from Commonwealth Bank Subsidiaries for Fees for No Service Conduct’ (Media Release, 18-102MR, 13 April 2018).

²⁶² ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 35–8.

²⁶³ ASIC, *Report 499: Financial Advice: Fees for No Service*, October 2016, 36–8.

²⁶⁴ Corporations Act pt 7.7A div 3 ss 962A–962Q, see especially ss 962K, 962L.

Often, clients will invest funds through platform or other arrangements conducted by entities associated with the adviser's **financial services licensee**. Whether or not those investment entities are associated with the adviser or the adviser's licensee, **should the investment entity deduct amounts that are to be paid to the licensee, the adviser or both, without express authority from the client? Should that authority operate for only the period fixed by the ongoing service arrangement made between adviser and client in accordance with the ongoing fees provisions of the Corporations Act?**

7.3 Remediation

In September 2016, ASIC published Regulatory Guide 256: Client Review and Remediation Conducted by Advice Licensees (RG 256). The central premise for the guide is that a financial services licensee's general obligation to 'do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly'²⁶⁵ requires licensees to take 'responsibility for the consequences of their actions if things go wrong when financial services are provided and clients suffer loss or detriment'.²⁶⁶ And because the licensee is responsible for the conduct of its representative,²⁶⁷ the regulatory guide goes on to say that the licensee's obligations include 'remediating clients who have suffered loss or detriment as a result of misconduct or other compliance failure by the licensee or its current or former representatives'.²⁶⁸

No person who gave evidence to the Commission sought to dispute that the obligation to provide services 'efficiently, fairly and honestly' entails that the licensee must identify and compensate clients who have, in the words of RG 256, 'suffered loss or detriment as a result of misconduct or other compliance failure by the licensee or its current or former representatives'. The focus for debate in both the submissions and the evidence given to the Commission was about the ways in which the obligation was being

²⁶⁵ Corporations Act s 912A(1)(a).

²⁶⁶ ASIC, Regulatory Guide 256: Client Review and Remediation Conducted by Advice Licensees, September 2016, 6 reg 256.14.

²⁶⁷ Corporations Act s 917B.

²⁶⁸ ASIC, Regulatory Guide 256: Client Review and Remediation Conducted by Advice Licensees, September 2016, 6–7 reg 256.14.

performed. In particular, there was a deal of debate about how quickly a licensee should move if, for example, it became aware of one of its authorised representatives having given inappropriate advice.

Many clients who paid fees for no service have now received compensation, but even ASIC could not give a complete estimate of the amount in April 2018. AMP had not then given ASIC an estimate of how much more it expected to pay as compensation to clients who had been charged fees for no service. As is recorded, in connection with the case studies concerning inappropriate advice given by representatives of AMP licensees, Ms Britt gave evidence that AMP's remediation program for those clients was moving very slowly. Not giving ASIC an estimate of the amount expected to be paid to remaining clients who had been charged fees for no service is consistent with the fact that **the remediation program was moving too slowly**.

What emerged from the case studies was that there were many cases in which **licensees had not moved promptly**.

8 Platform fees

The second subject of evidence examined in the Commission's hearings about financial advice concerned platform fees. The evidence given about platform fees showed practices that have features redolent of both the conduct constituted by charging fees for no service and the provision of inappropriate advice.

There are several forms of platform product. They were described by Mr Keating, the head of platform products at AMP, as including 'investor directed portfolio services' (or IDPS) that are non-superannuation products in the name of the customer, IDPS-like products (another form of non-superannuation product in the name of the customer, but provided by a responsible entity) and superannuation funds.²⁶⁹ Mr Keating described the operation of the non-superannuation platforms as an investor investing an amount of money in the platform and the money then being invested in products made available through the platform and identified in an approved

²⁶⁹ Transcript, John Patrick Keating, 18 April 2018, 1211; Exhibit 2.69, Witness statement of John Patrick Keating, 9 April 2018, 2.

products list.²⁷⁰ The customer is the beneficial owner of the investments (held in the name of the platform operator) but, on some but not all platforms operated by AMP, the customer can transfer the assets held on behalf of the customer to another platform.²⁷¹ (Mr Keating explained this facility not being available on some AMP platforms as a product of history and said that there was no technical barrier to it being made available on all of AMP's platforms.)

The charging of platform fees evoked comparisons with fees for no service because the default setting seemed too often to be 'set and forget'. Charging platform fees evoked comparison with inappropriate advice because, very often, the platform that an adviser recommended the client use was a platform provided by an entity associated with the licensee with which the adviser was aligned or by which the adviser was employed and the arrangements were allowed to stay in operation despite the platform not remaining cost-competitive. Both the practice of 'set and forget' and the ways in which fees for, and services provided by, platforms could remain unaltered over time show that customers using platform services exert little or no effective competitive pressure on platform operators.

Two other particular issues emerged from the evidence given about the charging of platform fees. First, **platform operators have routinely deducted, and continue to deduct, ongoing service fees from clients' accounts and have remitted, and continue to remit, the fees to advice licensees without having any authority beyond the licensee's claim to be entitled to payment.** (If the client's account has insufficient cash to make the payment, assets are liquidated to realise sufficient cash.) To pay away money held on behalf of another on the request of the party who claims payment is a distinctly unusual arrangement.

Second, the evidence was that **it is general industry practice for platform operators to charge fees calculated by reference to the amount of funds under administration and not as a fixed fee.** This method of charging appears to owe much more to history than any other reason and its persistence suggests that there are not strong competitive pressures

²⁷⁰ Transcript, John Patrick Keating, 18 April 2018, 1213.

²⁷¹ Transcript, John Patrick Keating, 18 April 2018, 1214.

at work. Be this as it may, in 2017, Colonial First State (CBA's fund management entity) launched a product that charges a flat fee.²⁷²

Further weight may be given to there being an absence of effective competitive pressure, by the evidence showing that two platforms operated by Colonial First State have charged, and continue to charge, fees that are calculated in part as an administration fee and in part as an investment fee. The investment fee charged is greater than the investment fee charged to the platform by the underlying manager actually responsible for making the investments. Not only that, the overall amount charged to clients is calculated in a way that makes an allowance against the possibility that the calculation is wrong.²⁷³ For an entity to be able to charge a higher price to protect itself against the consequences of its own mistake is also unusual.

Finally, the evidence also showed that **platform operators continue to receive remuneration that, but for 'grandfathering', would be conflicted remuneration.**

As will be further explained in connection with inappropriate advice, licensees may and often do include third party manufacturers of products on their approved product lists (including the approved product lists maintained by platforms) but, much more often than not, advisers recommend that clients use products that are manufactured by entities associated with the advice licensee with which the adviser works.

Mr Keating of AMP said that, between July 2013 and October 2016, AMP had supplied benchmarking information to its advisers about AMP's platforms that showed whether the platforms were considered cost-competitive for investors.²⁷⁴ The information available to advisers gave separate results for different amounts being invested. The results were given in four bands ranging from Tier 1 (competitive on price alone for the

²⁷² Transcript, Linda Elkins, 18 April 2018, 1248.

²⁷³ Transcript, Linda Elkins, 18 April 2018, 1246.

²⁷⁴ Transcript, John Patrick Keating, 18 April 2018, 1233.

client at the relevant investment level)²⁷⁵ to Tier 4 (the AMP product is more than 15% more costly than comparable products).²⁷⁶

In 2015 and 2016, two of AMP's platforms were assessed as Tier 4 products: that is they were assessed as at least 15% more expensive than comparable products. In 2016, the two platforms that had been assessed as Tier 4 products were 'placed on hold' in the sense that advisers could not place new customers in the platforms without seeking permission to do that. By far the majority of the clients invested through the two platforms were clients of AMP affiliated advisers.

The relevant AMP advice licensees did not tell existing customers that the platforms they were using were judged to be markedly more expensive than other comparable products. The AMP advice licensees did not try to identify who were the advisers who had recommended investment through the platforms. The AMP advice licensees did not themselves ask customers whether they wished to move. As said earlier, it was a case of 'set and forget'.

Not only were investors left where they were, AMP took no step to make the platforms cost-competitive. Instead, as Mr Keating said, AMP 'focused on the more contemporary offers in terms of pricing changes' rather than consider the position of existing clients in the relevant products.²⁷⁷ AMP preferred its own financial interests over the interests of the investors (by continuing to charge the investors fees that were more than 15% above market rates).

AMP could act in this way because existing clients using the platforms had neither the occasion nor the ability to find out that they were being charged more than market rates.

Since 2016, AMP has not provided its advisers with benchmarking information about platform products. That is advisers do not have access to information that allows advisers to consider whether a platform is

²⁷⁵ Transcript, John Patrick Keating, 18 April 2018, 1224; Exhibit 2.69, Witness statement of John Patrick Keating, 9 April 2018, Exhibit JPK-1 [AMP.6000.0043.0379 at .0387].

²⁷⁶ Transcript, John Patrick Keating, 18 April 2018, 1225; Exhibit 2.69, Witness statement of John Patrick Keating, 9 April 2018, Exhibit JPK-1 [AMP.6000.0043.0379 at .0387].

²⁷⁷ Transcript, John Patrick Keating, 18 April 2018, 1232.

cost-competitive. How, then, can an adviser decide which platform it would be in the best interests of the client to use? How can an adviser tell a client that it may be time to change platform?

If a client wants to change platforms, or an adviser suggests that the client change, does the platform permit in specie transfer? If it does not, must the client choose between staying with the platform and realising the investments (with whatever capital gains consequences may follow from that event)?

The evidence about platform fees (and service provision) thus invited attention to some fundamental questions about aspects of the structure of the financial advice industry. In particular, it invited attention to **how the vertical integration of the industry may harm clients by protecting platform entities associated with advice licensees from competitive pressures. Clients end up paying more for platform services than other providers would charge for the same service.**

9 Inappropriate advice

The third subject of evidence was inappropriate advice.

It is important to begin with some points that cannot be ignored.

Hindsight will always show that some advice an adviser gives a client turns out to have been wrong. Advice that is given about financial products or investment will not always turn out for the best.

Not all advisers (financial or other) are equally skilled or diligent. In some cases reasonable advisers may form radically different views about what should be done.

Nothing can be done to change these outcomes. But recognising that there will be unforeseen and unwanted outcomes and recognising that some advisers will not be as skilled or diligent as others cannot be permitted to obscure some large and deep-seated issues examined in the course of the Commission's inquiries.

The cases of 'inappropriate' advice considered in the course of the Commission's work called attention to **four recurring points:**

- **advisers proposing actions that benefited the adviser;**
- **advisers proposing actions that benefited the licensee either with whom adviser was aligned or by whom the adviser was employed;**
- **advisers lacking skill and judgment; and**
- **licensees being unwilling to find out whether poor advice had been given and, if it had, to take timely steps to put it right.**

Whether, and to what extent, the first two points about the financial interests of advisers and licensees are properly seen as causing or contributing to the provision of bad advice will be considered first. Whether, and to what extent, providing ‘inappropriate’ advice might have amounted to misconduct or was conduct that fell below community standards and expectations directs attention to some basic issues that will be considered separately.

9.1 Causes

It is necessary to begin by making two simple points.

- **So long as advisers stand to benefit financially from clients acting on the advice that is given, the adviser’s interests conflict with the client’s interests.**
- **So long as licensees stand to benefit financially from clients acting on the advice that is given, the licensee’s interests conflict with the client’s interests.**

The client’s interests require consideration of whether to take any step, and only then consideration of what steps to take. If steps are to be taken, the client’s interests are to take whatever steps are best for the client (best both in the sense of achieving the best outcome for the client, but best also in the sense of achieving that outcome most efficiently at the best available price). The adviser’s and licensee’s interests are to have the client buy a product or make an investment that will give the adviser, the licensee, or both, a financial benefit.

The premise for the FoFA reforms was that conflicts of the kind described exist, must be recognised and should be regulated. The legislative response made by the FoFA reforms did not seek to eliminate the conflicts. Instead, the reforms sought to ameliorate the consequences of the conflicts. The legislation sought to do this by imposing on advisers the best interests

obligation²⁷⁸ with the associated requirements that the adviser provide appropriate advice²⁷⁹ and give priority to the client's interests.²⁸⁰ Those provisions were supplemented by the prohibitions on conflicted remuneration²⁸¹ and by adding to the general obligation of all financial licensees, to do all things necessary to ensure that the financial services covered by a financial services licence are provided efficiently, honestly and fairly,²⁸² the further requirement that licensees have in place adequate arrangements for the management of conflicts of interest that may arise in relation to activities undertaken by the licensee or a representative.²⁸³

As amplified in the legislation, and as implemented in practice, the best interests duty and associated obligations are more in the nature of obligations to 'do no harm' to the client than 'do what is best'.

The legislative provisions emphasise process rather than outcome. Although the fundamental obligation is cast as a '*best* interests duty' there is no explicit reference in the legislation to making comparisons of a kind that would merit the use of the superlative 'best' in the collocation 'best interests'. Instead, the Corporations Act provides that the best interests obligation will be met if an adviser follows the steps described in Section 961B(2).²⁸⁴ It is convenient to focus on one step identified in Section 961B(2). The best interests duty will be met if, among other things, an adviser considering recommending a financial product has conducted 'a reasonable investigation' into the products that might achieve the relevant objectives of the client.²⁸⁵ In practice this requires the adviser to make little or no independent inquiry into or assessment of products. Instead, in most cases advisers and licensees act on the basis that the obligation to conduct

²⁷⁸ Corporations Act s 961B(1).

²⁷⁹ Corporations Act s 961G.

²⁸⁰ Corporations Act s 961J.

²⁸¹ Corporations Act ss 963E–963L.

²⁸² Corporations Act s 912A(1)(a).

²⁸³ Corporations Act s 912A(1)(aa).

²⁸⁴ Section 961B(3) of the Corporations Act deals separately with satisfaction of the best interests duty when advice is given by Australian ADIs.

²⁸⁵ Corporations Act s 961B(2).

a reasonable investigation is met by choosing a product from the licensee's 'approved products list'.

It is necessary, then, to consider how approved product lists were and continue to be used in practice. In that regard, ASIC's January 2018 report *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* is important.²⁸⁶

ASIC's 2018 report showed that the approved products lists maintained by advice licensees controlled by the five largest banking and financial institutions included products manufactured by third parties and that third party products made up nearly 80% of the lists.²⁸⁷ But the report also showed that, overall, more than two-thirds (by value) of the investments made by clients were made in in-house products.²⁸⁸ (At the level of individual licensees the proportion varied from 31% to 88% invested in in-house products.²⁸⁹ By product type, the proportions invested in in-house products varied: 91% for platforms; 69% for superannuation and pensions; 65% for insurance; and 53% for investments. But taken as a whole, the report shows that advisers favour in-house products.)

The result is not surprising. Advisers may be expected to know more about the products manufactured by the licensee with which the advisers are associated than they know about a rival licensee's products. Advisers will often be readily persuaded that the products 'their' licensee offers are as good as, if not better than, those of a rivals. And when those views align with the adviser's personal financial interests, advising the client to use an in-house product will much more often than not follow as the night follows day.

The particular case studies examined in evidence reinforce these conclusions. So, for example, the advice given to Mr and Mrs McDowall

²⁸⁶ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018.

²⁸⁷ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018, 27 Figure 2.

²⁸⁸ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018, 27 [223].

²⁸⁹ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018, 29.

was to invest in in-house products. Investing in in-house products gave an immediate and direct financial benefit to the adviser in the form of commissions and bonuses. And the same observation can be made in respect of the other cases of poor advice that were examined in evidence.

The general point that emerges and must be examined is what these observations show about the working of the FoFA reforms.

As noted earlier, the basic premise for the FoFA reforms was that there are conflicts of interests between clients on the one hand and advisers and licensees on the other. The legislative solution adopted was not to eliminate the conflicts but regulate them. Has this solution been successful? Is it the right solution?

10 Post-hearing responses

After the Commission had finished the second round of evidence, ANZ announced that it would begin to implement several changes ‘to help improve the quality of financial planning, and customer remediation when things go wrong’.²⁹⁰

One of the changes proposed was to ‘[r]emove all sales incentives for bonuses and only assess performance on customer satisfaction, ANZ values and risk and compliance standards’.²⁹¹

Two other changes proposed were described as:

- ‘Quickly identify and remove planners that provide inappropriate advice – two audit fails and their contract will be terminated’; and
- ‘Commit to completing compensation on about 9,000 current inappropriate advice cases by the end of [2018]’.²⁹²

The first of the changes that ANZ announced points firmly away from a notion that underpinned at least some other submissions that sales-based

²⁹⁰ ANZ, ‘ANZ Unveils Plan to Improve Financial Planning’ (News Release, 7 May 2018).

²⁹¹ ANZ, ‘ANZ Unveils Plan to Improve Financial Planning’ (News Release, 7 May 2018).

²⁹² ANZ, ‘ANZ Unveils Plan to Improve Financial Planning’ (News Release, 7 May 2018).

financial incentives are essential to the efficient (and profitable) conduct of a financial advice business. The second change points to what is a simple, readily understood and easily adopted means of encouraging the provision of appropriate advice: fail two audits and your contract will be terminated. The third demonstrated a determination to remedy outstanding defaults.

All three changes invite close examination of claims that sales-based incentives cannot, or should not, be removed, that it is difficult to encourage good advice, or that remediation is an intrinsically protracted process.

In addition to ANZ announcing these particular changes, NAB and CBA each announced proposals to dispose of their advice businesses.²⁹³ By contrast, Westpac announced its intention to retain the advice business it conducts under the BT name.²⁹⁴

11 Improper conduct and discipline

Questions about improper conduct and discipline can be dealt with under three headings: prevention; detection; and consequences.

11.1 Prevention

Prevention of improper conduct (like prevention of poor advice) begins with education and training.

It is by education and training that advisers (and staff more generally) are made aware of *why* certain procedures are to be followed. In some cases the procedures may reflect legal requirements; in others they may reflect the particular requirements of the relevant licensee. But in

²⁹³ CBA, 'CBA Announces Intention to Demerge Wealth Management and Mortgage Broking Businesses' (Media Release, 25 June 2018) <www.commbank.com.au/guidance/newsroom/demerger-of-wealth-and-mortgage-broking-businesses-201806.html>; Andrew Thorburn and Gary Lennon, 'Half Year Results 2018: Investor Presentation' (Presentation, 3 May 2018) <www.nab.com.au/content/dam/nabrwd/documents/reports/corporate/2018-half-year-results-investor-presentation.pdf>.

²⁹⁴ Westpac Group, 'BT Announces Significant Cuts to Platform Pricing; Launches BT Open Services' (Media Release, 23 July 2018) <www.asx.com.au/asxpdf/20180723/pdf/43wpgx0t4v9g34.pdf>.

every case, those who know why the step is required are more likely to take it than those who know only that the relevant manual requires it.

The practice that developed in NAB (and was examined in evidence) of signing as a witness to a client's signature without having seen the client sign is a good example of the need to train and educate financial advisers (and staff more generally). When spelled out, the requirement is self-evident: do not sign as a witness if you have not seen the person sign the document. But what appeared not to be evident to the many who 'witnessed' a signature after the event was why it was important. They appeared not to recognise that saying (wrongly) that you witnessed a signature may affect the validity of the document and might mean that the client's expressed wishes were not carried into effect. What happened showed the need for education and training.

Preventing improper conduct (and promoting desirable conduct) is a central task of management, at every level in an entity: from the most junior supervisor to the most senior executives and the board. APRA's April 2018 report into CBA²⁹⁵ illustrates the issues and difficulties that can arise in managing operational compliance and conduct risks. Not least among those issues is striking a balance between what the report referred to as:

financial discipline and shareholder value considerations (the 'voice of finance') ... considerations of risk management, including aspects of a conduct and reputational nature (the 'voice of risk'), and ... good customer outcomes (the 'customer' voice).²⁹⁶

When an entity provides financial advice, whether it provides the advice by its employees or by an authorised representative, it is the voice of risk and the customer voice that must dominate. When considering the prevention of improper conduct and the promotion of desirable conduct it is those voices that must guide the entity. In the case of fees for no service, however, it was the siren song in the voice of finance that dominated. It is the siren song of finance (for the entity and the individual adviser) that leads to misaligned incentives. Far too often it has led to advisers preferring their own interests to the interests of the client.

²⁹⁵ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, 30 April 2018.

²⁹⁶ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, 30 April 2018, 47 [6.1].

And too often, pursuit of the adviser's interests has seen the giving of inappropriate advice.

Prevention can only go so far. To make prevention effective, it must be joined with detection.

11.2 Detection

The chief means of detecting both improper conduct and poor advice remains regular and random auditing of advisers' files.

The efficacy of the audit depends first upon there being a complete and accurate file recording the dealings between adviser and client. As the examples studied in evidence show, there can be no effective audit if the adviser keeps control of the file and will not release it to the licensee.

Next, the audit must be designed to reveal significant defaults. For too long, AMP maintained an audit system in which issues of high importance (such as not pursuing the client's best interests) could be treated as 'immaterial' when forming the overall audit grading. How can a departure from the central duty of an adviser ever be 'immaterial'?

Too often, bad audit results have had no, or no significant, consequences for the adviser. For too long, Westpac maintained a consequence management scheme under which point deductions for poor audit results were erased before the next audit would fall due. A system of that kind did nothing to penalise bad work and it did nothing to encourage better work.

11.3 Consequences: Regulatory

11.3.1 Civil penalty

Financial services licensees that breach those sections of the Corporations Act that impose the best interests duty (Section 961B), oblige the provision of appropriate advice (Section 961G), warn of incomplete or inaccurate advice (Section 961H), and require giving priority to the client's interests (Section 961J) are liable to civil penalty.²⁹⁷ Licensees must take reasonable steps to ensure that representatives of the licensee comply with those

²⁹⁷ Corporations Act s 961K.

sections (Sections 961B, 961G, 961H and 961J).²⁹⁸ Authorised representatives are themselves liable to civil penalty for contravention of any of those Sections.²⁹⁹ Clients who suffer loss or damage because of a breach of the Sections can recover compensation,³⁰⁰ and the Court dealing with an action under that Section can make any of several other kinds of order.³⁰¹

These civil penalty provisions have seldom been invoked. No civil penalty proceedings had been instigated in the five years before Ms Louise Macaulay (Senior Executive Leader of ASIC's Financial Advisers team) gave her evidence about these issues.³⁰² Ms Macaulay said of civil penalty proceedings generally, that they 'are time-consuming and resource intensive for ASIC', that 'their outcome is not proximate to the time of the misconduct' and that '[t]heir deterrent effect is limited by the (currently modest) size of the available penalty.'³⁰³ More particularly, in the context of financial advice, she pointed out that a civil penalty order could not include a banning order. These observations about civil penalty proceedings must be weighed against whether other ways in which breaches of the provisions may be dealt with are speedier, less time-consuming or more effective in deterring similar conduct.

11.3.2 Notice of breach

Some, but by no means all, breaches of the Corporations Act provisions about financial advice that have been mentioned earlier may come to the attention of ASIC through the breach notification procedures established by Section 912D. As the provisions now stand,³⁰⁴ a financial services licensee must lodge with ASIC a written report of the breach or the likely breach, of any of certain specified obligations. The breach, or likely breach, must be

²⁹⁸ Corporations Act s 961L.

²⁹⁹ Corporations Act s 961Q.

³⁰⁰ Corporations Act s 961M.

³⁰¹ Corporations Act s 961N.

³⁰² Transcript, Louise Anne Macaulay, 27 April 2018, 1915.

³⁰³ Exhibit 2.247, Witness statement of Louise Anne Macaulay, 25 April 2018, 16 [51].

³⁰⁴ The ASIC Enforcement Review has recommended changes. Those changes are described in Chapter 8.

‘significant’, having regard to a number of stated criteria. Not every breach must be notified.³⁰⁵

Notification of a breach must be given to ASIC ‘as soon as practicable, and in any case within 10 business days after becoming aware of the breach or likely breach’.³⁰⁶ Failure to comply with the notification requirements is an offence.³⁰⁷

For present purposes, the most relevant of the obligations of which breach or likely breach must be reported are those identified in Section 912A(1).³⁰⁸ Those obligations include not only the general obligation to do all things necessary ‘to ensure that the financial services covered by the licence are delivered efficiently, honestly and fairly’,³⁰⁹ but also the obligations to have adequate arrangements in place to manage conflicts of interest,³¹⁰ to take reasonable steps to ensure that the licensee’s representatives comply with the financial services laws,³¹¹ and to take reasonable steps to ensure that the licensee’s representatives are adequately trained and competent to provide the relevant services.³¹²

ASIC was advised by senior counsel that Section 912D, in its present form, presented difficulties in its application.

But even on the view adopted by ASIC, the case studies examined in the course of the Commission’s hearings show that, on more than one occasion, entities lodged Section 912D notices well beyond the time fixed by the Section’s requirement to lodge a written report as ‘as soon as

³⁰⁵ As first enacted, the breach notification provisions required notification of every breach: see *Financial Services Reform Act 2001* (Cth) sch 1. This was found to be unwieldy and was amended in 2003: see *Financial Services Reform Amendment Act 2003* (Cth) sch 2.

³⁰⁶ Corporations Act s 912D(1B).

³⁰⁷ Corporations Act s 1311(1).

³⁰⁸ Corporations Act ss 912D(1), 912D(1B).

³⁰⁹ Corporations Act s 912A(1)(a).

³¹⁰ Corporations Act s 912A(1)(aa).

³¹¹ Corporations Act s 912A(1)(ca). The expression ‘financial services law’ is defined in s 761A to include a large number of statutory provisions, including the provisions of Chapter 7 of the Corporations Act.

³¹² Corporations Act s 912A(1)(f).

practicable and in any case within 10 business days after becoming aware of the breach or likely breach'. **ASIC has taken no step to prosecute any licensee for contravention of Section 912D.**

11.3.3 Banning orders

The chief regulatory tool ASIC has used in connection with financial advice has been the power to make a banning order prohibiting a person from providing any, or any specified, financial services either permanently or for a specified period.³¹³ Since 2008, ASIC has made 350 banning orders, of which 229 were made in relation to financial advisers.³¹⁴ Just under half of those banning orders were permanent orders.³¹⁵

As Ms Macaulay explained, the process of making a banning order takes time. The time between ASIC becoming aware of the conduct that might warrant making a banning order and deciding to investigate the matter may vary from 'a couple of months' to 'any length of time up to a year'.³¹⁶ It may take six to twelve months to get a brief to the delegate and the delegate may take five months to make the decision.³¹⁷ Add to those times any appeal to the Administrative Appeals Tribunal or any proceedings for judicial review and the whole process may take anything up to two years before its final conclusion.

No doubt, as Ms Macaulay said, **banning orders serve a purpose of protecting the public. But a regulator's choice of regulatory steps should not be treated as requiring exercise of only one form of power.** There are cases where more than one power can and should be exercised. The process of making a banning order may be every bit as long as the pursuit of civil penalties. Court processes may prove to be more costly, if the action is fought. But chosen wisely, cases pursuing civil penalty may be

³¹³ Corporations Act s 920A–920B.

³¹⁴ Exhibit 2.247, Witness statement of Louise Anne Macaulay, 25 April 2018, 5; see also Transcript, Louise Anne Macaulay, 27 April 2018, 1914. The figures given in Exhibit 2.247 were said not to include banning orders made by a Court in civil proceedings or undertakings not to provide financial services given pursuant to enforceable undertakings.

³¹⁵ Transcript, Louise Anne Macaulay, 27 April 2018, 1914.

³¹⁶ Transcript, Louise Anne Macaulay, 27 April 2018, 1911.

³¹⁷ Transcript, Louise Anne Macaulay, 27 April 2018, 1911.

prosecuted to conclusions that lead to a public denunciation of conduct that has breached the law. And public denunciation of unlawful conduct is a deterrent and educative tool that is important to the proper regulation of the whole of the relevant regulated community (here financial advisers and advice licensees).

ASIC's emphasis on the use of banning orders invited attention to a more basic issue about regulatory structure. Should advisers be individually licensed? As noted earlier, the present regulatory structure permits holders of a financial services licence to authorise a person to provide a specified financial service or services on behalf of the licensee.³¹⁸ The licensee must notify ASIC of the authorisation.³¹⁹ As between the licensee and the client, the licensee is responsible for the conduct of an authorised representative,³²⁰ and that responsibility extends to loss or damage suffered by the client.³²¹

What is gained by having this structure? Would there be advantage in providing for the licensing of authorised representatives, thus bringing them under the direct supervision of ASIC?

11.4 Consequences: Industry

The general weight of the evidence given to the Commission was that the practice of giving financial advice is not yet a profession. Some said it is on the cusp; others were, perhaps, more cautious.

As noted elsewhere, recent legislation³²² seeks to advance the 'professionalism' of financial advice: by requiring higher education and training standards,³²³ by establishing FASEA³²⁴ and requiring compliance³²⁵

³¹⁸ Corporations Act s 916A.

³¹⁹ Corporations Act s 916F.

³²⁰ Corporations Act ss 917B–917C.

³²¹ Corporations Act ss 917E–917F.

³²² *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth).

³²³ Corporations Act pt 7.6 div 8A ss 921B–921D.

³²⁴ Corporations Act s 921X.

³²⁵ Corporations Act s 921E.

with a Code of Ethics to be prepared by FASEA³²⁶ and monitored by a 'monitoring body'.³²⁷

Both the Financial Planning Association of Australia (the FPA) and the Association of Financial Advisers (the AFA) seek to advance the cause of financial planners generally. Each seeks to promote the creation and growth of financial planning and advice as a profession. Each seeks to become a monitoring body under the new statutory arrangements.

Both FPA and AFA now have processes and systems for disciplining members. But the evidence before the Commission did not show that either the FPA or the AFA now plays any significant role in maintaining or enforcing proper standards of conduct by financial advisers.

Advice licensees do not look to the associations for that purpose. Licensees may encourage advisers to join a professional association. But licensees do not routinely tell either association of misconduct by advisers.

The FPA's treatment of the complaint made to it about the conduct of Mr Henderson in connection with Ms McKenna (examined as one of the case studies) did not encourage great confidence in FPA's disciplinary arrangements, at least as they stood when the Commission took evidence about the matter. The process described in evidence was prolonged, opaque and directed more to settling an agreed outcome to the complaint than imposing proper standards of conduct by members. And Mr Henderson chose not to renew his membership of FPA when he did not get his preferred outcome. The chief executive of the FPA said that the failure to pay membership dues does not terminate the membership of a member against whom a complaint remains outstanding. Even if that is so, and even if FPA were to expel the member concerned, it seems that the expulsion would be of little or no moment to a self-employed financial adviser.

Financial advisers are not currently required to belong to an association, and though some employers of employed financial advisers require it, few if any specify which. Advisers are free to switch between associations at any time, or, as Mr Hagger put it, 'go down the road to another association' if

³²⁶ Corporations Act s 921U.

³²⁷ Corporations Act ss 921G–921T.

they are expelled.³²⁸ The FPA and AFA therefore actively engage in recruitment of members from the industry and, to some necessary extent, from each other. Membership fees are their chief source of revenue.

Representatives of each association said that promoting the profession was one of its key functions.³²⁹ These characteristics sit uncomfortably with those of effective discipline that include objectivity, consistency and compulsion, and the tension was clearly borne out in the case of Mr Henderson and the FPA.

Mr De Gori, the chief executive officer of the FPA, gave evidence that the only compulsory sanction available to the FPA is to expel members. To encourage members to comply with disciplinary decisions, the association may threaten to publicly name them as the subject of its proceedings. Generally, names are kept confidential. The AFA has undertaken only two disciplinary matters since 2013, both of which resulted in a reprimand.³³⁰

The Code of Ethics being developed by FASEA will come into force in January 2020.

If, as both FPA and AFA hope, industry associations become monitoring bodies under the Corporations Act, much will depend upon how they perform those tasks. The monitoring bodies will play an important part in setting the tone and the culture of those who act as financial planners.

11.5 Operation of the disciplinary system

The disciplinary system (or systems) supervising financial advisers now consists of a number of bodies. Each is directed at regulating different, though related, norms of behaviour, and each is geared to different outcomes. The question is whether this segmentation imposes a satisfactory standard of behaviour on what is, as numerous witnesses noted, an aspiring profession.

Submissions from the parties generally agreed that the relevant disciplinary bodies were ASIC, professional associations and the employing licensee,

³²⁸ Transcript, Andrew Paul Hagger, 24 Apr 2018, 1671.

³²⁹ Transcript, Dante Giuseppe De Gori, 26 April 2018, 1819; Transcript, Philip Houston Kewin, 26 April 2018, 1828.

³³⁰ Exhibit 2.230, Witness statement of Philip Michael Kewin, undated, 14–15.

with an adjunct role for **external dispute resolution** schemes. ASIC's submission was that, as a regulator, its role is to oversee compliance by advisers with the law and not to supervise or monitor their work.³³¹ Primary responsibility for discipline lies with licensees, who are responsible under the law for the conduct of their advisers.³³² That is undoubtedly correct. In my view, however, ASIC's enforcement of the law with regard to individual advisers is an important part of the disciplinary system. It is for that reason that a robust approach to enforcement is critical.

According to ASIC it would be inaccurate to suggest there are gaps in this system. Rather, each body 'has its own distinct, overlapping role to play'.³³³ The other submissions did not share this view. Many of the gaps they identified can be ascribed to a lack of information sharing between ASIC, licensees and disciplinary bodies.

First, licensees are not doing enough to communicate between themselves about the backgrounds of prospective employees. The Australian Bankers' Association reference checking protocol is limited to signatories and not consistently applied.³³⁴ Licensees also frequently fail to respond adequately to requests for references regarding their previous employees.³³⁵ Nor do they always take the information delivered to them seriously enough. The result is that financial advisers facing disciplinary action from their employer can shop for another licensee to employ them. Dover Financial Advisers, for example, authorised three people as its representatives before conducting background checks and after those people themselves disclosed to Dover that other entities held serious concerns about their ability to provide financial advice. The AFA submission

³³¹ ASIC, *Submissions of the Australian Securities and Investments Commission Round 2: Financial Advice*, 7 May 2018, 16.

³³² ASIC, *Submissions of the Australian Securities and Investments Commission Round 2: Financial Advice*, 7 May 2018, 15–16.

³³³ ASIC, *Submissions of the Australian Securities and Investments Commission Round 2: Financial Advice*, 7 May 2018, 15 [77].

³³⁴ Exhibit 2.248, ABA Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol; Transcript, Louise Ann Macaulay. 27 April 2018, 1918–19.

³³⁵ ASIC, *Submissions of the Australian Securities and Investments Commission Round 2: Financial Advice*, 7 May 2018, 13 [64].

discussed the view that some licensees are considered by advisers with poor track records as ‘licensees of last resort’.³³⁶

Second, licensees and ASIC are not sufficiently sharing information about advisers. Licensees may fail to report, or report late, their concerns about an adviser’s conduct, which obviously impedes ASIC’s ability to enforce disciplinary sanctions on those that have breached the law. That is so even though, as Mr Hagger of NAB noted, licensees themselves depend on ASIC’s Financial Adviser Register for a definitive listing of banned advisers to indicate whether an adviser has a poor history.³³⁷ ASIC, however, noted that it ‘rarely if ever’ uses its power under Section 916G of the Corporations Act to disclose information about an adviser to a licensee.³³⁸ The licensee may therefore lack information necessary for it to determine how to supervise or monitor the adviser properly.

Third, neither ASIC nor licensees are sharing information with industry associations. Both the AFA and the FPA find out about members under ASIC investigation from media releases and news stories. Licensees almost never report their concerns about advisers to industry associations. The two associations do not share disciplinary information between them. Members of the public are generally unaware that the AFA and FPA exist, and are more likely to take their complaint to a dispute resolution body than report advisers to the industry bodies. The result is that industry bodies now have little basis on which to play any effective disciplinary role.

11.6 The new regulatory provisions

When the amended regulatory provisions come into effect, all advisers will be required to become members of a code monitoring body. Advisers will be prohibited from changing associations while under investigation by a monitoring body, and all breaches of the code will have to be reported to ASIC and the adviser’s licensee. Breaches of the code and any sanctions will be listed on the Financial Adviser Register.³³⁹

³³⁶ AFA, *AFA Response: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 7 May 2018, 19.

³³⁷ Transcript, Andrew Paul Hagger, 24 Apr 2018, 1672.

³³⁸ Exhibit 2.247, Witness statement of Louise Anne Macaulay, 25 April 2018, 13 [34].

³³⁹ Treasury, *Submission Hearings on Financial Advice*, undated, 15 [94].

In these ways, the new scheme will deal directly with several of the issues raised above. The requirement to share information is welcome. The restriction on advisers changing schemes mid-investigation should limit the evasion of disciplinary processes that is otherwise possible in a system where multiple bodies administer one code of ethics. However, advisers not under investigation but looking for a lighter touch will still be free to switch monitoring bodies. **The consistency between various code monitoring bodies in enforcing discipline will therefore be important.**

It is important to recognise the proper place of the proposed Code of Ethics. Professional codes are not laws. Codes of ethics are important to fostering public confidence and practitioner integrity in a profession. They are composed by industry practitioners according to agreed industry processes. Laws, by contrast, are the product of a public process conducted under the authority of democratic institutions. It is laws, and not codes of ethics, that are the proper repositories for basic norms of conduct. This qualitative disparity mandates a difference in approach to contraventions of each.

While codes of ethics have a part to play in setting professional standards of behaviour, the industry must be conscious of their boundaries. The **investigation and punishment of breaches of law should not be outsourced to private bodies. Licensees and industry bodies should not try to resolve breaches of law by advisers internally, but must notify ASIC or other appropriate authorities.** A breach of the code of ethics must not be allowed to obscure, or be treated as more significant than, a breach of the law.

Though laws and professional codes serve different normative purposes the discipline they impose can have similar objectives. Both ASIC and the FPA emphasised the protection of the public as their overriding disciplinary aim. For that reason, they may not take action, for example, against an unscrupulous adviser who has ceased to practice.

Disciplinary powers do have a protective aspect. In some cases protecting the public will be a critical aspect of disciplinary action. But the imposition of discipline in a civil or even a professional setting usually, by analogy with criminal sentencing, serves multiple and sometimes contradictory purposes. Among those purposes will ordinarily be purposes of punishment, denunciation, and the identification of conduct that breaches applicable norms. To characterise disciplinary action as serving *only* to protect the public is wrong. Not only is the characterisation wrong, it is a fallacy that

hides the need for regulatory bodies to give proper weight to the other purposes that are to be achieved by taking regulatory action.

12 Issues that have emerged

The issues that emerged in connection with financial advice related to:

- culture and incentives;
- conflicts of interest and duty, and confusion of roles; and
- regulator effectiveness.

The first of those themes, culture and incentives, includes issues about the culture of particular parts of the financial services industry, such as **mortgage brokers**, financial advisers, and point of sale agents for consumer lending. But it also includes more specific issues about the culture created and maintained by particular entities. And running through all of those issues are questions about how industry participants are paid (including how bonuses and other incentives are calculated).

The second theme, conflict of interest and duty, and confusion of roles, is closely related to the first. It includes issues about FoFA's treatment of conflicts of interest as conflicts that can, and should be, 'managed' (by advisers and licensees meeting the 'best interests duty' and giving the client's interests priority over the interests of the adviser and licensee). The second theme goes further, however, and requires consideration of structural considerations. In particular, the second theme draws attention to consequences that appear to be related to, if not stem from, some entities being vertically integrated, in the sense that the entity manufactures and sells **financial products** while, at the same time, advising clients which products to use or buy. And the second theme also embraces the issues that emerged in the first round of hearings about the confusion of roles and responsibilities of, for example, mortgage brokers and **mortgage aggregators**.

The third theme, regulator effectiveness, directs attention to what responses regulators can make, and what responses regulators should make, to conduct of the kinds examined in the Commission's hearings. A necessary part of the second branch of that inquiry (what responses regulators should

make) is to consider whether (with all the benefit of hindsight) the responses that were made have proved to be satisfactory.

The particular issues can be further identified as including:

- How does a financial adviser's employer encourage provision of sound advice (including, where appropriate, telling the client to do nothing)?
- How do advice licensees encourage advisers aligned with the licensee to provide sound advice (including, where appropriate, telling the client to do nothing)?
- Can conflicts of interest and duty be managed?
- How far can, and how far should, there be separation between providing financial advice and manufacture or sale of financial products?
- Should financial product manufacturers be permitted to provide financial advice?
 - At all?
 - To retail clients?
- Should financial product sellers be permitted to provide financial advice?
 - At all?
 - To retail clients?
- Should an authorised representative be permitted to recommend a financial product manufactured or sold by the advice licensee (or a related entity of the licensee) with which the representative is associated?
 - At all?
 - Only on written demonstration that the product is better for the client than comparable third party products?

- Should the grandfathered exceptions to the **conflicted remuneration** provisions now be changed?
 - How far should they be changed?
 - If they should be changed, when should the change or changes take effect?
- Should the life risk exceptions to the conflicted remuneration provisions now be changed?
 - How far should they be changed?
 - If they should be changed, when should the change or changes take effect?
- Should any part of the remuneration of financial advisers be dependent on value or volume of sales?
- Should all financial advisers (including those who now act as authorised representatives of an advice licensee) be licensed by ASIC?
- Are current product and interests disclosure requirements sufficient to allow customers to make fully informed choices?
- Should the period after which a client must positively review an ongoing fee arrangement be reduced from two years to one?
- Should platform operators be permitted to deduct fees on behalf of licensees without the express authority of the client of the platform operator?
- When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?
- When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidents of misconduct?

- Should negotiation and settlement be the main approach for a regulator?
- Should there be greater focus on general deterrence in regulatory strategy?
- Should a component of **enforceable undertakings** be the acknowledgment of specific wrongs?
- Should self-reported breaches of the Corporations Act generally attract legal sanctions unless some special circumstances exist?
- Should banning orders continue to be preferred to civil penalty proceedings in case of licensee/adviser misconduct?
- Should ASIC make more use of its Section 916G power to give a licensee information about a person who is or will be a representative of the licensee?
- Does Section 916G need to be amended so as to be more effective?
- Should there be more focus on criminal proceedings against licensees rather than individual advisers?

4. Small and medium enterprises

Introduction

Round 3 of the Commission's hearings looked at some issues arising from banks dealings with small and medium enterprises (SMEs).

Small and medium enterprises are very important to Australia's economy. Most businesses in Australia are small businesses, no matter which definition of that term is used. Small businesses represent about 97.5% of all businesses operating in Australia¹ and employ about 44% of people in the private, non-financial sector.² Those statistics reflect the number of businesses, not their size. And most small businesses are indeed very small. The majority employ no one at all; those that do, generally employ fewer than four people.³

1 What is an SME?

I say 'no matter which definition ... is used' because there are many definitions of what is a small business. Definitions differ between, and even within, statutes. They differ between government and industry entities.

The *Corporations Act 2001* (Cth) (the Corporations Act)⁴ and Section 12BC of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) apply certain protections to small businesses, defined as

¹ FSRC, *FSRC Background Paper No. 12: Financial Services and Small and Medium-Sized Enterprises*, 14 May 2018, 7.

² FSRC, *FSRC Background Paper No. 12: Financial Services and Small and Medium-Sized Enterprises*, 14 May 2018, 9.

³ FSRC, *FSRC Background Paper No. 12: Financial Services and Small and Medium-Sized Enterprises*, 14 May 2018, 8.

⁴ Corporations Act s 761G.

those employing fewer than 20 employees, or if manufacturing businesses, fewer than 100. But Section 12BF of the ASIC Act and the *Competition and Consumer Act 2010* (Cth),⁵ providing unfair contracts protections, define a small business as one with fewer than 20 employees and a contract with an upfront price of less than \$300,000, or if the contract lasts more than 12 months, a price of no more than \$1 million. The *Australian Small Business and Family Enterprise Ombudsman Act 2015* (Cth) gives the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) jurisdiction over small businesses employing fewer than 100 people or taking in less than \$5 million yearly in revenue.⁶ The *Fair Work Act 2009* (Cth) provides different unfair dismissal provisions for businesses employing fewer than 15 people.⁷ The *Income Tax Assessment Act 1997* (Cth) provides access to certain concessional treatment in the tax laws for entities that have a turnover of less than \$10 million.⁸ The Australian Bureau of Statistics collects information about small businesses defined as those employing fewer than 20 people.⁹ The Australian Financial Complaints Authority (AFCA) will apply a definition of 100 or fewer employees.

Then there are definitions applied by the banking industry. The 2013 Code of Banking Practice (the Code) defines small business as a business having fewer than 20 employees, or 100 employees if it is a manufacturing business. It provides that if the banking service provided is a **financial product** or service regulated under Chapter 7 of the Corporations Act, the Code only applies to 'retail clients' within the meaning of the Corporations Act.¹⁰ The 2019 Code will define a small business as one having three characteristics: an annual turnover of less than \$10 million in the previous financial year; fewer than 100 full time equivalent employees; and, less than \$3 million total debt to all credit providers (including amounts undrawn, all loans applied for and the debt of all related entities that are businesses).¹¹

⁵ ASIC Act s 12BF; *Competition and Consumer Act 2010* (Cth) sch 2 s 23.

⁶ *Australian Small Business and Family Enterprise Ombudsman Act 2015* (Cth) s 5.

⁷ *Fair Work Act 2009* (Cth) s 23.

⁸ *Income Tax Assessment Act 1997* (Cth) s 328-110.

⁹ ABS, 8155.0 – *Australian Industry, 2016–17* (25 May 2018) ABS <www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/8155.0Glossary12016-17?opendocument>.

¹⁰ 2013 Code cl 42.

¹¹ 2019 Code cl 1.

Practice within banks varies. CBA adopts the 2013 Code definition for the purposes of lending.¹² ANZ lending to small business is subsumed into its ‘commercial lending’ category, which also includes medium sized business and generally goes up to loans of \$10 million.¹³ Westpac’s business bank includes an SME business unit that distinguishes between ‘Micro SMEs’, which employ four or fewer employees and borrow up to \$250,000, and ‘SMEs’, which have business turnover of less than \$5 million and lending requirements of up to \$3 million.¹⁴ NAB generally categorises SME lending as up to \$50 million, and segments those customers based on various characteristics relating to the complexity of their requirements and business structures.¹⁵ Bank of Queensland (BOQ) and Bankwest both define small businesses as those borrowing up to \$1 million.¹⁶

1.1 Harmonise the definitions?

There appears to be little appetite to choose one or two of these definitions and apply it or them more generally. The Productivity Commission has said that a single definition is not desirable, as it may lead to inflexibility and higher costs.¹⁷ And even if that were not so, there may be little point in seeking uniformity for its own sake.

Even so, two general points should be made. First, no matter what definition is adopted for use in a particular context it should be cast in terms that will enable the proper pursuit of the relevant policy objectives. That is, the definition that is adopted should identify the field of operation of the relevant provisions in a way that is appropriate to the purposes being pursued by those provisions. It is not immediately apparent to me that all the different definitions that have been used in legislation or other instruments reflect clear identification of the reason or reasons that have led to drawing the boundary of operation of the relevant provisions at the particular points

¹² Exhibit 3.130, Witness statement of Joanna Charlene White, 8 May 2018, 3 [16].

¹³ Exhibit 3.129, Witness statement of Isaac James Christian Rankin, 8 May 2018, 3 [12].

¹⁴ Exhibit 3.132, Witness statement of Alastair Derek Dawson Welsh, 8 May 2018, 3 [12].

¹⁵ Exhibit 3.131, Statement of Howard William Silby, 23 May 2018, 4–5 [10]–[11].

¹⁶ Exhibit 3.133, Witness statement of Douglass Robert Snell, 8 May 2018, 6; Exhibit 3.134, Witness statement of Sinead Taylor, 8 May 2018, 3 [17].

¹⁷ Productivity Commission, *Regulator Engagement with Small Business*, September 2013, 14.

chosen. Second, as explained in Chapter 8, legislative complexity can lead to difficulties in supervision and enforcement. It can cause the regulated community to lose sight of what the law is intending to achieve and instead see the law as no more than a series of hurdles to be jumped or compliance boxes to be ticked. Whatever definition of small business is chosen, someone will be able to point to a case that lies at the edge of the definition. Lines must therefore be drawn. But the fewer the lines, the easier the law is to administer and the easier it is for the regulated community to understand when particular provisions of the law are engaged.

1.2 Why treat small businesses differently?

Small businesses can be seen to resemble consumers in several ways. Like consumers, small businesses lack the bargaining power and resources of larger entities. They may only have limited access to legal and financial advice. The financial dealings of the business and the business owner's understanding of finance may be relatively unsophisticated. There may be substantial overlap between the finances of the small business and the personal finances of its owner, most commonly because personal assets are offered as security for a business loan. In the case of sole traders, who constitute many of Australia's small businesses, there is no legal distinction between the sole trader and the business, and the owner is personally responsible for the business's debts. And small businesses, like consumers, accept the services of banks largely on the basis of standard form contracts, which typically have strongly favoured the interests of banks.

What then is the current legal framework?

2 The current framework

The responsible lending provisions of the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act) do not apply to lending for business purposes. In particular, the provisions of Section 128 of the NCCP Act prohibiting an Australian credit licensee from entering a credit contract with a consumer without making an assessment that the credit contract will not be unsuitable for the consumer does not apply. The hardship, pre-contractual disclosure, price regulation, and enforcement provisions of the National Credit Code (NCC) do not apply. Financial services entities that are not engaged wholly or predominantly in personal, domestic or household

credit or credit for investment in residential property are not required to hold an **Australian Credit Licence** (ACL). It follows that entities providing credit only for business purposes need not conform with the ACL requirement to be a member of an approved **external dispute resolution** (EDR) scheme. But about 80% of small business lending is provided by the major banks, who do hold licences.¹⁸

The policy choices that have been made to limit the application of these statutory regimes reflect recognition of the need to ensure small businesses have access to reasonably affordable and available credit. The extension of protections has been judged likely to restrict the circumstances in which banks may lend and likely to limit the banks' capacity to reduce credit risk when they do lend, thus restricting the supply of credit and increasing its cost. This has been seen as especially the case where credit is sought for a new business (for which there can be no trading records) and the lender seeks security for the loan either from the principals of the business or from a **third party guarantor**, or, often enough, both.¹⁹ There has been reluctance, therefore, not least on the part of small business owners themselves, to take up proposals for increased protections. And the small business representatives consulted in the course of the Khoury Review of the Code of Banking Practice (discussed in Section 2.1, below) said that they did not have concerns about irresponsible lending to small businesses.²⁰

There are important provisions that do apply to lending to small businesses. In particular, some provisions of the ASIC Act that apply to consumers apply also to lending to small businesses. The ASIC Act prohibits misleading conduct in relation to financial services.²¹ It prohibits unconscionable conduct in connection with the supply or possible supply of financial services to a person other than a listed public company.²² The ASIC Act also implies a number of terms into contracts for the supply of financial services where the services under the contract were acquired for use or

¹⁸ Treasury, *FSRC Background Paper No. 11: Request for Information Reforms to Small Business Lending*, 9 May 2018, 5.

¹⁹ Phil Khoury, *Independent Review Code of Banking Practice*, 31 January 2017, 49 [8.4.2].

²⁰ Phil Khoury, *Independent Review Code of Banking Practice*, 31 January 2017, 49 [8.4.2].

²¹ ASIC Act ss 12DA, 12DB, 12DC, 12DF.

²² ASIC Act ss 12CA, 12CB.

consumption in connection with a small business.²³ The implied terms warrant that services will be rendered with 'due care and skill'²⁴ and will be reasonably fit for any purpose made known to the supplier.²⁵

Since November 2015, the ASIC Act has provided that unfair terms in standard form small business contracts for financial services and financial products are void.²⁶ The provisions apply where at least one party is a business employing fewer than 20 people and the upfront price of the contract is no more than \$300,000, or if the contract has a duration of longer than 12 months, \$1 million.

Eight months after these provisions commenced operation, and following reviews by ASIC and ASBFEO of small business loan contracts offered by the four major banks, those banks agreed to remove a number of standard clauses considered 'unfair'. Clauses removed included entire agreement clauses; broad indemnification clauses; unilateral variation clauses; and, except in respect of certain specialised industries, financial indicator covenants.

It is also necessary to recall that general law principles may be engaged in the relationship between small businesses and their banks. A contract will almost always govern the parties' relationships. Equitable doctrines may operate in cases where there has been an abuse of power, other doctrines may apply to require lenders to perform their services with reasonable care. In rare circumstances, a bank might be found to have undertaken some fiduciary duties to its customer.

The evidence and submissions provided to the Commission did not reveal any great appetite to change the legal framework. In particular, I did not understand there to be substantial support for changing the legal framework in ways that would bring some or all SMEs within the application of the NCCP Act.

The chief protection for small business borrowers, however, has been, and remains, the Code. And, as will later be seen, the chief focus of attention in

²³ ASIC Act s 12ED, read with the definition of 'small business' in s 12BC(2).

²⁴ ASIC Act s 12ED(1).

²⁵ ASIC Act s 12ED(2).

²⁶ ASIC Act s 12BF.

the case studies in this round of hearings was upon the application of the Code and its requirement that a bank considering making a loan will exercise the care and skill of a diligent and prudent banker. In considering what emerged from those case studies it is, therefore, necessary to begin by saying something about the Code.

2.1 The Code of Banking Practice

The Code is prepared and published by the Australian Banking Association (ABA). The ABA is a voluntary association of 24 banks that carry on business in Australia. The Association says that it ‘works with government, regulators and other stakeholders to improve public awareness and understanding of the industry’s contribution to the economy and to ensure Australia’s banking customers continue to benefit from a stable, competitive and accessible banking industry’.²⁷

The Association first published a code of banking practice in 1993. The Association did not require its members to apply the code, but many members, including the four largest banks, said publicly that they would comply with its provisions. From time to time, the code was amended. A new edition of the code was published in 2013.

In 2016, as part of its ‘banking reform program’, the association appointed Mr Philip Khoury to review the Code.²⁸ (The Sedgwick Review was conducted as part of the same program.²⁹) Mr Khoury told the Commission that he was asked to review the Code from the perspective of what stakeholders wanted from banks and what would help restore trust in the banking industry. Mr Khoury rightly described the Code as a document that sets out the promises the industry makes to its customers. He said that, in his view, the Code as it stood when he began his review ‘was really written from the point of view of the banks’ and ‘was not accessible for consumers because, in many cases, it was not clear what the promise was’.³⁰ Mr Khoury said that he understood his task in reviewing the Code as being to make significant ‘transformational’ changes to the Code that would help

²⁷ ABA, The Australian Banking Association’s Role <www.ausbanking.org.au/About-Us/The-ABA>.

²⁸ Transcript, Anna Maria Bligh, 31 May 2018, 2912–3.

²⁹ Transcript, Anna Maria Bligh, 31 May 2018, 2913.

³⁰ Transcript, Philip George Khoury, 21 May 2018, 2023.

restore trust in the banking industry.³¹ Mr Khoury gave the association his final draft of the Code in early February 2018.³²

Section 1101A of the Corporations Act permits ASIC to approve codes of conduct that relate to any aspect of the activities of financial services licensees, authorised representatives of **financial services licensees** or issuers of financial products ‘being activities in relation to which ASIC has a regulatory responsibility’. Although Section 1101A was inserted in the Corporations Act in 2001,³³ the ABA did not seek ASIC’s approval of any of the several versions of the Code published by the Association before Mr Khoury’s review.

The Chief Executive Officer of the ABA, Ms Anna Bligh, told the Commission that, over a number of months before and after Mr Khoury submitted his report, members of the Association gave consideration to submitting the Code to ASIC, for its approval.³⁴ The Association decided to submit the Code for approval by ASIC because ‘providing the code ... to a body outside the industry, in this case a regulator, may well add public reassurance that this code was a code that would be of benefit to customers, that it had been assessed, and that it had been developed in accordance with appropriate regulatory guidelines’.³⁵ (Ms Bligh’s reference to ‘regulatory guidelines’ was to ASIC’s Regulatory Guide 183: Approval of Financial Services Sector Codes of Conduct. It is enough to notice that it states, as ‘key criteria for code approval’ that, among other things, the code should provide ‘effective and independent code administration’; it should be ‘enforceable against subscribers’; it should provide that ‘compliance is monitored and enforced’; it should have ‘appropriate remedies and sanctions’; and, there should be a ‘mandatory three-year review of code’.³⁶)

Having received Mr Khoury’s draft of the Code, the ABA made some changes to the draft and submitted the revised draft to ASIC for its approval.

³¹ Transcript, Philip George Khoury, 21 May 2018, 2023.

³² Transcript, Anna Maria Bligh, 31 May 2018, 2913.

³³ *Financial Services Reform Act 2001* (Cth).

³⁴ Transcript, Anna Maria Bligh, 31 May 2018, 2914.

³⁵ Transcript, Anna Maria Bligh, 31 May 2018, 2914.

³⁶ ASIC, Regulatory Guide 183: Approval of Financial Services Sector Codes of Conduct, March 2013, 6 [183.12].

ASIC and the association had not completed their discussions about the revised draft when the Commission took evidence during its third round of hearings.

Ms Bligh identified the chief point of debate between the ABA and ASIC as being the Code's proposed definition of a 'small business'. As already noted, the ABA proposed to define a small business as one that, at the time it obtained the relevant banking service met three criteria: annual turnover of less than \$10 million in the previous financial year; fewer than 100 full-time employees; and, less than \$3 million total debt to all credit providers (including amounts undrawn under existing loans, any loan being applied for and the debt of all of its related entities that are businesses).

Mr Khoury had proposed that it would be both simpler and better to have the Code govern loans to any business where the loan being applied for was less than \$5 million. He said, in evidence, that the test he proposed would be simpler for customers (and banks) to apply and that, adopting that test rather than the three-part test now proposed by the ABA would have a relatively small effect, extending the coverage of the provisions to an additional 10,000 or 20,000 businesses.³⁷

In July 2018, ASIC approved the draft that the ABA submitted. The new code is to commence on 1 July 2019 and is called 'The Banking Code of Practice'. It defines 'small business' in the manner proposed by the ABA.

Four points underpin any consideration of the Code. First, it is a document that has been written for the industry to put forward as a statement of a voluntary code of its practice. Second, the Code proceeds from the premise that the rules it sets out are consistent with, but go beyond the requirements of, the applicable law. Third, the Code sets out rules and principles that signatories to the Code identify as precepts that those who deal with banks can expect banks to follow. That is, the Code sets out standards of behaviour that the banks accept members of the community can expect banks to follow. Fourth, intermediate courts of appeal have held that relevant provisions of the Code can be incorporated in, and form part of, a contract of guarantee between a bank and a third party guarantor and, it may be assumed, can therefore be incorporated in, and form part of, the

³⁷ Transcript, Philip George Khoury, 21 May 2018, 2024–9.

loan contract between the bank and its customer.³⁸ (And the 2019 Code will expressly provide that the terms and conditions for banking services and guarantees to which the Code applies will include a statement to the effect that the relevant provisions of the Code apply to the service or guarantee.)³⁹ Chapter 17 (Clauses 49–61) of the 2019 Code is entitled ‘A responsible approach to lending’. Clause 49 says that ‘[i]f we are considering providing you with a new loan, or an increase in a loan limit, we will exercise the care and skill of a diligent and prudent banker’. Clause 51 provides that ‘[i]f you are a small business, when assessing whether you can repay the loan we will do so by considering the appropriate circumstances reasonably known to us about (a) your financial position; or (b) your account conduct’. And Clause 52 provides that ‘[w]e also owe an obligation to any guarantor of the loan to comply with the above paragraph in assessing the borrower’s ability to repay the loan’. (This last obligation, like the provisions of Clause 49 about exercising the care and skill of a diligent and prudent banker, must be understood in light of the Code’s definition of the words ‘you’ and ‘your’, as including a guarantor, or a prospective guarantor.)

The 2019 Code (like earlier versions) thus requires a bank considering the provision of a new loan or an increase in loan limit to exercise the care and skill of a diligent and prudent banker. This imposes on a bank a duty that the law would not otherwise impose. Ordinarily, parties negotiating a new contract must not mislead or deceive or act unconscionably, but neither party to the negotiation owes a duty to consider the interests of the counterparty when deciding whether to make the contract. In particular, neither party makes any promise that it has assessed whether the counterparty can perform the obligations that it assumes by making the contract.

By adopting the Code, banks recognise that failing to act as a diligent and prudent banker would act when deciding whether to make a new or increased loan will have consequences for the customer and any guarantor of the customer’s obligations. And, as noted above, intermediate courts of appeal have decided that the promises that banks make in the Code may be enforced as terms of the contract ultimately struck between the bank and a

³⁸ *Brighton v Australia and New Zealand Banking Group Ltd* [2011] NSWCA 152; *Doggett v Commonwealth Bank of Australia* (2015) 47 VR 302; [2015] VSCA 351.

³⁹ 2019 Code cl 2.

guarantor of the customer's obligations. That is, the obligations voluntarily assumed by the banks by their subscribing to the Code have been given legal effect.

When considering a loan proposal, a diligent and prudent banker will consider whether the borrower is likely to be able to comply with the terms and conditions of the loan. If periodical payments are required, can the borrower make those payments? If the loan is for a term, is it likely that the borrower will be able to repay on time? There is, however, always a risk of default. It is for the diligent and prudent banker to decide what the risk is and whether that is a risk that the bank is willing to undertake.

It seems to me to follow from providing that a bank owes to the borrower and any prospective guarantor a duty to exercise the care and skill of a diligent and prudent banker, that the content of the duty is formed in an important respect by what the hypothetical banker would regard as an acceptable level of risk. And that is not necessarily identical in every respect with a particular lender's appetite for risk. In many, probably most, cases, there would be no relevant difference between the objectively determined level of acceptable risk and the risk appetite of a particular entity. But that may not always be so. I say that because, in the past, there have been cases where particular banks have pursued certain kinds of lending more aggressively than other market participants. In such a case there may be some room for debate about whether the hypothetical diligent and prudent banker would have approved the relevant transaction.

That a borrower defaults in performing the loan agreement does not, without more, show that the lender did not act as a diligent and prudent banker. When a loan is provided to allow the borrower to start a new enterprise, there will always be a risk that the business does not prosper and that the borrower may default.

It is, therefore, unsurprising, that banks lending to SMEs seek security for the debt. If the borrower has no satisfactory security to offer, it is unsurprising that the bank will seek not only third-party support for the loan from a guarantor of the principal debtor's obligations but also security for the guarantor's performance of his or her obligations as guarantor. When the borrower is a small or medium enterprise, the borrower may have no security to offer other than the principal's family home. If the bank seeks third-party support, beyond the immediate participants in the enterprise, the guarantor will often be related to the principal of the enterprise that is

to borrow. If the guarantor is a parent of the principal of the enterprise, and the guarantee is to be secured, the security may be the parent's residence. If the venture fails, and the loan cannot be repaid, realisation of the security provided by the principal of the business or by a relative of the principal will have very serious consequences for whomever provided that security.

Unsurprisingly, there was, therefore, a deal of attention paid in both evidence and submissions to whether any change should be made to law or practice relating to voluntary guarantees with respect to SME lending. These issues are considered later. Before doing that, it is important to record what the entities told the Commission about their conduct in connection with SME lending.

3 Conduct acknowledged by the entities

As previously noted, a large number of entities were asked, at the start of the Commission's work, to provide submissions setting out misconduct and conduct falling short of community standards and expectations they had identified as occurring during the previous 10 years. Before the Round 3 hearings, a further request, specific to small businesses, was sent to ANZ, BOQ, CBA, Macquarie Bank, NAB and Westpac asking whether there was any feature of their earlier responses that those entities wished to point to as relating to SME lending, and inviting those entities to add to their responses specifically in relation to SME lending. The entities made the following disclosures.

3.1 ANZ

In its SME-specific submissions, made in April 2018, ANZ acknowledged that it has engaged in misconduct and conduct falling below community standards and expectations in relation to SME lending.

In particular, ANZ acknowledged misconduct or conduct falling below community standards and expectations in relation to applications for business loans. And ANZ identified instances where frontline staff engaged in inappropriate sales practices in an effort to increase incentive payments,

including selling or referring customers to unsuitable products, some of which involved SME lending.⁴⁰

In addition, ANZ identified instances where its staff or representatives were involved in submitting false information in connection with loans and loan applications.⁴¹ For example, in its first, January 2018 submissions, ANZ acknowledged that, in 2017, two ANZ business banking managers were found to have been colluding with external third parties to make 47 fraudulent loans. One was dismissed, the other resigned during the disciplinary process.⁴²

In its SME-specific submissions, ANZ also acknowledged misconduct or conduct falling below community standards and expectations in cases where business loan arrangements had been varied or come to an end. It said that, in some instances, dealings between its collection team and customers breached the Code of Banking Practice and the ASIC debt collection guidelines.⁴³ ANZ also identified concerns raised by the Financial Ombudsman Services (FOS) of systemic issues in failing to suspend collections activity once a dispute was before the ombudsman, including in connection with SME lending.⁴⁴

3.2 BOQ

In both its January 2018 submissions and its SME-specific submissions, BOQ acknowledged that, following the initiation of a product review program, a number of issues had been identified with respect to the incorrect charging of fees and interest that also affected business

⁴⁰ ANZ, *Small-Medium Enterprise Lending ANZ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 4–5 [22].

⁴¹ ANZ, *Small-Medium Enterprise Lending ANZ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 4 [21].

⁴² ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 32 [6.74].

⁴³ ANZ, *Small-Medium Enterprise Lending ANZ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 5 [26].

⁴⁴ ANZ, *Small-Medium Enterprise Lending ANZ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 5 [27].

customers.⁴⁵ BOQ said that there had been instances in which guarantees for SME loans were taken from and sought to be enforced against guarantors who claimed not to have understood the effect of the guarantee or their waiver of independent legal advice, including where guarantees were given by relatives of an SME borrower.⁴⁶ In addition, it identified instances, before some risk framework developments and enhancements were made in 2012, where complaints had been made about BOQ's assessment of the ability of an SME borrower to service an SME loan.⁴⁷

BOQ identified circumstances where business loan arrangements had been varied or come to an end: instances in which it did not provide an extensive period of notice before taking action against a borrower in default, giving rise to complaints about the adequacy of the notice provided;⁴⁸ and instances in which it did not provide an extensive period of notice of the expiry of a small or medium enterprise facility giving rise to complaints about the adequacy of that notice.⁴⁹ In identifying these instances, BOQ emphasised that the bona fide reliance on contractual terms should not be seen as conduct falling below community standards and expectations.

In its January 2018 submission, BOQ told the Commission that about 3,200 external dispute resolution cases involving the FOS had been taken against it between 2009 and 2017.⁵⁰ In its later specific submission, BOQ elaborated that some of those cases included complaints by SME lending customers that were resolved in favour of the borrower.⁵¹ Nevertheless,

⁴⁵ BOQ, *BOQ Response to the Royal Commission's Letter dated 15 December 2017*, 29 January 2018, 10–11 [59] (a), (c), (g), (h); BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 2 [9].

⁴⁶ BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 3 [17].

⁴⁷ BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 4 [30].

⁴⁸ BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 3 [21].

⁴⁹ BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 4 [25].

⁵⁰ BOQ, *BOQ Response to the Royal Commission's Letter dated 15 December 2017*, 29 January 2018, 23 [154].

⁵¹ BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 3 [12].

BOQ said that it did not consider that it had identified any systemic problems in the conduct of its SME lending business.⁵²

3.3 CBA

CBA identified instances in which customers had raised concerns in relation to applications for business loans. In its SME-specific submission, CBA made particular reference to two decisions of the Supreme Court of Victoria concerning business loans the bank had made: *Doggett v Commonwealth Bank of Australia*, and *Doggett and Doggett v Commonwealth Bank of Australia*.⁵³ The court held, both at first instance and on appeal, that CBA had breached the then applicable provision of the Code (by not exercising the skill and care of a diligent and prudent banker) and that the guarantors of the business facility were not liable to the bank.⁵⁴

CBA also identified in its RiskInSite data:

- 59 instances of provision of a business lending product for a potentially ineligible purpose that did not comply with a policy or business rule;
- 17 instances of inadequate or inaccurate disclosure being made to customers in relation to an SME lending product;
- 16 instances relating to loan conditions including servicing;⁵⁵
- 5 instances in which customers have raised concerns relating to account management; and
- 25 incidents relating to fee and interest inaccuracy including some incidents that involved multiple customers.⁵⁶

⁵² BOQ, *BOQ Submission in Response to the Commission's Letter dated 5 April 2018*, 17 April 2018, 5 [33].

⁵³ *Commonwealth Bank of Australia v Doggett* [2014] VSC 423; *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351.

⁵⁴ CBA, *Business Lending CBA Response to the Royal Commission's Letter dated 5 April 2018*, 17 April 2018, 6 [27]–[28].

⁵⁵ CBA, *Business Lending CBA Response to the Royal Commission's Letter dated 5 April 2018*, 17 April 2018, 6–7 [29].

⁵⁶ CBA, *Business Lending CBA Response to the Royal Commission's Letter dated 5 April 2018*, 17 April 2018, 7 [31].

In connection with this last class of events, CBA pointed to a notification by FOS, on 6 October 2017, of what FOS considered to be a systemic issue in connection with the charging of interest on both business overdrafts, and what CBA called 'Simple Business Overdrafts' on business transaction accounts. FOS pointed to what it said was double debiting of interest.⁵⁷

CBA had first identified a problem of this kind in 2013. In 2015 it paid compensation to customers and made what it thought to be a sufficient change to its computer systems. But the change did not wholly solve the problem. And this became apparent from the dispute in FOS that lay behind FOS's notification of a systemic issue. Additional cases of double debiting interest were identified.

The double debiting of interest was the subject of one of the case studies in the third round of hearings.

CBA also notified the Commission of an incident, shortly before the Round 3 hearings, in which it identified that CBA and Bankwest merchant customers may have been charged fees for merchant facilities provided to them despite the customers not using or ceasing to use those facilities. CBA said that it had notified ASIC of the issue and was continuing to investigate it.⁵⁸

CBA's SME-specific submissions showed that, since 2010, CBA had had 196 cases in FOS relating to business financial or SME lending issues with FOS having a view adverse to CBA in 86 of those cases.⁵⁹ More particularly, CBA acknowledged concerns where business loan arrangements had been varied or come to an end and gave details of 24 cases where FOS had a view adverse to CBA, including business customers experiencing financial difficulty.⁶⁰ CBA acknowledged that the experience of one customer, who had made a submission to the loan

⁵⁷ CBA, *Commonwealth Bank of Australia and Its Associated Australian Entities (Group) – Revised Table (1)*, 22 March 2018, 57 [307].

⁵⁸ Letter from Jane Couchman, CBA, to Chris Green, ASIC, 15 May 2018.

⁵⁹ CBA, *Business Lending CBA Response to the Royal Commission's Letter dated 5 April 2018*, 17 April 2018, 8 [40].

⁶⁰ CBA, *Business Lending CBA Response to the Royal Commission's Letter dated 5 April 2018*, 17 April 2018, 9 [40] (f).

impairment inquiry conducted by the Parliamentary Joint Committee, had been poor.⁶¹

3.4 Macquarie Bank

Macquarie Bank's SME-specific submissions identified 23 complaints, from 16 business banking customers, since 1 January 2012, relating to:

- unsuitable lending (2 complaints);
- financial hardship or proposed enforcement action (15 complaints); and
- declined applications and guarantees (6 complaints).⁶²

Macquarie Bank also identified 679 complaints from customers of its Macquarie Leasing Pty Ltd and Macquarie Equipment Rentals Pty Ltd entities, of which:

- 29 complaints were identified by customers as relating to 'maladministration';
- 217 related to 'financial difficulty'; and
- 75 related to 'processes'.⁶³

One of the instances relating to maladministration concerned a man's complaint about Macquarie Leasing's provision of finance for a purchase by his son of a luxury imported vehicle for business purposes, on the basis that his son had psychological issues that prevented him from making sound financial decisions at the time. Macquarie Leasing resolved the complaint by taking back the vehicle and waiving the shortfall.⁶⁴

3.5 NAB

NAB did not aggregate instances of misconduct or conduct falling below community standards and expectations in relation to SME lending, instead

⁶¹ CBA, *Business Lending CBA Response to the Royal Commission's Letter dated 5 April 2018*, 17 April 2018, 8 [33].

⁶² Macquarie Group, *SME Lending Request*, 17 April 2018, 5 [14].

⁶³ Macquarie Group, *SME Lending Request*, 17 April 2018, 6 [16]–[17].

⁶⁴ Macquarie Group, *SME Lending Request*, 17 April 2018, 6 [19] (b).

identifying 180 events recorded in their internal risk reports relevant to business lending. A review of the events identified by NAB showed that there were four recurring issues:

- first, incorrect disclosure of interest rates and interest calculated incorrectly resulting in clients being over charged;
- second, duplication of or incorrect disclosure of fees;
- third, defects with the provision of customers and guarantor consent, including consent forms missing from files or being provided after a loan had been granted or consent received after application; and
- fourth, failures to complete credit checks.

In its January 2018 submission, NAB acknowledged some specific instances of misconduct in relation to SME lending. It referred, in particular, to litigation in the Supreme Court of Victoria (*NAB v Rice*⁶⁵ and *NAB v Rose*⁶⁶) in which the court found, in 2015, that NAB had failed to give a customer prominent notice of certain matters before execution of the guarantees, including, in particular, that the customer should seek independent legal and financial advice.⁶⁷

As part of a program to review Code compliance, NAB identified in 2016/2017, that it may not be able to demonstrate that appropriate warnings and disclosures had been made to guarantors in compliance with Clause 31 of the Code. This matter was reported by NAB to the Code Compliance and Monitoring Committee in its annual compliance statements. The committee found that NAB had breached the Code when procuring guarantees prior to 2016.⁶⁸

⁶⁵ *National Australia Bank Ltd v Rice* [2015] VSC 10.

⁶⁶ *National Australia Bank Ltd v Rose* [2016] VSCA 169.

⁶⁷ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, 6 [2]; see also *National Australia Bank Ltd v Smith* [2014] NSWSC 1605.

⁶⁸ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, 6 [2].

3.6 Suncorp

Suncorp's submissions to the Commission acknowledged instances of conduct falling below community standards and expectations, of which two related to business banking. Suncorp acknowledged in its January 2018 submission that between 14 November 2015 and 10 March 2016, it failed to issue approximately 54,000 system-generated letters to retail and small business loan customers due to human error. This affected about 31,000 individual accounts. Suncorp reported this to ASIC as a breach of the National Consumer Credit Code. In December 2016, Suncorp and ASIC agreed to resolve the matter by ASIC issuing 20 infringement notices with a non-negotiable penalty of \$270,000.⁶⁹

The second matter acknowledged by Suncorp was an error, identified in 2015, in relation to Suncorp's systems and controls with respect to margin call facilities that had exposed borrowers to incorrect margin calls totalling about \$4 million.⁷⁰

3.7 Westpac

Westpac provides business lending under several different brand names: Westpac, St George, Bank SA, Bank of Melbourne and Capital Financial Australia.

In relation to applications for business loans, Westpac said in its SME-specific submission that it had identified examples where business bank customers may have been offered customer loans for personal purposes but the loan had been assessed as a business loan when it should have been offered and assessed as a loan within the scope of the NCCP Act. At the time of the Round 3 hearings, Westpac had told ASIC about the issue and was still in the process of identifying its scope.⁷¹

Westpac acknowledged a number of matters relating to business loans being varied or coming to an end. It referred to issues relating to collection

⁶⁹ Suncorp, *Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 29 January 2018, 8–9 [1.3].

⁷⁰ Suncorp, *Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 29 January 2018, 10 [1.7].

⁷¹ Westpac, *Response of Westpac Banking Corporation Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 20 April 2018, 14 [88].

functions performed by Westpac and third parties on Westpac's behalf, including three instances of inappropriate enforcement action being taken against borrowers.⁷² It identified incidents where it did not verify the customer's financial information, did not appropriately test serviceability, did not follow appropriate process in meeting the customer face-to-face, or made errors in the origination of loans in the incorrect stream.⁷³ It referred to several FOS cases in which it had failed properly to consider or respond to a customer's notification to the bank about their financial distress with the consequence that it had continued with enforcement action rather than working with the customer.⁷⁴

Over all, Westpac identified 98 instances of matters being referred to EDR in relation to business banking.

4 The voluntary guarantor

Because third party guarantees are commonly taken in support of loans to small or medium enterprises, the general law principles that affect whether the guarantee is enforceable are important.

The **general law has always been careful of the position of the volunteer**: the person who enters a transaction from which he or she stands to gain no benefit. Some guarantees of SME loans are given by volunteers, often enough by a person related to the principal of the business.

In certain circumstances, well-established principles of law and equity will prevent a creditor enforcing a guarantee signed by a volunteer (a voluntary guarantor). In *Commercial Bank of Australia Ltd v Amadio* the High Court held it would be unconscionable to allow the bank to enforce a

⁷² Westpac, *Response of Westpac Banking Corporation Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 20 April 2018, 13 [85] (a).

⁷³ Westpac, *Response of Westpac Banking Corporation Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 20 April 2018, 13–14 [85] (f).

⁷⁴ Westpac, *Response of Westpac Banking Corporation Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 20 April 2018, 15 [90] (d).

guarantee given by the parents of a borrower because the bank's employee had shut his eyes to the misconduct by which the son had procured his parents to give the guarantee.⁷⁵ In *Garcia v National Australia Bank Ltd* the High Court held that it would be unconscionable to allow the bank to enforce a guarantee of a company's obligations given by the wife of the principal of the company when the bank had not taken steps to explain its content and effect or have a third party do so.⁷⁶ Though the wife was both a shareholder and director of the company, her participation was nominal rather than substantial and she was, therefore, treated as a volunteer.

Echoes of those decisions sounded loudly in Westpac's lending policy documents explored during the evidence given in connection with one of the case studies undertaken in this round of evidence (concerning a guarantee given to Westpac by Ms Carolyn Flanagan). The policy placed much emphasis on whether a prospective guarantor stood to benefit from the transaction being considered and on the need for the guarantor to receive independent legal advice. The case itself raised a number of separate but related issues about whether there are cases where a volunteer cannot given an enforceable guarantee, and if there are, how those cases would be defined. Those issues are identified more fully at the end of this chapter.

5 Responsible lending

The Commission considered several different case studies about responsible lending. The chief general issue that emerged from those case studies can be identified as being what inquiries a diligent and prudent banker should make when deciding to lend to an SME. More particularly, to what extent may the banker take the business case presented by the loan applicant at face value? Is the banker to do more than conduct such checks and stress testing of assumptions made in the business case as the lender's policies require?

⁷⁵ *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447.

⁷⁶ *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395.

6 More general issues

The most general issue that was raised by the whole of the hearings about SME lending is whether there should be any change to the present legal framework governing those loans. I have said already that I did not understand there to be substantial support for changing the legal framework in ways that would bring some or all SMEs within the application of the NCCP Act. But I mention that matter again in case there are those who seek to persuade me to the contrary.

Three further issues did arise.

The first can be described as an issue about power and communication. Much of the dissatisfaction that SME borrowers have expressed (in the course of evidence and submissions in the Commission and more generally) about their dealings with lenders can be traced to two related sources: one about power; the other about communication. Borrowers came to recognise, both during the life of the loan and later, that the lender had what they saw as 'all the power' and they had none. And borrowers did not understand, and were not told, why the lender took the steps that it did when bringing the loan to an end.

The second issue can be described as a competition between regulation and self-regulation. Are the issues that arise when a loan is brought to an end to be resolved by reference only to the terms of the agreement that was made when the loan was made or renewed? Apart from existing rules prohibiting unconscionable conduct and rendering unfair contract terms void, should there be some additional rules that govern what a lender can or cannot do before it brings a loan to an end or it seeks to enforce repayment?

The third issue is narrower. If a lender makes a loan that a prudent and diligent lender would not have made, what should an EDR like FOS (now the Australian Financial Complaints Authority – AFCA) direct the borrower and the lender to do?

Again, each of these issues arose out of, and were well-illustrated by the case studies undertaken in the hearings. The issues about power and communication were examined in the cases of Bank of Melbourne and Mr Bradley Wallis and NAB and Mr Ross Dillon. They were issues that ran

through all of the four Bankwest case studies about loans to entities associated with Mr Michael Kelly, Mr Stephen Weller, Mr Michael Doherty and Mr Brendan Stanford.

Many of the case studies, especially those relating to Bankwest, raised issues about how a lender may bring a loan to an end or enforce repayment. My sense of the evidence and submissions, however, was that there was no substantial support for changing the legal framework in a way that would prevent a lender enforcing its rights under a loan agreement or in a way that would oblige a lender to make some fresh loan after an existing loan has expired. For some time there has been debate about lenders relying on non-monetary defaults to bring about the termination of a loan contract. But the 2019 Code will set limits on the use of provisions of that kind. Assuming that the contractual terms relied on are not unenforceable under the unfair contract terms provisions of the ASIC Act, and assuming further that reliance on the terms is not affected by the 2019 Code, are there any circumstances in which termination and renewal of a loan contract should be governed except by the general law of contract?

Whether the reach of either the unfair contract terms provisions or the small business provisions of the 2019 Code should be extended is an altogether separate issue. Given the nature and extent of the debate that appears to have been had between ABA and ASIC about the definition of small business in the 2019 Code, is the debate to be regarded as now closed? The evidence led in the Commission fell short of persuading me that the simpler definition that had been put forward by Mr Khoury (with a monetary limit of \$5 million, not \$3 million) should not be preferred. And that view was reinforced by the case studies looked at in connection with business lending to agricultural enterprises.

The third set of issues was illustrated by the case study about the Lows and BOQ. One of several loans made by BOQ was found by FOS to have not been made responsibly. The loan was for a term of years. The borrower had had the use of the money. Despite the conclusion that the loan should not have been made, was the loan to be allowed to run its course? If it was to be repaid sooner, how long should the borrower have to repay?

7 Issues that have emerged

The most general issues emerging from consideration of lending to small and medium enterprises can be identified as being:

- **Should there be any change to the legal framework governing small and medium enterprise (SME) lending?**
- **In particular, should any lending to SMEs come within the reach of the *National Consumer Credit Protection Act 2009 (Cth)* (the *NCCP Act*)?**

The other issues calling for consideration can be described by reference to the following themes:

- **the content of Code of Banking Practice obligations;**
- **third party guarantors; and**
- **dispute resolution approaches by the Financial Ombudsman Service (FOS) and the Australian Financial Complaints Authority (AFCA).**

The first of these themes, the content of Code of Banking Practice obligations, concerns the meaning in particular of two obligations set out in the Code: first, the requirement that a bank providing a loan or limit increase will do so exercising the care and skill of a diligent and prudent banker, and second, the requirement that a bank assess whether a small business customer can repay a loan based on their financial position and account conduct. Submissions in response to this round of hearings demonstrated disagreement about the bounds and content of these obligations. That is significant given that they are the obligations that provide most practical protection to small businesses seeking funding from subscribing banks.

The second theme, **third party guarantors**, draws into sharp focus the disconnect between how the law, and lenders, may treat third party guarantors (as interested, or at least, rationally motivated actors) and the reality of the role played by many if not most guarantors of small business (family members assisting their loved ones in their plans). The questions raised here attempt to balance these inconsistent models, a task made more difficult by the central and perhaps irreplaceable role played by

guarantors in securing funding for small businesses and the particular vulnerability of small businesses to failure.

The third theme, dispute resolution approaches by FOS and AFCA, relates to the outcomes available to consumers who successfully seek intervention by a dispute resolution body. This round of hearings demonstrated that customers who were wholly or partly successful in their claims nonetheless sometimes struggled to achieve what they believed was a satisfactory outcome. If those beliefs were unrealistic, it is important to explore why. This theme encompasses the approach both of FOS and, necessarily, the approach of banks to the resolution of claims.

The issues can be amplified as follows:

7.1 Code of Banking Practice

- What inquiries should a diligent and prudent banker make when deciding whether to lend to an SME?
- Does ‘forming an opinion about the customer’s ability to repay the loan facility’ as required by Clause 51 of the 2019 Code involve bringing critical analysis to the cash flow forecasts and other business plan documents presented by customers?
- If so, what level of analysis is acceptable?
- Is it enough that the lender satisfy itself the borrower can repay the loan and that the business plan is not obviously flawed?
- Is the standard set out in Clause 51 of the 2019 Code, which requires a bank to determine whether a customer can repay a loan based on their financial position and account conduct, a sufficient standard?

7.2 Guarantees

- If established principles of judge-made law and statutory provisions about unconscionability would not relieve a guarantor of responsibility under a guarantee, and if, further, a bank's voluntary undertaking to a potential guarantor to exercise the care and skill of a diligent and prudent banker has not been breached, are there circumstances in which the law should nevertheless hold that the guarantee may not be enforced?
- What would those circumstances be?
- Would they be defined by reference to what the lender did or did not do, by reference to what the guarantor was or was not told or by reference to some combination of factors of those kinds?
- Is there a reason to shift the boundaries of established principles, existing law and the industry code of conduct?
- If the guarantor is a volunteer, and if further, the guarantor is aware of the nature and extent of the obligations undertaken by executing the guarantee, is there some additional requirement that must be shown to have been met before the guarantee was given if it is to be an **enforceable undertaking**?
- Should lenders give potential guarantors more information about the borrower or the proposed loan? What information could be given with respect to a new business?

7.3 External dispute resolution

- Should AFCA adopt FOS's approach of putting the borrower back in the position they would be in if the loan had not been made, but not awarding compensation for losses or harm caused?
- Are there circumstances in which AFCA should waive a customer's debt?

5. Bankwest and CBA

Introduction

Before the third round of hearings began, the Commission had received 43 public submissions from former customers of Bankwest. Taken together, the submissions alleged that, after CBA acquired Bankwest in December 2008, it had acted improperly by terminating, not renewing, or in some cases not increasing, performing business loan facilities that Bankwest had granted. It was said that the premature termination of performing loans was 'engineered'.

The complaints are not new. They have been made in litigation between Bankwest and borrowers and the courts have rejected the allegations. They have been made in other forums. CBA has always denied that it acted improperly. The complainants sought to re-agitate their complaints in the Commission.

1 The complainants' conundrum

Most of those who complained about CBA's conduct had suffered significant loss when the business loans they had obtained from Bankwest came to an end. They complained about how they had been treated. But in support of their individual complaints they pointed to how many other Bankwest business loans had been dealt with in ways that they suggested revealed a pattern of improper conduct. In particular they said that the losses inflicted on individual customers could be judged by how many loans CBA defaulted and how many millions of dollars of loans CBA wrote off after the Bankwest acquisition.

But there is a conundrum at the heart of the allegations.

The complaints that are made all proceed from the premise that, contrary to the judgments that CBA made at the time, and contrary to the facts as they unfolded, the individual loans were all sound. But, as will be seen, the loans, in fact, were not sound and were not all well-secured. Both CBA and HBOS

accepted at the time of the sale that there were problems with the Bankwest business loan book, as a result of which the sale price was discounted. For the purposes of the sale price adjustment mechanism, Ernst & Young (EY) concluded that the loan provisions should be increased (potentially leading to a price decrease), although other countervailing adjustments resulted in a small increase to the purchase price. Over time, CBA had to increase the provisions it made for impairments, including over loans that had been performing at the time of the takeover. CBA's auditors considered the increase of the provisions to be prudent. Eventually, in terms of the quantum, CBA wrote off more on the Bankwest commercial loans that were in place at the time of the takeover than it benefited from through the discount to the price.¹

So if, contrary to the facts as they unfolded, the loans were sound and well-secured, why would CBA deliberately set out to bring the loans to an end?

What motive could it have for 'engineering' default or not extending a loan if the borrower was meeting what was due and the loan was well-secured? What motive could CBA have to act in ways that would not maximise its profit from the transaction?

Over the course of the years since CBA acquired Bankwest, several theories have emerged as suggested answers to these questions. First to emerge was the clawback theory. It was said that CBA did what it did to reduce the amount it had to pay for Bankwest. Sometimes, it was said that loans were defaulted to give CBA a claim against HBOS plc, a UK bank, for breach of warranties given in the sale and purchase agreement. More recently, a **'Tier 1 Capital Ratio theory'** has emerged. It is said that CBA did what it did because doing so improved its Tier 1 Capital Ratio (or its 'economic capital' generally) or because doing so somehow helped CBA meet some unspecified 'regulatory' or 'prudential' requirements. And even more recently it has been suggested that CBA acted as it did because, having bought Bankwest cheaply, it could afford to write down the value of the loan book it thus acquired. That is, having paid less than the face value of the loans it acquired, writing off the loans it did still left CBA profiting from the acquisition.

The clawback theory (and its variant about claiming on warranties) is demonstrably false. So too, the Tier 1 Capital Ratio theory (and its variants

¹ Exhibit 3.2, 10 November 2015, Letter from CBA, 3.

referring generally to ‘economic capital’ or ‘regulatory’ or ‘prudential’ requirements) are demonstrably false. And common to those, and the ‘CBA got a bargain’ theory is the fact that each theory would prove too much. Each theory asserts, expressly or implicitly, that CBA did what it did to inflict harm on itself. That is, each theory asserts that CBA did not make the decisions it made about individual loans by reference to the circumstances affecting *that* loan; instead, CBA decided not to renew that loan, and others, or decided to enforce that loan, and others, so that CBA could derive some other advantage either by sustaining a loss in respect of the loans it brought to an end or by making less profit.

None of the theories, if true, would make commercial sense. The conundrum remains unanswered.

To explain why the theories are false it is necessary to say something about the acquisition of Bankwest, then something about earlier inquiries and consideration of these issues and finally deal directly with why the theories are false.

2 The Bankwest acquisition

Bankwest, formerly called the Bank of Western Australia Ltd, was the State Bank of Western Australia. In 2003, a subsidiary of the UK bank, HBOS plc, acquired Bankwest.

In the years that followed, Bankwest was heavily dependent on funding from its UK parent. But, like many other European and American banks, HBOS was badly affected by the Global Financial Crisis (GFC). In mid-September 2008, Lloyds TSB announced a proposal to acquire HBOS and, soon after the sale of HBOS, the UK Government took a 40% stake in the merged entity. HBOS decided to sell Bankwest.

The sale took place at a time of great fear about the global financial system. There had been a crisis in the United States sub-prime market in 2007. Lehman Brothers collapsed in September 2008. The GFC was upon us.

CBA agreed to buy Bankwest. There was no time for any prolonged due diligence. The sale agreement was made on 8 October 2008 and it provided for an initial purchase price of \$2.1 billion to be paid on 19 December 2008.²

The sale was subject to regulatory approval. Approval was granted by the Australian Competition and Consumer Commission (ACCC) on 10 December 2008.³ The Treasurer of the Commonwealth approved the sale on 18 December 2008.⁴

The principal asset of Bankwest was its loan book. The initial purchase price reflected a significant discount on the net assets of Bankwest. The inescapable conclusion is that both the vendor and purchaser regarded the true value of the business loan book as being much less than the face value and so accepted that there were issues with the 'quality' of the business loans that had been written by Bankwest. As will be seen, this assessment by the two parties to the transaction was correct, although eventually CBA wrote off more on the Bankwest business loans in place at the time of the takeover than the value of the discount to the price it paid for the loans.

The sale agreement provided a mechanism for adjustment of the initial purchase price. The adjustment was to be made by reference to the financial accounts of Bankwest as at the settlement date of 19 December 2008. HBOS was to provide its calculation of the adjustments necessary and, in the absence of agreement, the sale agreement provided a mechanism for resolution of the dispute and finalisation of the amount of the adjustment by expert determination.

On 19 February 2009, HBOS gave CBA a draft completion balance sheet for Bankwest as at 19 December 2008. The draft completion balance sheet was accompanied by price adjustment calculations and by an unqualified audit report by KPMG. CBA was required to give notice by 20 April 2009 whether it agreed or disagreed with the content of the draft completion

² Exhibit 3.200, 8 October 2008, Share Sale Deed, 20 [4.1]; CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 32 [181].

³ See ACCC, *Public Competition Assessment: Commonwealth Bank of Australia – Proposed Acquisition of Bankwest and St Andrew's Australia*, 10 December 2008, 1[1].

⁴ See Wayne Swan, Deputy Prime Minister and Treasurer, 'Proposed Acquisition of Bank of Western Australia and St Andrew's by the Commonwealth Bank of Australia' (Media Release, No. 144, 18 December 2008).

balance sheet and the price adjustment calculations. CBA gave notice that it disagreed with 22 items in the draft completion balance sheet.

HBOS and CBA tried to resolve the differences by negotiation and some were agreed. On 5 June 2009 the parties instructed EY to determine the remaining disputed items. EY completed its determination on 7 July 2009. The result was an increase of \$26.1 million in the price payable by CBA. That is, the final price paid by CBA was \$2,126.10 million. The figure of \$26.1 million was the balance resulting from increases and decreases that reflected EY's determination of the several disputed items.⁵ Of those disputed items, two related to impairment of loans. One related to the amount that should be allowed as *specific* provisions in respect of particular loans; the other related to the level of *general* provision that should be made in respect of some classes of loans. Taken together, the two items relating to impairment of loans accounted for a \$156.45 million price decrease,⁶ but they were more than netted out by other disputed items that EY determined required increasing the price. The amount of the adjustment (\$26.1 million) was much less than the provision (\$328 million) that CBA had made in its 31 December 2008 half yearly accounts for the outcome of the price adjustment mechanism.⁷

What then happened in connection with Bankwest's business loans must be understood bearing three dates at the forefront of consideration:

- First, the critical date in the purchase agreement was 19 December 2008. That was the settlement date. The financial accounts used to determine price adjustments were Bankwest's financial accounts as at 19 December 2008. Those accounts were prepared by Bankwest and audited by Bankwest's auditors. EY's expert determination decided, among other things, what specific provisions and what general provisions should be made *as at that date* for impaired loans.

⁵ Exhibit 3.186, 7 July 2009, Expert Determination Report Pursuant to the Share Deed dated 8 October 2008 (as amended) Commonwealth Bank of Australia and HBOS Australia Pty Ltd, 11 [14], 118 [Part D].

⁶ Exhibit 3.186, 7 July 2009, Expert Determination Report Pursuant to the Share Deed dated 8 October 2008 (as amended) Commonwealth Bank of Australia and HBOS Australia Pty Ltd, 10 [2], [3].

⁷ Exhibit 3.187, 11 February 2009, CBA, Profit Announcement for the Half Year Ended 31 December 2008, 47.

- EY made its determination on 7 July 2009 but that was a determination of what it considered to be true and fair accounts of Bankwest as at 19 December 2008.
- CBA began its review of Bankwest's business loan book – called 'Project Magellan' – in about April 2010.⁸ Planning for the review seems to have begun in about February of that year.

3 Previous inquiries

As already noted, there have been several inquiries into CBA's actions in connection with Bankwest business loans. Those inquiries have included:

- the Senate Economics References Committee Inquiry during 2012 into 'The Post-GFC Banking Sector';
- the Inquiry by the Parliamentary Joint Committee on Corporations and Financial Services Inquiry on 'Impairment of Customer Loans';
- the Australian Securities and Investment Commission's (ASIC's) inquiries into allegations of misconduct in relation to commercial loans and engineered defaults; and
- the Australian Small Business and Family Enterprise Ombudsman's (ASBFEO's) Inquiry into Small Business Loans.

Parliamentary privilege precludes me from canvassing what was said to, or decided by, either of the Parliamentary inquiries.

In the course of preparing for the third round of the Commission's hearings, counsel and solicitors assisting the Commission considered documents produced by ASIC in response to notices to produce and they consulted with senior members of ASIC's Deposit Takers, Credit and Insurers team about reports of misconduct that ASIC had received and considered in relation to commercial loans. About half of the matters related to loan

⁸ Exhibit 3.111, Witness statement of David Cohen, 17 May 2018, 32 [137(c)]. There were other overlapping projects, including Project Sonic, which sought to implement a lower risk strategy with a preference for what was described by CBA as 'straightforward' banking.

defaults occurring in the 2009/2010 or 2010/2011 financial years. ASIC considered that concerns that banks had imposed unfair terms or used their strong bargaining position to disadvantage debtors could not be made out on the evidence presented. It described the number of reports of alleged misconduct in relation to commercial lending involving 'engineered' defaults as negligible. ASIC considered two particular cases where Bankwest had made loans and the borrowers alleged that CBA had acted wrongly after it acquired Bankwest. ASIC decided not to pursue regulatory or enforcement action in relation to any of the matters reported to, or considered by it because it concluded that there was not sufficient evidence of misconduct to take further action.

In September 2016, the Minister for Small Business asked the ASBFEO to inquire into small business loans. Among other things, ASBFEO considered 23 particular cases and conducted a 'deep dive' review of eight selected cases. Of those eight cases, only two concerned business loans by Bankwest. Both related to property development. One of the two Bankwest business loans examined by ASBFEO was for more than \$170 million. During the inquiry the ASBFEO consulted business owners and stakeholders, including business owners in the case studies being reviewed, customer advocates of the four major banks, and regulators. The ASBFEO conducted a number of hearings. Documents relating to those reviews were produced to the Commission in accordance with notices to produce. They were considered in the course of preparing for the hearing at which the issue of the takeover of Bankwest by CBA was ventilated.

The ASBFEO's report recorded that the Ombudsman considered that some of the cases examined raised 'very real issues where bank conduct is unacceptable and possibly unconscionable'.⁹ But, as Senior Counsel Assisting the Commission pointed out when opening the third round of the hearings, the Ombudsman told the Commission that, contrary to what may have been thought to be countenanced by her report, she considered that the so-called 'clawback' theory was false.¹⁰

I agree.

⁹ ASBFEO, *Inquiry into Small Business Loans*, 12 December 2016, 6.

¹⁰ Exhibit 3.188, ASBFEO, *The Need for Further Inquiry into BWA/CBA's Treatment of Corporate and SME Customers Post Acquisition of BWA*, undated, 4 [9.1].

Other, more particular, criticisms made of CBA's conduct in relation to the particular loans the ASBFEO examined are better considered in connection with the case studies that the Commission undertook.

In the courts, borrowers have made complaints of the same general kind as were made to the Commission. Some of those cases were settled. A class action remains pending in the Supreme Court of New South Wales. Two cases that have gone to judgment raised the clawback theory.¹¹

In the first case that went to judgment (*International Skin Care*) the borrower made allegations that amounted to a form of the clawback theory. The borrower alleged that the borrower's facilities, though not in fact impaired, had been classified as impaired so that CBA could obtain a reduction in the purchase price for Bankwest. These allegations were abandoned at trial. Nonetheless, the trial judge, Hammerschlag J, considered the allegations and said of them that there was no proper basis for the charges of dishonesty that had originally been levelled at CBA and its officers, but then abandoned.¹² It is not to the point that the allegations were abandoned by the plaintiff at trial, and their resolution was not necessary to the quelling of the plaintiff's dispute. Having all of the relevant evidence, Hammerschlag J decided that '[t]here was no evidence that impairment of any of [the relevant facilities] could, let alone did, have any downward effect on the price paid' by CBA for Bankwest.¹³

In the second case, the borrower initially had sought to advance the clawback argument that had been made in *International Skin Care* but had been abandoned during the trial of that action. The trial judge in this second case (again Hammerschlag J) recorded that, once *International Skin Care* was decided, the borrower in the second case, Mr Neale, had accepted that

¹¹ *International Skin Care Suppliers Pty Ltd v Commonwealth Bank of Australia* [2013] NSWSC 1768; *Neale v Bank of Western Australia Ltd* [2014] NSWSC 315 and, on appeal, [2015] NSWCA 272.

¹² *International Skin Care Suppliers Pty Ltd v Commonwealth Bank of Australia* [2013] NSWSC 1768 [605].

¹³ *International Skin Care Suppliers Pty Ltd v Commonwealth Bank of Australia* [2013] NSWSC 1768 [602].

the clawback argument was not correct.¹⁴ Instead the borrower sought to advance an argument that ‘once the Commonwealth Bank had taken over Bankwest, it set out on a deliberate course of targeting Bankwest’s customers, including himself, with the intention of harming them by fraudulently forcing them into default and selling them up at an undervalue’.¹⁵ Despite what Hammerschlag J said¹⁶ was the borrower’s ‘describing himself as a doctor who had to push to the front of the queue to help other victims of the Commonwealth Bank’s behaviour, of a Senate inquiry which had failed to provide an avenue for redress, and of the failure of the fraud squad to react to his complaints’, his Honour refused the borrower leave to amend his pleadings to raise these arguments. Among other things, Hammerschlag J said that ‘no rational basis was given why [CBA] would, to its own detriment, seek destruction of its subsidiary’s assets’.¹⁷ The borrower’s appeal to the Court of Appeal against the decision of Hammerschlag J was dismissed.¹⁸

Together the decisions show that the theories advanced in those cases were abandoned (but said by the judge to be unsupported by evidence) or found by the judge to be so insubstantial (‘no rational basis was given ...’) that permission to raise the allegation was refused.

4 Analysis of the various theories

CBA has long asserted that it acted for sound commercial reasons. In its profit announcement for the year ended 30 June 2010 CBA said that:

[CBA] identified many pre-acquisition loans [made by Bankwest] reflecting poor asset quality, high loan to value ratios and insufficient covenant coverage. This resulted in significant risk grade reassessments and

¹⁴ *Neale v Bank of Western Australia Ltd* [2014] NSWSC 315 [31]. Mr Neale has since told the Commission, more than once, that he considers that the clawback theory has no foundation.

¹⁵ *Neale v Bank of Western Australia Ltd* [2014] NSWSC 315 [24].

¹⁶ *Neale v Bank of Western Australia Ltd* [2014] NSWSC 315 [32].

¹⁷ *Neale v Bank of Western Australia Ltd* [2014] NSWSC 315 [40].

¹⁸ *Neale v Commonwealth Bank of Australia Ltd (t/as Bank of Western Australia)* [2015] NSWCA 272.

security revaluations with loan impairment expenses increasing \$304 million. These loans are confined to the pre-acquisition business banking book.¹⁹

This observation captures the central elements of CBA's answer to allegations that what it did in connection with Bankwest's business loan book was improper. CBA says that Bankwest's business loan book had loans of poor quality; that 'Project Magellan' was directed to identifying what loans were poor and what provisions should be made; and that 'Project Magellan' was conducted as it was, when it was, to allow CBA to prepare true and fair accounts as at 30 June 2010. In addition, as will be considered more closely in connection with particular case studies undertaken in the course of the third round of hearings, CBA says that it acted in individual cases in the prudent exercise of its contractual powers, albeit on occasion attended by conduct that it now concedes falls short of community standards and expectations.

As already noted, those who complain about CBA's conduct in connection with Bankwest describe CBA's conduct in different ways, but the central uniting thread is that CBA 'engineered' the default of 'performing' loans. The notion of 'engineering' default of an otherwise 'performing' loan calls for close and careful consideration. In some cases, the complaint is not that a loan was brought to a premature end, but that a term loan, having reached its expiry, was not renewed. In one case (to which I will return below) the complaint is that the loan, though then in default, was not only not renewed but was not increased by a further \$19 million. In other cases, the loan was 'performing' in the sense that the borrower was making repayments as and when due, but other provisions of the loan agreement (in particular, financial indicator covenants) were not being met.

Care must be exercised lest words like 'engineered' and 'performing' are used in ways that convey more than the underlying facts will support.

The importance of unpacking the expressions is emphasised by asking the question that has already been identified. Why would CBA 'engineer' default of otherwise 'performing' loans? If the loan was sound, adequately secured, and being serviced, why bring it to an end? Why do that if the probable,

¹⁹ Exhibit 3.189, 11 August 2010, CBA, Profit Announcement for the Full Year Ended 30 June 2010, 30.

even inevitable, consequence of doing so was that CBA would itself suffer loss?

As has already been said, several explanations have been offered. The explanations are not consistent one with another. Common to all has been an attempt to identify a reason for CBA systematically to default loans for a reason or reasons that are unconnected with CBA's judgment of the risks associated with the particular loan. That is, as Senior Counsel said in the course of opening this aspect of the third round of hearings, those who complain about CBA's conduct say that CBA acted with some ulterior motive.

The clawback theory has been described. It asserts that after acquiring Bankwest CBA acted deliberately to impair some loans so that it could 'clawback' the amount of the impairment from HBOS under the price adjustment mechanism.

There are at least four reasons to reject the allegation. As has already been emphasised, the price adjustment mechanism in the sale agreement directed attention to the state of Bankwest's accounts as at 19 December 2008. If an adjustment was to be made to the purchase price because a loan was impaired, that provision had to be one that ought to have been made in Bankwest's account as at 19 December 2008. That is, the loans relevant to the price adjustment mechanism were ones in respect of which provision should have been made immediately *before* CBA acquired Bankwest. CBA's conduct *after* acquisition was irrelevant to whether the loan was impaired at the relevant date.

Second, the suggestion that CBA defaulted loans after 19 December 2008 in order to render them 'impaired' as at 19 December 2008 fails to recognise the real and radical distinction between a loan being 'impaired' and a loan being in default. A loan is impaired if the lender concludes that there is doubt about whether the lender will recover the full amount lent. A loan may be impaired even if the borrower is not in default. And, conversely, a borrower may be in default but, if the bank has sufficient security to cover both the amount of the loan and the costs of recovery, the loan may not be impaired. If the loan is impaired, the lender should make a provision in its accounts to cover the expected shortfall. The lender may make specific provisions in respect of particular loans; the lender with a large book may make a general provision against the risk of non-performance of the book taken as a whole.

Third, nearly all of the complaints by Bankwest customers that the Commission has considered are directed to events occurring well after 7 July 2009. For the most part, the complaints concern events in 2010 or later. (The case of Mr Rory O'Brien, to which I refer below, is a notable exception.) EY had completed its expert determination under the price adjustment mechanism by 7 July 2009. Nothing done after that date, could have, or did have, any effect on that determination. The price adjustment mechanism had done its work. Subsequent events were irrelevant to the price adjustment process.

Fourth, the Commission's review of what was done in connection with the price adjustment mechanism lends no support to the clawback theory. EY made its own determination about whether loans in respect of which CBA said the accounts should make specific provision as at 19 December 2008 were properly regarded as impaired.

The Commission reviewed the submissions made by CBA to EY in respect of each of the loans that it submitted should be the subject of specific provision in the HBOS balance sheet as at 19 December 2008. The review showed no evidence consistent with CBA having taken any action in respect of any of the relevant loans in order to bolster its argument that provision should be made. Indeed, the fact that HBOS sought to decrease the relevant adjustment, by its draft completion balance sheet, provided on 19 February 2009, and CBA sought, by its response provided on 20 April 2009, to increase the provision is hardly surprising. The parties had directly opposed commercial interests. That was why it was necessary for EY to resolve the difference, as the sale agreement contemplated. In the event, EY concluded that the provisions should be increased, although other adjustments resulted in a price increase.

The clawback theory is untenable.

Likewise, it cannot be said that CBA acted as it did so that it could make some claim on warranties given by HBOS in the sale agreement. The short answer to the allegation is that CBA made no warranty claims that related to the loan provisioning.²⁰ This theory, too, is untenable.

²⁰ The warranty claims related to other matters, including technology licences and other information technology issues and in relation to various basis swap trades.

As has been noted, a different explanation for what is alleged to have been CBA's deliberate engineering of defaults in otherwise performing loans has emerged more recently. It is suggested that CBA took the steps it did in order to improve its Tier 1 Capital Ratio.

Again, the argument takes several different forms. The most common form suggested that the Board of CBA decided, in early 2009, to lift its internal Tier 1 Capital Ratio target to more than 7%. This decision is said to have created pressure on CBA management to improve the bank's Tier 1 Capital Ratio and it is suggested that, because CBA did not wish to raise capital, CBA had an incentive to impair or write off loans to improve its capital ratio. And describing the argument more generally, as CBA acting as it did to meet unspecified 'prudential' or 'regulatory' requirements, simply hides the substance of the allegation that is being made.

The Tier 1 Capital Ratio theory has several fatal flaws.

First, at December 2008 CBA had a Tier 1 Capital Ratio of 8.4%, the highest of the big four banks. If, as most versions of the Tier 1 Capital Theory have it, CBA was looking to raise its Tier 1 Capital Ratio above 7%, CBA was already well above that figure at the time it acquired Bankwest and CBA's Tier 1 Capital Ratio did not drop below 8.1% at any time thereafter. After the acquisition, CBA's Tier 1 Capital Ratio was 8.3% at March 2009, 8.1% at June 2009, 8.2% at September 2009 and thereafter was always greater than 9%.²¹

Second, at the relevant times, CBA was not avoiding raising capital. In March and September 2009, CBA issued \$405 million and \$688 million of ordinary shares to satisfy its dividend re-investment plans. In March 2009, it issued \$865 million ordinary shares with respect to a share purchase plan. In October 2009 CBA issued \$2 billion of PERLS V securities of which \$1.6 billion qualified as Tier 1 capital.²² Third, and most importantly, neither impairing a loan nor making a provision for impairment improves a bank's

²¹ Exhibit 3.1, undated, Attachment A: Tier 1 Capital Ratios, 2.

²² Exhibit 3.190, CBA, Basel II Pillar 3 – Capital Adequacy and Risk Disclosures: Quarterly Update as at 31 March 2009, 1; Exhibit 3.191, CBA, Basel II Pillar 3 – Capital Adequacy and Risk Disclosures: Quarterly Update as at 30 September 2009, 1; Exhibit 3.192, CBA, Basel II Pillar 3 – Capital Adequacy and Risk Disclosures as at 31 December 2009, 5. See also Exhibit 3.193, 11 August 2010, CBA, Annual Report 2010, 3, 45, 47, 161.

Tier 1 Capital Ratio: it reduces the bank's Tier 1 Capital Ratio.²³ Thus the consequence of systematically impairing loans would be to reduce the Tier 1 Capital Ratio, not improve it. Likewise, writing off a loan does not improve a bank's capital ratio.²⁴ And, CBA's write-offs in 2009 and 2010 were markedly smaller than in the years between 2011 and 2015.

Fourth, there is nothing in any of the material that CBA produced to the Commission that shows any connection between CBA's conduct in relation to the Bankwest commercial loan book and CBA's capital management of its Tier 1 Capital Ratio.

Finally, the maintenance by a bank of the prescribed Tier 1 Capital Ratio is a regulatory requirement. CBA could not be criticised for seeking to comply with this requirement. There is nothing 'ulterior' in such a motive; it is required by the regulator.

Putting the argument in some more general and abstract form, by saying that CBA acted as it did to improve its 'economic capital' (by reducing its exposure to risky loans) or to meet some unspecified 'prudential' or 'regulatory' requirements, makes the argument worse, not better.

In the context of banking, economic capital refers to the capital that a bank needs to protect against future losses. Economic capital is a measure of risk (whereas regulatory capital [Tier 1] is a measure of capital). It is used as a means of managing risk across different lines of business.²⁵ It follows that saying that a bank is motivated by improving economic capital consumption (by reducing risk) is akin to saying that the bank is motivated by managing

²³ APRA, *FSRC Background Paper No. 9: The Regulatory Framework for Authorised Deposit-Taking Institutions (ADIs)*, 27 April 2018; APRA, *FSRC Background Paper No. 13: The Regulatory Capital Framework: Impairment, Provisioning and Enforcing Security*, 18 May 2018; see also APRA, *Prudential Standard APS 220 Credit Quality*, January 2015.

²⁴ APRA, *FSRC Background Paper No. 13: The Regulatory Capital Framework – Impairment, Provisioning and Enforcing Security*, 18 May 2018.

²⁵ The Basel Committee on Banking Supervision, 'Range of Practices and Issues in Economic Capital Frameworks', March 2009, 8, defined economic capital as 'the methods or practices that allow financial institutions to consistently assess risk and to attribute capital to cover the economic effects of risk-taking activities'.

its risk. This is eminently prudent and so again, there is nothing ‘ulterior’ about such a motive.

The theory that CBA bought Bankwest for a bargain (one submission quantified it as CBA buying each dollar of loans for 73 cents in the dollar) and so could afford to write off loans is also untenable. There are two reasons.

First, unless it is assumed that CBA was irrational, there is no logical connection between the price CBA paid for Bankwest and how it managed loans after acquisition. I would expect that CBA managed loans after its acquisition of Bankwest for its commercial benefit. If it thought that it would achieve a better outcome by extending a loan then it would do so. If it thought that it would likely achieve a worse outcome if it extended a loan (for example because the value of an asset was likely to continue to deteriorate) then it would not extend the loan. The price it had paid for Bankwest was a sunk cost. Whether it had obtained a bargain or not did not affect future outcomes.

Second, the argument misunderstands the facts as they occurred. CBA eventually wrote off \$2.77 billion of the commercial loans held at 19 December 2008. Of that, \$630 million was accounted for in the loan impairment provisions as at 19 December 2008 (as allowed by EY).²⁶ The balance of \$2.14 billion was an additional loss not accounted for in the purchase price.

None of the several different reasons that have been advanced in support of the allegation that CBA deliberately engineered defaults of business loans made by Bankwest holds water. The complainants’ conundrum remains unsolved.

Why then did CBA act as it did? Mr David Cohen, Chief Risk Officer of CBA, gave evidence to the Commission about these matters. He said that CBA acted as it did for a combination of reasons reflecting four heads of concern:

- the overall quality of the loan book;
- there was an undue concentration of lending;

²⁶ Exhibit 3.2, 10 November 2015, Letter from CBA, 3.

- the quality of loan management; and
- the adequacy of provisioning.

First, it became apparent to CBA, soon after it acquired Bankwest, that there were problems with the quality of the business loan book. It must be borne in mind that, given the urgency with which the sale and purchase was made, CBA had no opportunity to conduct extensive due diligence inquiries. The vendor had to sell and sell quickly. CBA paid less than book value for Bankwest and took Bankwest as it found it. The vendor got the best price it could for what both vendor and purchaser evidently regarded as a poor loan book.

By March 2009, there had been a notable increase in the concentration of troublesome assets.²⁷ (CBA and Bankwest distinguished between ‘impaired’ assets and ‘troublesome’ assets. An impaired asset is a loan where the bank does not expect to recover the full proceeds of the loan and expects to make a loss. A troublesome asset is an asset that is not an impaired asset but where there is a concern about the health of the loan and ‘derives from a view that the likelihood of loss from that loan has increased’.²⁸) During 2009, Bankwest increased its provisions for losses in its business loan portfolio. Mr Cohen said that ‘these increases had not been anticipated by Bankwest or flagged to CBA in advance’.²⁹

Second, soon after CBA acquired Bankwest it learned that Bankwest had adopted a very aggressive strategy in lending with respect to commercial property, particularly in the eastern states.³⁰ At the time of CBA’s acquisition of Bankwest, 50% of Bankwest’s ‘non-retail exposures’ were ‘commercial property related’.³¹ CBA’s internal documents, particularly papers put to CBA’s Executive Risk Committee, showed, unsurprisingly, that the CBA group sought to manage, and limit, the Group’s exposure to commercial property lending. I say that is ‘unsurprising’ because, as Mr Cohen

²⁷ Transcript, David Antony Keith Cohen, 29 May 2018, 2726–7.

²⁸ Transcript, David Antony Keith Cohen, 29 May 2018, 2727.

²⁹ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 28 [120].

³⁰ Transcript, David Antony Keith Cohen, 29 May 2018, 2738–9.

³¹ Exhibit 3.116, 11 September 2009, Memorandum to Executive Risk Committee CBA, 1–2 [3.5].

explained, banks seek to mitigate risk by diversification, limiting concentration in lending to particular industries and particular geographic areas.³² To that end, CBA's Executive Risk Committee decided in December 2009 to introduce exposure caps for commercial property lending and to reduce Bankwest's property exposures.³³

Third, in light of the increases in provisions that were made during 2009, and the number of times increases were being made, CBA and Bankwest became concerned about three aspects of the management of Bankwest's business loans:

- the effectiveness of Bankwest's collective provisioning models and processes;
- the extent of monitoring and awareness of the health of the Bankwest business loan portfolios; and
- whether the Bankwest business loan portfolio was being credit rated and managed in accordance with CBA's standards.³⁴

Mr Cohen explained the third of these points as a concern first, that the credit ratings used by Bankwest when it was rating particular business loans were not being as diligently applied as CBA applied credit ratings and, second, that the day-to-day management of a loan by business relationship managers was not as active as it should have been.³⁵

A fourth concern arose out of the issues that had emerged about risk rating and loan management. Was there proper collective provisioning?³⁶ The amount allowed as a collective provision was calculated in a way that depended upon (among other things) the credit risk rating that was given to each particular loan in the portfolio. Hence, if the risk rating was not determined diligently and business relationship managers did not monitor

³² Transcript, David Antony Keith Cohen, 29 May 2018, 2731.

³³ Exhibit 3.116, 11 September 2009, Memorandum to Executive Risk Committee CBA, 2 [4.2].

³⁴ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 28 [121].

³⁵ Transcript, David Antony Keith Cohen, 29 May 2018, 2734.

³⁶ Transcript, David Antony Keith Cohen, 29 May 2018, 2735.

the health of outstanding loans, the amount to be allowed as a collective provision may be incorrectly assessed.

CBA responded to the issues that had emerged during 2009 in a number of ways. First, it added more resources to, and improved the operating procedures of, the 'Credit Asset Management' team within Bankwest. The Credit Asset Management team (often referred to as 'CAM') was the group that looked after troublesome and impaired loans. (In 2012 Bankwest's CAM team became part of CBA's 'group credit structuring' or GCS team.³⁷)

Second, in about April or May 2009, Bankwest introduced, for the first time, a 'watch list' of loans for which the 'credit health' had started to deteriorate and cause concern, but not to the point where the loan had become a troublesome or impaired asset.³⁸ An important purpose of the watch list was to try to prevent loans on the list reaching the point of being rated as troublesome or impaired.

Third, by September 2009, Bankwest had put in place revised caps on commercial property exposure. It was reported to the CBA Executive Risk Committee that Bankwest had committed to reducing its commercial property exposure from \$14.8 billion to \$14.25 billion by 31 December 2009 and to capping the exposure at that level through to December 2010. Bankwest also committed to reducing the level of non-retail assets that property services and construction then represented from 50.5% at 31st July 2009, to 45% by 31st December 2009 and to 40% by 31st December 2010.³⁹ Mr Cohen's evidence was that looking back, the introduction of these caps was a prudent response to Bankwest's over exposure to commercial property.⁴⁰ The commercial property exposure cap was reduced to \$13 billion in August 2011, and to \$12 billion in November 2012.⁴¹

In March 2013, it was reported that Bankwest's commercial property exposure had fallen from a peak of \$14.8 billion in July 2009, to \$9.8 billion

³⁷ Transcript, David Antony Keith Cohen, 29 May 2018, 2735.

³⁸ Transcript, David Antony Keith Cohen, 29 May 2018, 2736.

³⁹ Exhibit 3.116, 11 September 2009, Memorandum to Executive Risk Committee, 2 [4.2].

⁴⁰ Transcript, David Antony Keith Cohen, 29 May 2018, 2733.

⁴¹ Exhibit 3.120, 5 March 2013, Report to the CBA Executive Risk Committee, 1 [3.1].

at 31 December 2012.⁴² Most of that reduction had occurred by January 2011.⁴³

Between July 2009 and February 2010, 250 loans with a value of \$1.4 billion were transferred into CAM because they had been identified as being troublesome or impaired. CAM's task was to manage the loan to the point where either its credit rating improved such that it was no longer classified as troublesome or impaired (when the loan would be returned to the relevant business unit for continued management in the ordinary way) or, as Mr Cohen put it, to 'work with the customer to end the relationship in a normal way, such as when a loan matures, when it reaches expiry or through repayment by re-financing for example ... or if none of those were available then through enforcing as a last resort'.⁴⁴

In about February 2010, CBA began to plan a systematic review of the rest of Bankwest's business loan book. The project was called 'Project Magellan'. Project Magellan and its consequences lie at the heart of many of the complaints that former Bankwest customers make about CBA's conduct. One of the first steps that the Commission took when considering how to identify and deal with the allegations that have been made about CBA's conduct with respect to Bankwest was to require CBA to produce documents relating to Project Magellan. Counsel and solicitors assisting the Commission examined many thousands of documents relating to Project Magellan produced by CBA in response to notices to produce.

Project Magellan was a review of what was described as the 'good book' from Bankwest's business portfolio. The 'good book' was that part of Bankwest's business loan portfolio that had not been classified as troublesome or impaired. The purpose of the review was to determine whether the loans had been properly classified (as neither troublesome nor impaired) and to determine whether there should be an adjustment to the

⁴² Exhibit 3.120, 5 March 2013, Report to the CBA Executive Risk Committee, 1 [3.1], 4 [Figure 1].

⁴³ Exhibit 3.120, 5 March 2013, Report to the CBA Executive Risk Committee, 4 [Figure 1].

⁴⁴ Transcript, David Antony Keith Cohen, 29 May 2018, 2736–7; see also Exhibit 3.117, March 2010, Bankwest Business Watch List, Troublesome and Impaired Accounts Update.

amount of collective provision that should be made in respect of the 'good book'.⁴⁵

Accurate provisioning for impaired loans was then, and remains, important for two simple but compelling reasons. First, proper provisioning is necessary to satisfy prudential obligations. Second, proper provisioning is necessary to allow calculation of the loan impairment expense that should be taken into account in determining the amount of the profit to be recorded in the bank's financial statements and reported to the market.⁴⁶ At that time, the second requirement assumed significance; the end of the 2009/2010 financial year was fast approaching. Despite it being said in one submission that this urgency demonstrates some ulterior purpose, the need to prepare the bank's financial statements, and comply with its legal and other obligations, explains the urgency that attached to the review process being undertaken by the bank.

The files reviewed in Project Magellan met one or more of a long list of criteria. The criteria required review of accounts for all hotels and pubs, most exposures classified as property in Bankwest's commercial business, many accounts relating to aged care (including retirement villages), and land bank and property development businesses.⁴⁷ There were other criteria that, if met, required loans to be included in the Project Magellan reviews but their detail need not be noticed. For present purposes it is enough to notice that all hotels and pubs and many property loans were to be examined.

Project Magellan reviewed more than 1,100 customer groups. Exactly what proportion of Bankwest's business book was reviewed may be open to some doubt. Mr Cohen believed that it was more than half and may be as much as 60%. The exact percentage does not matter.⁴⁸ Many files were reviewed.

⁴⁵ Transcript, David Antony Keith Cohen, 29 May 2018, 2740–1.

⁴⁶ Transcript, David Antony Keith Cohen, 29 May 2018, 2741.

⁴⁷ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 29–30 [125].

⁴⁸ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 31 [133]–[134]; Transcript, David Antony Keith Cohen, 29 May 2018, 2740.

Project Magellan proceeded in three steps. First, relationship managers provided basic information about loans to be reviewed. The second step was taken by about 42 business credit specialists. Those specialists included CBA and Bankwest staff but also included staff from four external firms: Grant Thornton, Ferrier Hodgson, KordaMentha and PPB Advisory. These specialists reviewed the file, provided a risk assessment and risk grade and made a recommendation about future action.⁴⁹

At this second step, files were divided into those that were judged not to be high risk ('green') and those judged to be high risk ('red' or 'double red'). Files that were judged not to be high risk were not reviewed further. But those that were deemed to be high risk were reviewed by one of two review panels that could accept, reject or modify the recommendations made in the file review.⁵⁰

As a result of the reviews, 161 customer group files (about 15% of the files reviewed) were downgraded to the status of troublesome or impaired asset. These files were transferred to CAM.⁵¹ Of the files that were transferred to CAM, 31 were rehabilitated and returned to the relevant business unit; 37 were terminated by enforcement action of one kind or another; the remaining 124 files continued on the same or different terms. Of this last group of 124 files, 31 continued on the same terms; 93 continued on different terms. In cases where the loan continued, but on different terms, the changes made included extending the term of the loan, changing the pricing and changing the repayment arrangements. In some cases CBA increased the funding provided; in others the borrower agreed to sell assets.⁵²

As just noted, 37 of the files transferred into CAM were subsequently terminated by enforcement action. Of those 37 files, 10 were first in default of a monetary term; the remaining 27 were first in default of a non-monetary

⁴⁹ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 33 [139]–[140].

⁵⁰ Transcript, David Antony Keith Cohen, 29 May 2018, 2743; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 33 [139].

⁵¹ Exhibit 3.112, Supplementary witness statement of David Antony Keith Cohen, 17 May 2018, 2 [8].

⁵² Exhibit 3.112, Supplementary witness statement of David Antony Keith Cohen, 17 May 2018, 2–3 [8]–[11].

term (a description covering terms about insolvency events, as well as financial ratio requirements like loan-to-value ratios, interest cover or debt service ratios or minimum levels of earnings before interest, taxes, depreciation and amortisation [EBITDA]).⁵³ As Mr Cohen rightly said, breach of financial ratio requirements often indicate that a borrower's financial circumstances are deteriorating.

The statistics about Project Magellan do not support the contention that the reviews then undertaken were the first step along a path towards 'manufacturing' defaults of 'performing' loans. The 161 files transferred into CAM were only about 15% of the files reviewed. Only 37 of the 161 files transferred ended in enforcement action; 124 continued on the same or different terms.

PwC was Bankwest's auditor and reviewed and reported on the findings of Project Magellan. In particular, PwC reported to Bankwest's audit committee that, in increasing total provisions to \$2,089 million at 30 June 2010 (from \$1,281 million at 30 June 2009), management had 'applied a prudent approach in calculating loan loss provisions'.⁵⁴ PwC said in its report that the increase was 'largely a result of the outcome of Project Magellan and the continued deterioration in the Business Portfolio'.⁵⁵

What was done in Project Magellan is consistent with responding properly to legitimate concerns about the quality of Bankwest's business banking loan book. The repeated, and unforeseen, increases in provisions during 2009 warranted close attention to the quality of those loans that had not been classified as troublesome or impaired. Of course it may be observed that the reviews included loans for purposes that CBA had decided should not form so large a part of the combined CBA Bankwest business loan book as they then did. But it must also be recognised that Project Magellan was not confined to loans of those kinds and that Bankwest's auditors concluded that management had 'applied a prudent approach' in calculating loan provisions. In forming that view, PwC considered what had been done in

⁵³ Exhibit 3.112, Supplementary witness statement of David Antony Keith Cohen, 17 May 2018, 3 [12].

⁵⁴ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-69 [CBA.0002.1566.7527 at .7531].

⁵⁵ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-69 [CBA.0002.1566.7527 at .7531].

Project Magellan and dealt separately with collective provisions and individually assessed provisions. The process adopted in Project Magellan was described as ‘robust with a prudent outlook taken in light of recent experience’.⁵⁶

In respect of collective provisions, PwC noted that the revised risk grades and collateral values identified in Project Magellan had caused a significant increase in collective provisions but that the additional confidence gained in underlying data had allowed some changes in the method of calculating the amount to be allowed.⁵⁷ Tellingly, PwC noted that the amount of individually assessed provisions for Bankwest had continued to increase from \$620 million at 30 June 2009 to \$956 million at 30 June 2010. This was said to be ‘primarily due to the ongoing deterioration in the quality of the corporate portfolio’.⁵⁸ The reasons for deterioration had been revealed by Project Magellan.

Project Magellan found (among other things) that Bankwest had had aggressive risk appetite settings between 2006 and 2008, ‘with poor quality business written on the east coast and with a lack of ongoing management of files’.⁵⁹ It found that Bankwest had ‘relied on independent valuations, without due diligence, to support the business written at or near the top of the cycle in 2006–2008’.⁶⁰ It found that Bankwest had ‘placed heavy reliance on going concern valuations (based on future maintainable earnings) where businesses had not performed according to expectations and [on] security lending with an absence of identified servicing sources for property loans, especially land bank’.⁶¹ Nothing in the material the

⁵⁶ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-69 [CBA.0002.1566.7527 at .7532].

⁵⁷ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-69 [CBA.0002.1566.7527 at .7533].

⁵⁸ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-69 [CBA.0002.1566.7527 at .7533].

⁵⁹ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 33 [143(a)].

⁶⁰ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 33 [143(c)].

⁶¹ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 33 [143(d)].

Commission has examined shows any challenge to, let alone reason to doubt, these conclusions. It is then unsurprising that the quality of the 'corporate portfolio' or business loan book deteriorated.

There can be no doubt that CBA took steps to alter the structure of the business loan book that it acquired by taking over Bankwest. Nor can there be any doubt that, consistent with its intention to alter the structure of its business loan book, CBA chose not to renew some loans that had expired even where the borrower had not defaulted in performance of the expired loan. Some of those borrowers could not refinance. As the case study concerning Mr Michael Kelly, Wildlines Pty Ltd and Silversun Corporation Pty Ltd showed, even if CBA did not demand immediate repayment and the borrower was eventually able to refinance, the pressure to refinance, coupled with the price at which funds were made available, left the borrower feeling aggrieved.

Nor can there be any doubt that CBA did give notice of default to some borrowers and thereafter set about seeking to enforce its securities and recover the debt. Almost always the borrower and CBA both suffered loss. More often than not the effect of the loss was devastating for the borrower. And rarely, if ever, could the borrower accept that the optimism with which the borrower had embarked on the venture had proven to be misplaced. Almost always, the borrower looked for reasons beyond the immediate state of the business. And almost always, the borrower will blame the lender for not having let the business last just that little bit longer until it turned the corner towards success. And this borrower, too, will feel aggrieved.

In these circumstances, it should not be surprising that the sense of individual grievance, joined with the grievances of others, should spark allegations that the lender did not act according to the lender's judgments about the risks of continuing the loan to a particular borrower, but acted according to some overall plan that was at least improper if not unlawful. And this is what has happened with respect to CBA's conduct in relation to the Bankwest business loan book. Borrowers, seeing that others were dealt with and affected in ways that they regard as relevantly similar, have formed the unshakeable view that CBA's conduct towards them was wrong. They will not accept that CBA may have acted case by case, according to judgments made about each loan. Instead they seek to assign reasons for CBA's conduct that they say show how and why the conduct was wrong. And out of the search for improper reasons has grown first the clawback

theory and then the Tier 1 Capital Ratio Theory and their more generalised offspring. But both of the particular theories (and their offspring) are false.

Faced with demonstration that the theories are false, those who allege misconduct reframe the allegation as ‘engineering’ the default of ‘performing’ loans. Or they go so far as to reframe the allegation as an overall pattern of conduct by CBA that, seen as a whole, was ‘unconscionable’. Both of these ways of framing the allegation assert wrongdoing. But **both ways of framing the allegation hide so much more than they reveal.** Each is a proposition that depends on the content that is given to the critical terms. What exactly is meant by ‘engineering’ or ‘performing’? What are the considerations that make reliance on legal rights under the contract ‘unconscionable’? Is it said that there has been some taking advantage of the borrower? How? Is there said to be some other circumstance, or combination of circumstances that made reliance on the lender’s rights unconscionable? What is that circumstance, or combination of circumstances? None that has been put forward persuade me that CBA adopted an overall pattern of unconscionable conduct.

In the end, the borrowers’ complaints stem from a belief that ‘their’ bank should have ‘backed them’ further than it did. The sense of grievance is acute if the borrower can say that all instalments due under a loan that was not renewed had been paid in full and on time. And it would equally be so if the borrower to whom notice of default was given could say not only that there had been no monetary default but also that the default alleged in the notice was trivial. But in none of the cases examined by the Commission, in which there had been a notice of default, could the borrower properly say that the default assigned was trivial. Financial ratio covenants provide important financial indications of the overall health of the loan.

Whenever a borrower does not comply with the terms of a loan agreement, there comes a point where the lender must judge for itself whether acting now is more prudent than waiting to see what happens. And the loans that were not rolled over or renewed were all loans for a defined term that had expired. Any further loan required the lender and the borrower to make a new contract. The borrower could not demand that the lender agree. The lender had to judge whether it wished to make the loan and, if it did, at what price it would do so.

As the case studies show, CBA did not always act towards the borrowers concerned as well as it should have acted. But the defaults

revealed in the case studies fall very well short of showing that CBA engaged in deliberate conduct of the kind that those who continue to complain about its conduct allege.

5 Further submissions

The Commission received a number of further submissions in relation to the issue of the takeover of Bankwest by CBA after the conclusion of the third round of hearings. Six people were the authors of most of those submissions. Some of these people described themselves as victims of CBA's conduct. Others presented as speaking for such victims. Some of the submissions challenged conclusions that Senior Counsel Assisting had submitted were or were not open to me. Some of those who made submissions complained that they had not had the opportunity to give evidence before the Commission and said, in effect, that their evidence would have proved that CBA had an ulterior motive. Others said that the time that the Commission spent on this issue was inadequate.

Some of the submissions appeared to me to proceed from misconceptions about the Commission's tasks. To ensure that interested persons were given the opportunity to put forward any further matters that they considered relevant, and to ensure that I had not overlooked any relevant considerations, I said, at the start of the fourth round of hearings:

Since the conclusion of the third round of hearings, a number of persons have written to the Commission about [matters relating to CBA and Bankwest]. Some of these have suggested that insufficient time was devoted to that matter; that more case studies should have been examined. It was explained by Counsel Assisting, both in the opening and the closing of that round, [that] the work of the Commission regarding the CBA takeover of Bankwest to that date had been intensive and was not limited to consideration of the circumstances of the four witnesses who gave evidence.

Some of these further communications have also proceeded from the premise that it is the Commission's role to advance the interests of those who describe themselves as Bankwest's victims. That, of course, misunderstands the role and the duty of a Royal Commissioner, which is to inquire, without fear or favour, into matters falling within the terms of reference. Neither I, nor Counsel Assisting, or the solicitors assisting the Commission, carry any brief for those who assert a grievance arising from

the takeover of Bankwest or, indeed, any other issue. We are here to inquire.

Another misconception which has appeared in many of these further communications is that findings have already been made by me. They have not. Counsel Assisting has made submissions as to the findings that they submit are open on the basis of the evidence heard during the course of the third round of hearings, but I have not yet made any findings. My findings about these matters and my reasons as to why those decisions are ultimately made are matters to be dealt with when I report in accordance with my terms of reference, a task that remains some time away, and in the meantime, the Commission continues to consider, and will keep under constant review, how best it should execute the tasks committed to it by the Letters Patent.

Now, with that in mind, additional information which is received by the Commission will be carefully considered. To facilitate that process, we have indicated to those who have written to the Commission in recent weeks about the Bankwest matter that, if there are additional matters that they wish to raise with the Commission, they should do so. However, we have made clear that we will derive most assistance if those who take up this invitation focus on identifying matters which have not already been raised with us and identifying evidence, not mere assertions and conjecture, that is said to be relevant to the consideration of these matters. Of course, I will bear well in mind that any additional material raised by this process may, in turn, trigger procedural fairness obligations in favour of other persons.

After I made this statement at the commencement of the fourth round of hearings, I received further submissions from various interested persons. I have considered those submissions carefully and will say something about all of them.

The person who provided the most extensive further submissions was Mr Rory O'Brien. Mr O'Brien considers himself to be a victim of CBA's conduct. He propounds the 'clawback theory' and says that it explains CBA's conduct towards him.

As I have said, I consider that the clawback theory is false.

Mr O'Brien's complaint arises from loans Bankwest made in respect of his Whisper Bay project. He says that the project had achieved completion at the end of November 2008 and that the conduct of CBA, particularly its

appointment of receivers in April 2009, was directed to achievement of an adjustment to the purchase price CBA paid for Bankwest.

Mr O'Brien's further submissions were accompanied by a bundle of material. With the exception of a handful of emails, the Commission had already obtained all of this material before the third round of hearings. (The additional emails Mr O'Brien provided added nothing of substance to the material in hand.) In the main, the material relied upon by Mr O'Brien in support of his further submissions was material he had put before the ASBFEO.

It is important to identify some basic facts about Mr O'Brien's dealings with Bankwest and CBA.

By the end of November 2008, Mr O'Brien's company, FOB-Airlie Beach Pty Ltd had borrowed approximately \$172 million from Bankwest. The term of the loan had expired. The loan was due to be repaid. FOB-Airlie did not, and could not, repay the loan on the due date. It was in default.

In December 2008, Mr O'Brien asked for more funding to complete the project. It appears from the documents that FOB-Airlie then owed Westpac money. CBA completed the acquisition of Bankwest on 19 December 2008.

Mr O'Brien complains that CBA 'stalled' on its consideration of the application for further funding that he had made in December 2008 after the term of the existing loan had expired. In fact, during December 2008, Bankwest made two additional temporary advances: one of \$2.3 million and the other of \$750,000 (a total of \$3.05 million).⁶²

Bankwest did not advance the additional \$16 million that FOB-Airlie sought. The application was considered by the bank and rejected. In April 2009, Bankwest appointed receivers.

In its determination in July 2009, EY rejected CBA's argument that, on 19 December 2008, there should have been a provision of \$46.05 million in respect of FOB-Airlie's loan. EY accepted that, as at 19 December 2008, the loan was impaired. EY determined that, as at 19 December 2008: (a) the borrower was in financial difficulty; (b) the borrower had breached the initial contract through delinquency in interest and principal; and (c) the

⁶² Exhibit 3.194, 23 January 2009, Credit Sanctioning Increase, 5.

lender had granted the borrower a concession that the lender would not otherwise consider, being the extension of the facility and interest capitalisation.⁶³ But, having regard to the workout strategy then in place, EY was satisfied that no specific provision was required as at 19 December 2008.⁶⁴

Bankwest sued Mr O'Brien (and another company associated with him, Bakota Holdings Pty Ltd) for approximately \$158 million pursuant to his personal guarantee of the loans of FOB-Airlie. Mr O'Brien brought a cross-claim against Bankwest alleging, amongst other things, misleading or deceptive conduct and unconscionable conduct by the bank. He said that his cross-claim was for about \$500 million. The litigation was the subject of an interlocutory dispute that reached the NSW Court of Appeal⁶⁵ but was ultimately settled.

Bankwest agreed to pay Mr O'Brien an amount representing a small proportion of CBA's estimated legal costs of running the court proceedings in full and final settlement of all of the claims made in the proceeding. That is, CBA forgave Mr O'Brien's personal liability under the guarantee he had given. A joint statement issued by CBA and Mr O'Brien recorded Mr O'Brien's acknowledgment that he would have lacked the means to satisfy the full judgment or costs order against him were CBA to have succeeded.⁶⁶

So, the dispute was settled as it was because Bankwest, the plaintiff, thought that at the end of what would probably be prolonged litigation it would obtain a judgment that Mr O'Brien could not meet and Mr O'Brien was prepared to compromise on the basis that he would receive only a slight fraction of the amount he had claimed in his cross-claim.

⁶³ Exhibit 3.186, 7 July 2009, Expert Determination Report Pursuant to the Share Deed dated 8 October 2008 (as amended) Commonwealth Bank of Australia and HBOS Australia Pty Ltd, 21 [2.25].

⁶⁴ Exhibit 3.198, 19 December 2008 and 23 December 2008, Letters from Bankwest and BOS International (Australia) Limited to Rory O'Brien; see also Exhibit 3.194, 23 January 2009, Credit Sanctioning Increase.

⁶⁵ *O'Brien v Bank of Western Australia Ltd* (2013) 16 BPR 31,705; [2013] NSWCA 71.

⁶⁶ Exhibit 3.195, 2 May 2014, CBA, Joint Statement by Commonwealth Bank and Rory O'Brien.

The dispute being quelled, and Mr O'Brien having had the benefit of that settlement, including the forgiveness of his very significant debt to the bank, further examination of the matter would serve no purpose when the central theory he propounds (based on the clawback) is false.

Mr O'Brien's case was considered by the ASBFEO. As noted above, the ASBFEO concluded that '[t]he significant and sudden change in support for the project, driven by the CBA representative, in March '09 appears consistent with CBA's intent to maximise the clawback against the purchase price of [Bankwest]'. But, later, when the ASBFEO made submissions to the Commission, she said that the hypothesis that 'losses on loans incurred post acquisition could be 'clawed back' by [Bankwest]/CBA as part of the sale process' was false. Rather, as the ASBFEO rightly explained:⁶⁷

There was no capacity in the Share Sale Deed for a clawback of performing loans that were present at acquisition and which post-acquisition became impaired.

Although Mr O'Brien's loan was not performing at the time of the acquisition, the underlying principle conveyed by the ASBFEO applies equally to him: the clawback clause did not allow CBA to rely on post-acquisition events to claim an adjustment. Mr O'Brien's case is a clear example of those who describe themselves as 'victims' of Bankwest and CBA proceeding from the premise that the loans about which they complain could only be regarded as sound and well-secured. The loans to the O'Brien interests, like other loans the subject of submissions, were made before the full fury of the GFC hit. They were loans made with a very aggressive risk appetite. It is entirely unsurprising that, from late 2008, others would make, and did make very different judgments about the soundness of the loans that Bankwest had made and CBA had acquired when it bought Bankwest.

Perhaps the decision that CBA made, not to lend more money to Mr O'Brien's company when it was already in default, was not the only decision open to CBA. But the decision not to lend more money was reasonably open, especially when CBA knew that Mr O'Brien had defaulted to it and owed Westpac more than \$17 million. It was a matter for CBA to decide whether it would grant a new and larger loan. It chose not to do so.

⁶⁷ Exhibit 3.188, ASBFEO, *The Need for Further Inquiry into BWA/CBA's Treatment of Corporate and SME Customers Post Acquisition of BWA*, undated, 4 [9.1].

The decision that CBA made was not directed in any way to obtaining some 'clawback' of purchase price.

In addition to the submissions made by Mr O'Brien on his own behalf, he, together with Mr Guy Goldrick, also made a number of submissions on behalf of what they called the 'Bankwest Victims Group'. Most of the points raised in these submissions are adequately addressed elsewhere. However, there are issues raised in some of the later submissions of Messrs O'Brien and Goldrick, as the representatives of the Bankwest Victims Group, with which I should deal.

Messrs O'Brien and Goldrick (and others) have advanced a further theory of premeditated foreclosures which is not easy to explain. It involved a number of steps.

The first step was to assert that 'CBA's 2009 audited accounts show Bankwest's value at \$3.676 billion as at 19th Dec 2008'. This assertion is incorrect. CBA's 2009 Annual Report records the fair value of the net identifiable assets of *each of* Bankwest (consisting of retail and business banking), St Andrew's Australia Pty Ltd (consisting of insurance and wealth management services businesses) and HBOSA Group (Services) Pty Ltd (HBOSGS) (an internal administrative support entity) *as at 30 June 2009* as \$3.676 billion.

The second step was to assert that '[t]he evidence shows that the price [of Bankwest, St Andrew's and HBOSGS] was reduced by \$1.639 billion' rather than, as Senior Counsel Assisting explained, being increased by \$26 million. This assertion is misconceived. The initial price for the acquisition of Bankwest, St Andrew's and HBOSGS was \$2.1 billion; after adjustments it was increased, as we have seen, by \$26.1 million. The \$1.639 billion identified by the submitters is their calculation of the difference between the fair value of Bankwest, St Andrew's and HBOSGS as at 30 June 2009 (as shown in CBA's 2009 Annual Report) and the proportion of the initial price (before adjustment) as at 19 December 2008 attributable to Bankwest (as recorded in the Share Sale Deed). This calculation goes nowhere and is not informative of anything. The price agreed between CBA and HBOS for Bankwest, St Andrew's and HBOSGS was a price agreed at as part of an arm's length commercial negotiation. There is no doubt that the price paid was less than what CBA believed to be the fair value of the net assets of those entities as at 19 December 2008. That does not assist the submitters for reasons I explain at the conclusion of this chapter.

The third step was to assert that '[w]e can see a sharp rise in impairments to \$1.639 billion immediately appearing on Bankwest's balance sheet as at 19th Dec 2008'. This assertion is incorrect. The Bankwest balance sheet does not record \$1.639 billion of impairments as at 19 December 2008. Nor is it something that was 'immediately appearing'. The submitters have misunderstood the 31 December 2008 Annual Financial Report for Bankwest.⁶⁸ In fact, the provision for impairment losses on loans and advances as at 31 December 2008 was recorded as being \$894.7 million.⁶⁹ The submitters have derived their figure of \$1.639 billion 'of impairments' by rounding off the \$1.6394 billion of *gross loans* that were past due or in possession and also impaired. This compared to figures for the year ending 31 December 2007 of total gross loans of \$446.5 million that were past due or in possession and also impaired. The submitters say that the Commission must 'identify why \$1.639 billion of impairments immediately appeared on the Bankwest balance sheet ... immediately after the acquisition'. The answer is that \$1.639 billion of impairments did not appear on the balance sheet as at 19 December 2008 and that the assertion to that effect is incorrect.

The fourth step, which was the culmination of the preceding three steps, was to assert that the difference between, on the one hand, the proportion of the initial price paid by CBA to HBOS and attributable to Bankwest of \$2.037 billion and, on the other hand, the fair value of Bankwest and St Andrew's of \$3.676 billion, is equal to the 'immediate increase in impairments exactly'. Because each of the preceding steps is wrong, this fourth step is also wrong. In fact, what the submitters have identified is that the difference between the initial price (but not the final price) attributable to Bankwest as at 19 December 2008 and the fair value of Bankwest, St Andrew's and HBOSGS as at 30 June 2009 is approximately the same as the gross value of Bankwest's loans as at 31 December 2008 that are past due, or in possession, and impaired. Further, it is wrong to treat the initial price for Bankwest as based on the value of impairments. The initial price was an arm's length commercial agreement of a price that was less than the net assets of Bankwest, HBOSGS and St Andrew's. The adjustment to the initial purchase price was to be done pursuant to the calculation stipulated in clause 4.2 of the Share Sale Deed. That clause

⁶⁸ Exhibit 3.196, 30 April 2009, Bankwest, Annual Financial Report 31 December 2008.

⁶⁹ Exhibit 3.196, 30 April 2009, Bankwest, Annual Financial Report 31 December 2008, 19.

required consideration of more than the general and specific loan provisions in the calculation of the relevant adjustment. The exercise undertaken by EY did not turn solely on determining the value of impaired loans. It is therefore wrong to try to draw a direct correlation, as Messrs O'Brien and Goldrick seek to do, between the purchase price for the businesses and impaired loans as at 19 December 2008.

The fifth step, which was said to follow from the preceding four steps, was that '[t]his means that CBA mass foreclosures were premeditated and indeed provisioned for as part of the purchase price reduction'. There are at least two problems with this fifth step. The first is that each of the preceding steps on which it depends is wrong. The second is that there is no logic by which the fifth step would follow from the preceding four steps even if they were all correct.

Messrs O'Brien and Goldrick submitted that, on the premise that the purchase price was 'discounted' by \$1.639 billion for impaired loans, 'CBA were "double-dipping" by further pursuing these debts from customers'. For reasons I have just explained, the premise is wrong. But even if it were right (and it is not), there was no 'double-dipping'.

The suggestion seems to be that if CBA had paid less than net asset value for Bankwest because of the value of impaired loans it ought therefore follow that Bankwest should forgive those impaired loans and not hold the borrowers to their contractual obligations. I do not accept that suggestion. Having paid what it paid to acquire Bankwest, CBA was entitled to cause Bankwest to manage them in accordance with their terms and the prevailing economic conditions.

It follows that these submissions do not point to, let alone establish, misconduct in CBA's approach to managing the Bankwest loans. I reject the submissions.

Three of the other submissions made after the statement made at the start of the fourth round of hearings do not refer to or rely on the personal circumstances of particular borrowers. Rather, they are submissions directed to the *general* conduct of CBA after its acquisition of Bankwest.

Of these, I will deal first with the submissions made by Mr Romesh Wijeyeratne. Mr Wijeyeratne has communicated frequently with the

Commission and following the invitation made at the commencement of the fourth round of hearings, made further submissions.

Mr Wijeyeratne said that the recognition of impairments at the time of the sale demonstrates that CBA had a pre-meditated plan to foreclose the loans. The submission reflects a misunderstanding regarding the impairment of loans. As has been explained, where a bank considers that there is a risk that a borrower will default, it is obliged to make a provision, by reason of regulatory and other requirements. Doing so does not pre-determine anything. This aspect of Mr Wijeyeratne's submission must be rejected.

Another aspect of Mr Wijeyeratne's submissions relied on a footnote to a Background Paper prepared by APRA. The relevant footnote states that:⁷⁰

In limited circumstances, it is possible that an ADI using the IRB approach [which is a method of determining capital adequacy ratios used by the major banks such as CBA and is described in the Background Paper] might obtain a capital benefit where it purchases a loan that has already become impaired and the purchase price is significantly discounted from the loan amount.

Mr Wijeyeratne argued that the potential to obtain a capital benefit provided the motive for CBA's actions.

APRA has confirmed to the Commission that the footnote in APRA's Background Paper is referring to the fact that, because of the requirements under APS 113 imposed on an IRB bank in relation to expected losses and eligible provisions, it is possible to conceive of very limited circumstances in which an IRB bank purchases an already distressed or defaulted loan at a very significant discount to the loan amount and, if there is a shortfall in eligible provisions relative to expected losses on the IRB bank's other defaulted exposures, the effect is that there is a temporary (until the conclusion of enforcement action) improvement in the IRB bank's capital ratio (but then the capital ratio would subsequently decrease post enforcement action and that ratio would be lower than if the asset had been originally recorded as unimpaired on the IRB bank's balance sheet). There is no evidence that CBA had determined that it was possible that any of the

⁷⁰ APRA, *FSRC Background Paper No.13: The Regulatory Capital Framework – Impairment, Provisioning and Enforcing Security*, 18 May 2018, 8, n 5.

Bankwest loans in respect of which enforcement action was subsequently taken satisfied this limited circumstance. There is nothing in the internal documents of CBA reviewed by the Commission to suggest that CBA caused Bankwest to manage its loans in a particular way because it was motivated to obtain a capital benefit of this kind. I do not accept Mr Wijeyeratne's submission.

Another person who lodged a further submission was Mr Ross Waraker. Mr Waraker is not a former customer of Bankwest but has been involved in advocating on behalf of those who were. Mr Waraker made two submissions to the Commission, the second being in response to the invitation made at the start of the fourth round of hearings. He submitted that the lens through which CBA's conduct should be viewed is its adoption of a so-called 'bad bank' strategy. This is a reference to a strategy for banks to deal with risky assets, promoted by the consulting firm McKinsey and Company following the GFC, although the concept is older than that. In short, it involves quarantining 'bad' assets, such as non-performing and troublesome loans and perhaps strategically undesirable assets, into a 'bad bank' structure within the bank. The aim is then to exit systematically from those assets. This is seen as carrying a number of advantages, including lessening the bank's risk profile, improving its risk weighted assets and improving investor confidence. The assets that are left are the on-going core business of the bank.

Mr Waraker pointed to internal CBA communications to demonstrate that the bank had adopted such a strategy. He said the steps taken by the bank to give effect to this strategy included acting to reduce its consumption of economic capital, shifting away from riskier and less profitable loans, seeking to improve return on equity, ensuring credit ratings are not affected and that Tier 1 capital requirements were met. Even if CBA did adopt (formally or informally) a 'bad bank' strategy, and I am not persuaded that it did, all of the identified steps are prudent steps to take (and in the case of Tier 1 capital, required by reason of regulatory and other requirements). Mr Waraker rightly acknowledged that the adoption of a 'bad bank' strategy is not illegal and does not, in and of itself, constitute misconduct. He submitted, however, that CBA had 'crossed the line' into unconscionable conduct. The steps he suggested took the bank over the line included the bank having recourse to non-monetary covenants that the bank 'would not ordinarily rely upon alone' and refusing to roll over loans when 'in ordinary circumstances' they would have been.

The difficulty with this submission is that the circumstances that faced the bank were anything but 'ordinary' and there were very good reasons for the bank to adopt an approach that sought to reduce its exposure to risky loans. Indeed, the concerns identified by the bank in relation to the business loan book turned out to be justified, as demonstrated by the need for the bank constantly to increase provisions and eventually having to make substantial write offs when assets were sold and loans could only be partly repaid.

For the reasons already explained, I consider that Mr Waraker's reliance on economic capital is apt to mislead. Economic capital is a risk measurement and management tool. Saying the bank was motivated to reduce its economic capital consumption seeks to criticise the bank for managing its credit risk following the acquisition of Bankwest. Of course that is what it did, and it was a course reasonably open to it. That conduct does not amount to an 'unconscionable systemic plan', as Mr Waraker submitted.

Mr Peter McNamee has made a number of submissions to the Commission. He is not a former customer of Bankwest but has, over a long period of time, sought to advocate on behalf of such persons. The submission lodged by Mr McNamee after the invitation made at the beginning of the fourth round of hearings covered a range of issues, many of them policy-related. In those submissions, he drew attention to Mr O'Brien's circumstances, suggesting that the state of the Bankwest business loan book may not have been as low quality and high risk as Mr Cohen conveyed in his evidence.

Mr McNamee suggested that evidence should be taken from past Bankwest executives to 'hear the other side of the story'. But Mr McNamee's conjecture about the state of the Bankwest business loan book was no more than speculative and is inconsistent with the facts described earlier regarding the recognition by both parties to the sale that the commercial loan book was impaired (such recognition later being reinforced by EY); the need for CBA to increase its provisions, which its auditors described as prudent; and the level of write-offs that CBA ultimately was required to make on the loans. Nothing raised by Mr McNamee has caused me to alter my conclusions.

Two further submissions were provided from the perspective of the personal circumstances of the authors, each of whom was a former customer of Bankwest. But each also made broader submissions directed to identifying CBA's motives.

The first of these was lodged by Mr Jim Neale. The first point to note is that Mr Neale has, on a number of occasions, rejected the clawback theory. Second, he also dismisses the Tier 1 Capital theory, at least as it has been advanced by others. Third, he cautions against the misuse of terms relating to impaired loans. In particular, Mr Neale (rightly) notes that one should not confuse the whole value of an impaired loan with the amount of a provision made for impairment after the realisation of securities.

In summary, Mr Neale contends that it is not inimical for a bank to sell assets taken as security for the lowest price possible. He says that holds true when one bank has bought another bank for less than shareholders' funds and the securities being sold are 'secondary'. He explained that by 'secondary', he means that the loan is still fully secured by other real property or guarantees. He further contends that the maximum profit for the bank is achieved by selling the secondary property 'for nothing', by which I take him to mean for less than its true value, as this means there is no reduction in the loan amount on which penalty interest is being charged. His contention is that penalty interest earned CBA 13 times as much profit as a loan without penalty interest being charged.

He explained that another benefit to CBA in this case was that a sale at less than true value yields no surplus funds for the borrower, thereby reducing its capacity to take action against the bank. A further benefit to the bank that he identifies is that if they were sold for more than the impaired value, that would have exposed CBA to a claim by HBOS (although it is difficult to understand what that claim would be in the context of a commercial transaction where both parties agreed the price). He also said that CBA benefited from the 'destruction' of Bankwest customers whose businesses competed with the businesses of CBA customers. He cited his own property development in support of this contention, and observed that Meriton, a CBA customer, was a competing developer in the area.

Mr Neale argued that by buying Bankwest for \$1.3 billion less than shareholders' funds meant that this created a reduction in Bankwest's (and so CBA's) Tier 1 capital. Added to that, he said that CBA did not disclose this provision in a prospectus to raise \$2.1 billion in funds for the purchase and was forced by ASIC to withdraw the prospectus, which led to a further (albeit temporary) worsening of its Tier 1 position. While he acknowledged that impairing loans does not improve Tier 1 capital, he emphasised that calling in loans does improve the Tier 1 position as this reduces the amount

of Tier 1 capital that is required, and the position is also improved by raising capital that increases Tier 1 capital. He also noted that extra profit made from penalty interest also improves Tier 1 capital.

Lastly, Mr Neale has said that CBA bought the Bankwest loans at a discount (which he has quantified at 73 cents in the dollar) and that CBA was able to make a profit by realising the securities on the loans for 100c in the dollar.

The proposition advanced by Mr Neale regarding Tier 1 capital is addressed by my earlier comments on that topic. I address below the submission he advances (which is also advanced by others) based on the proposition that CBA bought Bankwest for a bargain. And Mr Neale's argument regarding secondary securities cannot be accepted in the face of the facts as they occurred: CBA eventually wrote off \$2.77 billion of the commercial loans held at 19 December 2008 and the proceeds from realising securities that had been held did not cover the loans to that extent.

A further submission was also received from Mr Trevor Eriksson. Mr Eriksson was a customer of Bankwest. He supported the submission made by Mr O'Brien and Mr Goldrick to the effect that CBA had accounted for the impaired loans and purchased Bankwest at a price well below the 'true value'. He argued that this meant that CBA had to default the loans or otherwise would face a claim by HBOS. It can be seen that this echoes one of the submissions made by Mr Neale. He also argued, as did Mr Neale, that CBA profited from charging penalty interest. The question he posed is whether there was any surplus from the sale of securities. There was no surplus. CBA did not recover the full amount of the loans on enforcement and it could not recover more than the full amount of the loans (plus interest and costs).

There are two final points to make.

First, it was said that the treatment of Bankwest by Counsel Assisting differed from the treatment of ANZ's acquisition of the loan and deposit books of Landmark Financial Services. I set out elsewhere the conclusions I have reached about matters arising from ANZ's acquisition of Landmark.⁷¹

The two acquisitions were different in many ways. They were made at different times and in different circumstances. Each acquirer made its own

⁷¹ See Case studies: Agricultural lending, in Volume 2.

decisions and took its own path. It is unsurprising, therefore, that I should reach different conclusions about different events and circumstances. The comparisons that it was sought to draw between the two matters are simplistic and ill-founded. The only point at which the two matters intersect is that in each case a new entity acquired an existing loan book.

The second point to make is that some submitters pointed out that CBA was expecting to pay, and did pay a price for acquisition of Bankwest that was a discount to the net assets of Bankwest (and St Andrews and HBOSGS). They are correct. As at October 2008, the purchase price of \$2.1 billion before adjustments was 0.8 multiplied by the 2007 book value of Bankwest, St Andrews and HBOSGS.⁷² But the point goes nowhere. Whether CBA engaged in misconduct in its dealings with Bankwest borrowers after acquisition depends upon how it dealt with those borrowers. Dealings that do not otherwise constitute misconduct or conduct falling below community standards and expectations are not transformed into misconduct because CBA paid a discount to book value. Similarly, had CBA paid a price for Bankwest based on a multiplier of greater than one on the book value, that would not have somehow lessened the legal obligations that applied to it in dealing with Bankwest borrowers.

⁷² Exhibit 3.197, 8 October 2008, CBA, Acquisition of Bankwest and St Andrew's Australia – A Compelling Strategic Growth Opportunity, 4.

6. Agricultural lending

Introduction

The agricultural industry is an important contributor to the Australian economy. It is the primary source of jobs in many regional and rural areas. In 2017, about 260,000 were employed in the agricultural industry.¹ In 2016, there were about 84,500 farming businesses having an estimated value of agricultural operations of \$40,000 or more.²

All agricultural enterprises are subject to the effects of events beyond the control of the individual farmer: seasonal variation, changes in prices obtained for outputs and paid for inputs, longer-term climate events like drought, natural disasters like flood and fire, regulatory decisions of both foreign and domestic governments, and outbreaks of pest or disease. Occurrence of any of these events, let alone a combination of them, will affect cash flow and profitability and, hence, the ability to service debts. Their occurrence will often have profound personal effects on those who conduct the business.

Australia's climate is very variable. The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) notes that Australia has a lower mean rainfall and higher rainfall variability than most other nations. As a result, agriculture in Australia is subject to more revenue volatility than almost any other country in the world. Changing seasonal conditions cause variations in agricultural production that are difficult to predict accurately beyond the current season.³

¹ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 4.

² ABS, *Catalogue Number 7503.0 – Value of Agricultural Commodities Produced, Australia, 2016–17* <www.abs.gov.au/Ausstats/abs@.nsf/0/5D9BB73004B25F66CA2578A00014F415?OpenDocument>.

³ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 16–17 [6.1].

Australian farming businesses rely heavily on debt finance.⁴ There is little institutional investment in agriculture.⁵ ABARES reports that ‘more than 95% of farms’ in the broadacre and dairy industries are family owned and operated.⁶ Most Australian agricultural enterprises fund the acquisition of land on which the enterprise is to be conducted by loans secured over the land. More often than not the enterprise funds its working capital by debt. In 2015–2016, almost 85% of businesses in the agriculture, forestry and fishing sector who sought debt finance sought it from banks.⁷

At 30 June 2017, total rural debt in Australia was \$71.7 billion (equivalent to about 2.3% of net loans and advances held by **authorised deposit-taking institutions** [ADIs] as assets). The share of rural debt held by banks has increased over recent years. In 2007, banks’ share of rural debt was about 89%; as at 30 June 2017 banks held about \$68.6 billion or 96% of all rural debt outstanding.

At 30 June 2016, more than two-thirds of the aggregate broadacre debt was held by 12% of farms.⁸ Those farms produced about half of the value of broadacre farm production. In the dairy industry, one third of farms held about two thirds of the total debt.⁹ For broadacre farms, the most common reason to borrow was to buy land (43%); for dairy farms, the

⁴ ABS, *Catalogue Number 8167.0 – Selected Characteristics of Australian Business, 2015–16* <www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8167.02015-16?OpenDocument>.

⁵ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 24 [7.2].

⁶ Department of Agriculture and Water Resources ABARES, *Farm Debt: Broadacre and Dairy Farms, 2014–15 to 2016–17* (18 April 2018) Department of Agriculture and Water Resources ABARES <www.agriculture.gov.au/abares/research-topics/surveys/debt>.

⁷ ABS, *Catalogue Number 8167.0 – Selected Characteristics of Australian Business, 2015–16* <www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8167.02015-16?OpenDocument>.

⁸ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 22 [7.1].

⁹ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 22 [7.1].

most common reason to borrow was to cover operating expenses (26%) followed by to buy land (24%).¹⁰

At 30 June 2017, 945 farm business entities had loans more than 90 days past due.¹¹ The total value of loans more than 90 days past due was \$630 million or 0.90% of the total value of loans.¹² By contrast, at 30 June 2013, about 3% of the total value of agriculture, fisheries and forestry sector debt was more than 90 days past due compared with about 2% of the total value of all business sector debt.¹³

Both the federal and state governments provide various forms of assistance to agricultural industry. Some assistance is to relieve against the effects of drought or other natural disasters. Some is directed to supporting productivity and exports. The detail of those programs is not examined here.¹⁴ But there is one form of government assistance that should be explained.

The Farm Management Deposits Scheme is intended to help primary producers manage fluctuations in cash flow. Put shortly, the scheme allows producers to set aside pre-tax income in one year to be drawn on (and taken to account as taxable income) in a later year. In the tax year in which the deposit is to be made, the primary producer's income that is not from primary production must be less than \$100,000. The maximum amount that can be held in a farm management deposit is \$800,000. The deposit must be held for at least 12 months with an ADI. (The producer may be exempted from this requirement if the producer receives recovery assistance under

¹⁰ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 22 [7.1].

¹¹ Department of Agriculture and Water Resources, *FSRC Background Paper No. 17: Department of Agriculture and Water Resources*, 28 June 2018, 10.

¹² Department of Agriculture and Water Resources, *FSRC Background Paper No. 17: Department of Agriculture and Water Resources*, 28 June 2018, 10.

¹³ ABARES, The Australian Bankers' Association and the National Farmers' Federation, *Regional Farm Debt: Northern Queensland Gulf, South West Queensland and North West New South Wales*, December 2014, 5; Department of Agriculture and Water Resources, *FSRC Background Paper No. 17: Department of Agriculture and Water Resources*, 28 June 2018, 11.

¹⁴ See generally, Department of Agriculture and Water Resources, *FSRC Background Paper No. 17: Department of Agriculture and Water Resources*, 28 June 2018, 13–21.

natural disaster relief and recovery arrangements or if affected by a rainfall deficiency for at least six consecutive months.) At 30 April 2017, there were about 49,000 farm management deposit accounts holding a total of about \$5.17 billion.¹⁵

1 Legal and regulatory framework

1.1 General

The legal and regulatory framework within which agricultural lending occurs is the framework that applies to business lending generally. Hence, the provisions that apply to other forms of small and medium enterprises apply equally to primary producers conducting small and medium enterprises.

Some agricultural businesses are within the definition of small business in the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act). The provisions of that Act prohibiting misleading or deceptive conduct and implying warranties of fitness for purpose and due care and skill will apply to the provision of financial services to those businesses. The unfair contract terms provisions of the ASIC Act will apply to standard small business contracts that those businesses make.

The Code of Banking Practice applies to dealings with agricultural businesses that are small businesses. In the 2013 Code, small business is defined to include 'a business having ... less than 20 full time (or equivalent) people'. Many agricultural enterprises would meet this definition. By contrast, the 2019 Code requires a business to meet three criteria to fall within the definition of 'small business'. The criteria are turnover (less than \$10 million in the previous financial year), employees (fewer than 10 full time equivalent) and total debt to all credit providers (including the amount of any loan being applied for) of less than \$3 million. The reach of the 2019 Code in agricultural lending is diminished. Not all of the enterprises examined as case studies in the course of the fourth round of hearings would have met that definition.

¹⁵ Department of Agriculture and Water Resources, *FSRC Background Paper No. 17: Department of Agriculture and Water Resources*, 28 June 2018, 18.

The 2019 Code provides for longer minimum periods of notice to small business customers about changes to loan conditions or decisions about rolling over existing facilities. It will remove material adverse change clauses and restrict the operation of non-monetary default clauses.

One important difference in the legal and regulatory framework for agricultural lending is farm debt mediation.

1.2 Farm debt mediation and rural financial counsellors

Three states, New South Wales, Victoria and Queensland, have legislated for farm debt mediation.¹⁶ There are differences between the schemes but, essentially, each requires banks and other creditors to offer mediation to farmers before taking enforcement action against farm property, including the farm itself and farm machinery. The object is to have a neutral and independent mediator assist the farmer and the lender to try to reach an agreement about current and future debt arrangements.

ABARES estimates that the farm debt mediation schemes in New South Wales, Victoria and Queensland cover about 77% of Australia's farm businesses. In 2016/2017:

- New South Wales had 39 new cases under the *Farm Debt Mediation Act* (compared with 62 in 2015/2016) with 40 cases completed and agreement in 90% of those cases;
- Victoria had 54 new cases (56 in 2015/2016), 47 referred to mediation and 45 ending in agreement; and
- Queensland's statutory scheme began on 1 July 2017, replacing a voluntary scheme under the Queensland Farm Finance Strategy.

South Australia still uses a voluntary scheme under the South Australian Farm Finance Strategy.¹⁷ So, too, Western Australia operates a voluntary scheme.

¹⁶ *Farm Debt Mediation Act 1994* (NSW); *Farm Debt Mediation Act 2011* (Vic); *Farm Business Debt Mediation Act 2017* (Qld); see also *Farm Debt Mediation Bill 2018* (SA).

¹⁷ But see *Farm Debt Mediation Bill 2018* (SA).

One other important element affecting lending to agricultural enterprises is the availability of rural financial counselling services. These services are funded primarily by the federal government.¹⁸ They provide free financial counselling to farmers, fishing enterprises, forestry growers and related small businesses when the enterprise is experiencing financial hardship or difficulty.

1.3 Who are the principal lenders to agricultural businesses?

As noted earlier, most agricultural debt finance is obtained from banks.¹⁹ Of the four major banks, ANZ, CBA and NAB have a larger presence in the sector than Westpac.

Rabobank Australia Ltd, the Australian subsidiary of a Dutch multinational bank, focuses only on agricultural lending.²⁰ It aspires to be the leading rural lender in Australia. Rabobank operates 61 branches in rural areas (an increase of 10 in the last 10 years). As branch numbers have increased, so too there has been an increase in the number of branch managers and relationship managers. By contrast, the four major banks have closed branches in several rural areas. ANZ, for example, closed 91 rural branches between 2008 and 2018.²¹

Rural Bank is now a wholly owned subsidiary of Bendigo and Adelaide Bank.²² It is a 'dedicated agribusiness bank lending only in the agricultural sphere' with only a small amount of lending beyond the farm gate.²³ In 1998, Bendigo and Elders established what was then called Elders Rural

¹⁸ See generally Department of Agriculture and Water Resources, *Rural Financial Counselling Service (RFCS)* (6 August 2018) Department of Agriculture and Water Resources <www.agriculture.gov.au/ag-farm-food/drought/assistance/rural-financial-counselling-service>.

¹⁹ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 20 [7.1].

²⁰ Transcript, Bradley Mark James, 27 June 2018, 3341.

²¹ Exhibit 4.20, Witness statement of Benjamin William Steinberg, 18 June 2018, 9 [15].

²² Transcript, Alexandra Esma Maria Gartmann, 2 July 2018, 3612.

²³ Transcript, Alexandra Esma Maria Gartmann, 2 July 2018, 3613.

Bank as a fifty/fifty joint venture.²⁴ Elders Rural Bank began trading as an ADI in June 2000 and, in May 2009, Bendigo acquired a controlling interest in Rural Bank.²⁵ Rural Bank became a wholly owned subsidiary of Bendigo in late 2010.²⁶ Rural Bank does not have its own branded branches.

In opening the fourth round of hearings, Senior Counsel Assisting described the extent of lending by the principal agricultural lenders.²⁷ The description that was given was based on information supplied to the Commission in response both to correspondence from the Commission and to requests for statements from the relevant entities. Most of the statistics recorded the position at 30 June 2017. Where available, more recent statistics are now given.

At 31 March 2018, ANZ had more than 19,500 agricultural clients and at 30 June 2017 held agricultural loans with total limits of \$9 billion of which \$7.6 billion was outstanding.²⁸ Bankwest (as distinct from its parent, CBA) had more than 3,500 agricultural customers at 30 June 2017. More than 90% of those customers were in Western Australia.²⁹ Bendigo had about 2,600 agricultural customers and Rural Bank, its wholly owned subsidiary, had more than 8,000.³⁰ CBA had more than 25,000 agricultural client relationships and just under 5,000 agricultural lending relationships.³¹ NAB had just under 21,000 agricultural clients.³² Rabobank had nearly 34,000 agricultural clients and over 21,000 agricultural client groups. Of those,

²⁴ Transcript, Alexandra Esma Maria Gartmann, 2 July 2018, 3612.

²⁵ Transcript, Alexandra Esma Maria Gartmann, 2 July 2018, 3612.

²⁶ Transcript, Alexandra Esma Maria Gartmann, 2 July 2018, 3613.

²⁷ Transcript, Senior Counsel Assisting, 25 June 2018, 3078–84.

²⁸ Exhibit 4.20, Witness statement of Benjamin William Steinberg, 18 June 2018, 6 [19], 7 [23].

²⁹ Exhibit 4.92, Witness statement of Sinead Taylor, 24 June 2018, 6-7 [17], 7 [19].

³⁰ Exhibit 4.121, Witness statement of Alexandra Esma Maria Gartmann, 20 June 2018, 6 [27].

³¹ Exhibit 4.133, Witness statement of Grant Michael Cairns, 19 June 2018, 7 [12].

³² Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 7 [21].

about 11,000 agricultural clients and 8,750 agricultural client groups had active loans.³³

There have been exits from agricultural lending. The two most prominent were ANZ's acquisition, in 2010, of the loan and deposit books of Landmark Financial Services and CBA's acquisition, in 2008, of Bankwest. Issues arising out of loans made originally by Landmark and Bankwest were examined in the case studies.

What did the banks tell the Commission about past conduct relating to agricultural lending?

2 Conduct acknowledged by the entities

2.1 ANZ

ANZ accepted that there were respects in which its management of customers whose loans had been acquired from Landmark fell below community standards and expectations.³⁴ ANZ also acknowledged that in some cases its conduct might have breached the Code of Banking Practice obligation to act fairly and reasonably.³⁵ As Senior Counsel Assisting noted in her opening, it has been clear for some years that a significant number of former Landmark customers felt that they were treated unfairly by ANZ after ANZ took over their loans.³⁶ And, of the public submissions received by the Commission about agricultural finance, 32 related to a Landmark loan that had been acquired by ANZ.

In addition to these matters, ANZ told the Commission that:

³³ Exhibit 4.33, Witness statement of Bradley Mark James, 15 June 2018, 4–5 [12]–[13].

³⁴ ANZ, *Hearing Round 4: Experiences of Regional & Remote Communities ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 3–5 [17].

³⁵ ANZ, *Hearing Round 4: Experiences of Regional & Remote Communities ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 3–5 [17].

³⁶ Transcript, Senior Counsel Assisting, 25 June 2018, 3085.

- Between December 2013 and June 2014, the Financial Ombudsman Service (FOS) identified an instance of improper collections activity by ANZ in relation to a particular agribusiness customer.
- It had identified some system and process errors that would have affected some agribusiness customers.
- There had been instances of frontline staff engaging in inappropriate sales practices to increase incentive payments.³⁷

2.2 Bendigo

Bendigo identified five examples of conduct that it said fell below community standards and expectations. One of those five examples was examined as a case study. It concerned the failure to make appropriate inquiries and verifications before approving a number of loans to customers in the Queensland cattle industry that became non-performing loans. The bank did not assess serviceability of the loans properly, relied too heavily on security values and did not manage the loans adequately.

The other examples given by Bendigo concerned:

- the bank not making its own inquiries in response to a customer notifying the bank that her signature had been forged by her husband on documents to increase an agricultural facility;
- the bank charging, in 2016, more than 2,000 customers larger fees than it should on some agricultural products and paying more than \$160,000 to remedy the matter;
- the bank paying less interest on term deposits of 81 customers for as much as five years and paying more than \$10,000 to remedy that matter; and
- a relationship manager giving verbal approval to a loan (which lay outside the manager's lending authority), which led to the customer buying a property. When the subsequent loan application was declined, the customer did not complete the sale and forfeited the deposit paid.

³⁷ Transcript, Senior Counsel Assisting, 25 June 2018, 3079.

After the customer threatened legal action, the bank paid the customer the amount of the deposit.

2.3 CBA

In the tables that CBA supplied to the Commission on 22 March 2018, in response to the request to provide particulars of events of misconduct identified in the preceding five years, CBA disclosed five instances of conduct relating to agricultural financing. Three related to two products – Agri Advantage Plus and Agri Advantage – and were instances of processing errors. One related to the failure to apply fee waivers and provide promised benefits such as bonus credit interest. The matter had been reported to ASIC and had required a remediation program (completed in 2015) that led to a total of about \$7.6 million being paid to about 8,400 customers. This matter was the subject of a statement made by Johanna White, Managing Director of Business Lending, and was dealt with in the case studies for this round of hearings.³⁸ There were two other instances of customers being either overcharged with respect to Agri Advantage products or not being provided with promised benefits. Of those, one had been discovered in September 2012, had resulted in refunds of about \$72,000, and was not reported to ASIC.

The other two cases mentioned in CBA's 22 March table were, first, another case of overcharging of fees (with respect to an 'Agri Options' product) identified in 2012 and, second, an instance of potentially inappropriate advice to customers that may have involved agribusiness products. Both these cases were reported to ASIC. To remedy the overcharging of fees CBA refunded about \$330,000 to 726 customers.

Before the commencement of the fourth round of hearings the Commission asked a number of entities, including CBA, whether other instances of misconduct had been identified. In CBA's submission of 18 May it noted:

- First, that there were 16 incidents recorded in records CBA had provided to the Commission from its RiskInSite records of compliance breaches. CBA said that these had not been specifically dealt with in the 22 March tables because the incident record had been rated as 'insignificant' or 'low'.

³⁸ Exhibit 4.135, Witness statement Johanna Charlene White, 21 June 2018.

- Second, that it had identified two further ‘operational incidents’ that had both occurred in 2013:
 - one concerning interest rate management mis-selling where interest rate hedges did not match customer loan terms, or customers were not clear about the terms of the arrangement, which had affected 19 customers, of whom 10 were agribusiness customers. (18 of the 19 cases had been closed with refunds to customers of \$1.37 million, of which \$680,000 was to agribusiness customers; one case remained unresolved.); and
 - the other concerning an incorrect mapping of a reference rate for an agricultural line of credit onto a banking platform and required payment of about \$78,000.
- Third, that FOS had resolved some disputes with customers in favour of the customers.

That these matters were disclosed only at the third time of asking is further demonstration of the point made elsewhere in this report that CBA’s systems appear not to allow it to obtain readily any single, let alone comprehensive, report of conduct occurring within the entity that might amount to misconduct as defined in the Terms of Reference for this Commission. And, as also pointed out elsewhere, this means that neither the senior management nor the board of the entity can be given any single coherent picture of the nature or extent of failures of compliance with those norms of conduct and behaviour that must inform the daily conduct of the entity’s business.

2.4 NAB

In its submission in answer to the questions I asked at the outset of the Commission, NAB said that it had ‘identified responsible lending issues and lending related breaches of the Code of Banking Practice’. It gave one example of a matter from 2013 where the Code Compliance Monitoring Committee had found that, among other things, NAB had not acted in a fair and reasonable, consistent and ethical manner.³⁹ But the

³⁹ NAB, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry NAB Group’s Response to the Commission’s Letter dated 15 December 2017*, 29 January 2018, 7 [3].

29 January submission made no express mention of dealings with agricultural customers.

In its second submission, NAB provided printouts of entries made in and after 2013 in its RiskInSite risk management program. At least 85 of those events concerned agricultural clients. Examination of those entries revealed failures by NAB to tell agribusiness customers who was responsible for stamping and registration fees, and misunderstandings or disagreements between NAB and its customers about important aspects or functions of customer products and accounts (such as whether a deposit account operates as an offset account, or what the interest rate or term of a particular product was). But beyond these matters, NAB identified no conduct of a relevant kind when, in May 2018, it was asked to consider agricultural lending activities particularly.

As noted elsewhere, NAB told the Commission that it could not respond promptly and completely to the request made immediately after it had provided its initial response of 29 January, to provide more particular and comprehensive material about misconduct that it had identified during the preceding five years. Instead, NAB provided printouts from its risk management program.

In light of the nature and number of incidents relating to agricultural lending that other entities recorded in their responses to the Commission it would be remarkable indeed if NAB had had only the incidents noted above. I cannot and do not say that it did. I do no more than note NAB's repeated expressions of difficulty in making full response to the inquiries I have made.

2.5 Rabobank

Rabobank acknowledged seven instances of conduct directly relating to agricultural business lending that might amount to misconduct or was conduct falling below community standards and expectations. Three concerned the application of incorrect interest rates to a number of different accounts over different periods. One was overcharging fees, in 2011, to 126 clients, which required refunding about \$370,000 to the affected clients. The remaining three focused upon the conduct of three different employees:

- one of whom had more than once amended documents after the client had executed them;

- one of whom had not disclosed a conflict of interest arising from a connection with a customer but had executed a bank document on behalf of the customer; and
- the last of whom had made personal commercial arrangements with customers that were not disclosed to the bank.

2.6 Other inquiries

In addition to considering the information that the entities supplied in their several submissions to the Commission and as statements of evidence that could be given, the Commission issued 50 notices to produce to 11 agricultural lenders. About 12,000 documents were produced in response. The documents dealt with each entity's practices, procedures and conduct, both generally and in relation to particular cases.

Solicitors and counsel assisting the Commission spoke with more than 20 rural financial counsellors from New South Wales (in its northern, central and southern regions), Victoria (in the western and north-western regions), Queensland (in the northern and southern regions) and Western Australia. Some counsellors put the Commission in touch with farmers who had not made a submission to the Commission but who had a grievance with a **financial services entity**.

3 Issues identified

Consideration of all this information together with the information that farmers themselves provided, identified three important issues:

- First, there were cases where **banks revalued land or other assets held as security**, with the result that the loan-to-value ratio (LVR) changed, and the bank then relied on the deterioration in land-to-value ratio as a non-monetary default permitting the bank to call up the loan. Those who made submissions to the Commission about these matters often complained that the time given to repay the amount called was unreasonably short.
- Second, frequent reference was made to the **difficulty that farmers have in obtaining access to banking services and to appropriate support**. This issue embraced several distinct elements. There was the

difficulty presented by distance from the nearest branch and consequent difficulties in contacting and dealing with the manager responsible for management of the farmers' accounts (especially if the loans were being managed in an asset management unit of the bank). There was what farmers saw as the failure to recognise ordinary seasonal variations in cash flow as well as the effect of drought or other natural disasters when deciding whether and when to act on loan defaults.

- Third, there were complaints about **changes to conditions of lending** in ways that were to the detriment of the borrower: whether by increasing interest rates or altering the terms of overdrafts or other facilities. And particular reference was made in this connection to the changes that followed a change in the ownership of the lender.

One other issue that clearly emerged should be dealt with separately: the appointment of receivers or other external administrators to agricultural enterprises.

3.1 Receivers and other external administrators

Submissions made to the Commission complained about the conduct of receivers. The central complaint made was that receivers appointed by banks did not realise fair value for the assets under management. And associated with those complaints were complaints about the ways in which receivers acted when taking possession of assets or when in possession of those assets.

As Senior Counsel Assisting explained in the course of opening the fourth round of the Commission's hearings, the conduct of those who are receivers (or liquidators or other insolvency professionals) is not within the terms of reference of the Commission.⁴⁰ Those persons are not financial services entities. Their conduct in execution of the position to which they are appointed is not conduct *on behalf of* financial services entities; it is conduct by the receiver personally and conduct for which the receiver is personally liable. Invariably, receivers, and receivers and managers, are appointed to act as agents of the borrower not the lender. The conduct of receivers is regulated by Chapter 5 of the *Corporations Act 2011* (Cth).

⁴⁰ Transcript, Senior Counsel Assisting, 25 June 2018, 3077–8.

By contrast, the conduct of a financial services entity *appointing* a receiver, a receiver and manager, an agent for mortgagee in possession or other external administrator is directly within the Commission's terms of reference. And it is conduct that is to be considered against some well recognised basic facts of commercial life.

Sale of assets by a receiver or other external administrator is a forced sale. The price obtained on forced sale is almost always less than the best price that might have been achieved. Valuers recognise this to be so. Their valuations make clear whether the value stated is market value or forced sale value.

A receiver is bound to take 'all reasonable care to sell' property for not less than market value.⁴¹ But that obligation is primarily focused on the process undertaken to effect the sale, especially the means of sale (by auction, tender or private treaty) and the sufficiency of advertising to bring the property to the attention of the market. If proper process is followed, the price obtained is powerful evidence of what the market would pay for the property.

It is to be recalled, however, that *market value* is defined as the price that the willing *but not anxious* seller could reasonably expect to obtain and a willing, prudent, but not anxious buyer could reasonably expect to pay after proper negotiations between them (not overlooking any ordinary business consideration).⁴² On a forced sale (whether by receiver, agent for mortgagee in possession or other external administrator) the seller is seen by the market as obliged to sell. That is, the seller is seen as 'willing *and* anxious', not 'willing *but not* anxious'.

NAB rightly submitted that **'it will rarely be in the best interests of the customer or the bank to appoint an external administrator'** and that, accordingly, **'wherever possible, appointment of external administrators should be an option of last resort, where all other options have been exhausted.'**⁴³ Why that should be so was identified by Mr Steinberg (ANZ's

⁴¹ Corporations Act s 420A(1)(a).

⁴² *Spencer v The Commonwealth* (1907) 5 CLR 418, 441.

⁴³ NAB, Fourth Round of Public Hearings: Experiences with Financial Services Entities in Regional and Remote Communities Submission of National Australia Bank Limited – Questions Arising from the Fourth Round of Public Hearings, 16 July 2018, 5 [19]–[20]. Cf

Head of Lending Services – Corporate and Commercial) when he agreed that it is very rare for an external administrator to recover sufficient to repay the bank in full.⁴⁴ Hence, when considering whether to appoint an external administrator, the question is not whether appointment will avoid loss; rarely will appointment avoid all loss. Rather, the relevant question is whether appointment will avoid *greater* loss than would otherwise occur. That is, appointment of a receiver will almost always lead to an outcome where both lender and borrower lose; but the central question for the appointing party is whether the loss that will probably be suffered will be less than would be sustained if there were no appointment. And of course, losses are exaggerated if the assets are sold at a time of external distress like drought or collapse in the market for the commodity produced by the business.

The view from outside an appointing bank was accurately captured by the evidence of Mr Wheatcroft, a rural financial counsellor, when he said that ‘the act of putting in a receiver never benefits a client [and] ... in most cases it doesn’t benefit the bank’.⁴⁵ As Mr Wheatcroft said, farmers see what happens in such a case as ‘a massive destruction of value’.⁴⁶ And, judging from the great depth of feeling so obviously evident in farming circles, this view is widely held.

For this inquiry, the central question must be whether a decision to appoint an external administrator was conduct that either might amount to misconduct or was conduct falling below community standards and expectations. That question arose squarely in one of the case studies arising out of ANZ’s acquisition of the Landmark Financial Services loan and deposit books: where ANZ appointed an agent for the bank as mortgagee in possession of land owned by the Harleys in Western Australia.

CBA, Round 4 Hearing – Issues Affecting Australians Who Live in Remote and Regional Communities Closing Submissions Part B – Questions Arising from the Case Studies, undated, 5 [25], external administrators ‘are usually only appointed as a last resort’.

⁴⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3261–2. Cf CBA, *Round 4 Hearing – Issues Affecting Australians Who Live in Remote and Regional Communities Closing Submissions Part B – Questions Arising from the Case Studies*, undated, 5 [26], ‘in many instances of administrator or receivership appointments, both the customer and the bank may incur a loss’.

⁴⁵ Transcript, Chris Wheatcroft, 25 June 2018, 3105.

⁴⁶ Transcript, Chris Wheatcroft, 25 June 2018, 3105.

More generally, however, the tenor of the evidence led in the Commission was that banks have appointed external administrators in connection with agricultural loans less frequently in recent years, than once was the case. It may be inferred that there are several reasons for this. One is what appears to be an overall decline in the number of cases where banks have taken enforcement action with respect to loans to agricultural enterprises. But another important consideration has been that banks recognise that the appointment of external administrators is apt to provoke adverse publicity with consequent damage to reputation.

ANZ reviewed and made substantial changes to its ‘Farming Segment Support Strategy’ in 2015.⁴⁷ As the paper submitted to its board showed, ANZ recognised that ‘the special challenges facing the rural sector and loan foreclosures [had recently] attracted a heightened level of focus *including political and media attention*’.⁴⁸ And, internal emails of NAB in 2014, relating to one case study (NAB and the Smiths) spoke of the appointment of a receiver and manager as being ‘[n]ot acceptable due to the drought *and political environment*’ and of appointment after the rains come as being ‘as *politically unacceptable*’.⁴⁹ Banks have come to see the appointment of external administrators as presenting serious reputational risks. It will be necessary to return to consider further what follows from risks of this kind. Before doing that, however, it is necessary to deal more generally with the issues that arose in connection with the Commission’s consideration of dealings between banks and agricultural enterprises.

4 Analysing the issues

The issues that arose can be considered under the following headings:

- An overarching problem?

⁴⁷ Exhibit 4.23, Farming Segment Support Strategy ANZ Board, 6 August 2015; Transcript, Benjamin William Steinberg, 27 June 2018, 3296–8.

⁴⁸ Exhibit 4.23, Farming Segment Support Strategy ANZ Board, 6 August 2015, 1 (emphasis added).

⁴⁹ Transcript, Ross Hugh McNaughton, 29 June 2018, 3599; Exhibit 4.115, Emails between Avent, Starky and Others, 10 November 2014, 2 (emphasis added).

- Lending against 'market value'
- Who values the land?
- Dealing with distressed loans
 - Farm debt mediation
 - Hardship
 - Default interest and the enforcement of securities

4.1 An overarching problem?

It is tempting to see the issues presented in connection with agricultural lending as stemming from a single, overarching cause. How are borrowers and lenders in the agricultural sector to deal with the consequences of uncontrollable and unforeseen external events? Those events may be the onset and persistence of drought or other natural disaster, the collapse of a market as a result of governmental action here or abroad, or any of the many other perils of farming. Especially if the farmer has borrowed to acquire an asset at a price fixed in good times, or the external events destroy any immediate prospect of continuing profit, the loans that permitted acquisition or provide working capital may quickly become stressed.

For the reasons that follow, however, I doubt that it is useful to approach the issues that arise in connection with agricultural lending as allowing any single and all-embracing answer.

Behind the single question of how to deal with the consequences of external forces lie many distinct and different issues:

- What is the borrower to do? Is the borrower to sell up whatever can be sold to meet the debt?
- What is the lender to do? Is the lender not to seek repayment? Is the lender to extend not only time but more money?
- Who is to bear the consequences of what has happened, when neither borrower nor lender could have prevented it happening?
- Are there to be special rules for farmers? If there are, who bears the added cost?

- How, if at all, are the answers to these questions to be moulded in light of existing governmental assistance programs for farmers?

It is greatly to be doubted that any of these more particular questions could be given a *single* universal answer equally applicable to all cases. Not only that, I doubt that there is any *simple* answer to any of these questions. None has been offered in the submissions that have so far been made to the Commission. And the search for some more refined criteria for application of narrower general rules would seem likely to be soon lost in the thickets of individual cases.

Hence, **although there may appear to be a single and overarching problem – how agricultural borrowers and lenders are to deal with the consequences of uncontrollable external forces – the answer to be given to each of the more particular questions that have been posed must be case specific. And the answer that should be given in a particular case will seldom if ever be clear cut and obvious.** Nice questions of judgment will be required. As the case studies considered by the Commission show, the criticisms that can rightly be levelled at banks in their dealings with agricultural lending much more often than not find their roots in the bank's failure to take all of the relevant considerations into account when deciding, in a particular case, whether to lend or what to do when the loan becomes distressed.

All substantial loans to agricultural businesses are secured – usually over the land on which the business is conducted. If the business is a family business (and many are) the security will usually encompass the principal place of residence of the family. And if the enterprise is inter-generational (as many are) there may be more than one residence on the property that is given as security for the borrowing. Often, the security taken will encompass not only the land but also the means by which the enterprise generates its income: the stock, crops, plant and equipment. Realising the security may leave the borrower, and the borrower's immediate family (in some cases the borrower's extended family as well) with no home and no means of starting a new farming business.

How and by whom is the security to be valued?

4.2 Lending against ‘market value’

Determining the ‘market value’ of agricultural land must take account of the relevant characteristics of the land, including its productive capacity. But as pointed out at the start of this chapter, productive capacity of farming land in Australia often varies as the seasons vary and is difficult to predict accurately beyond the current season.⁵⁰ The valuations produced in evidence in the course of hearings did not deal expressly with variations of this kind. Instead, where possible, the valuer looked to comparable sales as the surest guidance to market value. And, of course, that was entirely understandable because, in accordance with commonly accepted practice, the valuer was required to express an opinion about market value *at the date of valuation*.

But **is a valuation of that kind a reliable tool for a bank to use when determining how much to lend to a venture that must endure through good times and bad where the income from the venture will inevitably vary markedly from year to year?** Are these recognised causes of volatility matters that a bank should be permitted, even required, to take to account in determining the value of its security?

Ascribing a market value to land assumes that there is a market for the land. If there has been a prolonged drought, there may be no market for the drought-affected land. How, if at all, is a bank to take account of that possibility when deciding whether to lend and, if so, how much? Again, is this a matter that can or should be taken into account?

Even if there is a market for the land, realisation may take months so that the land may not only be adequately advertised for sale but also be presented at its best. Is this a matter that can or should be taken into account in deciding how much may be lent against the land as security?

Some account of these considerations may be seen in banks fixing their LVRs. It may readily be accepted that the more conservative that ratio, the wider the buffer both borrower and lender have to absorb the effects of external events on capital values and the time it may take to realise the security. But LVRs say little or nothing about serviceability of the loan. And if external events diminish income to the point where servicing is impaired,

⁵⁰ FSRC, *FSRC Background Paper No. 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry*, 15 June 2018, 16–17 [6.1].

capitalising interest, especially default interest, may soon impair even a conservatively set LVR. And if default interest is charged, the total debt may soon be larger than the best obtainable price for the land.

None of the bank witnesses who gave evidence about these matters suggested that the possibility of external shocks to the business conducted on land affected the way in which the land was valued for security purposes. And as the Australian Prudential Regulation Authority (APRA) pointed out in its written submissions, *Prudential Standard APS 220 Credit Quality* (APS 220), which relates, among other things, to security valuation, does not distinguish between valuations of farms or other rural property and other types of security. All are to be valued, for prudential purposes, according to the valuation standards and practices of the Australian Property Institute or some equivalent local or overseas body.⁵¹

Market value at a date provides no more than a snapshot of value. Market value of agricultural land at a particular date takes no account of possibilities that are plainly on the cards whenever a loan is made to an agricultural business. If those possible events occur, the value of the land will be affected. Are there cases where not taking these matters into account when deciding how much to lend or on what terms to lend is to take no account of possibilities that call for consideration?

4.3 Who values the land?

As emerged from some of the case studies, banks do not always use external valuers to determine the security value of property offered as security for agricultural loans. Sometimes banks rely on an internal appraisal of value. Evidence led in the case studies showed that internal appraisals made in those cases were not always accurate.

Particular difficulty may arise if the employee who makes the appraisal is the employee who sells the loan. Especially is that so if the employee is rewarded for selling the loan. The conflict of interest and duty is evident. Contrary to the position taken by some banks, that conflict is not avoided by having a second employee 'sign off' on the appraisal made by the loan

⁵¹ APRA, *Written Submissions of the Australian Prudential Regulation Authority (APRA) Round 4: Experiences with Financial Services Entities in Regional and Remote Communities*, undated, 5 [18]; APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, Attachment B 28 [21].

originator. As illustrated by the facts and circumstances concerning Bankwest and the Ruddys, an internal appraisal may contain significant errors (in that case an error about the area of the block being valued). Not only that, an appraisal may depend upon an unduly optimistic view of the quality of the property and its productive capacity. A co-signatory who does not inspect the property has no means of checking and correcting errors of the latter kind. And even an obvious error of the kind made in the case of the Ruddys was not detected by Bankwest until long after the loan had been made.⁵²

As APRA pointed out in its written submissions, APS 220 permits an ADI to use valuations of suitably qualified internal appraisers or external valuers when determining the fair value of security.⁵³ As it stands, APS 220 requires an ADI to have policies and procedures directed at ensuring the reliability of the valuation processes and the valuations obtained in respect of security held. And APS 220 provides that these policies and procedures may include internal reviews of valuations by appropriate management or audit staff and formal reviews by an independent valuer.

APRA said, in its submissions, that its 'longstanding position' was that it is better practice for valuations to be made independently of staff engaged in loan origination.⁵⁴ But it also said that it intended to formalise this in its prudential standards 'by adopting the Basel Committee on Banking Commission's requirement that real property valuations are appraised independently from an ADI's mortgage acquisition, loan processing and loan decision process'.⁵⁵

I support the proposal and urge its prompt implementation.

⁵² Transcript, Sinead Taylor, 28 June 2018, 3476.

⁵³ APRA, *Written Submissions of the Australian Prudential Regulation Authority (APRA) Round 4: Experiences with Financial Services Entities in Regional and Remote Communities*, undated, 4 [15].

⁵⁴ APRA, *Written Submissions of the Australian Prudential Regulation Authority (APRA) Round 4: Experiences with Financial Services Entities in Regional and Remote Communities*, undated, 5 [19].

⁵⁵ APRA, *Written Submissions of the Australian Prudential Regulation Authority (APRA) Round 4: Experiences with Financial Services Entities in Regional and Remote Communities*, undated, 5 [20].

4.4 Dealing with distressed loans

Once a business loan (including a loan made to an agricultural business) shows signs of distress, management of the loan is often transferred into a special asset management unit of the bank. Those units have various names, such as 'Lending Services' (ANZ), 'Group Credit Services' (CBA), or 'Strategic Business Services' (NAB). But the purposes of these special asset management units are substantially the same. All of the units are intended to manage the loan to the point where either it can be returned to the ordinary business management unit or it is brought to an end, if needs be by enforcement.

One of the chief lessons that ANZ took from its experiences after acquiring Landmark's lending book was the need to establish a special 'Agri team' in Lending Services (as it did in August 2014). Without specialist knowledge and experience, the manager of a distressed agricultural loan may not recognise and take proper account of what the presentation to ANZ's board described as 'the special challenges facing the rural sector'.⁵⁶ As that paper said, '[t]he agricultural sector faces special challenges such as adverse weather cycles and market fluctuations which [at that time, 6 August 2015, had] resulted in difficult farm operating conditions for a sustained period of time.'⁵⁷

More fundamentally, however, **without specialist knowledge and experience, managers in an asset management unit cannot make informed decisions about whether or how it may be possible for the agricultural business borrower to work its way out of the difficulties that have led to financial distress.** No less importantly, those managers cannot make *timely* decisions that will accord with the needs of the business. As Mr Wheatcroft pointed out, 'if finance starts to be restricted because decisions take too long to be made, the opportunities to lower your costs, to be timely in putting in the crop are lost. And those things cost businesses significantly.'⁵⁸

In order to make informed decisions about whether or how a business borrower (no matter what the nature of the business) might be able to work

⁵⁶ Exhibit 4.23, Farming Segment Support Strategy ANZ Board, 6 August 2015, 1.

⁵⁷ Exhibit 4.23, Farming Segment Support Strategy ANZ Board, 6 August 2015, 1.

⁵⁸ Transcript, Chris Wheatcroft, 25 June 2018, 3097.

out of financial difficulties, the manager concerned must be able to speak frankly and fully with the borrower. Many farmers are used to dealing face to face about important financial issues. A bank's asset management unit will often operate a long way away from the agricultural borrower's property. But in many, probably most, cases, direct and frequent contact between manager and borrower will assist both bank and borrower to decide what is possible and what is not. Especially is that so when the management of the facilities has passed to an asset management unit.

Mr Steinberg gave evidence of changes that had been made to the operation of ANZ's Lending Services unit in and after March 2014.⁵⁹ One of those changes was to adopt a statement described as 'Lending Services Purpose'.⁶⁰ The document spoke of Lending Services managing 'high risk customers to achieve the best outcome for both ANZ and our customers'. It said there were four pillars for its work: 'Customer experience' (amplified as being 'We care; we act with fairness and honesty; we do what is right'), 'Staff experience', 'Well-managed' and 'Trusted Advisor'.⁶¹ And Mr McNaughton of NAB referred, in the course of his evidence in the third round of hearings, to an equivalent statement of the purposes of NAB's Strategic Business Services unit.⁶²

Without seeking to take away from the importance of these statements as means of conveying to staff in the relevant unit the values and purposes that should inform their work, it is important to recognise that there may appear to be a tension between seeking to rehabilitate a distressed loan (to the point where it returns to management by the relevant business unit of the bank) or to bring the loan to an end (if needs be by enforcement) and the specification by banks of times within which one of those outcomes is to be achieved. And in at least some cases, banks state 'churn rates'⁶³ as

⁵⁹ Transcript, Benjamin William Steinberg, 27 June 2018, 3293–9.

⁶⁰ Exhibit 4.20, Witness statement of Benjamin William Steinberg, 18 June 2018, Exhibit 4.8.22 [ANZ.800.552.2654].

⁶¹ Exhibit 4.20, Witness statement of Benjamin William Steinberg, 18 June 2018, Exhibit 4.8.22 [ANZ.800.552.2654].

⁶² Transcript, Ross Hugh McNaughton, 31 May 2018, 2906; Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit 19 [NAB.005.223.0960].

⁶³ Transcript, Benjamin William Steinberg, 27 June 2018, 3270; Transcript, Ross Hugh McNaughton, 29 June 2018, 3573.

indicating the rate at which files are to pass through the relevant asset management unit.

But whether or not it is right to identify a tension of that kind, or to identify it only where a churn rate is stated, management of distressed loans (agricultural and other) may be better informed by noting the analogy that may be drawn between the objects of managing a distressed loan with the objects of that part of the Corporations Act that deals with the administration of a company's affairs with a view to executing a deed of company arrangement. The latter set of objects is to administer the business, property and the affairs of an insolvent company in a way that 'maximises the chances of the company, or as much as possible of its business, continuing in existence' or 'if it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company'.⁶⁴

Like all analogies, the analogy is imperfect. **But the central ideas of treating working out as the best outcome and immediate winding up as worst, has evident application to the decisions that must be made when an asset management manager is considering how best to deal with a distressed loan to a farming business.**

It is important to emphasise immediately that invoking the analogy is not intended to permit, let alone require, the asset management unit to prefer the interests of the borrower over the interests of the bank that has lent. It is to observe no more than that maximising the chances of the business, or as much as possible of the business, surviving, or where that cannot be done, achieving the best available return on sale of the business and its assets, will almost always work in favour of both bank and customer.

In that regard it is to be noted that continuing to carry an impaired loan comes at a cost to the bank. Not only are there increased costs of administering the impaired loan, carrying the loan comes at a capital cost.

Tellingly, however, Mr McNaughton of NAB could not identify the amount of the capital cost or whether there is any relationship between cost of capital

⁶⁴ Corporations Act s 435A.

as a result of impairment and a bank's decision to charge default interest.⁶⁵ And in its written submissions, Westpac said that it is 'difficult to accurately identify the precise costs that are incurred by a bank when a loan falls into arrears', but that 'significant additional costs are incurred'.⁶⁶

It appears to follow that **at least those banks are not readily able to compare the costs of waiting to enforce for a time with an estimate of how much more might be realised at the end of that waiting period.**

And it is no answer to that conclusion to say, as NAB did in its written submissions, 'that there is insufficient evidence presently before the Commission to enable a meaningful answer to be given' to whether default interest reflects the cost of carrying impaired loans.⁶⁷ Nor is it an answer to say as NAB did, that this was not a topic on which NAB was asked to provide evidence.⁶⁸ Mr McNaughton is NAB's employee in charge of its Strategic Business Services unit. He could not say what the costs were. Without knowing what those costs were he could not make a comparison of the kind identified. Without being able to make a comparison of that kind, it is not possible to make an informed commercial decision about what will be in best interests of the bank or the customer. **Those responsible for those decisions should be armed with information that enables them to make informed commercial choices.**

When loans are distressed, there will be cases where both bank and borrower may be assisted by third party mediation. It is necessary to say something further about that, with particular reference to existing farm debt mediation arrangements.

⁶⁵ Transcript, Ross Hugh McNaughton, 29 June 2018, 3591.

⁶⁶ Westpac, *Westpac Banking Corporation General Submissions on Experiences with Financial Services Entities in Regional and Remote Communities*, 16 July 2018, 12 [49].

⁶⁷ NAB, *Fourth Round of Public Hearings: Experiences with Financial Services Entities in Regional and Remote Communities Submission of National Australia Bank Limited – Questions Arising from the Fourth Round of Public Hearings*, 16 July 2018, 11 [50].

⁶⁸ NAB, *Fourth Round of Public Hearings: Experiences with Financial Services Entities in Regional and Remote Communities Submission of National Australia Bank Limited – Questions Arising from the Fourth Round of Public Hearings*, 16 July 2018, 11 [51].

4.4.1 Farm debt mediation

As explained earlier, three states provide by statute for compulsory farm debt mediation before a lender seeks to enforce a loan. In other states there are voluntary schemes that provide for mediation.

First, there appears to be obvious advantage, and no evident disadvantage, in making national provision for farm debt mediation according to a common legislative scheme.

Second, it is necessary to challenge what seems to be the presently accepted position that farm debt mediation is undertaken only when the lender has decided to enforce recovery of the loan. Mediation undertaken in those circumstances will focus only on when and how securities will be realised and when and how repayments will be made. The borrower will very likely see the negotiations as conducted with the lender holding a gun at the borrower's head.

Consistent with what has been said above about the need for asset management units to approach their task recognising the importance of considering whether it is possible for the borrower to work out of the distress that brings it into the asset management unit, there will be cases where early mediation between borrower and lender, before the bank has determined to enforce the loan, may assist in deciding whether work out may be possible and, if it is, how best it is to be attempted.

Unless both borrower and lender were to agree to the contrary, **there would seem to be advantage, therefore, in requiring an offer of mediation in every case where an agricultural loan, secured by farm property, first becomes impaired (in the sense of there being a payment under the loan contract more than 90 days past due)**. A mediation then would ordinarily be in addition to, not in substitution for, the requirement for the lender to offer mediation before taking any step to enforce the loan. Its focus would almost always be on whether work out is possible. Rarely would it be evident immediately after the loan first becomes impaired that recovery is impossible.

I say that a mediation of this kind would 'ordinarily' be in addition to, rather than in substitution for a mediation before enforcement because it may be thought that an offer of further mediation should not be necessary if a mediation had been conducted within the period of (say) six months before the giving of notice of intention to take enforcement proceedings. Even in

that latter case, however, it may be thought that it would be as well to permit the borrower to require further mediation. But these are matters for further submission and consideration.

The third point to make about farm debt mediation is that, no matter whether changes of the kind described are made, **arrangements that are proffered by lenders at mediation must be capable of practical implementation.**

As the case studies examined in the fourth round of hearings revealed, nothing is to be gained by lenders insisting upon unrealistic times within which security properties are to be offered for sale or within which vacant possession of security properties should be given if sale is not effected. To say that the property must be sold by 30 June and, if it is not, vacant possession is to be given on the next day, is impractical. It is especially impractical if the borrower's principal place of residence is on the property.

Terms of this kind rarely if ever give lenders some discernible and valuable benefit not otherwise obtainable. Unless they do give some advantage of that kind, why seek them? On their face they appear to be terms that, if insisted upon, would rightly be seen by both borrower and onlookers as unfair assertions of power.

4.4.2 Hardship

All banks have hardship policies under which borrowers facing unexpected crises may be given some accommodation in meeting loan obligations. The 2013 Code of Banking Practice obliged, and the 2019 Code will oblige banks bound by the Code to try to help individual and small business customers to overcome financial difficulties. But most lenders, including banks, invite all borrowers facing financial difficulty to contact the bank and discuss what may be done to deal with the difficulty.

In many cases, financial hardship follows sudden and unexpected events: injury, death, fire or flood. The consequences may be seen as temporary. But prolonged drought is different. It is persistent and increasingly destructive. Stock is lost. Crops are lost and cannot be planted. Income is lost. Expenses persist. The effects multiply and are measured in years.

That the drought-affected borrower experiences hardship cannot be denied. But what is the bank to do?

After the fourth round of hearings, NAB announced that it would no longer charge default interest to rural customers in drought declared areas. (In the

written submissions NAB provided after the fourth round of hearings, NAB had denied that charging default interest to drought-affected customers was contrary to community standards and expectations.) If this change in policy is to be understood as NAB's recognition of what the community expects of it, it is a change rooted in community standards of fairness. That is, it is a change that recognises that insistence upon the letter of the loan contract may be unfair, and will be unfair when the borrower's business is radically affected by external forces beyond the control of lender and borrower. And if that is right, three further questions arise:

- Should others follow the same policy?
- If they should, how, and where, is the policy to be expressed?
- Should the policy apply to other natural disasters?

More generally, however, **are there other ways in which lenders can or should respond when an agricultural borrower's loan becomes distressed as a result of natural disasters like drought, flood and fire?**

Apart from cases of natural disaster, it is inevitable that there will be loans where the borrower defaults. It is inevitable that there will be cases where the lender concludes that the loan must be enforced. **Are there limits to how and when the lender pursues enforcement?**

4.4.3 Default interest and the enforcement of securities

Two particular issues emerged from the case studies: the charging of default interest and enforcement of security. One aspect of charging of default interest has been dealt with above. There are some other, more general, questions about the charging of default interest that call for examination.

Provision for a rate of default interest is commonplace in loan agreements. The agreement may provide for one rate of interest and then provide that a lower, or 'acceptable', rate will be charged if payments are made on time. The form of the provisions is not relevant to present issues. Default interest rates fixed by bank lenders may be markedly higher than the rate that is to be applied when payments are made when due. And on top of the default interest, the bank may charge fees when the account is not in order.

Default interest grows quickly. If an agricultural loan is distressed, and the borrower can make no substantial repayment in reduction of principal or interest, the balance owing can quickly become very large indeed. It seems not uncommon for a bank to use default interest as a bargaining chip to persuade the borrower to agree to prompt, sometimes immediate, realisation of the securities. That is, it seems that farm debt mediation may result in the parties making a deed of forbearance by which the borrower agrees to a program for sale of securities, the bank agrees to forgo default interest, but the parties agree that, if the property is not sold within the time fixed, the bank can enter judgment for much, if not all, of the balance then due on the loan.

Two points emerge. **What commercial purpose does the lender seek to achieve by continuing to charge default interest if the balance of the loan outstrips the likely worth of the security property?** Is there a realistic likelihood of the lender recovering the amount that is charged? If there is not, what is the purpose of charging it? And that is a question to be asked and answered in light of the fact that a bank will reach a point at which it decides not to take the interest that is charged in respect of a loan to account as profit.⁶⁹ Why continue to charge default interest then?

Second, **how, if at all, is the charging of default interest compatible with trying to rehabilitate the loan?** On the face of it, charging default interest for any extended time will amplify the borrower's difficulties. Does there not come a time where the charging of default interest shows that the loan must be enforced? And if the loan has reached that point, the immediate issues are about the best exit strategy. What steps will achieve the best outcome for lender and borrower?

5 Issues that have emerged

All agricultural enterprises are subject to the effects of events beyond the control of the individual farmer. Occurrence of any of these events, let alone a combination of them, will affect cash flow and profitability and, hence, the

⁶⁹ Transcript, Ross Hugh McNaughton, 29 June 2018, 3595–6.

ability to service debts. Their occurrence will often have profound personal effects on those who conduct the business.

Four issues emerged: about revaluation of securities; difficulties in obtaining access to banking services and appropriate support; changes to conditions of lending; and, enforcement by appointment of external administrators.

The particular questions can be identified as including:

- How are borrowers and lenders in the agricultural sector to deal with the consequences of uncontrollable and unforeseen external events?
- Does the 2019 Banking Code of Practice provide adequate protection for agricultural businesses? If not, what changes should be made?
- How, and by whom should property offered as security by agricultural businesses be valued?
 - Is market value the appropriate basis?
 - Should the possibility, or probability of external shocks be taken to account in fixing lending value? How?
 - Should the time for realisation of security be taken to account in fixing value? How?
 - Is the possibility, or probability of external shock sufficiently met by fixing the loan-to-value ratio?
 - If prudential standard APS 220 is amended to require internal appraisals to be independent of loan origination, loan processing and loan decision processes, when should that amendment take effect?
- Should distressed agricultural loans be managed only by experienced agricultural bankers?
- Do asset management managers need more information (such as the cost to the lender of holding the loan) to make informed commercial decisions about management of distressed agricultural loans?

- Are there circumstances in which default interest should not be charged?
 - In particular, should default interest be charged to borrowers in drought-declared areas?
 - If it should not, how, and where, is that policy to be expressed?
 - Should the policy apply to other natural disasters?
- In what circumstances may a lender appoint an external administrator (such as a receiver, receiver and manager or agent of the mortgagee in possession)? Is appointment of an external administrator to be the enforcement measure of last resort?
- Having regard to the answers given to the preceding questions:
 - Is any regulatory change necessary or desirable?
 - Is any change to the 2019 Code necessary or desirable?
- Should there be a national system for farm debt mediation?
 - If so, what model should be adopted?
- Should lenders be required to offer farm debt mediation as soon as an agricultural loan is impaired (in the sense of being more than 90 days past due)?

7. Remote communities

Introduction

The notions of 'remote' and 'very remote' areas, 'financial inclusion' and 'financial exclusion', and 'financial literacy' can all be used to help identify particular kinds of difficulty associated with the provision of financial services. My focus must be upon how financial services entities respond to those difficulties: in particular whether they have engaged in conduct that might amount to misconduct or conduct that falls short of community standards and expectations.

At 30 June 2017, about 28% of the Australian population lived in regional or remote areas. This is nearly 7 million people. At the same time, only 4% of all branches of **authorised deposit-taking institutions** (ADIs) and 2% of ATMs were located in areas classified as remote or very remote. The banks' branch networks have been shrinking for some years. The banks have fewer face-to-face points of presence.

Some Aboriginal and Torres Strait Islander people who live in remote or very remote areas encounter particular difficulties in their dealings with banks. Some, for whom English is a second or third language, encounter language difficulties. Some encounter difficulties in satisfying some forms of identification requirements. Some may have a low level of literacy, particularly financial literacy, and may have only a limited understanding of how credit, insurance and superannuation products work. And all who live in remote or very remote areas face the difficulties of geography.

In the cities, more and more banking is done electronically. A customer with a difficulty will telephone a call centre. If the operator cannot solve the problem, the customer will be invited to 'step into the nearest branch'. But the customer who lives in a remote or very remote area cannot just 'step into the nearest branch' if it is hundreds of kilometres away. They may have only limited access to phone or internet banking. They may have access to only one ATM.

In 2010, the Australian Financial Counselling and Credit Reform Association noted that the cost of ATM fees was having a significant and detrimental

effect on Aboriginal and Torres Strait Islander people living in remote communities. Withdrawal limits meant that a customer wanting to undertake a large transaction had to make more than one withdrawal, paying a fee for each separate transaction. And every time a customer wanted to check their account balance, the transaction would attract a \$2 fee.

In 2012, the Australian Bankers' Association (ABA) applied to the Australian Competition and Consumer Commission (ACCC) for authorisation of an agreement to provide fee-free ATM withdrawals and balance inquiries at some ATMs operated by participating entities in remote and very remote areas. Authorisation was granted for five years to 1 December 2017; it has since been renewed for a further 10 years.

The Commission asked several financial services entities whether they had identified particular conduct relating to Aboriginal and Torres Strait Islander people that might amount to misconduct or conduct falling short of community standards and expectations. Few entities disclosed conduct of that kind. That is unsurprising when it is recognised that, ordinarily, financial services entities do not ask customers whether they identify as Aboriginal or Torres Strait Islander people.

ANZ, Bendigo, CBA and Westpac all participate in the fee-free ATM arrangements. All have a presence in regional and remote areas.

CBA maintains an Indigenous Customer Assistance Line (or 'ICAL') to provide support for geographically isolated Aboriginal and Torres Strait Islander customers, in 90 remote communities, by providing free balance inquiries, replacement cards, access to funds, and other, more general, support. ICAL uses a special identification process tailored to the customers who use the service. CBA started the service in 2009 when it recognised that customers were paying fees to check account balances.

CBA told the Commission that it has recently identified cases where customers have been charged fees for using ATMs owned and operated by third parties under the ATM fee-free agreement. CBA said that it was working to identify the customers concerned, ensure the fees are refunded, and work with the ABA and the providers of ATMs to ensure that it does not happen again.

Westpac told the Commission that in 2015 the Australian Securities and Investments Commission (ASIC) had raised concerns about car loans that

had been provided in two remote communities by Capital Finance Australia Ltd (a company later acquired by Westpac). Westpac waived repayment of the loans and ensured that the customers had no default listed against them. Westpac continues to make car loans in remote areas. It told the Commission that it had reviewed a sample of accounts in substantial arrears to identify whether there were responsible lending issues but the results of those inquiries had not been made available to the Commission by the end of August 2018.

One other **financial services entity** should be mentioned. The Traditional Credit Union, or TCU, has branches in 14 remote communities in the Northern Territory, as well as branches in Darwin, Katherine and Alice Springs. TCU operates a business model different from other ADIs in that it relies on fee income rather than interest income. Because it has a low interest income, TCU cannot cross subsidise the costs of its branch and ATM networks. Its transaction and account fees are markedly higher than other ADIs.

1 Remote area issues

The issues that arose in connection with banking services in remote communities related to access to services; account fees; and the application of standard identification requirements. None of the banking relationships examined was complicated. The prevailing theme in the evidence was of basic transactions made bewildering by inadequate recognition on the part of the bank of an Indigenous customer's circumstances.

Four more particular kinds of issue relating to banking in remote and very remote areas emerged. All are issues affecting some Aboriginal and Torres Strait Islander people who live in remote or very remote areas. They concerned:

- basic accounts
- informal overdrafts;
- dishonour fees; and
- identification issues.

1.1 Basic accounts

'Basic' bank accounts provide the account holder with essential banking services at a lower cost than other forms of account. Those whose only income is from Centrelink benefits may therefore find that a basic bank account suits their needs better than other forms of account.

One of the case studies looked at in evidence showed a customer who lived in a remote community encountering needless difficulty in switching to a basic account, despite having the support and assistance of a very able community worker. The customer and her supporter had to travel long distances to go into the Katherine branch of ANZ more than once to achieve what should have been the simplest objective.

The banker with whom they dealt seemed either ignorant of, or unwilling to implement, the necessary steps. The banker embarked on a wide-ranging survey of the customer's 'needs' evidently seeking to sell the customer other bank products. And this she did. Only after several inquiries to ANZ's call centre to check information, only after several three-hour round trips to and from Katherine, and only on the third time of asking was the request to open a basic account met. Surely it need not be so hard.

One of the chief reasons for Centrelink recipients to prefer a basic bank account is to avoid incurring fees. Two particular kinds of fee require special mention: overdraft and dishonour fees.

1.2 Informal overdrafts

A bank may allow a customer to withdraw more than the amount standing to the credit of the customer's account. In former times, the bank would honour the customer's cheque even though the transaction would result in the account being overdrawn. The bank may allow overdrawing without any prior agreement with the customer. If the bank does meet the customer's request to withdraw an amount larger than the balance standing to the credit of the account, the bank will charge the customer a fee for lending the customer the amount of the informal overdraft.

Each fee may be small. But overdraft repeatedly, and the fees soon mount up.

In many cases, lending a Centrelink recipient even a small amount may be to make a loan that is unsuitable for the borrower. It may be unsuitable

because repayment of the amount lent, with the fee charged for the loan, will cause hardship. But whether or not the loan is contrary to the *National Consumer Credit Protection Act 2009* (Cth), there are circumstances in which the customer will know no more than that the request to withdraw has been met and will not consider whether the amount withdrawn is larger than the credit balance in the account.

If a Centrelink recipient seeks an overdraft facility, the application will be determined according to ordinary processes. Informal overdrafts are not allowed on basic accounts but the bank may allow other accounts to be overdrawn. Banks permit customers to ‘turn off’ informal overdraft arrangements. But are there circumstances in which banks should not allow informal overdrafts? In particular, should informal overdrafts not be allowed if credits to the account are only, or are substantially, by payment of Centrelink benefits?

If the overdrawn balance of an account builds up, arrangements called ‘90% arrangements’ can be made by which only 10% of Centrelink payments are applied in reduction of debt and the remaining 90% is available to the recipient. (Those arrangements are recorded in a Code of Operation endorsed by the Commonwealth Departments of Human Services and Veterans Affairs and the ABA and others.¹) **Should the application of these arrangements be at the discretion of the bank, the customer or both? Or should banks apply these arrangements automatically?**

1.3 Dishonour fees

Some bank customers in remote and very remote areas make arrangements with retailers and others that require periodic payments. The person to whom the payment is to be made will often have the customer give a direct debit authority to the bank. If the account on which the customer has given the authority has insufficient funds, the debit will be dishonoured and the bank will charge the customer a dishonour fee.

¹ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-17 [ANZ.800.643.0441].

Should direct debit arrangements be available in respect of all kinds of account? In particular, are there cases in which dishonour fees should not be charged for direct debits?

1.4 Identification issues

Aboriginal and Torres Strait Islander people may not always be readily able to assemble documentary proof of identity. Some Aboriginal and Torres Strait Islander people dealing with phone banking call centres may find it difficult to satisfy the operator of their identity.

The Australian Transaction Reports and Analysis Centre (AUSTRAC) has published guidelines intended to overcome the first kind of difficulty.² Bank staff must be trained to apply those guidelines.

The second kind of issue also requires thought and suitable training. CBA's solution of having a special assistance line for persons in remote and very remote communities appears to be the best practice so far devised and applied.

2 Funeral insurance

The Australian Securities and Investments Commission (ASIC) told the Commission that it had identified issues arising from the sale of funeral insurance products to Aboriginal and Torres Strait Islander people. ASIC pointed to inappropriate sales practices, particularly misrepresentations and pressure selling tactics, and to sales where what was sold was of little or no benefit to the purchaser. The issues extend, but are not confined, to persons in remote or very remote areas.

About half of all who take a form of funeral insurance are aged between 50 and 74 years. By contrast, about half of those who take a form of funeral insurance and identify as Aboriginal or Torres Strait Islander people, are aged under 20 years.

Funeral insurance is sold directly to consumers. It can be seen as a type of life insurance. There are two kinds of funeral insurance: funeral life

² See AUSTRAC, Aboriginal and/or Torres Strait Islander People <www.austrac.gov.au/aboriginal-andor-torres-strait-islander-people>.

insurance and funeral expenses insurance. A consumer buying funeral life insurance nominates a benefit amount (typically between \$5,000 and \$20,000) payable, on the death of the nominated life, to a person nominated by the policy holder. The recipient may apply the benefit as the recipient thinks fit. By contrast, funeral expenses insurance will pay funeral costs up to a nominated limit. Often the funeral expenses will be less (sometimes much less) than the nominated limit of cover.

The most recent statistics about funeral insurance were gathered by ASIC as at 30 June 2014. There were then about 430,000 policies covering about 740,000 insured lives. In the year ended 30 June 2014, more than 12,500 claims were accepted and more than \$103 million paid in claims – an average payout of about \$8,100. The amount paid in claims was about one-third of the value of premiums collected. (In the preceding year the proportion was one-fifth.) Nearly 73,000 policies were cancelled during the 2014 year but the rate of cancellation of new policies was about 80%.

Nearly two-thirds of policies had been held for less than three years. About 17.5% had been held for five or more years. Fewer than 5% had been held for more than eight years.

These figures suggest that the policies give little value to consumers. If they give little value, how are they sold?

The view that funeral insurance policies give little value is reinforced when it is observed that most consumers hold policies with stepped premiums increasing with age and it is further observed that the total premiums paid for a policy will often far exceed the costs of a funeral. And the particular cases examined in evidence emphasise not only the view that the policies are of little value but also the corollary that the policies are too often sold by the unscrupulous to the unsophisticated and vulnerable.

Three points emerge. They can be stated shortly.

2.1 Funeral insurance issues

First, are policies of this kind **financial products** warranting consideration by ASIC in the exercise of the product intervention powers soon to be given? Are there features of any of these policies that warrant attention of that kind?

Second, both funeral life policies and funeral expenses policies are life policies under the *Life Insurance Act 1995* (Cth) and contracts of life insurance under the *Insurance Contracts Act 1984* (Cth). But the consumer protection provisions of Chapter 7 of the *Corporations Act 2001* (Cth) apply only to funeral life policies, not funeral expenses policies. That is, issuers of funeral life policies must do all things necessary to ensure that the financial services they provide are provided efficiently, honestly and fairly; issuers of funeral expenses insurance fall outside those requirements. Is there any reason to draw this distinction? Is there any reason not to provide that all forms of funeral insurance are financial products for the purposes of Chapter 7?

Third, it is suggested that there may be some doubt about whether the consumer protection provisions of Part 2 Division 2 of the *Australian Securities and Investments Commission Act 2001* (Cth) apply to funeral expenses insurance. (It is accepted that the provisions do apply to funeral life policies.) Is there any reason not to put the point beyond doubt by providing that all forms of funeral insurance are covered by these provisions?

3 Issues that have emerged

This chapter examined how financial services entities are responding to the financial needs and vulnerabilities that can be experienced by Indigenous Australians, in particular those living in remote communities.

In relation to banking services in remote communities, the issues that arose related to access to services; account fees; and the application of standard identification requirements. None of the banking relationships examined was complicated. The prevailing theme in this part of the chapter was of basic transactions made bewildering by inadequate recognition on the part of the bank of an Indigenous customer's circumstances.

In relation to funeral insurance, what emerged was evidence pointing to predatory behaviour by insurers and salespeople. What followed were questions about the way in which funeral insurance should be regulated, and therefore how it should be categorised by the law.

Common to both parts of the chapter was the issue of culturally appropriate communication, a lack of which aggravated the existing difficulties in the interaction between entity and customer.

More specifically, the questions that arose can be set out as follows:

- Do financial services entities have in place appropriate policies and procedures to assist Aboriginal and Torres Strait Islander people:
 - to overcome obstacles associated with the geographical remoteness?
 - to address the cultural barriers to engagement that some face?
 - to address the linguistic barriers to engagement that some face?
 - to address the obstacles posed for some by their level of financial literacy?
- Are banks' identification requirements appropriate for Aboriginal and Torres Strait Islander customers?
 - If they are, are those policies sufficiently understood and applied by staff?
- Should more banks have a telephone service staffed by employees with specific training in assisting Indigenous consumers?
- Do banks take sufficient steps to promote the availability of fee-free accounts to eligible customers?
- If a customer seeking to open a basic bank account has no substantial income other than Centrelink benefits, should a bank ever try to sell the customer another form of account?
- Should informal overdrafts be allowed on a bank account if credits to the account are only, or are substantially, by payment of Centrelink benefits?

- Should the application of the 90% arrangements provided by the Code of Operation be at the discretion of the bank, the customer or both? Or should banks apply these arrangements automatically?
- If direct debits are dishonoured for want of sufficient funds, are there cases in which dishonour fees should not be charged?
- Are funeral policies, or particular kinds of funeral policy, **financial products** warranting intervention by ASIC in the exercise of its product intervention powers?
- Should all forms of funeral insurance be financial products for the purposes of Chapter 7 of the *Corporations Act 2001* (Cth)?
- Should all forms of funeral insurance be covered by Part 2 Division 2 of the *Australian Securities and Investments Commission Act 2001* (Cth)?
- Should it be unlawful to sell funeral insurance for persons under 18 years?

8. Regulation and the regulators

Introduction

In its submission on key policy issues dated 13 July 2018, Treasury said, and I agree, that there are three matters that go to the heart of the conduct that has been identified in the Commission's hearings:

- the **culture and governance** of financial (and other firms) and the related regulatory framework;
- the **capability and effectiveness of the financial system regulators** to identify and address misconduct; and
- **conflicts of interest** arising from **conflicted remuneration** and integrated business models.

The first of these issues, about entity culture and governance, is dealt with in the next chapter of this report. Conflicts of interest have been considered elsewhere, especially in Chapters 2 and 3. This chapter looks particularly at regulation and the regulators.

Almost all of the conduct identified and criticised in this report contravened existing norms of conduct. The most serious conduct broke existing laws. Other conduct either broke the law or broke the promises entities had made, generally (in documents like the Code of Banking Practice) or more specifically. Little if any of the identified conduct was *not* contrary to some existing norm of conduct.

The conduct that has been identified and criticised can be described simply. It included:

- **taking a customer's money when not entitled to take it** (for example by charging a fee for service when no service was given);
- **preferring personal financial interest over the customer's interest** when obliged to act in the customer's best interests;

- **misleading or deceiving** the customer; and
- **breaking some specific requirement of the law** including, but not limited to, provisions intended to protect the customer (such as the consumer lending provisions of the *National Consumer Credit Protection Act 2009* (Cth) – the NCCP Act).

Because the conduct was contrary to existing laws, two questions arise. First, **why were these breaches as widespread as they were?** Second, **why would changing the law make any difference?**

One important premise for those questions must not be ignored. Each **financial services entity** is responsible for its own conduct. It, and it alone, is responsible for every act that is identified in this report as conduct that might constitute misconduct or is conduct that falls short of community standards and expectations. The criticisms that are made of the ways that regulators have responded to this conduct must not be understood as diminishing in any way the culpability of the entities that engaged in the relevant conduct.

1 Why were breaches so many and so widespread?

To understand why the banks could, and did, act as they did, it is necessary to look at some fundamental considerations.

Banks have a special position in the economy. They are licensed under Commonwealth statute, by the Australian Prudential Regulation Authority (APRA), a statutory authority. To carry on any banking business in Australia without authority is an indictable offence.¹ Others can therefore enter the market only with permission. **Banks are regulated by APRA to ensure the proper functioning of the banking system and avoid failure of individual entities. Competition within the banking industry is weak.** Barriers to entering the industry are high. To participate in the economy, to participate in everyday life, **Australians need a bank account.** But **they**

¹ *Banking Act 1959* (Cth) ss 8, 9.

are reluctant to change banks. Each of the four largest banks is a powerful player in the market.

Then there are some considerations that arise from the very nature of banking. Banks' dealings with customers seek to minimise risk to the bank. The bank fixes *its* risk appetite. It decides to whom it will lend and on what terms. It decides whether security should be provided and what form and value it should take. Hence, banks have only as much 'skin in the game' in their dealings with customers as *the bank* chooses. And there is always a striking asymmetry of power and information between bank and customer that favours the bank.

Important deterrents to misconduct are, therefore, missing from the banking industry. Competitive pressures are slight. Fears of the enterprise failing are eliminated as far as possible. Fears of failure of particular transactions are mitigated by banks writing the terms on which the deal is done and then taking security against the customer's default.

Like any commercial enterprise, banks seek to maximise profit. Having survived the Global Financial Crisis, and being prudentially regulated against failure, annual profit has become the defining measure of success of Australian banks. That measure has been justified as being in the interests of shareholders and, because superannuation funds hold bank shares, as being in the interests of all Australians. But there being little threat of failure of the enterprise, and there being little competitive pressure, pursuit of profit has trumped consideration of *how* the profit is made. The banks have gone to the edge of what is permitted, and too often beyond that limit, in pursuit of profit. And they have gone beyond the limit:

- because they can; and
- because they profit from the misconduct that is described in this report.

Risk to reputation was ignored. Discovery of misconduct was 'managed' by words of apology and promises to do better. But little more was done than utter the apology and make the promise. More often than not, remediation programs were eventually set up but usually after protracted negotiation. Profit remained the informing value.

The law sets the bounds of permissible behaviour. If competitive pressures are absent, if there is little or no threat of enterprise failure, and if banks can and do mitigate the consequences of customers

failing to meet obligations, only the regulator can mark and enforce those bounds. But neither the Australian Securities and Investments Commission (ASIC) nor APRA has done that in a way that has prevented the conduct described in this report.

Why not?

APRA's chief focus is on governance and risk culture. In performing and exercising its functions and powers it is obliged 'to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, *is to promote financial system stability in Australia*.'² APRA's central task is to prevent failure of the financial system and to prevent failure of entities within the system. ASIC's focus is conduct regulation. Given the extent of known misconduct, attention must first be directed to whether, and how, ASIC might have better regulated conduct within the industry. Then, the more general issues of governance and risk culture with which APRA deals will be considered.

2 ASIC

2.1 ASIC's remit

In its 13 July submission, Treasury said that:

Over the past twenty years the remit of ASIC has expanded considerably, as has ASIC's regulated population. ASIC now has a wider regulatory remit than comparable market conduct regulators in overseas jurisdictions, such as the United Kingdom, the United States and Germany. The breadth of this regulatory remit increases the complexity of ASIC's operations and places demands on its leadership, internal communications and governance, and resourcing.³

So much may be accepted. But for present purposes, it is essential to consider *how* ASIC has dealt with reported misconduct by banks.

² *Australian Prudential Regulation Authority Act 1998* (Cth) s 8(2) (emphasis added).

³ Treasury, *FSRC Background Paper No. 24: Financial Services Royal Commission Submission on Key Policy Issues*, 13 July 2018, 23 [86].

2.2 ASIC's response to misconduct

When banks have disclosed, or ASIC has otherwise learned of, misconduct, ASIC has almost always sought to negotiate what will be done in response. Very often, remediation of customers has taken centre stage. Sometimes ASIC has used its banning powers to have one or more individual excluded from further participation in the industry. Rarely has ASIC gone to court to have the defaulting party penalised. The criminal prosecutions that have been brought have all been directed at individuals. Civil penalty proceedings have seldom been brought. **Enforceable undertakings** have been negotiated and agreed on terms that the entity admits no more than that ASIC has reasonably based 'concerns' about the entity's conduct. ASIC has issued infringement notices. But by paying the infringement notice the entity makes no admission. It is not taken to have engaged in the relevant contravention. Yet, ASIC and the Commonwealth are prevented from starting a civil or criminal proceeding in relation to the contravention that caused ASIC to issue the infringement notice.⁴

ASIC has a range of regulatory tools available. These tools include enforcement; engagement with industry and stakeholders; surveillance; guidance; education and policy advice.⁵

ASIC assigns 70% of its regulatory resources to surveillance and enforcement.⁶ Its 2016–2017 Annual Report states: 'Where we identify breaches of the law, we use our resources and power to ensure that there are meaningful consequences for the perpetrators.'⁷ Elsewhere, ASIC has emphasised that 'Our credibility as an effective regulator, across all our areas of responsibility, depends in part on how well we use our enforcement powers.'⁸

In deciding whether to undertake enforcement action, ASIC has said that it considers: the seriousness of the alleged misconduct; its consequences for the market, investors and consumers; whether the misconduct is

⁴ *Australian Securities and Investments Commission Act 2001* (Cth) s 12GXD.

⁵ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 2–3 [8].

⁶ ASIC, *Annual Report 2016–2017*, 5 October 2017, 4.

⁷ ASIC, *Annual Report 2016–2017*, 5 October 2017, 4.

⁸ ASIC, *Information Sheet 151: ASIC's Approach to Enforcement*, September 2013, 3.

widespread and whether pursuing enforcement will send a message to others; the time elapsed since the misconduct, and the evidence available.⁹ ASIC's Enforcement Outcomes reports classify as enforcement outcomes criminal and civil court determinations, administrative remedies, guilty pleas, enforceable undertakings, any regulatory action taken to secure compliance about which a public announcement has been made, and Small Business Compliance and Deterrence Team outcomes that are not generally made public.¹⁰

Seventy per cent of all of ASIC's enforcement outcomes come from the Small Business Compliance and Deterrence Team, which focuses very heavily on the prosecution by in-house ASIC legal teams of strict liability offences, primarily in relation to the failure of directors to assist liquidators.¹¹

When the Small Business Team outcomes are excluded, ASIC's enforcement results are very different. Between 1 July 2011 and 30 June 2016, 48% of all enforcement outcomes were administrative outcomes; 20% were enforceable undertakings and other negotiated outcomes; 18% were criminal outcomes; 12% were civil outcomes and 1% were public warning notices.¹² This trend is consistent with more recent statistics: between January and June 2018 ASIC's enforcement results, excluding small business, were 57% administrative; 21% enforceable undertakings and other negotiated outcomes; 4% criminal and 18% civil.¹³

Between 1 January 2008 and 30 May 2018, ASIC commenced 1,102 proceedings, an average of about 110 per year.¹⁴ Of those, more than half (587) were administrative proceedings, which include disqualification or bans on individuals from the industry; revocation, suspension or variation of

⁹ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 5–6 [15].

¹⁰ ASIC, *Report 536: ASIC Enforcement Outcomes: January to June 2017*, 22 August 2017, 21 [76]–[77].

¹¹ Ian Ramsay and Miranda Webster (2017) 'ASIC Enforcement Outcomes: Trends and Analysis', (2017) 35(5) *Company and Securities Law Journal*, 289, 297–8.

¹² Ian Ramsay and Miranda Webster (2017) 'ASIC Enforcement Outcomes: Trends and Analysis', (2017) 35(5) *Company and Securities Law Journal*, 289, 301.

¹³ ASIC, *Report 585: ASIC Enforcement Outcomes: January to June 2018*, August 2018, 24, Tables 5–7.

¹⁴ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 9–10 [28].

a licence; and public warning notices.¹⁵ That is, they were outcomes carried out in-house by ASIC and not through the courts, though they may be appealed to the Administrative Appeals Tribunal. In that time, ASIC commenced 238 criminal proceedings and 277 civil proceedings, and accepted 194 enforceable undertakings.¹⁶ Of those proceedings, just 10 were against major banks.¹⁷ Three of those proceedings arose out of the Storm Financial scandal and four of them related to Bank Bill Swap Rate manipulation.¹⁸ In the last 10 years ASIC has issued 45 infringement notices to the major banks, and accepted 13 enforceable undertakings.¹⁹ Enforceable undertakings are heavily negotiated.²⁰ As at April 2018, ASIC had never brought, or sought to have the Commonwealth Director of Public Prosecutions (CDPP) bring, proceedings against a licensee for failing to comply with the 10 day time limit for breach reporting under Section 912D of the *Corporations Act 2001* (Cth) (the Corporations Act),²¹ despite affirming that it believed that entities frequently fail to comply with the Section.²² At 30 May 2018, ASIC had never commenced, or sought to have CDPP commence, proceedings under Section 12DI of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act). This prohibits accepting payment for financial services when the payee does not intend to, or there are reasonable grounds to believe it cannot, supply the service.²³

¹⁵ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 9–10 [28], 7 [21].

¹⁶ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 9–10 [28].

¹⁷ Defined as Commonwealth Bank of Australia, Westpac Banking Corporation, Australia and New Zealand Banking Group Limited, National Australia Bank Limited, Bank of Queensland Limited and Suncorp-Metway Limited or entities related to them. Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 10–11 [31].

¹⁸ Transcript, Timothy Mullaly, 1 June 2018, 3017–8.

¹⁹ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 12–13 [33], 14 [36].

²⁰ Transcript, Louise Macaulay, 27 April 2018, 1923.

²¹ Transcript, Louise Macaulay, 27 April 2018, 1907.

²² Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, 32 [125].

²³ Exhibit 3.171, Witness statement of Timothy Mullaly, 30 May 2018, 10 [29]; ASIC Act s 12DI.

2.3 Infringement notices

Over the 10 years to 1 June 2018, ASIC's infringement notices to the major banks have amounted to less than \$1.3 million.²⁴ By contrast, in one year (the year ending 30 June 2017) one bank, CBA, declared a profit about 7,000 times greater – \$9.93 billion (net profit after tax on a statutory basis).²⁵ And the total amount that CBA had paid out in remediation of customers was many hundreds of millions of dollars.

ASIC issued infringement notices to the major banks as the outcome agreed with the bank.

In one case, ASIC issued infringement notices totalling \$180,000 to CBA in relation to what ASIC believed were breaches of responsible lending obligations in the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act) that prohibit a lender from entering into credit contracts that are unsuitable for the consumer. The breaches were the result of a programming error in the automated serviceability calculator that CBA used to assess applications for personal overdrafts. The breach continued for four years while the error went unnoticed, with the result that from 2011 to 2015 CBA failed to take into consideration customers' declared housing and living expenses when calculating their ability to service the loan. Approximately 11,000 customers required remediation. Yet CBA gave no Section 912D report to ASIC, only notifying it informally about two months after discovering the error.

In another case, ASIC issued infringement notices totalling \$212,500 to ANZ, for what ASIC believed were breaches of the NCCP Act obligation to make reasonable inquiries about the credit limit a customer requires, after ANZ distributed letters to its customers offering pre-approved overdraft amounts. ANZ did not, and does not, accept that it breached the NCCP Act. ASIC asked ANZ to provide remediation to affected customers. ANZ did not take any steps to do so.

²⁴ Transcript, Timothy Mullaly, 1 June 2018, 3024.

²⁵ CBA, 'Profit Announcement for the Full Year Ended 30 June 2017' (Announcement, 9 August 2017) 2.

In both cases, the ASIC media release about the infringement notices featured the disclaimer that ‘The payment of an infringement notice is not an admission of guilt in respect of the alleged contravention’.²⁶

It is difficult to identify any correspondence between the scale or severity of the conduct and the penalty imposed in either of these cases. With regard to a different penalty, of \$40,800 paid by NAB, Mr Timothy Mullaly, the Senior Executive Leader of ASIC’s financial services enforcement team, agreed that if ASIC had gone to court against NAB it would have sought a penalty markedly higher than the amount of the infringement notice.²⁷

If penalties are intended to have a deterrent effect, as suggested by the words of the ASIC media release about ANZ – ‘This case demonstrates that ASIC will impose penalties for breaching these important protections’²⁸ – then it must be plainly said that the amounts imposed in these cases do not.

2.4 Other regulatory responses

In the second round of hearings, the Commission heard evidence about ASIC’s approach to misconduct among financial advisers.

At the time of those hearings, ASIC had not commenced civil penalty proceedings against an adviser in the previous five years.²⁹ ASIC had never instigated a civil penalty proceeding against a financial adviser for a breach of the best interests duty.³⁰ Since 2008 ASIC had banned 229 advisers, just under half of whom were banned permanently, in an industry that now has approximately 25,000 financial advisers.³¹

In the previous 10 years, ASIC had commenced six civil penalty proceedings against **Australian financial services licensees**, of which four

²⁶ ASIC Act s 12GXD.

²⁷ Transcript, Timothy Mullaly, 1 June 2018, 3019–20.

²⁸ ASIC, ‘ANZ Pays \$212,500 Penalty for Breaching Responsible Lending Laws When Offering Overdrafts’ (Media Release, 16-063MR, 7 March 2016).

²⁹ Transcript, Louise Anne Macaulay, 27 April 2018, 1915.

³⁰ Transcript, Louise Anne Macaulay, 27 April 2018, 1915.

³¹ Transcript, Louise Anne Macaulay, 27 April 2018, 1914; Exhibit 2.247, Witness statement, Louise Anne Macaulay, 25 April 2018, 5 [20].

were commenced in 2018.³² It had undertaken one criminal action against a licensee, preferring to take criminal proceedings against individuals within an entity.³³ In that period, ASIC took action three times against a licensee for breach of the general obligations in Section 912A of the Corporations Act. In one case, it removed the licensee's licence. The two others resulted in suspensions of six and eight weeks respectively³⁴ and these were the only two cases in which ASIC suspended licences in connection with the provision of financial advice.³⁵ The other cases in which ASIC cancelled licences were what Ms Louise Macaulay, Senior Executive Leader of ASIC's financial advisers team described as 'binary' circumstances – easily proved failures on the part of the licensee to fulfil some statutory obligation, like lodging accounts.³⁶ By contrast, in the last 10 years ASIC has accepted 24 enforceable undertakings.³⁷

Ms Macaulay noted that ASIC 'rarely if ever' uses its statutory power to disclose information about an adviser to a licensee and releases little information about the circumstances of individual banning orders due to what it sees as procedural fairness concerns.³⁸

Yet ASIC has substantial concerns about the quality of financial advice provided in Australia. ASIC performed a review of sample customer files as part of the project that led to its *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interests*. It observed that in 75% of the customer files reviewed, 'the adviser had not demonstrated compliance with the best interests duty in Section 961B of the Corporation[s] Act.'³⁹ For 10% of the files reviewed, ASIC had 'significant concerns about the potential

³² Exhibit 2.247, Witness statement of Louise Anne Macaulay, 25 April 2018, 14–15 [43].

³³ Transcript, Louise Anne Macaulay, 27 April 2018, 1923–4.

³⁴ Transcript, Louise Anne Macaulay, 27 April 2018, 1919–20, 1922.

³⁵ Transcript, Louise Anne Macaulay, 27 April 2018, 1922.

³⁶ Transcript, Louise Anne Macaulay, 27 April 2018, 1920–1.

³⁷ Exhibit 2.247, Witness statement of Louise Anne Macaulay, 25 April 2018, 14–5 [43].

³⁸ Exhibit 2.247, Witness statement of Louise Anne Macaulay, 25 April 2018, 13 [34]; Transcript, Louise Anne Macaulay, 27 April 2018, 1910.

³⁹ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interests*, January 2018, 36 [137].

impact of the advice on the customer's financial situation'.⁴⁰ ASIC noted that a common theme that it observed in non-compliant advice 'was the unnecessary replacement of **financial products**'.⁴¹ The outcomes across the surveyed vertically-integrated institutions reflected that theme. For customers of the surveyed institutions 91% of customer funds invested in platforms were invested in an in-house product, 69% of funds invested in superannuation were invested in an in-house product and 65% of funds invested in insurance were invested in an in-house product.⁴²

ASIC's detailed research produced a report that revealed matters of serious concern. It may be said that its enforcement activities did not reflect the gravity of what its work revealed.

2.5 Responding to misconduct: The proper starting point

When deciding what to do in response to misconduct, ASIC's starting point appears to have been: How can this be resolved by agreement?

This cannot be the starting point for a conduct regulator. **When contravening conduct comes to its attention, the regulator must always ask whether it can make a case that there has been a breach and, if it can, then ask why it would not be in the public interest to bring proceedings to penalise the breach.** Laws are to be obeyed. Penalties are prescribed for failure to obey the law because society expects and requires obedience to the law.

These ideas are hardly novel. They inform the prosecuting policies of the CDP and every state and territory prosecuting authority. Can a case be made? Is it in the public interest that proceedings *not* be commenced? If a case can be made, and there is no public interest reason for not prosecuting, charges are laid.

⁴⁰ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interests*, January 2018, 37 [145].

⁴¹ ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interests*, January 2018, 36 [139].

⁴² ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interests*, January 2018, 30 [120], Figure 4.

Breaches of the offence and civil penalty provisions of the financial services laws are not to be dismissed as ‘*just a breach of those laws*’ as if the laws governing the conduct of financial services entities are some less important form of law. The financial services laws regulate the conduct of central actors in the Australian economy. Their enforcement should be governed by the same principles that inform enforcement of the general law.

Contraventions of law are not to be treated as no more than bargaining chips to procure agreement to remediate customers. If a contravener wants to face a penalty hearing without offering effective compensation to those harmed by its conduct, the absence of compensation will be reflected in the penalty. It will go directly to whether the entity remains a fit and proper person to retain the licence that it has to operate in the industry. Of course ASIC can, and should, offer its views about remediation and the adequacy of any proposal for remediation. But if ASIC has a reasonable prospect of proving contravention, the starting point must be that the consequences of contravention should be determined by a court.

This is not to ignore the Commonwealth’s obligation to act as a model litigant that is set out in Appendix B to the *Legal Services Directions 2017* (Legal Services Directions) and which applies to ASIC in the conduct of civil litigation, including the bringing of civil penalty proceedings. One aspect of the Model Litigant Policy is that agencies should endeavour to avoid, prevent and limit the scope of legal proceedings, including, where possible, by giving consideration to alternative dispute resolution before initiating proceedings. However, that is not to be understood as precluding the commencement of proceedings without first attempting to resolve the matter. For example, Note 4 to Appendix B recognises that the model litigant obligation does not prevent the Commonwealth, and Commonwealth agencies, from pursuing litigation in order to clarify a significant point (or, I would interpose, to obtain a civil penalty for a serious contravention) even if the other party wishes to settle the dispute.

Bringing proceedings does not preclude negotiation about how the proceedings may be resolved. Nor does bringing proceedings preclude discussion about how affected persons may be remediated. Often enough, the prospect of trial is a sharp spur to prompt and realistic discussion of whether and how issues about liability, final relief and compensation for those who have been affected by the conduct could be resolved.

There are statutory provisions on which ASIC can rely in civil penalty proceedings to seek compensation for persons affected.

First, for contraventions of the unconscionable conduct or consumer protection provisions in the ASIC Act that cause or are likely to cause loss to a class of consumers, ASIC can seek orders pursuant to Section 12GNB of the ASIC Act to redress loss or damage suffered by the consumers, or prevent or reduce loss likely to be suffered. Section 12GM of the ASIC Act gives a more general power to the Court to make orders for compensation for loss or damage arising from contraventions of the provisions of the ASIC Act about unconscionable conduct and consumer protection. The Court may make orders under Section 12GM on ASIC's application if ASIC has obtained the consumer's prior written consent.

Second, pursuant to Section 1324 of the Corporations Act or Section 177 of the NCCP Act, ASIC can apply for an injunction requiring an entity to take steps to identify consumers who have suffered loss or damage as a consequence of the entity's contravening conduct. And it may be that those powers could be invoked in support of the compensation arrangements that licensees are required to have in place. Section 912B of the Corporations Act requires financial services licensees to have arrangements, approved by ASIC, for compensating retail clients that suffer loss because of contraventions of Chapter 7 of the Corporations Act. Section 48 of the NCCP Act requires credit licensees to have adequate arrangements, approved by ASIC, for compensating persons who suffer loss because of contraventions of the NCCP Act.

Third, ASIC could apply for compensation orders on behalf of consumers pursuant to Section 1317HA and Section 1317J of the Corporations Act or pursuant to Section 178 or Section 179 of the NCCP Act (though not for breaches of the National Credit Code). Such orders require identification of the relevant consumers and the amount of the loss. But courts have ample powers to assist identification of the relevant consumers and the relevant amount of the loss and it is not to be supposed that a court would allow its processes to be frustrated by delay or intransigence on the part of an entity.

Because holders of financial services licences must report breaches of the requirement that the licensee do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly

and fairly,⁴³ there will often be cases where the licensee admits the facts that ASIC alleges constitute a breach of law. If misconduct is admitted, the only question should be whether there is some public interest in not taking enforcement proceedings.

In some cases, there may be real and lively debate between ASIC and an entity about the breadth and operation of the applicable provisions. But if there is, it may be all the more important to commence litigation than attempt to settle it. Only the courts can give binding interpretations of applicable law and, if there is doubt about the reach of particular provisions, it will often be better that the doubt is resolved once for all than allowed to linger. Resolution of the doubt will guide future conduct by all regulated entities.

The importance of seeking clarity about disputable provisions is amply demonstrated by ASIC's not seeking to litigate the operation of Section 912D of the Corporations Act. Continued uncertainty about the application of that provision, combined with ASIC's evident reluctance to seek to prosecute for breach of the section, has not encouraged entities to make timely breach reports. Too often this has meant that ASIC has been made aware of events long after they have occurred, at a time and in circumstances of the contravening entity's choosing. Entities appear to have treated the law as applying only when and if they chose to obey it.

When ASIC has sought to negotiate outcomes with entities, the negotiations have taken far too long. Too often, I suspect, ASIC has sought to accommodate the expressed wishes of the entity rather than determine what ASIC wants from the negotiation, tell the entity what it wants and insist upon it being provided promptly. Too often ASIC appears to have accepted an entity's request for time to take steps to remedy past misconduct or prevent future breach without examining, let alone examining closely, whether that time is needed. There have been too many cases where remediation programs have taken months, even years, to formulate and implement.

⁴³ Corporations Act ss 912A, 912D.

Too often, entities have been treated in ways that would allow them to think that they, not ASIC, not the Parliament, not the courts, will decide when and how the law will be obeyed or the consequences of breach remedied.

Attitudes of this kind have not been discouraged by ASIC's approach to the implementation of new provisions of financial services laws. Too often, ASIC has permitted entities confronted with new provisions, of which ample notice has been given (such as the unfair contract terms provisions), to take even longer to implement the provisions than the legislation provided.

2.6 Implementing new provisions

In the third round of hearings, the Commission heard from ASIC and Australian Competition and Consumer Commission (ACCC) about their approaches to the coming into effect of unfair contract terms (UCT) provisions for small business. The legislation to bring in the UCT legislation received royal assent in November 2015 and was due to come into effect on 12 November 2016. ASIC and ACCC were asked by Treasury to assist businesses to comply with the new legislation. Businesses would have to change the terms of the standard form contracts they used with small business.

The banks told ASIC that they intended to use the full 12 month transition period to update their small business contracts. On that basis, ASIC decided to wait until the new contracts were available to check their terms for compliance.⁴⁴ In February 2016, ASIC published an information sheet for small business providing guidance on the new provisions. In March 2016, ASIC participated in a joint webinar with ACCC directed to helping small business understand the new protections in the law.⁴⁵ Between March and August 2016, ASIC's work in relation to the UCT provisions consisted of what Mr Michael Saadat, Senior Executive Leader of ASIC's deposit takers, credit and insurers team described as presentations to and discussions with industry.⁴⁶

In the meantime, ACCC had identified five high risk industries (later extended to seven) with common UCT terms and examined the contracts of

⁴⁴ Transcript, Michael Saadat, 1 June 2018, 2975.

⁴⁵ Transcript, Michael Saadat, 1 June 2018, 2978.

⁴⁶ Transcript, Michael Saadat, 1 June 2018, 2979–80.

a number of key companies within those industries. Where a term was identified that potentially breached the provisions, ACCC asked the company to amend the term and, if it would not, to explain why. Where that did not satisfy ACCC's concerns, the company was warned of potential court action after 12 November 2016. ACCC was also planning to produce an industry report on the state of contracts in the five industries before 12 November 2016.⁴⁷

Mr Saadat agreed that, by August 2016, ACCC had 'done more' than ASIC in securing compliance with UCT provisions.⁴⁸ He suggested that a reason why ASIC took the approach that it did was that the institutions ASIC regulates 'were all very much aware about these new protections' because they were 'actively involved in the development and passage of this legislation, including lobbying against the legislation applying to them'.⁴⁹ That is, it would appear ASIC was sufficiently reassured of the banks' coming compliance with the legislation that it chose not to ask any of the banks about their particular small business contracts until 7 September 2016, a little more than two months before the law was to commence operation.⁵⁰

In those letters of early September 2016, ASIC asked for copies of the banks' amended small business contracts. On reviewing those contracts, 'ASIC became concerned that some banks had taken a minimalist approach ... by making only a few changes that were deemed absolutely necessary or by adding the word "reasonable" to qualify the exercise by the [bank] of its many broad powers and discretions in the terms.'⁵¹ Mr Saadat said that the banks' approach did not surprise ASIC.⁵²

But the result was that, when the UCT provisions came into effect on 12 November 2016, ASIC was of the view that a number of the banks' standard form contracts did not comply with the law in that they contained unfair

⁴⁷ Exhibit 3.162, Witness statement of Michael Saadat, 24 May 2018, Exhibit MS-9 [ASIC.0900.0005.0002 at .0003].

⁴⁸ Transcript, Michael Saadat, 1 June 2018, 2981.

⁴⁹ Transcript, Michael Saadat, 1 June 2018, 2983.

⁵⁰ Transcript, Michael Saadat, 1 June 2018, 2984–6.

⁵¹ Exhibit 3.162, Witness statement of Michael Saadat, 24 May 2018, 21 [41].

⁵² Transcript, Michael Saadat, 1 June 2018, 2987.

terms.⁵³ Even so, Mr Saadat said that ASIC would not express its belief that a term was unfair or in breach of the law unless a court had made such a finding. Instead, ASIC preferred to frame its comment in terms of ‘potential’ unfairness.⁵⁴ Moreover, ASIC would only express to a bank its belief that a term was ‘potentially’ unfair where ASIC had decided it was prepared to take the matter to court if the bank did not accept ASIC’s position. And because ASIC was not yet prepared to commence proceedings against the banks who had ‘taken a minimalist approach’, in ASIC’s internal view making those banks non-compliant with the law, ASIC was not prepared even to state directly that it believed terms in those contracts were unfair.⁵⁵

Instead, ASIC’s approach would be ‘consultative’, that is, ASIC would ‘assist non-compliant businesses to comply with their obligations in the first few months of the new regime’. If a business was uncooperative, enforcement action would be ‘considered’.⁵⁶

ACCC also defined its approach at this time as ‘consultative’. But in the case of ACCC, ‘consultative’ meant ‘working with businesses to ensure they are ready to comply from 12 November.’ ACCC made plain that, after the law came into operation, it would take enforcement action where it saw breaches of the UCT provisions.⁵⁷ In October 2017, ACCC commenced action against a company for breaches of the provisions.⁵⁸

In March 2017, (several months after the law had come into operation), a further ASIC review of small business loan contracts from eight lenders concluded that there had been a failure to comply with the new legal regime. On 16 May 2017, ASIC published a joint media release with the Small Business Ombudsman, stating that ‘lenders, including the big four banks, needed to lift their game in meeting the unfair terms legislation.’⁵⁹ Mr Saadat agreed that at this point ASIC was in a position in which the Ombudsman

⁵³ Transcript, Michael Saadat, 1 June 2018, 2987.

⁵⁴ Transcript, Michael Saadat, 1 June 2018, 2988.

⁵⁵ Transcript, Michael Saadat, 1 June 2018, 2988.

⁵⁶ Transcript, Michael Saadat, 1 June 2018, 2989.

⁵⁷ Transcript, Michael Saadat, 1 June 2018, 2989.

⁵⁸ *Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd* [2017] FCA 1224

⁵⁹ Exhibit 3.169, 16 May 2017, Media Release of ASIC and ASBFEO, 2.

was pushing it regarding the UCT provisions.⁶⁰ But over the next 10 months ASIC negotiated with the banks, and in March 2018 published a report detailing the changes the big banks had agreed to make to their small business contracts.⁶¹

Asked to reflect on the regulator's approach to the UCT reforms, the major banks between them could not find a word of criticism for ASIC. Both Westpac and ANZ called ASIC's approach 'appropriate'⁶² and 'effective'⁶³ and emphasised that negotiation with industry could achieve a result faster than compulsory enforcement action,⁶⁴ presumably on the basis they would have fought such action. CBA submitted that ASIC's approach was 'constructive', and enabled 'understanding from ASIC's perspective' of the 'genuine interests of the bank.'⁶⁵ It continued that:

ASIC's approach has prioritised persuasion and engagement with its regulated community rather than reliance on other methods of enforcement. This has been effective, albeit potentially involves longer consultation than a mandated, regulated outcome.⁶⁶

⁶⁰ Transcript, Michael Saadat, 1 June 2018, 3001.

⁶¹ ASIC, *Report 565: Unfair Contract Terms and Small Business Loans*, 15 March 2018.

⁶² Westpac, *Westpac Banking Corporation General Submissions on Business Lending*, 12 June 2018, 21 [78]; ANZ, *Submissions by ANZ in Respect of General Questions – Round 3 Hearing*, 12 June 2018, 13 [69].

⁶³ Westpac, *Westpac Banking Corporation General Submissions on Business Lending*, 12 June 2018, 21 [79]; ANZ, *Submissions by ANZ in Respect of General Questions – Round 3 Hearing*, 12 June 2018, 13 [69].

⁶⁴ Westpac, *Westpac Banking Corporation General Submissions on Business Lending*, 12 June 2018, 21 [79]; ANZ, *Submissions by ANZ in Respect of General Questions – Round 3 Hearing*, 12 June 2018, 13 [69].

⁶⁵ CBA, *Commonwealth Bank of Australia and Its Associated Australian Entities (Group) Round 3 Hearing – Loans to Small and Medium Enterprises, Closing Submissions PART B – Questions Arising from the Case Studies*, undated, 15 [70].

⁶⁶ CBA, *Commonwealth Bank of Australia and Its Associated Australian Entities (Group) Round 3 Hearing – Loans to Small and Medium Enterprises, Closing Submissions PART B – Questions Arising from the Case Studies*, undated 15 [65].

ANZ emphasised the testimony of Mr Saadat in explaining the advantages of ASIC's approach over the commencement of proceedings against it.⁶⁷

A regulator should look carefully at such positive reviews. They point to the regulated community having its way about when and how the law will be enforced. In this particular case it is necessary to bear at the very forefront of consideration the inescapable fact that the regulator did not cause the regulated community to begin to obey the law by the date set by Parliament. Obedience came later than the law required. That is unsatisfactory. That the regulated community found the result convenient and free from discomfort is simply beside the point.

2.7 Limited powers

ASIC's powers are limited. All regulatory and enforcement powers are limited. But ASIC has had greater enforcement powers than it has used.

ASIC pointed to gaps in its powers. The ASIC Enforcement Review Taskforce has recommended that ASIC's powers be expanded and some penalties increased. Final adoption of those recommendations has been said to depend upon the recommendations made by this Commission. At this point, it is enough to say that there appears to be good reason to make the several changes recommended but that the effect of making those changes depends entirely upon the way in which the provisions are implemented. In particular, increased penalties for misconduct will have only limited deterrent (or punitive) effect unless there is greater willingness to seek their application.

2.8 Litigation and regulation

More than once, ASIC witnesses referred to the cost of litigation, the time it takes and the inevitable uncertainties associated with it.

When it does go to court, ASIC's success rate for litigation has averaged above 90% since 2011–2012. In 2015–2016 it reached 96%.⁶⁸ That seeming accomplishment has concerning implications, for it suggests that

⁶⁷ ANZ, *Submissions by ANZ in Respect of General Questions – Round 3 Hearing*, 12 June 2018, 13 [69]; see also, eg, Transcript, Michael Saadat, 1 June 2018, 3003.

⁶⁸ Treasury, *FSRC Background Paper No. 24: Financial Services Royal Commission Submission on Key Policy Issues*, 28 [102] n 71.

ASIC has a preference for easily won cases – the ‘binary’ cases mentioned by Ms Macaulay – and does not do enough to resolve grey areas in the application of the law.

Financial services entities include some very large entities. Complex litigation against large entities is necessary. Regulation of banks must reflect their size, influence and market restraints. ASIC itself recognises that the behaviour of major banks shapes market conduct more widely. Mr Saadat, for example, explained ASIC’s approach to the UCT provisions as directing its negotiations to the big four banks so as to leverage across the other financial institutions in the market.⁶⁹ If persuading major banks to change their ways by way of protracted negotiation will inspire smaller entities to follow suit, there is every reason to think that imposing civil penalties or other litigated consequences upon them would have the same effect on smaller entities.

Yet the ASIC Capability Review found, in 2015, that ASIC’s litigation strategy is risk averse and that ASIC does not pursue strategically important litigation.⁷⁰ Only 41% of external stakeholders agreed that ‘ASIC deters individuals or organisations from engaging in misconduct’. Only 23% of external stakeholders, and 37% of ASIC senior executive leaders and Commissioners, thought that ‘ASIC acts quickly to investigate potential breaches of the law’.⁷¹

ASIC explained its approach to enforcement by reference to its limited resources. Of course ASIC, like any regulator, must make choices and assign priorities on the basis of resources. I need no persuasion that litigation is expensive. The expense is not just of financial outgoings but of the time and effort expended by staff. Their number is limited. As was the tenor of ASIC’s evidence, resources spent on litigation represent an opportunity cost to it in respect of other forms of enforcement.⁷² But I do not accept that the appropriate response to the problem of allocating scarce

⁶⁹ Transcript, Michael Saadat, 1 June 2018, 2993, 3004.

⁷⁰ ASIC, *Fit for the Future: A Capability Review of the Australian Securities and Investments Commission*, 4 December 2015, 120.

⁷¹ ASIC, *Fit for the Future: A Capability Review of the Australian Securities and Investments Commission*, 4 December 2015, 8; quoted in Treasury, *FSRC Background Paper No. 24: Financial Services Royal Commission Submission on Key Policy Issues*, 28 [103].

⁷² eg. Transcript, Louise Anne Macaulay, 27 April 2018, 1915.

resources is for a regulator to avoid compulsory enforcement action and instead attempt to settle all delinquencies by agreement.

Negotiation and persuasion are important and universal regulatory tools. The Commonwealth Government has issued a guide to regulators' administration of the Australian Consumer Law that features an escalating enforcement pyramid⁷³ based on the Braithwaite enforcement pyramid. The Braithwaite pyramid is often referred to in regulatory literature and founds the model of 'responsive regulation'. Regulatory response escalates from the tools at the base of the pyramid to the tools at the apex. The strength of response increases at each step. Central to the model is the regulator's willingness to escalate its response in order to secure compliance.⁷⁴ In the **Australian Credit Licence** enforcement pyramid, the base options are education, advice and persuasion; industry self-regulation; and formal written warnings. The next step is infringement notices; then enforceable undertakings, public warning notices and adverse publicity orders; then civil action; and finally criminal action.⁷⁵

The United States Consumer Financial Protection Bureau expresses the same ideas, in simpler terms, by describing its work as being to: 'Empower', 'Enforce' and 'Educate'.⁷⁶

Enforcement generates the moral suasion that underpins regulatory authority. A regulator 'speaking softly' will rarely be effective unless the regulator also carries a big stick. The academic literature has warned of the:

dangers in adopting a pure 'advise and persuade' or compliance oriented strategy of enforcement, which can easily degenerate into intolerable laxity and fail to deter those who have no interest in complying voluntarily. More broadly, there is considerable evidence that cooperative approaches

⁷³ Commonwealth of Australia, *Compliance and Enforcement: How Regulators Enforce the Australian Consumer Law*, 2010, 11.

⁷⁴ Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992) 38.

⁷⁵ Commonwealth of Australia, *Compliance and Enforcement: How Regulators Enforce the Australian Consumer Law*, 2010, 11.

⁷⁶ Consumer Financial Protection Bureau, *The Bureau* (undated) <www.consumerfinance.gov/about-us/the-bureau/>.

may actually discourage improved regulatory performance amongst better actors if agencies permit lawbreakers to go unpunished.⁷⁷

Persuasion of the major players has not had the effect of changing behaviour across the industry. Though that was ASIC's stated strategy with regard to the UCT provisions and ASIC submitted that a litigated outcome may have been confined to its facts and not had 'broader applicability'.⁷⁸ Once the negotiations with the big four were over, ASIC was left with 'a concern more broadly that other institutions may not have made the changes that are necessary', among them the fact that Suncorp had not even ascertained whether its contracts were compliant with the provisions.⁷⁹

The effect of negotiated outcomes that do not require approval by a court is that, at least to some degree, sanctions for breaches (or what ASIC considers to be breaches) are always within the control of the regulated entity. The consequence is that conduct that breaches the law, or is likely to breach the law, may be treated as involving calculated risks, taken in pursuit of some desired end (usually profit), with consequences that are seen as being manageable. Breach and the consequences of breach come to be treated as just a cost of doing business.

By contrast, litigated outcomes are compulsory. They produce outcomes that can only be produced by the judgments of the courts. Prime among them are general and specific deterrence. Specific deterrence involves imposing on offenders a penalty that will persuade them that it is not in their interests to reoffend. And, at the same time, penalties must be set at a level that deters other members of the regulated community from engaging in conduct of the same kind. A court judgment provides public denunciation of the conduct as wrong and meriting punishment. Both the determination of contravention and the proper setting of penalty provide a measure of general deterrence of the regulated community.

Of course, if a regulator commences a court proceeding against an entity, it is possible for the regulator and the entity to 'settle' the proceeding in the sense that they can agree that the entity will admit certain contraventions

⁷⁷ Neil Gunningham, 'Compliance, Deterrence and Beyond' in *Compliance and Enforcement of Environmental Law* (Edward Elgar Publishers, LeRoy Paddock ed, 2017) 63, 66.

⁷⁸ Transcript, Michael Saadat, 1 June 2018, 3003.

⁷⁹ Transcript, Michael Saadat, 1 June 2018, 3004.

(and the regulator may not press other alleged contraventions). They may also agree on what they consider to be the appropriate pecuniary penalty (taking into account co-operation and early admissions) and other relief for those admitted contraventions. That is a conventional course adopted by other regulators. But such a course still requires the approval of the court. It still requires a court to be satisfied that the agreed penalty is appropriate.⁸⁰ The court still delivers a judgment and by that judgment the court denounces the contravening conduct.

Public denunciation of unlawful conduct enforces and affirms the applicable norms of behaviour. It both expresses and forms community standards and expectations. ASIC's witness Ms Macaulay agreed, however, that public denunciation plays no part in ASIC's current enforcement approach.⁸¹

Judicially determined consequences have other obvious advantages. They set a binding precedent. They depend upon a judicial determination of the proper construction and application of relevant legislation. It should bring the understanding of the applicable law better into line with the principles of the general law than can readily be achieved by one agency interpreting and applying what it sees as 'its own' legislation.

There is also value in the public and conclusive demonstration that legislation is not achieving its stipulated aims. ASIC has taken the view, at least until very recently, that Section 912D of the Corporations Act is too difficult to enforce through litigation. While ASIC has informed government of its view, there is no more powerful way of making the point that the law is not working as it was intended to work than litigating its application. This would of course be a drain on ASIC's resources in the first instance. But if ASIC's legal advice is correct the resulting, binding, judicial determination would be a powerful persuasive tool when seeking to obtain a workable legislative alternative. (In that regard, reference may usefully be made to the ACCC's losses in a series of proceedings in 2015 under the misuse of market power provisions of the *Competition and Consumer Act 2010* (Cth). Those losses added to pressure for reform of the relevant legislative test, eventually yielding legislative amendment in 2017.)

⁸⁰ *Commonwealth of Australia v Director, Fair Work Building Industry Inspectorate* (2015) 258 CLR 482 at 504 per French CJ, Kiefel, Bell, Nettle and Gordon JJ.

⁸¹ Transcript, Louise Anne Macaulay, 27 April 2018, 1910.

3 The future: Regulation

3.1 Change the law?

As noted elsewhere in this report, I begin from the premise that breaches of existing law are not prevented by passing some new law that says 'Do not do that'. And given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. That should not be done unless there is a clearly identified advantage. It should be considered recognising that there is every chance that adding a new layer of law and regulation would serve only to distract attention from the very simple ideas that must inform the conduct of financial services entities:

- **Obey the law.**
- **Do not mislead or deceive.**
- **Be fair.**
- **Provide services that are fit for purpose.**
- **Deliver services with reasonable care and skill.**
- **When acting for another, act in the best interests of that other.**

These ideas are very simple. Their simplicity points firmly towards a need to simplify the existing law rather than add some new layer of regulation. But the more complicated the law, the easier it is to lose sight of them. The more complicated the law, the easier it is for compliance to be seen as asking 'Can I do this?' and answering that question by ticking boxes instead of asking 'Should I do this? What is the *right* thing to do?' And there is every reason to think that the conduct examined in this report has occurred when the only question asked is: 'Can I?'.

The existing law has rightly been described, in at least some respects, as labyrinthine and overly detailed. In the blizzard of provisions, it is too easy to lose sight of those simple ideas that must inform the conduct of financial services entities.

It follows that **the regulatory framework does not always assist the regulator to impose discipline on entities. Regulatory complexity increases pressure on the regulator's resources and may allow entities to develop cultures and practices that are unfavourable to compliance.**

Regulatory complexity affects the conduct of banks and other financial services entities. In particular, it affects how legal requirements are interpreted by and for front line staff. Mr David Cohen, Chief Risk Officer of CBA, observed that the accretion of new legal requirements:

has been an additive process and layer upon layer upon layer is introduced, is absorbed. Rules and policies are set around that new layer. And it is sometimes difficult to distil the very essence of the fundamental obligations out of all of that set of policies, procedures, processes, etc.⁸²

In particular, as noted above, regulatory complexity may foster the development of a 'box-ticking' approach to compliance, in which entities develop and focus on internal procedures intended to fulfil various complicated legal obligations, not only at the expense of considering the circumstances in each matter on their merits but also at the expense of measuring what is proposed against those simple ideas that must inform the conduct of all entities in the financial services industry.

3.2 The place of the Banking Code of Practice

Significant instances of conduct identified and criticised in this report are criticised because the relevant bank did not comply with the banking industry code of practice as it stood at the relevant time. The most notable of these instances concerned lending to small and medium enterprises (SMEs) and lending to agricultural enterprises. Their occurrence requires consideration of what place the Banking Code of Practice (the Code) should have in moulding general practice in the industry and particular dealings with individual customers.

Until the most recent code, the content of all codes of banking practice has been determined only by the industry. And in years past, the codes did not bind all banks. Although approved by ASIC, it is necessary to recognise that the content of the 2019 Code was also determined by those who are to be

⁸² Transcript, David Antony Keith Cohen, 30 May 2018, 2822.

bound by its provisions: the banks themselves. It is they who decided how the definition of small business should be framed. It is the banks, therefore, who determined what reach the Code will have.

Contravention of a provision of the current Code or of a provision of the 2019 Code may be a breach of contract but otherwise it is not, and will not be, a contravention of law. The Code stands as a set of promises made by the banks enforceable only at the behest of an aggrieved customer. Yet, the Code has particular significance for SMEs and some agricultural enterprises.

The Code is not subject to Part IVB of the *Competition and Consumer Act 2010* (Cth) (Sections 51ACA–51AEA). The Code therefore stands in sharp contrast with generally similar industry codes of practice that are dealt with under that Part. Codes dealt with by Part IVB of the Competition and Consumer Act are called ‘applicable industry codes’. Section 51ACB of the Competition and Consumer Act provides that ‘[a] corporation must not, in trade or commerce, contravene an applicable industry code’.⁸³ And a contravention of an applicable industry code engages all the remedial provisions of Part VI of the Competition and Consumer Act. Further, if the relevant provision of an applicable industry code is a civil penalty provision, the regulator, ACCC, may bring civil penalty proceedings under Section 76. None of this applies to the current banking code and none of this will apply to the 2019 Code.

As has been noted in connection with both lending to SMEs and lending to agricultural enterprises, the banking codes state norms of conduct that are very important to borrowers, especially SMEs and agricultural enterprises. The norms that are stated in the Code provide important protections to those borrowers.

The enforcement of these norms should not be left to borrowers. To leave enforcement to borrowers means, too often, that failure to comply with relevant norms of behaviour by a bank is unrecognised or, if recognised, is not remedied. The default will seldom emerge before the borrower is in

⁸³ An ‘applicable industry code’ is defined by s 51ACA as ‘the prescribed provisions of any mandatory industry code and the prescribed provisions of any voluntary industry code that binds the corporation’.

difficulty. Too often, then, the borrower will not have the means, or the will, to take on the battle.

But if provisions of the kind provided by the Competition and Consumer Act are applied to the Code, the regulator may enforce its provisions. And if there were evidence of systemic failure, the regulator should.

Making the promises made in the Code enforceable, as contraventions of the law, may provide better protection for SMEs and agricultural enterprises.

The immediate response to proposals of this kind may be to warn of effects on the availability or cost of credit. (As explained in Chapter 4, much was made of these matters in connection with the definition of small business in the 2019 Code.) If warnings of that kind are sounded, they should be examined with care. The banks have agreed to apply the norms that are stated in the Code. It is to be presumed that they now seek to apply them. That being so, it is far from obvious why making their contravention a breach of law (as well as a breach of contract) should impose any additional cost or burden on the banks. In particular, it is anything but obvious why applying provisions of the kind now found in Part IVB of the Competition and Consumer Act to the 2019 Code should affect the availability or price of credit.

No matter whether the banking or other financial services industry codes should be given legislative recognition and application similar to the provisions of Part IVB of the Competition and Consumer Act, application for approval of a code by ASIC must be taken to entail that ASIC will determine for itself whether the terms proposed are complete and satisfactory. The fact that the industry has settled upon a draft of the Code cannot be treated as determinative.

If contravention of codes becomes a contravention of law, it will be even more important that the regulator makes its own decisions about how the relevant provisions of the Code should be framed. Those decisions extend beyond debates about the framing of particular provisions. They call for careful consideration of whether the Code should deal with additional issues. The course of evidence in this Commission may well be thought to suggest that there are matters not now dealt with in the 2019 Code that should be considered. Without seeking to limit the field of debate, reference may be made to some of the issues that arose in connection with the

enforcement of loans to agricultural enterprises and in connection with access to banking services by Aboriginal and Torres Strait Islander peoples.

4 The future: The regulators

4.1 ASIC

As the Commission's work has continued, there are signs that ASIC may be seeking to alter its approach to enforcement. Even so, I remain to be persuaded that it can and will make the necessary changes.

There are several reasons for caution. First, there is the size of ASIC's remit. Second, there seems to be a deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of and punishment for wrongdoing. Third, remediation of consumers is vitally important but it is not the *only* relevant consideration. Fourth, there seems no recognition of the fact that the amount outlaid to remedy a default may be much less than the advantage an entity has gained from the default. Fifth, there appears to be no effective mechanism for keeping ASIC's enforcement policies and practices congruent with the needs of the economy more generally.

Something more should be said about each of these points.

4.1.1 Size of remit

Is ASIC's remit *too* big? If it were to be reduced, who would take over those parts of the remit that are detached from ASIC? Why would detachment be better?

The ASIC Capability Review observed that ASIC's mandate has increased over time. ASIC now administers 11 pieces of legislation and their associated regulations.⁸⁴ The legislation itself has grown longer and more complex. The length of the Corporations Act, for example, has increased by 178% since 1981.⁸⁵ The Commission's preparation of Background Papers for the hearings found that an introductory overview of the law governing

⁸⁴ ASIC, *Fit for the Future: A Capability Review of the Australian Securities and Investments Commission*, 4 December 2015, 133.

⁸⁵ ASIC, *Fit for the Future: A Capability Review of the Australian Securities and Investments Commission*, 4 December 2015, 134.

consumer credit in Australia required 86 pages of explanation; financial advice and sale of financial products required 114; and small business lending, which did not repeat matters overlapping with consumer lending, required 41 pages.

ASIC is called upon to provide the additional guidance required by these expanding regulatory regimes. It has done this by more than 450 regulatory guides and information sheets published on its website.⁸⁶ That work, and the undoubted corollary of informal discussion and liaison with industry, deflects resources from ASIC's enforcement work. The regulatory guidance issued by ASIC is generally first class. But it is important that emphasis is not placed on guidance at the expense of enforcement. Hence, if guidance is given, it is important to discover whether the guidance is being applied and, if it is not, to do what is necessary to have it applied. When guidance is given about the operation of the law (as it is in the many regulatory guides ASIC has published) the law, as interpreted by ASIC, should be monitored and enforced. When guidance is given about desirable business practices (as it was, for example, in connection with funeral insurance) consideration must be given to whether those practices are then adopted and, if they are not, whether some enforcement action can and should be taken or some regulatory change promoted.

That is particularly so with respect to the largest entities. Although regulatory complexity imposes burdens on business, the largest entities are very sophisticated and well-resourced. They are well able to find out what the law requires of them. It may be that there are respects in which compliance imposes unjustified costs for business. That is a question periodically examined by government and one that the banks are quite able to agitate for themselves.

4.1.2 Negotiated outcomes

Of course there will be cases where a negotiated outcome to some contravention of law, outside any proceedings in court, will serve the public interests best. But whether or not proceedings are on foot or anticipated, there can be no satisfactory negotiated outcome if ASIC has not *first*

⁸⁶ ASIC, *Fit for the Future: A Capability Review of the Australian Securities and Investments Commission*, 4 December 2015, 134.

decided what it *wants* from the negotiation (as distinct from what it thinks the entity is prepared to give).

4.1.3 Remediation

Remediation programs can be long and difficult. But paying attention to how the entity will remedy those hurt by its conduct must never be allowed to detract from the fact of contravention. What is to be done about the contravention? The regulator is not called on to choose between remediation and enforcement. Often, enforcement will induce an entity to set about remedying the consequences of its default, or committing to doing so, before the penalty is fixed.

4.1.4 Remedy less than profit

Financial services entities will often have profited from their contraventions of the law. Often the profit earned will be larger than the damage to consumers. Nothing in the evidence before the Commission shows that ASIC takes this into account when negotiating outcomes with entities. So-called community benefit payments associated with enforceable undertakings appear, at least on their face, to be less than the penalty that ASIC might properly have sought in civil penalty proceedings and unrelated to the profit derived by the entity from the contravening conduct. The regulator *must* do whatever can be done to ensure that breach of the law is not profitable.

4.1.5 Congruence between policies and the needs of the economy

Legislation allowing punishment (criminal or civil) of conduct proceeds from the premise that engaging in the conduct is harmful to society. In financial services legislation, the premise is more likely to be that the conduct will be harmful to the economy generally. Hence, the ways in which ASIC (or APRA) enforce these laws will affect the overall health of the economy. Is the manner of enforcement of these laws a matter that is to be supervised by or on behalf of the political branches of government – either by the Parliament generally or by a particular minister?

In its Final Report, the Murray Inquiry did not recommend major changes to the overall regulatory system but did recommend action in five areas ‘to improve the current arrangements and ensure regulatory settings remain fit

for purpose in the years ahead'.⁸⁷ One of those areas was to improve 'the regulator accountability framework' by, among other things, establishing a new Financial Regulator Assessment Board 'to undertake annual ex post reviews of overall regulator performance against their mandates'.⁸⁸ Is it time to revisit these ideas? Is there a case for a supervisory body of this kind? That is, is there a case for external review by an inspectorate or a statutory officer reporting directly to the Parliament about how regulatory powers have been exercised in some preceding period?

These may not be small changes. They are changes that would have to be examined in the light of what, if any, other changes in law were to be made.

4.2 APRA

APRA's chief focus is governance and risk culture. Proper governance and risk culture are critical to the prudent conduct of banking business; they are subjects falling within the 'prudential matters' about which APRA can issue, and has issued, Prudential Standards under the *Banking Act 1959* (Cth).⁸⁹

The *Australian Prudential Regulation Authority Act 1998* (Cth) provides that 'In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia'. That is, APRA is obliged to look at issues of governance and risk culture through the lens of financial system stability.

Understood in that light, APRA's lack of action in response to the widespread occurrence of the conduct described in this report may, perhaps, be more readily understood. Even so, by August 2017, there had been so many 'incidents in CBA's recent history that [had] damaged its reputation and public standing' that APRA decided to establish a Prudential

⁸⁷ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-22 [ASIC.0902.0001.0581 at .0845].

⁸⁸ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-22 [ASIC.0902.0001.0581 at .0845].

⁸⁹ See, eg, APRA, *Prudential Standard CPS 510 Governance*, July 2017; APRA, *Prudential Standard CPS 220 Risk Management*, July 2017.

Inquiry into governance, culture and accountability within the CBA group.⁹⁰ Until that time, APRA had taken no public step pointing to any deficiency in the governance and risk culture of any of the major banks or any of the other large financial services entities falling within APRA's remit.

As a consequence of the CBA review, CBA offered, and APRA accepted, an enforceable undertaking to 'submit a remedial action plan' that would include 'a clear and measurable set of responses in respect of each recommendation made in the Final Report' of the review.

For the purposes of this report, the central question posed by the chain of events that has been described is whether other financial services entities have the same or similar deficiencies of governance and risk culture the panel identified in relation to CBA. As this report records, other entities have engaged in conduct of the kinds that led APRA to conduct its inquiry into CBA. The conduct suggests that there has been insufficient attention given within those entities to regulatory and compliance risk. It suggests want of attention by those entities to reputational risk. Some of the conduct suggests want of proper governance in the entity.

What steps can APRA take with respect to other entities? What steps (if any) should it take?

These questions and the several questions raised in connection with ASIC's responses to the conduct that has been identified and criticised in this report must be considered in light of the issues raised in the next chapter of this report. But it is convenient to draw together the questions that have been identified in this chapter.

⁹⁰ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 6 [1.1].

5 Issues that have emerged

5.1 The present regulatory regime

- Is the law governing financial services entities and their conduct too complicated?
 - Does it impede effective conduct risk management?
 - Does it impede effective regulatory enforcement?

5.2 Accountability of the regulators

- Should there be annual reviews of the regulators' performance against their mandates?

5.2.1 ASIC

- Is ASIC's remit too large?
 - If it were to be reduced, who would take over those parts of the remit that are detached?
 - Why would detachment be better?
- Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?
- Should industry codes relating to the provision of financial services, such as the 2019 Banking Code of Practice, be recognised and applied by legislation like Part IVB of the *Competition and Consumer Act 2010* (Cth)?
- Are ASIC's enforcement practices satisfactory? If not, how should they be changed?
- If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?

- Should ASIC's enforcement priorities change? In particular, if there is a reasonable prospect of proving contravention, should ASIC institute proceedings unless it determines that it is in the public interest not to do so?

5.2.2 APRA

- Are APRA's regulatory practices satisfactory? If not, how should they be changed?
- Are APRA's enforcement practices satisfactory? If not, how should they be changed?
- Does the conduct identified and criticised in this report call for reconsideration of APRA's prudential standards on governance?
- Having examined the governance, culture and accountability within the CBA group, what steps (if any) can APRA take in relation to those issues in other financial services entities?

9. Entities: Causes of misconduct

1 Culture, governance and remuneration

The Terms of Reference require me to inquire into whether my findings about misconduct and conduct falling short of community standards and expectations:

- (a) are attributable to the particular culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant subsector; or
- (b) result from other practices, including risk management, recruitment and remuneration practices, of a financial services entity, or in the relevant industry or relevant subsector.

One simple, but telling, observation informs those inquiries. **All the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned.** If there are exceptions, they are immaterial. For individuals, the conduct resulted in being paid more. For entities, the conduct resulted in greater profit.

The governance and risk management practices of the entities did not prevent the conduct occurring.

The culture and conduct of the banks was driven by, and was reflected in, their remuneration practices and policies.

The conduct that is at the heart of the Commission's work is inextricably connected with remuneration practices, with deficiencies in governance and risk management and with the culture of the entities concerned.

Remuneration policies were tailored to different parts of the staff or work of each of the major banks but substantially they were the same for almost every employee at almost every level of the organisation. At least until very recently, the central tenet of the remuneration policies of not only the four

largest banks but other banks as well (apart from the mutuals) has been to reward what the organisation treats as important: sales and profit. If there were exceptions to this approach, they were immaterial.

The conduct identified and criticised in this report was driven by the pursuit of profit – the entity's revenue and profit and the individual actor's profit. Employees of banks learned to treat sales, or revenue and profit, as the measure of their success.

The banks say that they have changed or are changing their remuneration policies and it will be necessary to look carefully at those claims. But almost every piece of conduct identified and criticised in this report can be connected directly to the relevant actor gaining some monetary benefit from engaging in the conduct. And every piece of conduct that has been contrary to law is a case where the existing governance structures and practices of the entity and its risk management practices have not prevented that unlawful conduct.

2 Management by measurement

Banks have sought to manage their staff by measurement. From the most senior executives to the most junior employee, remuneration has been measured in two parts: a base salary and a short term incentive payment or bonus. Often enough a large part of the short term incentive payment has been payable if the employee has performed satisfactorily. That is, a bonus has been paid for an employee doing what the employee is employed to do. The premise must be that the immediate supervisor either cannot, or will not, adequately manage and supervise those employees.

An employee will treat as important what the employee believes that the employer generally, or the employee's supervisors and peers, treat as important. When the employee and others in the organisation, including the employee's supervisors and peers, are remunerated according to how much product they sell, or how much revenue or profit they contribute to the entity, sales or revenue and profit are treated as the goal to pursue. *How* the goal is pursued is treated as a matter of lesser importance. If the short term incentive scheme reduces the amount allowed if an employee does not meet some standard (of accuracy or behaviour) the employee may focus as much upon avoiding error being discovered as upon avoidance of error.

Management by measurement assumes, wrongly, that measurement can capture all that matters in dealings between bank and customer. It cannot and does not. So much was illustrated most clearly in the financial advice cases considered by the Commission. There are often circumstances where it is in the best interests of an adviser's client or a bank's customer to make no change to existing arrangements and take no new or different product. It is not easy to measure how often an employee is right to give advice to do nothing.

There can now be no doubt that remuneration practices can drive, and in Australia have driven, conduct of staff and conduct of intermediaries that is not consistent with the interests of the customer. The emphasis given to sales and profit, and the rewards that were given for selling the employer's product, are central reasons for the conduct of banks and intermediaries that has been identified and is criticised in this report.

The connections between remuneration, governance, risk management and misconduct have been recognised for many years. It is, therefore, useful and important to trace some of that history.

3 Some matters of history

3.1 The GFC and remuneration

As the Australian Prudential Regulation Authority's (APRA's) Prudential Inquiry into governance, culture and accountability within the CBA group noted, remuneration practices at financial institutions globally 'came under a harsh spotlight during the global financial crisis'.¹ The report said that remuneration practices 'were exposed as promoting behaviours and outcomes that were inconsistent with sound risk management and the best interests of customers'.²

¹ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 65 [8.1].

² APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 65 [8.1].

The immediate responses to this exposure were directed to improving risk management. In 2009, the Financial Stability Board³ released its Principles for Sound Compensation Practices⁴ and accompanying Implementation Standards.⁵ As the panel inquiring into CBA recorded, these principles 'sought to realign executive remuneration systems with prudent risk management and long-term financial sustainability'.⁶ The published principles and standards were not explicitly directed to issues about the best interests of customers.

Soon after the Financial Stability Board had published these principles and standards, APRA issued a Prudential Practice Guide about remuneration.⁷ The guide was directed to all institutions regulated by APRA including **authorised deposit-taking institutions** (ADIs), general insurers and life companies. It was described as supporting compliance with APRA's prudential standards about governance.⁸ The guide said that 'APRA's remuneration requirements and guidance relate to managing or limiting risk incentives associated with remuneration'.⁹ The guide did not identify the kinds of risk, or risk incentives, to which it was directed. It said nothing about conduct risk, compliance or regulatory risk and nothing about reputational risk. Coming, as it did, in the immediate wake of the Global Financial Crisis, it seems probable that those to whom the guidance was addressed would

³ Established in 2009 as the successor to the Financial Stability Forum that had been founded in 1999 by the G7 Finance Ministers and Central Bank Governors as a mechanism (among other things) for developing and implementing strong regulatory, supervisory and other policies in the interest of financial stability. See Financial Stability Board, *Our History* (2018) Financial Stability Board <www.fsb.org/about/history/>.

⁴ Financial Stability Forum, *FSF Principles for Sound Compensation Practices* (2 April 2009) Financial Stability Board <www.fsb.org/wp-content/uploads/r_0904b.pdf>.

⁵ Financial Stability Board, *FSB Principles for Sound Compensation Practices Implementation Standards* (25 September 2009) Financial Stability Board <www.fsb.org/wp-content/uploads/r_090925c.pdf>.

⁶ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 65 [8.1].

⁷ APRA, *Prudential Practice Guide PPG 511 – Remuneration*, 30 November 2009 <www.apra.gov.au/sites/default/files/PPG511_REM_revised-Dec-09_1.pdf>.

⁸ See APRA, *Prudential Standard APS 510 – Governance*; APRA, *Prudential Standard GPS 510 – Governance*; and APRA, *Prudential Standard LPS 510 – Governance*; as made from time to time.

⁹ APRA, *Prudential Practice Guide PPG 511 – Remuneration*, 30 November 2009, 5 [2].

have seen it as directed primarily, even exclusively, to the management of financial risk taking.

3.2 Future of Financial Advice reforms

The **Future of Financial Advice** (FoFA) reforms of 2012 drew the connection between remuneration and poor customer outcomes. The legislation did that by including provisions expressly directed to the subject of **conflicted remuneration**, defined as: benefits (monetary and non-monetary) given to a **financial services licensee**, or a representative of a licensee, who gives **financial product** advice to persons as retail clients that ‘because of the nature of the benefit or the circumstances in which it is given’ could reasonably be expected to influence the choice of product recommended or product advice given to the client.¹⁰

To the extent to which the banks or their subsidiaries participated in the personal financial advice market, these provisions applied directly. But no wider application of the premise for these FoFA amendments (that remuneration affects conduct) to general remuneration arrangements within the banks seems to have been identified or considered by the Australian Securities and Investments Commission (ASIC), APRA or the banks themselves until several years after the FoFA reforms came into effect.

3.3 International developments

By 2015, there had been significant incidents of misconduct at financial institutions around the world. In that year, the Financial Stability Board launched a work plan to reduce misconduct.¹¹ The work resulted in the publication, in March 2018, of *Supplementary Guidance to the FSB*

¹⁰ *Corporations Act 2001* (Cth) s 963A.

¹¹ See Financial Stability Board, *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices* (9 March 2018) Financial Stability Board <www.fsb.org/2018/03/supplementary-guidance-to-the-fsb-principles-and-standards-on-sound-compensation-practices-2/>.

Principles and Standards on Sound Compensation Practices.¹² As the foreword to that guide said:¹³

Inappropriately structured compensation arrangements can provide individuals with incentives to take imprudent risks that are inconsistent with the firm's long-term value creation and time horizon of firm's risk. Costs may be imposed on firms and their customers not only by inappropriate risk-taking but also by misconduct that can result in harm to institutions, and their customers and other stakeholders and impair trust in the financial system more generally.

3.4 The Sedgwick Review

In the meantime, in Australia, the Australian Bankers' Association had appointed Mr Stephen Sedgwick AO to conduct an independent review into remuneration practices in retail banking. The review began in July 2016 and Mr Sedgwick provided his final report in April 2017.¹⁴ The report said that:¹⁵

[S]ome current [remuneration] practices carry an unacceptable risk of promoting behaviour that is inconsistent with the interests of customers and should be changed. Some of these relate to management practices that may reduce the effectiveness of the bank's risk mitigation strategies. Other practices relate to the way incentives and remuneration are structured. The need for change is true of both direct (i.e. staff) and some third party channels ...

New approaches to retail bank remuneration are by no means a panacea. But the Issues Paper [issued by Mr Sedgwick in January 2017] has documented instances in retail banking and across the financial services sector more broadly, both in Australia and abroad, in which incentives have at least appeared to drive behaviour that was not in the best interests of customers and, on occasion, scandalously so.

¹² See Financial Stability Board, *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices: The Use of Compensation Tools to Address Misconduct Risk* (9 March 2018) Financial Stability Board <www.fsb.org/wp-content/uploads/P090318-1.pdf>.

¹³ See Financial Stability Board, *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices: The Use of Compensation Tools to Address Misconduct Risk* (9 March 2018) Financial Stability Board 1 <www.fsb.org/wp-content/uploads/P090318-1.pdf>.

¹⁴ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review.

¹⁵ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, i.

Mr Sedgwick made 21 recommendations. He summarised the effect of the recommendations he made about retail bank staff (as distinct from introducers, referrers, franchisees and **mortgage brokers**) as being:

- Incentives are no longer paid to any retail staff based directly or solely on sales performance (see Recommendations 2 and 7);
- Instead, eligibility to receive any personal incentive payments will be based on an assessment of that individual's contribution across a range of measures, of which sales (if included at all) will not be the dominant component (Recommendations 3, 4, 5, and 6); and the maximum available payments will be scaled back significantly for some roles (Recommendation 8);
- Retail bank culture will be demonstrably ethically and customer oriented (Recommendation 9);
- A significant investment will have been undertaken, as necessary, to ensure that performance is managed consistently with such a philosophy, supported by proactive steps to develop leadership and management skills at all levels so that management practices match the intent of the recommendations (Recommendations 10, 11, and 12); and
- With clear and consistent leadership shown by the Board and the most senior managers of the bank (Recommendations 13 and 14).¹⁶

The important features of those recommendations were to propose eliminating incentives directly or solely related to sales and reducing the influence of sales in performance scorecards. But those proposals were coupled with the need for changes in culture, philosophy and leadership. And as the report made clear, the sales oriented culture is deeply ingrained.¹⁷ Care must therefore be taken in considering discretionary remuneration arrangements lest that ingrained culture cause the exercise of discretion favouring sales over other goals or targets. No less importantly, the report observed that not all indicators of desirable behaviour can be measured.¹⁸ It follows, therefore, that to implement the recommendations,

¹⁶ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, ii.

¹⁷ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, 21 [5.1].

¹⁸ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, 23 [5.2].

especially with their focus on changing culture and developing leadership and management skills at all levels of the entities, marked changes would be needed in remuneration arrangements.

4 Responses to the Sedgwick Review: Changing remuneration and changing culture

Much attention is given in the Sedgwick Review, and in other reports looking at the connection between culture and remuneration, to the remuneration of front line staff. But, as already noted, the general scheme of remuneration by base salary plus incentive payments has been applied at every level of employment within most banks.

It is important, therefore, to recognise that providing senior management with incentives based on sales or revenue and profit will inevitably affect how senior management acts with respect to more junior members of staff. It will always be in the interests of any manager (no matter how senior) to have subordinates carry out their work in a way that will allow the manager to achieve whatever incentive targets have been set for that manager.

It follows, then, that **eliminating incentive based payments for front line staff will not necessarily affect the ways in which they are managed if their managers are rewarded by reference to sales or revenue and profit**. The behaviour that the manager will applaud and encourage is behaviour that yields sales or revenue and profit. The behaviour that is applauded and encouraged sets the standards to be met and forms the culture that will permeate at least that part of the entity's business.

When it is the most senior levels of the organisation that applaud and encourage behaviour that yields sales or revenue and profit, but do not adequately applaud and encourage consideration of compliance and conduct risks, the lesson from APRA's Prudential Inquiry into CBA is that the entity's culture is compromised. As the panel said in its report, CBA was 'vulnerable to missteps' because the 'voice of risk' particularly for 'non-financial risks' and the 'customer voice' were muted and were not

heard.¹⁹ And this, the panel found, was brought about by deficiencies in governance and risk management, especially management of conduct risk.

In response to the Sedgwick Review, all the major banks have made changes in remuneration practices. All would say that they now assess staff performance according to a 'balanced scorecard'. But what does this mean? It will be sufficient to explore that question by reference to ANZ and Westpac. That exploration shows that both continued (at least until very recently) to remunerate employees in ways that emphasised profit. That is, both entities sought to fix the amount of each employee's incentive payment by drawing, for the employee, an explicit connection between the ultimate success of the bank (as measured by revenue and profit) and the particular ways in which the individual employee had performed her or his job.

4.1 ANZ

ANZ has used a balanced scorecard since at least April 2017. The scorecard seeks to move away from focusing only on sales.

Before April 2017, ANZ branch staff had been required to achieve a 100% score on their financial Key Results Area (KRA) target in order to receive an incentive payment.²⁰ If 100% was achieved, the bonus would be paid unless a manager exercised his or her discretion to deprive the staff member of the payment.²¹

Since April 2017, ANZ says, the approach has placed greater emphasis on non-financial KRAs by requiring an overall performance of 'good' across both the financial KRA and the other three, non-financial KRAs: Customer; People and Reputation; and Risk and Process. So, Mr Tony Tapsall, ANZ's General Manager, retail branch network for Northern Queensland and Northern Territory said that 'a staff member who did not meet their financial KRA might still receive an incentive payment if they performed at above expectations in one or more of the other three KRAs.'²²

¹⁹ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 4.

²⁰ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, 12 [48(a)].

²¹ Exhibit 4.201, Witness statement of Tony Colin Tapsall, 21 June 2018, 12 [48(a)].

²² Exhibit 4.201, Witness statement of Tony Colin Tapsall, 21 June 2018, 12 [48(b)].

The description of the operation of the balanced scorecard is very complicated. But beneath the complexity lies a simple point, made in ANZ's 2017 Performance Management and Performance Measures for the Australian Branch Network. It is that 'Performance is reviewed half yearly and annually *to ensure employees are appropriately recognised and rewarded for their contributions towards ANZ's overall results*'.²³ The purpose of the incentive scheme is to improve 'ANZ's overall results'.

To be eligible to participate in the incentive program a staff member must meet certain minimum standards for the performance period. These assess performance, competencies and behaviours (the ratings and categories differing according to the employee's designation); completion of all accreditations and training required by their role; and meeting compliance standards for their role.²⁴

For retail staff that are not home lenders, the only two compliance measures that automatically disqualify an employee from the incentive program are failure to complete mandatory training or failure to attain sales accreditation.²⁵ For home lenders, there is one additional compliance requirement, which is that they achieve a greater than 85% initial pass rate and a greater than 95% final pass rate in their home loan file compliance review, which is calculated monthly.²⁶ A failure to achieve these minimum standards will not result in full disqualification from a half-yearly incentive payment until the failure has endured for at least four months. Failure to meet the minimum standard in the first three months will result in partial reduction of any incentive.²⁷ But ANZ tells its employees that 'where a large

²³ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0003] (emphasis added).

²⁴ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-9 [ANZ.800.634.3072 at .3076]. References are to the program as it stood at April 2017. ANZ sought and obtained a non-publication direction preventing disclosure of some details of its current program. The changes that were made to the program after April 2017 are not immediately relevant to the points considered here.

²⁵ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0038].

²⁶ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0039].

²⁷ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-9 [ANZ.800.634.3072 at .3081].

number of the same final breaches are recorded in the same month, impact to incentives may be limited to 1 month, subject to DM & GM approval. For the rest of the 6 month rolling period, this multi-breach situation would count as a single breach for incentives impact and eligibility assessment.²⁸

Once the minimum standards have been met, the retail employee's performance is assessed according to the four KRAs mentioned above: Customer (weighted at 35%), People and Reputation (15%), Financial and Discipline (30%) and Risk and Process (20%). Within each KRA are 'sub pillars' or subcategories that detail the outcomes that contribute to the KRA. Most subcategories are assessed at an individual level, but some are assessed at branch or even district level. The following discussion takes the breakdown of KRAs as assigned to personal bankers and home investment lending managers and associates as its example.

The Customer KRA contains four subcategories:

- Voice of Customer;
- SNBC Leads and Offers;
- Digital Engagement; and
- A–Z reviews.

Voice of Customer is assessed half at the individual level and half at the branch level. Voice of Customer is measured by Net Promoter Score, which is a measure of customer satisfaction based on real-time feedback.²⁹ The Net Promoter Score does not measure whether a customer has been serviced according to their best interests, or indeed their needs and it does not measure whether the service they have received is legally compliant. The Net Promoter score captures only the customer's level of satisfaction at the time of their interaction with bank staff.

SNBC Leads and Offers includes a measure for action rate, lead acceptance rate, and offer acceptance rate. Leads and offers are potential

²⁸ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-9 [ANZ.800.634.3072 at .3082].

²⁹ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0047–.0048].

sales to customers.³⁰ Action rate is measured by the number of customers a staff member contacts to try to make a sale. Lead and offer acceptance rate is measured by the number of sales resulting.³¹

Digital Engagement, for all roles but one, is measured by the percentage of accounts opened where a customer uses online banking or the ANZ app within 28 days of opening.³² The measure rewards staff for identifying and discussing 'digital solutions in interactions for new and existing customers' and 'educating customers about ANZ's digital offerings.'³³ Migrating customer activity online is a key aspect of many entities' strategy to reduce costs.

An A–Z review is said to be an opportunity to have a 'needs based conversation' with the customer. That is, it is an opportunity to sell products to the customer. For the purposes of the employee's scorecard, the item 'A–Z reviews' focuses entirely on what is called the 'quality' of the review.³⁴ The quality of an A–Z review is measured by the percentage of sales to customers who have completed an A–Z review in the last six months. This, like SNBC Leads and Offers, is a sales target.

Home lenders have a fifth Customer subcategory, called Home Loan Pipeline.³⁵ It is a measure of increased funds under management.³⁶ It too is a sales target.

³⁰ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0052].

³¹ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0052–.0053].

³² Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0055].

³³ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0035].

³⁴ See, eg, Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0016–.0017].

³⁵ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0017].

³⁶ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0057].

The People and Reputation KRA considers how well an employee 'brings the ANZ Purpose to life', implements change initiatives, contributes to customer and banker experience, delivers customer promises and is competent with digital products.

The Financial and Discipline KRA measures financial performance relevant to each retail role, with sales of products contributing different weightings towards the target. Cross selling is also rewarded, with referrals to other groups in the bank allocated weightings.³⁷

The Risk and Process KRA contains the compliance steps discussed above. In addition to the two compulsory requirements, without which an employee is ineligible for a bonus, and the home loan file compliance review for home lenders, the Risk and Process KRA requires the employee to have taken at least 10 days' annual leave and to have participated in workplace health and safety activities, training, and the conduct of a review.³⁸ Home lenders must have completed a home loan interview guide.³⁹ Apart from the two compulsory requirements, the employee's manager has the discretion to determine whether failure of any criterion should disqualify the employee from an incentive payment.

Both the Customer KRA and the Financial Discipline KRA emphasise financial performance. Together they account for more than half of the measures that go into the score. Though variously described – as meeting 'customer needs' or as 'leads accepted' – it is well open to the employee to read the scorecard as emphasising and rewarding sales. And that is its focus. The scorecard is 'balanced' in as much as it takes account of more than sales. But, despite the scorecard's complexity, sales lie at its heart and the chief purpose of the whole incentive program remains to enhance the bank's 'overall results'.

³⁷ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0008].

³⁸ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT-10 [ANZ.800.638.0001 at .0038].

³⁹ Exhibit 4.202, Witness statement of Tony Colin Tapsall, 21 June 2018, Exhibit TCT 10 [ANZ.800.638.0001 at .0039].

4.2 Westpac

Westpac has moved from variable remuneration arrangements that saw 80% to 85% of variable remuneration dependent upon achieving financial goals to the point where ‘the only time that somebody is considered for variable reward is where they meet our behavioural expectations and where they also meet the risk and compliance requirements for the roles’.⁴⁰ Hence, it is said that there is to be a ‘holistic performance assessment’ based on:

- behaviours and compliance gates;
- behaviours and risk considerations;
- role deliverables and Development Goals; and
- Performance Goals (Individual and Scorecard).⁴¹

The so-called ‘compliance gates’, however, require no more than attendance at mandatory training and the taking of 10 days’ consecutive leave.⁴²

Despite referring to ‘holistic assessment’, Ms Carol Separovich, Westpac’s Head of Reward and Performance Management for Consumer Bank, Business Bank and Support Functions, said of Westpac’s variable remuneration program that ‘the variable reward is really our mechanism for people to share in our business success’, it is ‘a very objective view of their performance and contribution’.⁴³

It is, then, unsurprising that in Westpac’s FY18 Banker Performance Framework, ‘scorecard goals’ for most roles are said to be ‘50% financial and 50% customer measures’ and the customer measures or metrics are described as comprising four measures:

⁴⁰ Transcript, Carol Separovich, 23 May 2018, 2274.

⁴¹ Exhibit 3.28, Witness statement of Carol Separovich, 21 May 2018, Exhibit CS4-9 [WBC.107.003.1047 at .1058].

⁴² Exhibit 3.28, Witness statement of Carol Separovich, 21 May 2018, Exhibit CS4-9 [WBC.107.003.1047 at .1058].

⁴³ Transcript, Carol Separovich, 23 May 2018, 2273.

- ‘Customer Needs per Connection’ (measuring whether ‘we have met 12 defined needs groupings centred around cash flow, financing, investing and protection needs’);
- ‘Net Promoter Score’ making up 20% of the scorecard and measuring how customers rate their individual banker and the Westpac brand;
- ‘Growth in Payments and Transactions’ directed to ‘having deep and enduring main bank relationship with customers’; and
- ‘New to Bank’ measuring the acquisition of new customers.⁴⁴

All but one of the Customer metrics (the Net Promoter Score) are directly related to sales.

Read as a whole, Westpac’s variable remuneration program (like ANZ’s) places much emphasis on sales. And that is unsurprising when the program seeks ‘a very objective view of their [that is the individual member of staff’s] performance and contribution’ to ‘our [that is, Westpac’s] business success’.⁴⁵

4.3 Other banks

Some of the smaller banks accept that they have not implemented the Sedgwick recommendations. They are recommendations that do not fit easily with the franchise model adopted by Bank of Queensland (BOQ).⁴⁶ And Mr Bradley James of Rabobank accepted that its then current remuneration structure for rural managers was not consistent with the Sedgwick recommendations.⁴⁷

⁴⁴ Exhibit 3.28, Witness statement of Carol Separovich, 21 May 2018, Exhibit CS4-9 [WBC.107.003.1047 at .1059].

⁴⁵ Transcript, Carol Separovich, 23 May 2018, 2273.

⁴⁶ Transcript, Douglas Robert Snell, 24 May 2018, 2353–4.

⁴⁷ Transcript, Bradley Mark James, 28 June 2018, 3410–1.

5 Changed remuneration and changed culture?

The point of present importance is that, despite the Sedgwick recommendations, banks continue to remunerate employees in ways that emphasise sales. True it is, the emphasis has been reduced, but sales remain an important feature of variable remuneration arrangements. They take that place because the *entity's* success is measured by reference *only* to revenue and profit and it is sought to measure the *individual's* contribution to that measure.

This need not be so. It is not necessary to attempt to draw an immediate and direct connection between *individual* conduct and entity profit.

The Sedgwick Review referred to remuneration practices in the UK and the radical changes that have been made there with respect to incentive pay since 2006 when the then Financial Services Authority launched what was called 'Treating Customers Fairly'.⁴⁸ Around one half of the UK banks surveyed allocated variable pay 'based on a discretionary performance assessment of the individual by the line manager against a balanced scorecard of measures, rather than a formulaic assessment of the individual's performance against quantitative targets'.⁴⁹ Some allocated variable pay 'based on a flat share of the variable pay pool based on organisation performance' thereby seeking 'a consistent "cross-bank" one-team approach to reward'.⁵⁰ Some have removed all variable remuneration for customer facing staff. To varying degrees and in different ways, each of these approaches either severed, or at least loosened, the connection between individual conduct and entity profit. The simplest and most comprehensive severance may be the adoption of a flat share of a variable pay pool that varies with overall entity performance.

⁴⁸ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, 41.

⁴⁹ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, 42.

⁵⁰ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review, 42.

6 What can or should be done about remuneration practices and policies?

Two points should be made at the outset. First, **changing culture in the Australian banks may not be easy and may take time**. It cannot be assumed that entities will embrace change willingly or immediately. It cannot be assumed that entities will make desirable changes at all levels of the organisation. The move to balanced scorecards may be one step along the path of change, but scorecards of the kind described do not complete that journey.

Second, and no less important, **the unstated premise for so much of the debate about remuneration of both bank staff and intermediaries, that staff and intermediaries will not do their job properly and to the best of their ability without incentive payments, must be challenged**. And in the case of intermediaries, **arguments based in predictions of industry damage or collapse should be examined with special care**.

6.1 Is incentive remuneration necessary?

Why do staff (whether customer facing or not) need incentives to do their job *unless* the incentive is directed towards maximising revenue and profit? How can staff (especially customer facing staff) be encouraged to do the right thing (to ask 'Should I') except by the line manager observing, encouraging counselling and supporting the staff in that task? What is the point of allowing an incentive payment for doing the assigned task in a way that meets but does not exceed what is expected of that staff member?

And, as explained earlier, if customer facing staff should not be paid incentives, why should their managers, or those who manage the managers? Why will altering the remuneration of front line staff effect a change in culture if more senior employees are rewarded for sales or revenue and profit?

6.2 Would better disclosure help?

In its 13 July submission on key policy issues, Treasury asked whether better disclosure of remuneration arrangements would make a difference.⁵¹ In considering that question it is important to recognise that the interests of shareholders are not the same as the interests of customers. It may be that they are opposed. Shareholders will see what happens at the entity only through the lens of dividend and share price. Some shareholders will take a short term view of both dividends and share price, others may have a longer term view. But customers are concerned only with how the entity's conduct affects them in their dealings with the entity.

Shareholders might be able to bring some pressure to bear to have an entity change its remuneration policies. It is not apparent to me that consumers could do that.

6.3 Regulatory intervention?

Is regulatory intervention possible and necessary?

I have already referred to APRA's publication, in 2009, of its Prudential Practice Guide about remuneration. In 2017, 'APRA reviewed remuneration policies and practices across a sample of large APRA-regulated entities to gauge how their stated remuneration frameworks and policies were translated into outcomes for senior executives'.⁵² Based on this work, APRA published, in April 2018, an information paper in which it said that it 'intends to strengthen its prudential requirements on remuneration to better support' an outcome that 'better [aligns entities'] remuneration arrangements with good risk management and the long-term soundness' of the entities.⁵³

The paper noted that 'other financial regulators and industry bodies' had conducted reviews focused on remuneration 'largely from the perspective of limiting the potential for misconduct'.⁵⁴ It went on to say that the link

⁵¹ Treasury, *FSRC Background Paper No. 24: Submission on Key Policy Issues*, 13 July 2018, 19 [68]–[70].

⁵² APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 65 [8.1].

⁵³ APRA, *Information Paper: Remuneration Practices at Large Financial Institutions*, April 2018, 5.

⁵⁴ APRA, *Information Paper: Remuneration Practices at Large Financial Institutions*, April 2018, 6.

between remuneration and misconduct 'is also of interest to APRA as a prudential supervisor' but explained that this was 'because conduct issues can provide additional insights into an organisation's attitudes towards risk more generally'.⁵⁵ Evidently, APRA did not then treat the link between remuneration and misconduct as a matter calling for direct consideration in its proposals to 'strengthen its prudential requirements on remuneration'.⁵⁶

Yet, when setting the terms of reference for the prudential inquiry into CBA, APRA specifically required the panel to assess whether CBA's remuneration frameworks conflicted with sound risk management and compliance outcomes.⁵⁷ Chapter 8 of the panel's report was devoted wholly to that subject and the panel recommended that the CBA Board 'exercise stronger governance to ensure the effective application of the remuneration framework' and, in particular, assess certain remuneration outcomes 'to reflect individual and collective accountability for material adverse risk management *and compliance* outcomes'.⁵⁸ Not only that, the **enforceable undertaking** that CBA offered and APRA accepted following the report included undertakings about remuneration. They were:

- First, to report to APRA by 30 June 2018 'how the findings contained in the Final Report have been reflected in remuneration outcomes for current and (where appropriate) past executives'.
- Second, to 'reflect and give significant weight to the accountability for completing items in the remedial action plan with the performance scorecards of the senior executive team, and other staff as relevant'.⁵⁹

⁵⁵ APRA, *Information Paper: Remuneration Practices at Large Financial Institutions*, April 2018, 6.

⁵⁶ APRA, *Information Paper: Remuneration Practices at Large Financial Institutions*, April 2018, 5.

⁵⁷ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 105 [2(d)].

⁵⁸ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 74 Recommendation 23 (emphasis added).

⁵⁹ See APRA, *Enforceable Undertaking*, 30 April 2018, <www.apra.gov.au/sites/default/files/20180430-CBA-EU-Executed.pdf> 3 pt 14.

When APRA released the report of the Inquiry into CBA, it said, in a press release, that:⁶⁰

Given the nature of the issues identified in the Report, all regulated financial institutions will benefit from conducting a self-assessment to gauge whether similar issues might exist in their institutions. APRA supervisors will also be using the Report to aid their supervision activities, and will expect institutions to be able to demonstrate how they have considered the issues within the Report.

In June 2018, APRA wrote to regulated entities pointing to what it had said in that press release and seeking, for the largest financial institutions, board endorsed written assessments of whether issues similar to the issues identified about CBA might exist in those entities.

The Information Paper on Remuneration practices at large financial institutions, that APRA published in April 2018, suggested that APRA saw the undoubted link between remuneration and conduct risk as no more than a matter of indirect interest and concern in formulating a new prudential standard about remuneration. Given the terms of reference for, and the resulting report of, the Prudential Inquiry into CBA it would be surprising and cause for concern, if APRA's approach to prudential governance of remuneration remained as narrowly focused as its Information Paper suggested.

There can be no doubt that the banks and other financial services entities are primarily responsible for the management of conduct and compliance risks. But as APRA's inquiry into CBA showed, the culture of and governance within the entity will determine how effective that management is. As APRA's report said, conduct risk is now rightly seen by bank boards and by regulators as a clear and present danger.⁶¹

How is that danger to be met?

6.4 Meeting the dangers of conduct risk

Good culture and proper governance cannot be implemented by passing a law. Culture and governance are *affected* by rules, systems

⁶⁰ See APRA, 'APRA Releases CBA Prudential Inquiry Final Report and Accepts Enforceable Undertaking from CBA' (Media Release, 1 May 2018).

⁶¹ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia*, April 2018, 3.

and practices but in the end they *depend* upon people applying the right standards and doing their jobs properly.

This being so, what are banks doing to meet the danger of conduct risk? What are regulators doing to meet it? What can banks do? What can regulators do? What should either or both be doing?

Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any ‘customer facing employee’ be paid variable remuneration? If the answer is either ‘no’ or ‘some should not’, what follows about incentive remuneration for managers or more senior executives? **If more junior employees should not be remunerated in this way, why should their managers and senior executives?**

Should other changes be made to the remuneration practices of banks? What would they be, and how could change be required?

6.5 The BEAR

The Banking Executive Accountability Regime (‘the BEAR’) individualises accountability for ADIs. In its 13 July submission on key policy issues, Treasury described the BEAR as providing ‘an enhanced accountability framework for ADIs and persons in director and senior executive roles (accountable persons)’ and said that ‘[a]n ADI must ensure that it has clearly defined accountability statements for each accountable person and an accountability map covering its ADI group’.⁶² Under these arrangements, ADIs must defer a minimum percentage of a senior executive’s variable remuneration for at least four years and have a remuneration policy that provides for reduction of the deferred variable remuneration where a senior executive has not met obligations under the BEAR.⁶³

How will this ‘enhanced accountability’ affect the culture of banks? Is the BEAR relevant to the intersections between remuneration and culture more

⁶² Treasury, *FSRC Background Paper No. 24: Submission on Key Policy Issues*, 13 July 2018, 10 [33].

⁶³ Treasury, *FSRC Background Paper No. 24: Submission on Key Policy Issues*, 13 July 2018, 10 [35].

generally than in its application to particular senior executives? Should the BEAR be changed? Should its application be extended?

6.6 Intermediaries

How do the questions about remuneration, culture and governance apply outside the realm of employer and employee? How do they apply to:

- introducers or referrers;
- advisers; and
- brokers and other intermediaries?

These issues are identified and considered in more detail in the chapters about consumer lending and about financial advice. It may be useful, however, to repeat some of them here and to do that in two parts: one about duties and the other about remuneration.

Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client? In particular, what duty, if any, should a mortgage broker owe to the prospective borrower? Is value based commission, paid to the broker by the lender, consonant with that duty? Should a **mortgage aggregator** owe any duty to the borrower? Again, are the remuneration arrangements for aggregators consonant with that duty?

If some or all of those who are not employees of banks, but deal with bank customers, should owe the customer a duty to act in that customer's interests, **is it enough to prescribe the duty and require 'management of conflicts between interest and duty'** What is to be made of the fact that, when persons are paid to give advice and rewarded for selling their employer or sponsoring entity's products, all too often the client's interests are treated as coinciding with the adviser's commercial advantage, no matter how obviously that course harms the client? Perhaps the adviser believes that selling the employer's or sponsor's product is in the client's interests, perhaps the adviser does not think about the conflict. But in too many cases, what is sold is not in the interests of the client.

What, if anything, is to be done about remuneration of intermediaries? How is a value based commission consistent with acting in the interests, or

best interests, of the client? Should intermediaries be subject to rules generally similar to the conflicted remuneration prohibitions applying to the provision of financial advice?

6.7 Business structures

Finally, it is necessary to ask whether the conduct that has been identified and is criticised in this report directs attention to questions about the structure of financial services entities.

In considering these issues it is important to recognise that legislative regulation of the structure of the banking industry is not unknown. From time to time, overseas jurisdictions have limited not only the kinds of transaction, but also the affiliations with other firms, that banks may have. The *United States Banking Act of 1933* (usually called the ‘Glass Steagall Act’) sought to separate commercial and investment banking. In 2013, the UK enacted the *Financial Services (Banking Reform) Act 2013* requiring banks to ‘ring-fence’ certain ‘core activities’ by 2019.⁶⁴ These references are not to be misunderstood. They are not to be read as my suggesting that either of these laws could be, or should be, directly imported and applied here. But the point of immediate relevance is that structural regulation of banking activities is not novel.

The inescapable fact seems to be that interest too often trumps duty. Too often conflicts between interest and duty are ‘managed’ in a way that coincides with the interests of the party who owes some conflicting duty or has some conflicting interest.

Three of the four large banks are withdrawing, or have withdrawn, from some or all aspects of the financial advice business. CBA is disposing of its interests in Aussie Home Loans the **mortgage broker**. Other changes in the structure of the financial services industry are underway.

Do the events that have happened raise any issue about business structures? More particularly, do they provoke examination of how and to what extent conflicts of interest and duty arising from the structure of the business *can* be managed? The very basis of a business structure in which a financial product manufacturer (or a related entity of the manufacturer)

⁶⁴ See generally, Kate Britton et al, ‘Ring-Fencing: What Is It and How Will It Affect Banks and Their Customers’ in *Bank of England Quarterly Bulletin* (2016) Q4, 164.

engages others to advise clients about which product to buy appears to be the expectation that the adviser will recommend and sell the manufacturer's products. How is that expectation congruent with the adviser's duty to the client?

Do the events that have happened invite consideration of whether structural changes should now be made?

Do the events that have happened suggest that manufacturers of financial products and the related entities of manufacturers should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?

7 Issues that have emerged

The issues identified above can then be presented by reference to the following questions:

7.1 Conduct risk

- What are banks doing to meet the danger of conduct risk?
- What are regulators doing to meet it?
- What can banks do? What can regulators do?
- What should either or both be doing?

7.2 Remuneration

- What more should be done to implement the recommendations of the Sedgwick Review?
- Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any 'customer facing employee' be paid variable remuneration?

- If the answer is either 'no' or 'some should not' what follows about incentive remuneration for managers or more senior executives? If more junior employees should not be remunerated in this way, why should their managers and senior executives?
- Should other changes be made to the remuneration practices of banks? What would they be, and how could change be required?

7.3 The BEAR

- Is the Banking Executive Accountability Regime ('the BEAR') relevant to the intersections between remuneration and culture more generally than in its application to particular senior executives?
 - Should the BEAR be altered?
 - Should the BEAR be extended in application?

7.4 Intermediaries

- Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client?
 - In particular, what duty, if any, should a mortgage broker owe to the prospective borrower?
 - Is value based commission, paid to the broker by the lender, consonant with that duty?
 - Should an aggregator owe any duty to the borrower?
 - Again, are the remuneration arrangements for aggregators consonant with that duty?
- How is a value based commission consistent with acting in the interests, or best interests, of the client?

- Should intermediaries be subject to rules generally similar to the **conflicted remuneration** prohibitions applying to the provision of financial advice?
- If some or all intermediaries should owe the customer a duty to act in that customer's interests, or best interests, is it enough to prescribe the duty and direct 'management' of conflicts between interest and duty?

7.5 Business structures

- Do the events that have happened raise any issue about business structures?
- Do the events that have happened invite consideration of whether structural changes should now be made?
- Do the events that have happened suggest that manufacturers of **financial products** should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?
- More particularly, do they provoke examination of how and to what extent conflicts of interest and duty arising from the structure of the business can be managed?

10. Issues that have emerged

Introduction

In all but the introductory chapter of this report, I have sought to identify issues that arise from the matters examined in that chapter. Although it is to repeat what appears elsewhere in this report, it is convenient to set out again those issues, substantially in the form in which they appear at the end of each of the relevant chapters. I will then seek to draw the issues together in ways that may assist identification of common threads and some more general questions.

1 Consumer lending

The issues that emerged in connection with consumer lending concerned:

- intermediaries, and confusion of roles;
- communication with customers; and
- responsible lending.

Intermediaries stand between consumers and the providers of financial services. They include **mortgage brokers**, **mortgage aggregators**, introducers, financial advisers, authorised representatives of **financial services licensees**, and representatives (at point of sale) of credit licensees. Often, intermediaries are given tasks that, done properly, will help to fulfil the entity's responsible lending obligations. There are, therefore, issues about entities' oversight of these contractually stipulated tasks, and their responsibility for their own, non-delegable statutory obligations. Intermediaries are often seen by the customer as the face of the entity. Entities, on the other hand, have given conflicting messages about whether intermediaries represent entities, themselves, or the customer. There are, therefore, questions about intermediaries' obligations toward customers and

entities, and customer expectations of the intermediaries with whom they deal.

Both entities and customers appear to be confused about the roles of intermediaries. Issues then arise about how entities can communicate with customers to create realistic expectations of products bought through intermediaries. And questions of communication arise when considering what obligations an entity owes to clients of an employee or intermediary when the entity suspects that employee or intermediary of misconduct toward at least some of their clients.

Responsible lending raises issues about the interpretation and application of obligations imposed by the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act). A particular issue that arose concerned entities' interpretation of the requirement to verify a customer's financial situation. Later changes to verification processes may suggest some entities have changed their interpretation of the relevant provisions. Examination of responsible lending also directed particular attention to the tension between responsible lending and some products long sold by, and some processes long used by, entities and intermediaries, including add-on insurance, pre-approved credit limit increases and the **Household Expenditure Measure** (HEM).

The particular issues can be identified as including:

- What duties does an intermediary owe to a borrower?
- What duties should an intermediary owe to a borrower?
- How can entities' systems be improved to detect and prevent breaches of responsible lending obligations by intermediaries?
- Are 'introducer' programs compatible with responsible lending obligations?
- Do broker contracts, as they stood at the time of the hearings, meet the statutory requirement imposed by Section 912A of the *Corporations Act 2001* (Cth) to have arrangements in place to manage conflicts of interests? Do broker contracts, as now made, meet those requirements?
- What should be disclosed to borrowers about an intermediary's obligations to the lender and to the borrower?

- What should be disclosed to borrowers about an intermediary's remuneration?
- What steps, consistent with responsible lending obligations, should a lender take to verify a borrower's expenses?
- Do the processes used by lenders, at the time of the hearings, to verify borrowers' expenses meet the requirements of the NCCP Act? Do the processes now used meet those requirements?
- Should the HEM continue to be used as a benchmark for borrowers' living expenses?
- Is the offer of a credit limit increase, where the customer has consented to receive such marketing, consistent with the NCCP Act obligation not to provide credit that is not unsuitable for the customer, having regard to their requirements and objectives?
- Is the offer of a credit limit increase based only on information held by the bank about a customer a breach of the NCCP Act obligation to take reasonable steps to verify the consumer's financial situation?
- When an employee or intermediary is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?
- When an employee or intermediary is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidence of misconduct?
- Are certain types of add-on insurance, by their nature, poor value propositions for customers?

2 Financial advice

The issues that emerged in connection with financial advice related to:

- culture and incentives;
- conflicts of interest and duty, and confusion of roles; and
- regulator effectiveness.

The first of those themes, culture and incentives, includes issues about the culture of particular parts of the financial services industry, such as mortgage brokers, financial advisers, and point of sale agents for consumer lending. But it also includes more specific issues about the culture created and maintained by particular entities. And running through all of those issues are questions about how industry participants are paid (including how bonuses and other incentives are calculated).

The second theme, conflict of interest and duty, and confusion of roles, is closely related to the first. It includes issues about FoFA's treatment of conflicts of interest as conflicts that can, and should be, 'managed' (by advisers and licensees meeting the 'best interests duty' and giving the client's interests priority over the interests of the adviser and licensee). The second theme goes further, however, and requires consideration of structural considerations. In particular, the second theme draws attention to consequences that appear to be related to, if not stem from, some entities being vertically integrated, in the sense that the entity manufactures and sells **financial products** while, at the same time, advising clients which products to use or buy. And the second theme also embraces the issues that emerged in the first round of hearings about the confusion of roles and responsibilities of, for example, mortgage brokers and aggregators.

The third theme, regulator effectiveness, directs attention to what responses regulators can make, and what responses regulators should make, to conduct of the kinds examined in the Commission's hearings. A necessary part of the second branch of that inquiry (what responses regulators should make) is to consider whether (with all the benefit of hindsight) the responses that were made have proved to be satisfactory.

The particular issues can be further identified as including:

- How does a financial adviser's employer encourage provision of sound advice (including, where appropriate, telling the client to do nothing)?
- How do advice licensees encourage advisers aligned with the licensee to provide sound advice (including, where appropriate, telling the client to do nothing)?
- Can conflicts of interest and duty be managed?
- How far can, and how far should, there be separation between providing financial advice and manufacture or sale of financial products?

- Should financial product manufacturers be permitted to provide financial advice?
 - At all?
 - To retail clients?
- Should financial product sellers be permitted to provide financial advice?
 - At all?
 - To retail clients?
- Should an authorised representative be permitted to recommend a financial product manufactured or sold by the advice licensee (or a related entity of the licensee) with which the representative is associated?
 - At all?
 - Only on written demonstration that the product is better for the client than comparable third party products?
- Should the grandfathered exceptions to the **conflicted remuneration** provisions now be changed?
 - How far should they be changed?
 - If they should be changed, when should the change or changes take effect?
- Should the life risk exceptions to the conflicted remuneration provisions now be changed?
 - How far should they be changed?
 - If they should be changed, when should the change or changes take effect?
- Should any part of the remuneration of financial advisers be dependent on value or volume of sales?
- Should all financial advisers (including those who now act as authorised representatives of an advice licensee) be licensed by ASIC?

- Are current product and interests disclosure requirements sufficient to allow customers to make fully informed choices?
- Should the period after which a client must positively review an ongoing fee arrangement be reduced from two years to one?
- Should platform operators be permitted to deduct fees on behalf of licensees without the express authority of the client of the platform operator?
- When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?
- When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidents of misconduct?
- Should negotiation and settlement be the main approach for a regulator?
- Should there be greater focus on general deterrence in regulatory strategy?
- Should a component of **enforceable undertakings** be the acknowledgment of specific wrongs?
- Should self-reported breaches of the Corporations Act generally attract legal sanctions unless some special circumstances exist?
- Should banning orders continue to be preferred to civil penalty proceedings in case of licensee/adviser misconduct?
- Should ASIC make more use of its Section 916G power to give a licensee information about a person who is or will be a representative of the licensee?
- Does Section 916G need to be amended so as to be more effective?
- Should there be more focus on criminal proceedings against licensees rather than individual advisers?

3 Small and medium enterprises

The most general issues emerging from consideration of lending to small and medium enterprises can be identified as being:

- Should there be any change to the legal framework governing small and medium enterprise (SME) lending?
- In particular, should any lending to SMEs come within the reach of the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act)?

The other issues calling for consideration can be described by reference to the following themes:

- the content of Code of Banking Practice obligations;
- third party guarantors; and
- dispute resolution approaches by the Financial Ombudsman Service (FOS) and the Australian Financial Complaints Authority (AFCA).

The first of these themes, the content of Code of Banking Practice obligations, concerns the meaning in particular of two obligations set out in the Code: first, the requirement that a bank providing a loan or limit increase will do so exercising the care and skill of a diligent and prudent banker, and second, the requirement that a bank assess whether a small business customer can repay a loan based on their financial position and account conduct. Submissions in response to this round of hearings demonstrated disagreement about the bounds and content of these obligations. That is significant given that they are the obligations that provide most practical protection to small businesses seeking funding from subscribing banks.

The second theme, **third party guarantors**, draws into sharp focus the disconnect between how the law, and lenders, may treat third party guarantors (as interested, or at least, rationally motivated actors) and the reality of the role played by many if not most guarantors of small business (family members assisting their loved ones in their plans). The questions raised here attempt to balance these inconsistent models, a task made more difficult by the central and perhaps irreplaceable role played by guarantors in securing funding for small businesses and the particular vulnerability of small businesses to failure.

The third theme, dispute resolution approaches by FOS and AFCA, relates to the outcomes available to consumers who successfully seek intervention by a dispute resolution body. This round of hearings demonstrated that customers who were wholly or partly successful in their claims nonetheless sometimes struggled to achieve what they believed was a satisfactory outcome. If those beliefs were unrealistic, it is important to explore why. This theme encompasses the approach both of FOS and, necessarily, the approach of banks to the resolution of claims.

The issues can be amplified as follows:

3.1 Code of Banking Practice

- What inquiries should a diligent and prudent banker make when deciding whether to lend to an SME?
- Does ‘forming an opinion about the customer’s ability to repay the loan facility’ as required by Clause 51 of the 2019 Code involve bringing critical analysis to the cash flow forecasts and other business plan documents presented by customers?
- If so, what level of analysis is acceptable?
- Is it enough that the lender satisfy itself the borrower can repay the loan and that the business plan is not obviously flawed?
- Is the standard set out in Clause 51 of the 2019 Code, which requires a bank to determine whether a customer can repay a loan based on their financial position and account conduct, a sufficient standard?

3.2 Guarantees

- If established principles of judge-made law and statutory provisions about unconscionability would not relieve a guarantor of responsibility under a guarantee, and if, further, a bank’s voluntary undertaking to a potential guarantor to exercise the care and skill of a diligent and prudent banker has not been breached, are there circumstances in which the law should nevertheless hold that the guarantee may not be enforced?
- What would those circumstances be?

- Would they be defined by reference to what the lender did or did not do, by reference to what the guarantor was or was not told or by reference to some combination of factors of those kinds?
- Is there a reason to shift the boundaries of established principles, existing law and the industry code of conduct?
- If the guarantor is a volunteer, and if further, the guarantor is aware of the nature and extent of the obligations undertaken by executing the guarantee, is there some additional requirement that must be shown to have been met before the guarantee was given if it is to be an enforceable undertaking?
- Should lenders give potential guarantors more information about the borrower or the proposed loan? What information could be given with respect to a new business?

3.3 External dispute resolution

- Should AFCA adopt FOS's approach of putting the borrower back in the position they would be in if the loan had not been made, but not awarding compensation for losses or harm caused?
- Are there circumstances in which AFCA should waive a customer's debt?

4 Agricultural lending

All agricultural enterprises are subject to the effects of events beyond the control of the individual farmer. Occurrence of any of these events, let alone a combination of them, will affect cash flow and profitability and, hence, the ability to service debts. Their occurrence will often have profound personal effects on those who conduct the business.

Four issues emerged: about revaluation of securities; difficulties in obtaining access to banking services and appropriate support; changes to conditions of lending; and, enforcement by appointment of external administrators.

The particular questions can be identified as including:

- How are borrowers and lenders in the agricultural sector to deal with the consequences of uncontrollable and unforeseen external events?

- Does the 2019 Banking Code of Practice provide adequate protection for agricultural businesses? If not, what changes should be made?
- How, and by whom should property offered as security by agricultural businesses be valued?
 - Is market value the appropriate basis?
 - Should the possibility, or probability of external shocks be taken to account in fixing lending value? How?
 - Should the time for realisation of security be taken to account in fixing value? How?
 - Is the possibility, or probability of external shock sufficiently met by fixing the loan-to-value ratio?
 - If prudential standard APS 220 is amended to require internal appraisals to be independent of loan origination, loan processing and loan decision processes, when should that amendment take effect?
- Should distressed agricultural loans be managed only by experienced agricultural bankers?
- Do asset management managers need more information (such as the cost to the lender of holding the loan) to make informed commercial decisions about management of distressed agricultural loans?
- Are there circumstances in which default interest should not be charged?
 - In particular, should default interest be charged to borrowers in drought-declared areas?
 - If it should not, how, and where, is that policy to be expressed?
 - Should the policy apply to other natural disasters?
- In what circumstances may a lender appoint an external administrator (such as a receiver, receiver and manager or agent of the mortgagee in possession)? Is appointment of an external administrator to be the enforcement measure of last resort?
- Having regard to the answers given to the preceding questions:

- Is any regulatory change necessary or desirable?
- Is any change to the 2019 Code necessary or desirable?
- Should there be a national system for farm debt mediation?
 - If so, what model should be adopted?
- Should lenders be required to offer farm debt mediation as soon as an agricultural loan is impaired (in the sense of being more than 90 days past due)?

5 Remote communities

This chapter examined how financial services entities are responding to the financial needs and vulnerabilities that can be experienced by Indigenous Australians, in particular those living in remote communities.

In relation to banking services in remote communities, the issues that arose related to access to services; account fees; and the application of standard identification requirements. None of the banking relationships examined was complicated. The prevailing theme in this part of the chapter was of basic transactions made bewildering by inadequate recognition on the part of the bank of an Indigenous customer's circumstances.

In relation to funeral insurance, what emerged was evidence pointing to predatory behaviour by insurers and salespeople. What followed were questions about the way in which funeral insurance should be regulated, and therefore how it should be categorised by the law.

Common to both parts of the chapter was the issue of culturally appropriate communication, a lack of which aggravated the existing difficulties in the interaction between entity and customer.

More specifically, the questions that arose can be set out as follows:

- Do financial services entities have in place appropriate policies and procedures to assist Aboriginal and Torres Strait Islander people:
 - to overcome obstacles associated with the geographical remoteness?

- to address the cultural barriers to engagement that some face?
 - to address the linguistic barriers to engagement that some face?
 - to address the obstacles posed for some by their level of financial literacy?
- Are banks' identification requirements appropriate for Aboriginal and Torres Strait Islander customers?
 - If they are, are those policies sufficiently understood and applied by staff?
- Should more banks have a telephone service staffed by employees with specific training in assisting Indigenous consumers?
- Do banks take sufficient steps to promote the availability of fee-free accounts to eligible customers?
- If a customer seeking to open a basic bank account has no substantial income other than Centrelink benefits, should a bank ever try to sell the customer another form of account?
- Should informal overdrafts be allowed on a bank account if credits to the account are only, or are substantially, by payment of Centrelink benefits?
- Should the application of the 90% arrangements provided by the Code of Operation be at the discretion of the bank, the customer or both? Or should banks apply these arrangements automatically?
- If direct debits are dishonoured for want of sufficient funds, are there cases in which dishonour fees should not be charged?
- Are funeral policies, or particular kinds of funeral policy, financial products warranting intervention by ASIC in the exercise of its product intervention powers?
- Should all forms of funeral insurance be financial products for the purposes of Chapter 7 of the *Corporations Act 2001* (Cth)?
- Should all forms of funeral insurance be covered by Part 2 Division 2 of the *Australian Securities and Investments Commission Act 2001* (Cth)?

- Should it be unlawful to sell funeral insurance for persons under 18 years?

6 Regulation and the regulators

Chapter 8 of the Report, about regulation and the regulators sought to identify questions that had emerged in the course of the first four rounds of hearings about the content of the law governing financial services entities and their conduct and about the ways in which the regulators, ASIC and APRA had responded to the conduct identified and criticised in this report.

As indicated in Chapter 8, I begin from the premise that no new layer of law or regulation should be added unless there is clearly identified advantage to be gained by doing that. And I begin from the further premise that very simple ideas must inform the conduct of financial services entities.

Hence, the first question to be asked and answered is:

- Is the law governing financial services entities and their conduct too complicated?
 - Does it impede effective conduct risk management?
 - Does it impede effective regulatory enforcement?

The questions that are raised about the regulators, ASIC and APRA can be described as follows:

- Should there be annual reviews of the regulators' performance against their mandates?
- Is ASIC's remit too large?
 - If it were to be reduced, who would take over those parts of the remit that are detached?
 - Why would detachment be better?
- Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?

- Should industry codes relating to the provision of financial services, such as the 2019 Banking Code of Practice, be recognised and applied by legislation like Part IVB of the *Competition and Consumer Act 2010* (Cth)?
- Are ASIC's enforcement practices satisfactory? If not, how should they be changed?
- If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?
- Should ASIC's enforcement priorities change? In particular, if there is a reasonable prospect of proving contravention, should ASIC institute proceedings unless it determines that it is in the public interest not to do so?
- Are APRA's regulatory practices satisfactory? If not, how should they be changed?
- Are APRA's enforcement practices satisfactory? If not, how should they be changed?
- Does the conduct identified and criticised in this report call for reconsideration of APRA's prudential standards on governance?
- Having examined the governance, culture and accountability within the CBA group, what steps (if any) can APRA take in relation to those issues in other financial services entities?

7 Entities: Causes of misconduct

In Chapter 9, I noted that all of the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned. (If there were exceptions, they were immaterial.) The governance and risk management practices of the entities did not prevent the conduct. The culture and conduct of the banks was driven by, and was reflected in their remuneration practices and policies.

The issues identified in that chapter give rise to the following questions:

7.1 Conduct risk

- What are banks doing to meet the danger of conduct risk?
- What are regulators doing to meet it?
- What can banks do? What can regulators do?
- What should either or both be doing?

7.2 Remuneration

- What more should be done to implement the recommendations of the Sedgwick Review?
- Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any 'customer facing employee' be paid variable remuneration?
- If the answer is either 'no' or 'some should not' what follows about incentive remuneration for managers or more senior executives? If more junior employees should not be remunerated in this way, why should their managers and senior executives?
- Should other changes be made to the remuneration practices of banks? What would they be, and how could change be required?

7.3 The BEAR

- Is the Banking Executive Accountability Regime ('the BEAR') relevant to the intersections between remuneration and culture more generally than in its application to particular senior executives?
 - Should the BEAR be altered?
 - Should the BEAR be extended in application?

7.4 Intermediaries

- Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client?

- In particular, what duty, if any, should a mortgage broker owe to the prospective borrower?
 - Is value based commission, paid to the broker by the lender, consonant with that duty?
 - Should an aggregator owe any duty to the borrower?
 - Again, are the remuneration arrangements for aggregators consonant with that duty?
- How is a value based commission consistent with acting in the interests, or best interests, of the client?
- Should intermediaries be subject to rules generally similar to the conflicted remuneration prohibitions applying to the provision of financial advice?
- If some or all intermediaries should owe the customer a duty to act in that customer's interests, or best interests, is it enough to prescribe the duty and direct 'management' of conflicts between interest and duty?

7.5 Business structures

- Do the events that have happened raise any issue about business structures?
- Do the events that have happened invite consideration of whether structural changes should now be made?
- Do the events that have happened suggest that manufacturers of financial products should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?
- More particularly, do they provoke examination of how and to what extent conflicts of interest and duty arising from the structure of the business can be managed?

8 Restating the issues

The many questions that have been set out above can then be distilled and organised in three categories:

- Issues
- Causes
- Responses

8.1 Issues

The issues can be divided into four groups. First, there are issues about *access* to banking services. Second, there is a group of issues about the *roles and responsibilities of intermediaries* – those who stand between the purchaser of a financial service and the provider of that service. Third there is a group of issues about *responsible lending*. And fourth, there is a group of issues about *regulation and the regulators*.

The issues intersect and overlap in different ways. Putting the issues in groups should not be allowed to diminish the importance of identifying and responding to those intersections and overlaps.

8.1.1 Access

Do all Australians have adequate and appropriate access to banking services?

8.1.2 Intermediaries

- For whom do the different kinds of intermediary act?
 - mortgage brokers
 - mortgage aggregators
 - introducers
 - financial advisers
 - authorised representatives of Licensees

- point of sale sellers of loans
- For whom should each kind of intermediary act?
- If intermediaries act for the consumer of a financial service
 - What duty do they now owe the consumer?
 - What duty should they owe?
- Who is responsible for each kind of intermediary's defaults?
- Who should be responsible?
- How should intermediaries be remunerated?
- Are **external dispute resolution** mechanisms satisfactory?
- Should there be a mechanism for compensation of last resort?

8.1.3 Responsible lending

- Consumers
 - Should the test to be applied by the lender remain 'not unsuitable'?
 - How should the lender assess suitability?
 - Should there be some different rule for some home loans?
- Should the NCCP Act apply to any business lending? In particular, should any of its provisions apply to:
 - SMEs?
 - agricultural businesses?
 - some guarantors of some business loans?
- To what business lending should the Banking Code of Practice apply?
 - Is the definition of 'small business' satisfactory?
- Should lenders adopt different practices or procedures with respect to agricultural lending?

- Are there classes of persons from whom lenders
 - should not take guarantees; or
 - should not take guarantees unless the person is given particular information or meets certain conditions?
- How should lenders manage exit from a loan
 - at the end of the loan's term;
 - if the borrower is in default?

8.1.4 Regulation and the regulators

- Have entities responded sufficiently to the conduct identified and criticised in this report?
- Has ASIC's response to misconduct been appropriate?
 - If not, why not?
 - How can recurrence of inappropriate responses be prevented?
- Has APRA's response to misconduct been appropriate?
 - If not, why not?
 - How can recurrence of inappropriate responses be prevented?

8.2 Causes

What were the causes of the conduct identified and criticised in this report?

- Conflict of interest and duty?
- Remuneration structures?
- Culture and governance?
- Regulatory response?

8.3 Responses

What responses should be made to the conduct identified and criticised in this report?

- Are changes in law necessary?
 - Should the financial services law be simplified?
 - Should carve outs and exceptions be reduced or eliminated? In particular, should
 - grandfathered commissions
 - point of sale exceptions to the NCCP Act
 - funeral insurance exceptionsbe reduced or eliminated?
- How should entities manage conduct and compliance risks?
- How should
 - APRA
 - ASICrespond to conduct and compliance risk?
- Should the regulatory architecture change?
 - Are some tasks better detached from ASIC?
 - Are some tasks better detached from APRA?
 - What authority should take up any detached task?
 - Should either or both of ASIC and APRA be subject to external review?
- What is the proper place for industry codes of conduct?
 - Should industry codes of practice like the 2019 Banking Code of Practice be given legislative recognition and application?

- Should an intermediary be permitted to
 - recommend to a consumer
 - provide personal financial advice to a consumer about
 - sell to a consumer

any financial product manufactured by an entity (or a related party of the entity) of which the intermediary is an employee or authorised representative?

- Is structural change in the industry necessary?



Interim Report

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

VOLUME 2:
CASE STUDIES

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Contents

Volume 2: Case Studies

Glossary	xvii
Abbreviations	xxi
Legislation	xxiii
The Commission's tasks	xxv
Case studies: Consumer lending	1
1 NAB Introducer home loans	1
1.1 Background	1
1.2 Evidence	1
1.3 What the case study showed	5
1.3.1 Misconduct?	5
1.3.2 Causes?	6
<i>Incentives</i>	7
<i>Training</i>	9
<i>Controls</i>	10
1.3.3 Conduct falling short?	13
1.3.4 Mechanisms for redress	14
1.3.5 Other conclusions?	14
2 CBA broker relations and accreditation	16
2.1 Background	16
2.2 Evidence	17

2.3	What the case study showed	26
2.3.1	How does CBA see the roles of brokers and aggregators?	26
2.3.2	Managing conflicts of interest	27
2.3.3	What CBA tells borrowers about intermediary remuneration	30
2.3.4	How important is disclosure of remuneration?	32
3	Aussie Home Loans broker misconduct	32
3.1	Background	32
3.2	Evidence	33
3.3	What the case study showed	36
3.3.1	Misconduct by the four former brokers	36
3.3.2	Systems and practices	37
3.3.3	Remediation	41
3.3.4	Conduct falling below community standards and expectations	41
4	ANZ responsible lending	43
4.1	Background	43
4.2	Evidence	43
4.3	What the case study showed	48
4.3.1	ANZ's home lending processes	48
4.3.2	Mr Regan's case	49
4.3.3	Conduct falling short?	50
5	CBA add-on insurance	51
5.1	Background	51
5.2	Evidence	52
5.2.1	CCP insurance	52
5.2.2	LPP insurance	55

5.3	What the case study showed	57
5.3.1	Changing scripts	59
5.3.2	Dealing with CCP and LPP sequentially	59
5.3.3	Section 912D and notifying ASIC about LPP	60
5.3.4	The course of the remediation negotiations	62
5.3.5	Stopping selling CCP and LPP	63
6	CBA personal overdrafts	64
6.1	Background	64
6.2	Evidence	64
6.3	What the case study showed	66
6.3.1	Misconduct	66
6.3.2	Conduct falling short of community expectations	67
7	ANZ pre-approved overdrafts	68
7.1	Background	68
7.2	Evidence	68
7.3	What the case study showed	72
7.3.1	Scalability	72
7.3.2	Infringement notices	73
8	ANZ processing errors	74
8.1	Background	74
8.2	Evidence	74
8.3	What the case study showed	77
8.3.1	What are processing errors?	78
8.3.2	Remediation	79
8.3.3	Notification to ASIC	80

9	Westpac car loans	82
9.1	Background	82
9.2	Evidence	83
9.2.1	Ms Thiruvangadam	86
9.3	What the case study showed	88
9.3.1	Flex commissions	89
9.3.2	Responsible lending obligations and intermediaries	90
9.3.3	Ms Thiruvangadam	92
9.3.4	Redress	94
10	ANZ car loans	94
10.1	Background	94
10.2	Evidence	95
10.3	What the case study showed	98
10.3.1	Flex commissions and add-on insurance	99
11	CBA credit cards	101
11.1	Background	101
11.2	Evidence	101
11.3	What the case study showed	106
11.3.1	CBA systems	107
11.3.2	Assessment of customer's needs and requirements	108
12	Westpac credit card limit increases	108
12.1	Background	108
12.2	Evidence	108
12.3	What the case study showed	113
12.3.1	Reasonable enquiries and verification	114

13 Citi international transaction fees	117
13.1 Background	117
13.2 Evidence	117
13.3 What the case study showed	120
Case studies: Financial advice	123
1 Fees for no service: AMP	123
1.1 Background	123
1.2 Ongoing service fee conduct	124
1.2.1 Nature of the relationship	124
1.3 Conduct in issue	125
1.4 The BOLR policy	126
1.5 Ringfencing	128
1.6 Ongoing service fee conduct	130
1.7 Culture and governance practices	134
1.8 Ongoing service fee systems	136
1.9 Misleading statements conduct	138
1.10 What the case study showed	144
1.10.1 Misleading statements as to ongoing service fee conduct	144
1.10.2 Conduct in connection with the Clayton Utz Report	145
2 Fees for no service: CBA	151
2.1 Background	151
2.2 The Advice Licensees	152
2.3 Ongoing service arrangements	153
2.3.1 CFPL	153
2.3.2 BWFA	155
2.3.3 Count	155

2.4	The fees for no service conduct	155
2.5	How the issue was identified and reported	157
2.6	What the case study showed	161
2.6.1	Fees for no service: Misconduct and causes	161
2.6.2	Reporting: Misconduct and causes	166
3	Bad advice: Westpac	168
3.1	Background	168
3.2	Evidence	169
3.2.1	Mr Mahadevan and Mr and Mrs McDowall	169
3.2.2	Mr Smith	174
3.2.3	Westpac's financial advice business	177
3.3	What the case study showed	179
3.3.1	Mr Mahadevan and Mr and Mrs McDowall	179
3.3.2	Mr Smith	180
3.3.3	Westpac	181
3.4	Causes of the conduct	186
3.5	Effectiveness of mechanisms for response and redress	186
4	Bad Advice: ANZ	187
4.1	Background	187
4.2	Evidence	188
4.2.1	Mr Doyle	188
4.2.2	Mr Harris	193
4.2.3	Mr A	196
4.2.4	ANZ's financial advice business	199
4.3	What the case study showed	201
4.3.1	Mr Doyle	201
4.3.2	RI Advice Group	202
4.3.3	Mr Harris	205

4.3.4	Mr A	206
4.3.5	Millennium3	207
4.3.6	Mr Harris	207
4.3.7	Mr A	210
4.4	Causes of the conduct	212
4.4.1	Risk management practices	212
4.4.2	Adequacy of internal control systems	213
4.4.3	Recruitment practices	214
4.5	Effectiveness of response and redress	214
5	Bad advice: AMP	215
5.1	Background	215
5.2	Evidence	216
5.2.1	Mr E	216
5.2.2	Ms Coleman	218
5.2.3	Mr Palmer	221
5.3	What the case study showed	224
5.3.1	Mr E	224
5.3.2	AMP Financial Planning	224
5.3.3	Ms Coleman	227
5.3.4	Charter	228
5.3.5	Mr Palmer	228
5.3.6	Genesys	229
5.4	Causes of the conduct	232
5.5	Effectiveness of mechanisms for response and redress	232
6	Bad advice: NAB	233
6.1	Background	233
6.2	Evidence	234
6.3	What the case study showed	238

6.4	Causes of the conduct	240
7	Bad advice: Henderson Maxwell	242
7.1	Background	242
7.2	Evidence	242
7.3	What the case study showed	246
8	Bad advice: Dover	249
8.1	Background	249
8.2	Evidence	250
8.2.1	Conduct in respect of recruitment	250
8.2.2	Conduct in respect of liability to and complaints by clients	252
8.3	What the case study showed	255
	Case studies: Small and medium enterprises	257
1	Third party guarantees: Ms Flanagan and Westpac	257
1.1	Background	257
1.2	The loan goes into default	259
1.3	Categories of guarantors	261
1.4	A fully informed decision?	263
1.5	Characteristics of parental guarantors	264
1.6	What the case study showed	266
1.7	What issues arise?	269
2	Responsible lending: The Banking Code's diligent and prudent banker	271
2.1	Background	271
2.2	ANZ and the gelato franchise	272
2.3	Westpac and the Pie Face franchise	279
2.4	BOQ and Wendy's franchises	286

3	Responsible lending: Unsolicited offers of credit	294
3.1	Background	294
3.2	What the case study showed	295
4	Responsible lending: Suncorp and Low	298
4.1	Background	298
4.2	What the case study showed	302
5	CBA and double debiting interest	304
5.1	Background	304
5.2	What the case study showed	307
6	Power and communication	308
6.1	Background	308
6.2	Westpac – Bank of Melbourne: Mr and Mrs Wallis	308
6.3	NAB: Mr Ross Dillon and National Music Pty Ltd	313
6.4	What the case studies showed	322
	Case studies: Bankwest and CBA	325
1	Background	325
2	Mr Michael Kelly	326
2.1	Evidence	326
2.2	What the case study showed	331
3	Mr Stephen Weller	331
3.1	Evidence	331
3.2	What the case study showed	337
4	Mr Michael Doherty	338
4.1	Evidence	338
4.2	What the case study showed	343

5	Mr Brendan Stanford	344
5.1	Evidence	344
5.2	What the case study showed	352
6	Issues	352
Case studies: Agricultural lending		355
1	Landmark – ANZ	355
1.1	Background	356
1.2	The Cheesmans	358
1.3	Annexure B customers	366
1.4	The Hirsts	368
1.5	The Harleys	369
1.6	The Handleys	377
1.7	Annexure F customers	378
1.8	Other customers	379
1.9	More recent changes	380
1.10	What the case study showed	382
	1.10.1 Community standards and Clause 2.2 of the Code	382
	1.10.2 Causes of ANZ's conduct	384
	1.10.3 Appointment of external administrators	387
2	Rabobank (the Brauers)	388
2.1	Background	389
2.2	Rabobank contacts the Brauers about Jamberoo	390
2.3	Negotiations in respect of Jamberoo	390
2.4	Conflict of interest	393
2.5	The sale completes	394

2.6	Immediate difficulties arise	395
2.7	Rabobank insists on repayment of \$3 million	396
2.8	Farm debt mediation	397
2.9	What the case study showed	398
2.9.1	Loan origination conduct	398
2.9.2	Hardship	400
2.9.3	Pre-farm debt mediation conduct	400
2.10	Causes of the conduct	401
2.10.1	Adequacy of internal systems	401
2.10.2	Internal appraisal	402
2.10.3	Remuneration	404
3	Bankwest (the Ruddys)	405
3.1	Background	405
3.2	What the case study showed	409
3.3	Causes of the conduct	413
4	NAB (the Smiths)	415
4.1	Background	416
4.2	Default	417
4.3	Farm debt mediation	419
4.4	What the case study showed	422
4.4.1	Hardship	422
4.4.2	Default interest	424
4.4.3	Culture	426
5	Rural Bank	427
5.1	Background	427
5.2	APRA and serviceability issues	432
5.3	Evidence about approach to enforcement	432
5.4	What the case study showed	433

6	CBA failure to apply fee waivers and package benefits	438
6.1	Background	438
6.2	What the case study showed	441
6.3	Adequacy of internal systems	442
	Case studies: Remote communities	443
1	Aboriginal Community Benefit Fund	443
1.1	Background	443
1.2	Ms Walsh and ACBF	445
1.3	ACBF's business	447
1.3.1	Marketing ACBF products	447
1.3.2	Selling ACBF products	448
1.3.3	Health statements	449
1.3.4	ACBF's premium structure	450
1.3.5	ACBF policy cancellations	451
1.3.6	ACBF payouts upon suicide	451
1.4	What the case study showed	452
1.4.1	Misleading and deceptive conduct	452
1.4.2	Conduct falling below community standards and expectations	455
1.4.3	Culture, governance and remuneration practices	457
1.4.4	Effectiveness of response and redress	457
2	Select	458
2.1	Background	458
2.2	The 2015 spike in funeral insurance sales	461
2.3	Correspondence with ASIC	464
2.4	What the case study showed	466
2.4.1	Conduct in relation to Ms Marika	466
2.4.2	Conduct of Select more generally	468

3	ANZ Basic accounts	470
3.1	Background	470
3.2	Disputed events	476
3.3	What the case study showed	476
3.3.1	Culture and adequacy of internal systems	478
4	ANZ (Groote Eylandt)	479
4.1	Background	479
4.2	Informal overdrafts	480
4.3	The extent of informal overdrafts in the Northern Territory	481
4.4	Client 1 and Client 2	482
4.5	Code of Operation	484
4.6	What the case study showed	485
4.6.1	Implementation of the Code of Operation	485
4.6.2	Disclosure of information	486
4.6.3	Culture, governance practices and adequacy of internal systems	487

Glossary

Term	Definition
anti-hawking provisions	Provisions set out in Sections 736, 992AA and 992A of the <i>Corporations Act 2001</i> (Cth) that prohibit offering financial products for issue or sale during, or because of, an unsolicited meeting or telephone call with a retail client.
authorised deposit-taking institution (ADI)	A body corporate authorised under the <i>Banking Act 1959</i> (Cth) to carry on a banking business in Australia.
Australian Credit Licence (ACL)	A licence issued under the <i>National Consumer Credit Protection Act 2009</i> (Cth) that authorises a licensee to engage in particular credit activities.
Australian financial services licence (AFSL), Australian financial services licensee	A licence under the <i>Corporations Act 2001</i> (Cth) that authorises a person who carries on a financial services business to provide financial services. A licensee is the person who provides the services.
Bank Bill Swap Rate (BBSY)	An interest rate used as a benchmark when pricing financial products.
buyer of last resort (BOLR)	Arrangements whereby a licensee or an authorised representative acquires the business of another representative. The purchase price is determined using a specific formula.
conflicted remuneration	Any benefit, whether monetary or non-monetary, given to a financial services licensee , or their representatives, who provides financial product advice to retail clients that, because of the nature

Term	Definition
	of the benefit or the circumstances in which it is given could reasonably be expected to influence the choice of financial product recommended by the licensee or representative or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative: see Section 963A of the <i>Corporations Act 2001</i> (Cth).
enforceable undertaking	An undertaking enforceable in a court. Issued under the <i>Australian Securities and Investments Commission Act 2001</i> (Cth) and the <i>National Consumer Credit Protection Act 2009</i> .
external dispute resolution (EDR)	An independent service for resolving disputes between consumers and providers of financial products and services, as an alternative to the court system.
financial product	Under the <i>Corporations Act 2001</i> (Cth), a facility through which, or through the acquisition of which, a person makes a financial investment, manages financial risk and/or makes non-cash payments.
financial services entity	Defined by the Letters Patent as (among other things) ‘an ADI (authorised deposit-taking institution) within the meaning of the <i>Banking Act 1959</i> , ‘a person or entity required by section 911A of the <i>Corporations Act 2001</i> to hold an Australian financial services licence , or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative’, and ‘a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders’.

Term	Definition
Financial Services Guide (FSG)	A guide that contains information about the entity providing financial advice, and explains the services offered, the fees charged and how the person or company providing the service will deal with complaints.
financial services licensee	An individual or business that has been granted an Australian financial services licence (AFSL) by ASIC.
Future of Financial Advice (FoFA)	A 2012 package of legislation intended to improve the trust and confidence of Australian retail investors in the financial services sector and ensure the availability, accessibility and affordability of high quality financial advice.
Household Expenditure Measure (HEM)	A measure of what families spend on different types of household items, calculated quarterly by the Melbourne Institute of Applied Economic and Social Research.
mortgage aggregator	An intermediary between mortgage brokers and lenders. Mortgage aggregators have contractual arrangements with lenders that allow brokers operating under the aggregator to arrange loans from those lenders.
mortgage broker	An intermediary between borrowers and lenders of home loans.
third party guarantor	A person or business other than the borrower who guarantees to pay back a loan if the borrower does not.

Term	Definition
Tier 1 Capital	Capital against which losses can be written off while an authorised deposit-taking institution (ADI) continues to operate and can absorb losses should the ADI ultimately fail.
trail commission	A regularly recurring commission to an intermediary, such as a broker, based on a proportion of the current or average loan balance and payable periodically after the loan is made/drawn. Distinct from a commission that is paid up front.
vertical integration	A description of the relationship between entities where financial advice, platforms and funds management are controlled by a single entity.

Abbreviations

ABA	Australian Bankers' Association (now Australian Banking Association)
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ACBF	Aboriginal Community Benefit Fund
ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ADI	authorised deposit-taking institution
AFCA	Australian Financial Complaints Authority
AFA	Association of Financial Advisers
AFSL	Australian financial services licence
APRA	Australian Prudential Regulation Authority
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
BOLR	buyer of last resort
EDR	external dispute resolution

FASEA	Financial Adviser Standards and Ethics Authority
FoFA	Future of Financial Advice (legislation reforms)
FOS	Financial Ombudsman Service
FPA	Financial Planning Association of Australia
FSG	Financial Services Guide
HEM	Household Expenditure Measure
KPI	Key Performance Indicator
LVR	loan-to-value ratio
PDS	product disclosure statement
SME	small and medium enterprises
SMSF	self managed superannuation fund

Legislation

Australian Securities and Investments Commission Act 2001 (Cth)
(The ASIC Act)

Australian Small Business and Family Enterprise Ombudsman
Act 2015 (Cth)

Banking Act 1959 (Cth)

Competition and Consumer Act 2010 (Cth)

Corporations Act 2001 (Cth) (the Corporations Act)

Fair Work Act 2009 (Cth)

Farm Business Debt Mediation Act 2017 (Qld)

Farm Debt Mediation Act 1994 (NSW)

Farm Debt Mediation Act 2011 (Vic)

Financial Services Reform Act 2001 (Cth)

Income Tax Assessment Act 1997 (Cth)

Insurance Contracts Act 1984 (Cth)

National Consumer Credit Protection Act 2009 (Cth) (the NCCP Act)

Privacy Act 1988 (Cth)

Royal Commissions Act 1902 (Cth)

The Commission's tasks

In the introduction to this Interim Report I pointed out that the first paragraph of the Terms of Reference obliged me to inquire into whether conduct *might* have amounted to misconduct (as defined) and the second paragraph required me to consider whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and expectations. It is important to say something more about my understanding of these tasks.

As has already been noted, 'misconduct' is defined in the Letters Patent as including four classes of conduct:

- conduct that constitutes an offence against certain laws;
- conduct that is misleading, deceptive, or both;
- conduct that is a breach of trust, breach of duty or unconscionable conduct; and
- conduct that breaches a professional standard or a recognised and widely adopted benchmark for conduct.

Consistent with the essential character of a Royal Commission (as a non-judicial task) the Letters Patent require me to inquire into whether any conduct *might* have amounted to misconduct. I am not asked to decide whether conduct did constitute an offence, or other contravention of law. If conduct might have amounted to misconduct, I am required and authorised to decide whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, state or territory agency. Any decision about bringing proceedings is a matter for the relevant agency, not me.

This report sets out some conclusions I have reached in relation to the matters explored in public hearings. I set out my conclusions about what happened, what was done or not done, and what legal characterisations might attach to or be associated with those factual conclusions.

The conclusions I reach about whether conduct might have amounted to misconduct are, and must be, based on the information that has been assembled during the course of the Commission's inquiries. Much, but not all, of that information was provided by evidence given in the course of public hearings; some was gathered otherwise, including, for example, from submissions made to the Commission by **financial services entities** and others.

The conclusions that I reach have no binding or enforceable effect, whether against those who are said to have engaged in relevant conduct, against others who have appeared in the course of public hearings or in any other way. I cannot, and do not, decide whether evidence given in hearings conducted by the Commission, if it could be, and later was, adduced in properly constituted criminal or civil proceedings, would support a finding of contravention of law.

Submissions made by persons given leave to appear have often emphasised that a conclusion that there might have been misconduct should not be reached lightly. Unsurprisingly, the submissions have been framed in the language of the courtroom with references to standards and burdens of proof. And references of that kind (especially to notions of burden of proof) have their origins in the essentially adversarial common law system of judicial trial in accordance with applicable rules of evidence. The processes of a Royal Commission, and hence the inquiry I have conducted, are radically different from those of a court conducting a trial. The Commission is an inquiry instituted by the Executive. It is not bound by the rules of evidence. The notion of a burden of proof has no application. But the essential point made – that a conclusion that there might have been misconduct should not be reached lightly – is undeniably true.

I cannot form a conclusion about what has happened or what has been done or not done without my being persuaded of the relevant fact. And as Dixon J pointed out in 1938, '[t]he seriousness of an allegation made, the inherent unlikelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations

which must affect the answer to the question whether the issue has been proved to the reasonable satisfaction of the tribunal'.¹

The conclusions that I express in my reports (interim and final) may have grave consequences. Allegations of misconduct are serious.

Members of society ordinarily do not engage in conduct that is dishonest. Most members of society try to act within applicable legal rules and regulations.

All of these are matters that I have striven to bear at the forefront of consideration when forming the conclusions I express. Most especially has that been so in respect of two kinds of conclusion – first, a conclusion that conduct by a financial services entity (or by directors, officers or employees of an entity or by someone acting on behalf of the entity) might have amounted to misconduct and second, the related but distinct conclusion about whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, state or territory agency.

It will be seen that there are some cases in which I say that particular conduct *amounted to* misconduct rather than that the conduct *might* be of that character. I have thought it right to go so far in cases where the entity concerned acknowledged in its submissions to the Commission that what had happened amounted to misconduct. Apart from those cases, however, I have sought to express no larger conclusion than that conduct might have amounted to misconduct of a particular kind.

¹ *Briginshaw v Briginshaw* (1938) 60 CLR 336 at 361–2.

Case studies: Consumer lending

1 NAB Introducer home loans

1.1 Background

In its response to the Commission's initial inquiries, NAB acknowledged that between 2013 and 2016, NAB bankers in the Greater Western Sydney area and in other parts of NSW, the ACT and Victoria, engaged in misconduct in connection with home loan applications submitted through the NAB Introducer Program. Anthony Waldron, the Executive General Manager for Broker Partnerships at NAB, Angus Gilfillan, the Executive General Manager, Consumer Lending, in the Customer Products and Services Division at NAB and Lynda Dean, Executive General Manager, Performance and Reward, gave evidence in relation to this case study.

1.2 Evidence

From 2013 to 2016, the NAB Introducer Program was (and at the time the evidence was given, remained) a program by which third parties ('Introducers') received a commission payment for referring loan applications to NAB. Most loans referred to NAB by Introducers are home loans.¹ The commission paid was (and remained) calculated as a percentage of the loan amount paid to the Introducer when the customer's loan application is approved and drawn down.² Commission payments to certain Introducers involved in the conduct examined in evidence totalled about \$630,000 over four years, of which \$488,000 was paid to a single Introducer.³

¹ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 7 [13].

² Transcript, Anthony John Waldron, 13 March 2018, 65.

³ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 166) [NAB.032.001.2605 at .2605].

The Introducer Program has been a profitable source of lending for NAB, resulting in more than \$24 billion in loans between 2013 and 2016.⁴ At its peak, there were approximately 8,000 Introducers in the program.⁵ NAB's internal policies during the period of the relevant conduct required Introducers to submit minimum volumes of home loan applications.⁶ As at the end of October 2015, the four Introducers involved in the conduct had provided to NAB \$139.78 million in loans drawn down.⁷

In September and October 2015, NAB received two anonymous calls from whistle-blowers. These whistle-blowers told NAB about certain practices alleged to have taken place in Greater Western Sydney branches of NAB, including alleged bribery.⁸ In April 2015, NAB had conducted a Comprehensive Assurance Review that uncovered a range of concerns related to Introducer files and sales incentive discrepancies in relation to one of the branches that was later found to be involved in the relevant conduct,⁹ but NAB's full investigation did not commence until late October 2015.¹⁰

In December 2015, KPMG was engaged to conduct an investigation in relation to the allegations.¹¹ KPMG's initial review identified many issues both in respect of the NAB Introducer Program and in respect of controls that had been in place to prevent or deter fraud and other misconduct, including in respect of the loan origination and application process and income verification procedures for both personal loans and home loans. KPMG noted that NAB's Forensic Team had identified: unapproved Introducers introducing new customers to the lending managers; loans being approved on the basis of potentially fraudulent documentation (such as forged pay slips); and bankers accepting payments from unapproved

⁴ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 8–9 [19].

⁵ Transcript, Anthony John Waldron, 13 March 2018, 65.

⁶ Transcript, Anthony John Waldron, 13 March 2018, 79.

⁷ Exhibit 1.9, undated, Task Force Steering Committee, 1.

⁸ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 126) [NAB.005.074.0522]; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018 (Tab 127) [NAB.0005.074.0550].

⁹ Exhibit 1.5, 2 April 2015, Email from Windridge to Bosnich dated 02/04/2016, 1.

¹⁰ Transcript, Anthony John Waldron, 13 March 2018, 97.

¹¹ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 9 [25].

Introducers.¹² KPMG said that there could be about \$50 million of loans with ongoing serviceability issues.¹³

On 21 December 2015, NAB sent a letter to the Australian Securities and Investments Commission (ASIC), informing ASIC of its investigations.¹⁴ By letter dated 3 February 2016, NAB notified ASIC of a significant breach pursuant to Section 912D of the *Corporations Act 2001* (Cth) (the Corporations Act).¹⁵

NAB continued to investigate potential misconduct by bankers and Introducers in 2016. Later that year, it became aware that the conduct was not confined to the Greater Western Sydney area.¹⁶ NAB established several projects to investigate the misconduct and identify causes. NAB's investigations and the review conducted by KPMG found that NAB bankers had engaged in conduct including:

- applying signatures to consent forms that had the effect of triggering a commission payment to an Introducer in circumstances where this was not warranted;¹⁷
- knowingly accepting falsified documentation in connection with home loan applications;¹⁸

¹² Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 161) [NAB.005.037.0887 at .0889].

¹³ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 161) [NAB.005.037.0887 at .0896].

¹⁴ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 159) [NAB.032.001.0042].

¹⁵ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 167) [NAB.032.001.0069].

¹⁶ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 9 [26]; Transcript, Anthony John Waldron, 14 March 2018, 144–5.

¹⁷ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 12–13 [55]–[56]; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 167) [NAB.032.001.0069 at .0071]; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, (Tab 126) [NAB.005.074.0522 at .0540].

¹⁸ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 126) [NAB.005.074.0522 at .0540]; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 161) [NAB.005.037.0887 at .0964–.0965]; Transcript, Anthony John Waldron, 13 March 2018, 83, 100.

- receiving payments from Introducers;¹⁹
- failing to disclose personal relationships with Introducers;²⁰
- failing to meet face-to-face with customers;²¹ and
- accepting home loan applications and supporting documentation from Introducers, rather than directly from the customer.²²

As a result of the investigations, 10 bankers were dismissed, 10 are no longer with NAB and 32 had internal consequences applied, such as reduction of their incentives.²³ A number of the bankers involved in the conduct, including a number of those who were dismissed, were Branch Managers.²⁴

In some instances, the conduct identified resulted in loans being made by NAB that were later found to be unsuitable. Mr Waldron gave evidence of examples of customers who were potentially entitled to remediation, including one customer who provided all funds to complete their loan transaction to the relevant Introducer and attended the NAB branch to complete the relevant application forms accompanied by the Introducer.²⁵ As part of NAB's remediation program, it emerged that the information

¹⁹ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 126) [NAB.005.074.0522 at .0540]; Transcript, Anthony John Waldron, 13 March 2018, 100.

²⁰ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 126) [NAB.005.074.0522 at .0540]; Transcript, Anthony John Waldron, 13 March 2018, 101.

²¹ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 126) [NAB.005.074.0522 at .0540]; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 161) [NAB.005.037.0887 at .0964—.0965]; Transcript, Anthony John Waldron, 13 March 2018, 100.

²² Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 167) [NAB.032.001.0069]; Transcript, Anthony John Waldron, 14 March 2018, 118.

²³ Transcript, Anthony John Waldron, 14 March 2018, 116–17.

²⁴ Transcript, Anthony John Waldron, 14 March 2018, 118, 125, 135.

²⁵ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 10 [29].

obtained about the customer was inaccurate because it failed to take into account that she had five dependants at the time of the loan application.²⁶

In another example provided by Mr Waldron, a customer's general living expenses were assessed on the basis that the customer would rent out the property for which the loan was being obtained to purchase and a rental appraisal was used for that purpose. During a conversation with the customer as part of NAB's remediation program, the customer told NAB that he did not recognise the rental appraisal and did not provide it to NAB, nor did he know who had.²⁷ The customer also told NAB that he never received rental income from the property.²⁸ As at early March 2018, NAB was still reviewing this loan, but was concerned that the rental income should not have been included in the serviceability calculations for the loan.²⁹

1.3 What the case study showed

1.3.1 Misconduct?

As noted above, NAB acknowledged in its response to the Commission's initial inquiries that, between 2013 and 2016, there had been misconduct by its employees and by Introducers. In its written submissions provided after the first round of hearings had finished, NAB described it as 'misconduct ... involving a cohort of bankers and Introducers in the Greater Western Sydney (GWS) area, and other areas including the ACT, New South Wales and Victoria'.³⁰ In those submissions, NAB acknowledged that, in respect of 'those bankers the subject of the case study who were terminated by NAB and/or to whom NAB applied a red conduct gate',³¹ it had breached its statutory obligations under Section 47(1)(a) of the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act) and Section 912A(1)(a) of the Corporations Act to do all things necessary

²⁶ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 11 [30].

²⁷ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 11 [40].

²⁸ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 12 [42].

²⁹ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 11 [39].

³⁰ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 2 [4(a)].

³¹ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 18 [63].

to ensure that its credit activities, and the financial services covered by its **Australian financial services licence** (AFSL), were engaged in efficiently, honestly and fairly.

In March 2016, in a meeting with ASIC, NAB described the events in question as involving six types of conduct:

- false attribution of customer details to Introducers;
- non-disclosure of conflicts of interest between NAB bankers and Introducers;
- incorrect allocation of incentives under NAB's Star Sales Incentive Plan to NAB bankers *in order to inflate the incentive applicable to the Branch Manager*;
- customer information being received directly from Introducers (rather than customers); and
- the use of Introducers in non-preferred businesses.³²

Apart from the last of these matters (about using Introducers 'in non-preferred businesses') all of the descriptions that NAB gave of the conduct were cast in terms consistent with the conduct constituting a breach of duty (and hence a form of 'misconduct' as defined in the Commission's Terms of Reference).

I have no reason to doubt that NAB was right in making the acknowledgments that it did to ASIC in March 2016 and in its submissions to the Commission.

1.3.2 Causes?

As for the causes of the conduct, in its written submissions provided after the first round of hearings, NAB said that the 'misconduct was ... found to have occurred, and required a response that embraced systemic, cultural and policy changes'.³³

³² NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 4 [14] (emphasis added).

³³ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 4 [16].

NAB's own analysis of the root causes of the conduct concluded, among other things, that 'there was a lack of controls in relation to addressing intentional misconduct (including fraud)' and that 'monitoring and reporting was not being used adequately to enable early identification by NAB of emerging issues'.³⁴ As NAB said, 'NAB's investigations and its root cause analysis revealed that its processes were, in the relevant period, not adequate to detect and prevent the misconduct.'³⁵

Again, there is no reason to doubt that NAB was right in making the acknowledgments that it did. It is necessary, however, to say a little more about a number of more particular issues that emerged, especially: the significance of the incentives program, the sufficiency of training of bankers, and the adequacy of NAB's controls more generally.

Incentives

NAB accepted, in its written submissions, that the conduct that was identified in the GWS area (and subsequently discovered in other areas as well) 'was attributable to several systemic issues in relation to the Introducer Program itself and, more broadly, the structure of NAB's incentives program'.³⁶ It went on to say, however, that there is no evidence to warrant finding that the incentives program was a 'significant' cause of the conduct, as opposed to having 'contributed to a small number of people choosing to behave unethically'.³⁷

I do not accept this last proposition. The proposition makes sense only if it is read as asserting that some of those who engaged in the relevant conduct ('a small number of people') were driven by the pursuit of financial gain but that there was, or may have been, some other unknown reason why others participating in the conduct acted as they did. NAB has not

³⁴ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 5 [17].

³⁵ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 8 [31].

³⁶ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 5 [19].

³⁷ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 21 [91].

previously suggested that those who acted as they did were motivated by anything but financial gain.

The evidence shows that from as early as April 2015, NAB was aware that one of the potential root causes of the conduct was the Star Sales Incentive program that the relevant bankers were operating under, which rewarded bankers with bonuses for achieving certain targets for the sale of home loans.³⁸ The investigation of the conduct confirmed that the incentive program was driving inappropriate behaviour.³⁹ Although NAB has since moved many of its employees to a different incentive plan (the Short Term Incentive Plan), and proposes to introduce further changes to its remuneration structures from 1 October 2018,⁴⁰ that program presently continues to reward bankers with bonuses for achieving targets for the sale of home loans.⁴¹ The scorecards by which employees were assessed were weighted heavily in favour of financial matters, with marginal weight attributed to compliance-related matters.⁴² In the words used in one of the documents produced by NAB, the 'risk/reward equation for bankers [was] unbalanced in favour of sales over keeping customers and the bank safe'.⁴³

Not only were bankers rewarded in this way, NAB told bankers that Introducers were required to commit to referring a minimum of \$2 million worth of loans a year for personal lending (\$10 million a year for business

³⁸ Transcript, Anthony John Waldron, 13 March 2018, 73; Transcript, Anthony John Waldron, 14 March 2018, 124.

³⁹ Exhibit 1.9, undated, Task Force Steering Committee, 2; see also Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 131) [NAB.005.043.0427 at .0432]; Transcript, Anthony John Waldron, 14 March 2018, 124; Transcript, Anthony John Waldron, 13 March 2018, 85.

⁴⁰ Exhibit 1.200, Witness statement of Lynda Maree Dean, 15 August 2018, Exhibit LMD-1 (Tab 1) [NAB.005.903.0001].

⁴¹ Transcript, Anthony John Waldron, 14 March 2018, 154.

⁴² For example, Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 29) [NAB 005.061.0028]; see also Transcript, Anthony John Waldron, 14 March 2018, 174–5.

⁴³ Transcript, Anthony John Waldron, 14 March 2018, 166; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 253) [NAB.005.037.0722 at .0726].

lending)⁴⁴ and the commissions paid to Introducers were themselves tied to the amounts of loans referred that were drawn down. This created a further incentive for collusion between bankers and Introducers and NAB itself identified Introducer commission structures as potentially not driving the right behaviours.⁴⁵

The incentive arrangements used by NAB for bankers and for Introducers were a significant cause of the conduct.

Training

One of the key findings of the ‘root cause analysis’ conducted by NAB was that its approach to the recruitment, training and accreditation of bankers has not been ‘fully effective in ensuring that all bankers understand consumer lending process compliance requirements’.⁴⁶ NAB also found that limited training was available and provided to frontline bankers regarding Introducers and their ‘spot and refer’ function.⁴⁷ In its written submissions, NAB accepted that ‘a cause of the misconduct was the inadequacy of its processes for the training of bankers’.⁴⁸ However, NAB went on to submit that the evidence did not ‘support a finding that NAB’s policies (as opposed to processes) with respect to the training of bankers was a cause of the misconduct’, nor a finding that ‘that inadequacy (whether of policies or processes) in relation to recruitment of bankers was a cause of the misconduct’.⁴⁹

⁴⁴ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 125) [NAB.005.062.0003 at .0005]; see also Transcript, Anthony John Waldron, 13 March 2018, 78–9.

⁴⁵ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 131) [NAB.005.043.0427 at .0432].

⁴⁶ Transcript, Anthony John Waldron, 14 March 2018, 164; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 35 [222].

⁴⁷ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 162) [NAB.032.001.0044 at .0049]; Transcript, Anthony John Waldron, 14 March 2018, 130; Transcript, Anthony John Waldron, 14 March 2018, 155.

⁴⁸ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 21 [93].

⁴⁹ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 21 [93].

I see no reason to doubt NAB's internal assessment that its approach to the recruitment, training and accreditation of bankers was not 'fully effective in ensuring that all bankers [understood] consumer lending process compliance requirements'.⁵⁰ This deficiency, whether described as a defect in policy or process, was a cause of the conduct. Relevant staff did not understand what they had to do.

Controls

Another of the key findings of the 'root cause analysis' conducted by NAB was that the control environment was not effectively designed to mitigate conduct and fraud risks 'across the end-to-end value chain'.⁵¹ More particularly, the analysis found that the overall effectiveness of the control systems was reliant on bankers doing the right thing.⁵² Controls were not designed to identify effectively and consistently instances of intentional misrepresentation of information, which was a key characteristic of the relevant conduct. That is, the then existing monitoring and reporting systems did not adequately detect and deter non-compliant conduct and fraud. So, for example, the absence of effective 'feedback loops' limited the use of outcomes of monitoring activities to inform bankers of process quality and compliance issues and allow them to change their behaviour.⁵³

In its written submissions, NAB accepted that a cause of the conduct was the inadequacy of NAB's policies for the prevention and detection of fraud by bankers and Introducers.⁵⁴ I agree.

More particularly, Mr Waldron agreed that 'gaps' in the end-to-end loan application process were exploited by bankers and that NAB itself raised the question whether the end-to-end process of mortgage origination,

⁵⁰ Transcript, Anthony John Waldron, 14 March 2018, 164; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 35 [222].

⁵¹ Exhibit 1.14, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 155) [NAB.005.043.0298 at .0013].

⁵² Transcript, Anthony John Waldron, 14 March 2018, 165–6.

⁵³ Transcript, Anthony John Waldron, 14 March 2018, 166.

⁵⁴ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 22 [99], 5 [17(c)].

fulfilment, ongoing management, and eventual repayment required fundamental review from a ‘controls effectiveness’ perspective.⁵⁵

NAB used Introducers from a variety of business backgrounds that were unconnected with financial, property or legal services, such as gymnasiums and tailors,⁵⁶ even though its guide for Introducers informed them that they were not to provide a referral that was not incidental to the carrying on of the Introducer’s business.⁵⁷ Some of the Introducers who were involved in the conduct in the case study had formed close relationships with certain NAB bankers, and bankers who signed on an Introducer were told at the time that they had to maintain the primary relationship with the Introducer.⁵⁸ Mr Waldron explained that, at the time he gave his evidence, NAB was reforming the Introducer Program, including by taking steps to divide referred work from Introducers between various bankers⁵⁹ and to introduce business development managers in the field who would work with the bankers and the Introducers and manage that process.⁶⁰

In its written submissions, NAB accepted that a cause of the conduct in issue was the inadequacy of its ‘policies for the recruitment and monitoring of Introducers’.⁶¹ It is important to identify what was covered by the reference to ‘monitoring’ Introducers.

The role to be played by an Introducer, as described in Mr Waldron’s evidence, was very limited. The Introducer could do nothing more than say to a person who might wish to obtain a loan: ‘NAB lends money. May I give NAB your name and contact details?’. Introducers signed an agreement by which they were not to do certain things (such as explaining

⁵⁵ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 129) [NAB.005.046.2163 at .2165].

⁵⁶ See, eg, Transcript, Anthony John Waldron, 14 March 2018, 128.

⁵⁷ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 117) [NAB.005.068.0025 at .0028]; see Transcript, Anthony John Waldron, 13 March 2018, 76–7.

⁵⁸ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 125) [NAB.005.062.0003 at .0006].

⁵⁹ Transcript, Anthony John Waldron, 13 March 2018, 79, 80.

⁶⁰ Transcript, Anthony John Waldron, 13 March 2018, 80.

⁶¹ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 21 [95].

loan or security documentation, procuring execution of loan or security documentation or accepting money on behalf of NAB).⁶² Mr Waldron conceded that these contractual clauses were not complied with by a number of the Introducers involved in the relevant conduct.⁶³ The agreement also prohibited Introducers from representing themselves to an applicant as the agent of NAB,⁶⁴ and by the guide NAB issued to Introducers, Introducers were told they must not act as an intermediary between NAB and the borrower.⁶⁵ However, it was apparent from Mr Waldron's evidence that Introducers adopted various roles in the loan application process that went beyond the mere 'spot and refer' function NAB intended for them.⁶⁶ That they did so seems unsurprising if their permitted function was as artificially narrow as it was said to be. And if an Introducer was not to 'sell' the bank's services to the would-be borrower, why reward the Introducer so handsomely?

In its written submissions, NAB attempted to disentangle the '[w]eaknesses in NAB's policies and procedures' that 'meant the misconduct was not identified earlier' from 'the actions of individual Introducers and bankers'. NAB submitted that the latter, rather than the former, was the cause of the conduct.⁶⁷

Of course NAB is right to say that individuals acted wrongly. In that sense, those individuals were a cause of the conduct in issue. But it would be artificial, and wrong, to confine attention to their conduct and say of it that the individuals' behaviour was *the* cause of what occurred. Confining attention in that way (as NAB sought to have me do) would look only at what

⁶² Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 116) [NAB.005.039.0003].

⁶³ Transcript, Anthony John Waldron, 13 March 2018, 73.

⁶⁴ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 116) [NAB.005.039.0003 at .0008].

⁶⁵ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 117) [NAB.005.068.0025 at .0027].

⁶⁶ See, eg, Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 47–9 [283]–[294].

⁶⁷ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 22 [101].

happened rather than how and why. Contrary to NAB's submission,⁶⁸ the weaknesses in NAB's policies and procedures that have been identified were an important contributing cause for the conduct in issue.

1.3.3 Conduct falling short?

NAB said, in its written submissions, that there were respects in which its responses to what had happened 'could have been (and should have been) quicker' than they were.⁶⁹

To understand and evaluate this last acknowledgment it is necessary to recall the chronology of events.

NAB first began its investigations about conduct in the GWS area in September 2015. In December 2015, NAB notified both ASIC⁷⁰ and the New South Wales Police⁷¹ of what it had found. In February 2016, NAB gave written notice to ASIC under Section 912D of the Corporations Act that there had been a breach of its obligations under Section 912A. In August 2016, NAB gave a second notice under Section 912D, this time about the further conduct it had identified as occurring outside the GWS area. Also in August 2016, NAB proposed to ASIC a remediation scheme with respect to the GWS matter. As other conduct came to light (outside the GWS area) NAB sought, in November 2017, to develop a broader remediation program.

The conduct in issue appears to have occurred between 2013 and 2016. Yet, when the Commission examined these matters in March 2018, not a single customer had been offered any compensation.⁷² NAB had conducted 11,000 file reviews⁷³ and had identified as many as 1,360⁷⁴

⁶⁸ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 22 [101].

⁶⁹ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 10 [35].

⁷⁰ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 159) [NAB.032.001.0042].

⁷¹ Transcript, Anthony John Waldron, 14 March 2018, 118.

⁷² Transcript, Anthony John Waldron, 14 March 2018, 183; Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, 46 [273].

⁷³ Transcript, Anthony John Waldron, 14 March 2018, 184.

⁷⁴ Transcript, Anthony John Waldron, 14 March 2018, 182–3.

customers who may have been affected by the conduct. But NAB could say only that the amount it expected to pay out was between \$9 million and \$23 million.⁷⁵

In light of this chronology, I agree that NAB's responses to what had happened 'could have been (and should have been) quicker' than they were.⁷⁶ Two and a half years after the issues were first identified, NAB could not say which customers had been affected or what was the extent of the effect of the conduct. More particularly, I consider that, by not responding more quickly, NAB fell short of community standards and expectations.

1.3.4 Mechanisms for redress

What has been said about the timeliness of NAB's execution of its remediation program shows that the mechanisms NAB has adopted to provide redress for consumers who have suffered detriment as a result of the conduct that it identified have not been as effective as they should have been.

1.3.5 Other conclusions?

In the course of her closing address, Senior Counsel Assisting framed her submissions, in part, by reference to particular provisions of applicable law and other relevant provisions, especially, Sections 912A and 912D of the Corporations Act, Sections 47, 128, 130 and 133 of the NCCP Act, ASIC's Regulatory Guides RG 78 (Breach Reporting by AFS Licensees) and RG 209 (Credit Licensing Responsible Lending Conduct) and the then applicable Code of Banking Practice. The advantage of framing the submissions with this degree of particularity is evident for it points precisely to what may be said to have been the relevant conduct.

As has been described earlier, Mr Waldron gave evidence of some examples of customers who NAB had identified as potentially entitled to remediation. And, if the facts were to be shown as he described them to be, there may well be a question about the suitability of the transactions

⁷⁵ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 10–11 [37]–[39], 13–14 [45]–[47]; Transcript, Anthony John Waldron, 14 March 2018, 194.

⁷⁶ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 10 [35].

that NAB had made with those customers. But, because NAB has not yet completed its inquiries about these matters, it is not possible to go beyond the following observations and conclusions.

NAB accepts that its systems failed. It accepts that the conduct ‘was attributable to several systemic issues in relation to the Introducer Program itself and, more broadly, the structure of NAB’s incentives program’.⁷⁷

Necessarily implicit in these acknowledgments is an acceptance that, to the extent there was the misconduct it has acknowledged, NAB did not provide its services efficiently, honestly and fairly.

I take NAB’s acknowledgment of systemic issues to be an acknowledgment that a cause for the occurrence of these events was a want of sufficient and effective systems for control and supervision. And of course, NAB acknowledges that its incentives program was also a cause of what occurred.

It seems to me to follow from what NAB said about its proposed remediation program that it acknowledges that there may be, and probably are, cases in which NAB did not comply with applicable provisions of the NCCP Act (or ASIC’s interpretation of that Act in RG 209). And to the extent that there was failure of compliance with the NCCP Act or RG 209, there may well also have been a failure to comply with the requirement of the then applicable Code of Banking Practice to exercise the care and skill of a diligent and prudent banker. Were there no breach of the responsible lending requirements, there would appear to be no reason to compensate the customer. But I cannot say in how many cases there was a departure from the requirements of the NCCP Act, RG 209 or the Code. Nor can I say what was the nature or the extent of departure from the relevant provisions. And I cannot form a view about these matters because NAB had not completed its investigations. All I can do is note that NAB’s estimate of the amount of compensation to be allowed is between \$9 million and \$23 million, as I have previously mentioned.

There remains for separate consideration what conclusions should be reached about the timeliness of NAB’s reports to ASIC under Section 912D of the Corporations Act.

⁷⁷ NAB, *Submissions of National Australia Bank – Introducer Case Study*, 3 April 2018, 5 [19].

ASIC has made no submission to the Commission that NAB did not meet its obligations under Section 912D. There is no evidence that ASIC has complained to NAB about the timeliness of NAB's communications about these matters. It is to be observed that NAB gave notice under Section 912D by letter dated 3 February 2016,⁷⁸ yet had considered it necessary to tell ASIC and the New South Wales Police about these matters five weeks earlier. How that is consistent with the obligation under Section 912D to make a report 'as soon as practicable and in any case within 10 business days after becoming aware of the breach or likely breach' is unexplained. All that NAB says is that I should not conclude that there was a breach of Section 912D.

Given that the regulator, ASIC, has not made and does not now make any complaint of lack of timely performance of the statutory obligation, I will say no more about the application of Section 912D to the specific events that were the subject of evidence in this case study. Instead I refer to and repeat what I have said elsewhere in this report about the application of Section 912D.

2 CBA broker relations and accreditation

2.1 Background

The Commission took evidence about CBA's arrangements with **mortgage brokers** and **mortgage aggregators** from the Executive General Manager for Home Buying at CBA, Mr Daniel Huggins,⁷⁹ and from a mortgage broker, Mr Mark Harris.⁸⁰

⁷⁸ Exhibit 1.4, Witness statement of Anthony John Waldron, 2 March 2018, Exhibit AJW-1 (Tab 167) [NAB.032.001.0069].

⁷⁹ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018; Exhibit 1.28, Witness statement of Daniel James Huggins, 7 March 2018.

⁸⁰ Exhibit 1.24, Witness statement of Mark Andrew Harris, 7 March 2018; Exhibit 1.25, Witness statement of Mark Andrew Harris, 12 March 2018.

2.2 Evidence

Home loan applications are submitted to CBA through two channels: the proprietary channel and the third party distribution channel. The proprietary channel refers to loans offered through CBA's employees or authorised representatives, as well as through CBA's referral source program. It represents about 59% of CBA's home loan portfolio.⁸¹ The third party distribution channel refers to loans submitted to CBA by brokers, and represents about 41% of CBA's home loan portfolio.⁸²

The home loan applications submitted to CBA through the third party distribution channel come to CBA through mortgage aggregators or mortgage franchisors, which CBA (and others in the industry) refer to as 'Head Groups'. Head Groups have their own **Australian Credit Licence** (ACL) and their own contractual arrangements with brokers.⁸³ CBA has no direct contract with the brokers who submit loans to CBA.⁸⁴

CBA requires those brokers who wish to submit home loan applications to CBA to go through an accreditation process.⁸⁵ When Mr Huggins first gave his evidence, a broker seeking accreditation would complete an 'Authority to Act' form in which they acknowledged that, to maintain accreditation with CBA, they needed to submit a minimum of four home loan applications, and settle a minimum of three home loans, in a six-month period.⁸⁶ Mr Huggins said that CBA had not been enforcing this requirement 'systemically'.⁸⁷ Mr Huggins later gave evidence to the Commission that between April and June 2018, CBA informed brokers that maintaining their CBA accreditation would not require them to write a minimum number of loans with CBA.⁸⁸

⁸¹ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, 3 [18].

⁸² Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, 3 [18].

⁸³ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, 5 [31].

⁸⁴ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, 6 [36].

⁸⁵ Transcript, Daniel James Huggins, 15 March 2018, 266.

⁸⁶ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-11 [CBA.0001.0027.4036 at .4038].

⁸⁷ Transcript, Daniel James Huggins, 15 March 2018, 267–8.

⁸⁸ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 6 [28].

The tenor of Mr Huggins' evidence was that CBA regards its accredited brokers as acting as its agent when dealing with customers. In its written submissions, CBA denied that the brokers were its agent.⁸⁹ I will say more about this issue below. For the moment, however, it is to be noted that Mr Huggins' evidence was that an accredited broker will 'act on behalf of CBA ... in the process of selling the home loan' and in submitting home loans to CBA for the customer.⁹⁰ Be this as it may, it is plain that CBA expects brokers to promote its products. CBA's contracts with Head Groups contain provisions requiring Head Groups to promote CBA's reputation and products.⁹¹

When Mr Huggins gave his evidence, CBA paid Head Groups upfront commissions and **trail commissions** for each home loan that was drawn down. The amount of the commission paid was tied to the size and duration of the loan. An upfront commission was paid when the loan was funded; trail commissions were paid during the life of the loan and were calculated by reference to the net balance of the home loan account at the end of each month.⁹² Head Groups passed on part of these commissions to the brokers.⁹³

CBA's contractual arrangements with Head Groups give CBA certain rights and entitlements in its dealings with Head Groups.⁹⁴ Again, Mr Huggins gave evidence to the effect that CBA had then chosen, or would choose, not to enforce a number of those rights and entitlements.⁹⁵ Examples of such contractual entitlements included the right to alter the commission

⁸⁹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 1 [4(b)].

⁹⁰ Transcript, Daniel James Huggins, 15 March 2018, 267.

⁹¹ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-4 [CBA.0001.0028.0344 at .0370, cl 2.10].

⁹² Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, 7 [40].

⁹³ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, 7 [43].

⁹⁴ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-4 [CBA.0001.0028.0344].

⁹⁵ See, eg, Transcript, Daniel James Huggins, 15 March 2018, 252.

structure if the average monthly settlements for the Head Group in respect of CBA loans for the previous year fell below \$5 million.⁹⁶

CBA pays bonuses to Head Groups if certain performance targets are met. If the Head Group meets certain minimum volume requirements for loans drawn down, CBA also makes payments to Head Groups to assist with training, development and compliance.⁹⁷ Head Groups are also remunerated for sales of non-home loan CBA-branded products provided to home loan customers, such as insurance products, through CBA's Connect Referral Program.⁹⁸ Such payments (or portions of them) may also be passed on to brokers.

CBA also gives non-financial benefits to brokers directly, such as tickets to hospitality or sporting events and charity golf days. From December 2017, CBA has limited the value of these non-financial benefits to \$350 per person per event. Before December 2017, CBA had no policy limiting the number or value of non-financial benefits that CBA could give directly to brokers.

The general tenor of Mr Huggins' evidence was that the text of the Head Group agreements that CBA had when he gave his evidence did not reflect the arrangements that CBA sought to have with its Head Groups and that the agreements would be changed.

In around April 2018, CBA made a number of changes to its contractual arrangements with Head Groups in respect of which Mr Huggins gave further evidence. The changes included:⁹⁹

- removal of any requirement for the Head Group to meet any minimum volume of loans over a period;

⁹⁶ Transcript, Daniel James Huggins, 15 March 2018, 252; Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-4 [CBA.0001.0028.0344 at .0357].

⁹⁷ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-4 [CBA.0001.0028.0344 at .0363].

⁹⁸ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-4 [CBA.0001.0028.0344 at .0355, .0385–.0386].

⁹⁹ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 9 [41].

- replacement of the two components of upfront commission (previously ‘base’ and ‘additional’ commission) with one type of upfront commission that merged the two; and
- amendment of the commission plans such that all Head Groups will be transitioned to ‘Plan A’, which Mr Huggins said represented the plan selected by approximately 99.95% of brokers.

However, Mr Huggins gave evidence that the types of financial or non-financial benefits payable to Head Groups have not changed.¹⁰⁰

Until shortly before Mr Huggins first gave evidence, CBA had divided its accredited brokers into four tiers based on volume thresholds.¹⁰¹ Brokers in the highest tier (the ‘diamond’ tier) received the best service from CBA, in that their applications were turned around faster than applications by other brokers.¹⁰² CBA had recognised that this structure could create a conflict of interest,¹⁰³ and at the time that Mr Huggins gave evidence, CBA was in the process of changing to a two-tier system.¹⁰⁴ Under the new system, accredited brokers are classified as either ‘essential’ or ‘elite’, on the basis of the application of ‘quality and complementary metrics’. As a result, brokers may reach ‘elite’ status for reasons other than the volume of loans submitted and drawn down, although the metrics recognise brokers who contribute a high volume of settlements with CBA and whose total portfolio grows over the year.¹⁰⁵

In February 2017, CBA’s then-CEO, Mr Ian Narev, wrote to Mr Stephen Sedgwick AO, the independent reviewer for the Retail Banking Remuneration Review, acknowledging on behalf of CBA that the use of loan

¹⁰⁰ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 10 [43].

¹⁰¹ Transcript, Daniel James Huggins, 15 March 2018, 246.

¹⁰² Transcript, Daniel James Huggins, 15 March 2018, 246.

¹⁰³ Transcript, Daniel James Huggins, 15 March 2018, 246.

¹⁰⁴ Transcript, Daniel James Huggins, 15 March 2018, 245–6.

¹⁰⁵ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 11–12 [49]–[52].

size tied with upfront and trail commissions for third parties can potentially lead to poor customer outcomes.¹⁰⁶ Mr Narev said that:¹⁰⁷

Mortgages also sit outside the financial advice framework, even though buying a home and taking out a mortgage is one of the most important financial decisions an Australian consumer will make. We would support elevated controls and measures on incentives related to mortgages that are consistent with their importance and the nature of the guidance that is provided. For example, the delinking of incentives from the value of the loan across the industry; and the potential extension of regulations such as **Future of Financial Advice** (FoFA) to mortgages in retail banking.

Mr Huggins said that this statement represents CBA's current position on these matters.¹⁰⁸ Mr Huggins acknowledged that there is a conflict in a commission structure that is linked to the size and length of the loan, so that the larger the loan and the longer the period over which it extends, the larger the commission payable to the broker.¹⁰⁹ Like Mr Narev, Mr Huggins acknowledged that this kind of commission structure can lead to a conflict between the customer's interests and the broker's interests, since the broker maximises their income by getting the largest loan possible approved, extending over the longest period of time.¹¹⁰

CBA has found its broker loans to have higher total debt-to-income levels, higher loan-to-value ratios (LVRs), and higher interest costs than loans that originate in its proprietary channel.¹¹¹ CBA has observed that these findings are consistent with the hypothesis that differences in remuneration between the two channels are driving different customer outcomes.¹¹²

¹⁰⁶ Exhibit 1.37, 10 February 2017, Letter from Mr Narev to Mr Sedgwick dated 10/02/2017 and the Annexed Issues Paper Submission dated 10/02/2017 [CBA.0001.0038.0929].

¹⁰⁷ Exhibit 1.37, 10 February 2017, Letter from Mr Narev to Mr Sedgwick dated 10/02/2017 and the Annexed Issues Paper Submission dated 10/02/2017 [CBA.0001.0038.0929 at .0930].

¹⁰⁸ Transcript, Daniel James Huggins, 15 March 2018, 240.

¹⁰⁹ Transcript, Daniel James Huggins, 15 March 2018, 239.

¹¹⁰ Transcript, Daniel James Huggins, 15 March 2018, 239.

¹¹¹ Transcript, Daniel James Huggins, 15 March 2018, 241; Exhibit 1.37, 10 February 2017, Letter from Mr Narev to Mr Sedgwick dated 10/02/2017 and the Annexed Issues Paper Submission dated 10/02/2017, 11 [24].

¹¹² Transcript, Daniel James Huggins, 15 March 2018, 241.

Despite CBA's views and findings on these matters, CBA has not stopped paying volume-based commissions to brokers, nor has it taken any steps to cease that practice. Mr Huggins said that if CBA were to change its remuneration practices, customers would move to competitor lenders, which would have a material impact on CBA's business.¹¹³

CBA does not tell its customers the amount of commission that will be paid to the Head Group or broker in respect of the customer's loan.¹¹⁴ CBA gives each customer a credit contract schedule that records any commission amount as 'not ascertainable'.¹¹⁵ Mr Huggins explained this statement as reflecting the fact that the actual amount that will be paid as trail commission will depend upon whether the loan is repaid before its term expires. And of course that is true. But the statement is less than frank. The amount of upfront commission that is to be paid, the rate at which trail commissions will be paid and any amount paid under the CONNECT Referral Program are all known to and could readily be disclosed by CBA to the customer at the time the loan is entered into.¹¹⁶ No doubt the aggregator knows this information too. The broker may know only how much the broker will receive. Either or both of the broker and the aggregator could tell the borrower how much each stands to gain from the borrower taking the loan but the lender, as payer, is in the best position to tell the borrower how much the lender is paying others to secure the borrower's business. There is no obvious reason for CBA to maintain its present practice.

After giving the above evidence in respect of disclosure to customers, Mr Huggins later gave evidence that CBA proposes to improve disclosure to customers of the remuneration that CBA pays to brokers, by disclosing in the credit contract schedule the rate or quantum of any commission paid or to be paid to a Head Group.¹¹⁷ That change had not yet been made at the time Mr Huggins provided further evidence to the Commission.

¹¹³ Transcript, Daniel James Huggins, 15 March 2018, 243.

¹¹⁴ Transcript, Daniel James Huggins, 15 March 2018, 258–9.

¹¹⁵ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-8 [CBA.0507.0003.0448 at .0464].

¹¹⁶ Transcript, Daniel James Huggins, 15 March 2018, 259–60.

¹¹⁷ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 16 [69].

In 2017, CBA revoked the accreditation of 710 accredited CBA brokers on the basis of 'inactivity'.¹¹⁸ Initially, CBA had intended to revoke the accreditation of another 2,500–3,000 brokers, but it did not go ahead with this plan.¹¹⁹ Mr Huggins' evidence was that CBA had identified a group of less active or inactive brokers, and that inactivity was potentially associated with less desirable customer outcomes.¹²⁰ He said that the aim of de-accreditation program was to improve the overall quality of the brokers accredited by CBA.¹²¹

Mr Mark Harris, a mortgage broker, gave evidence that he was accredited by CBA until 20 February 2017, when his accreditation was revoked by CBA, with immediate effect.¹²² CBA told Mr Harris that his accreditation was revoked on the basis of 'inactivity'.¹²³ Mr Harris said that, as a result of the revocation of his accreditation, he is now unable to submit home loan applications to CBA on behalf of a customer.¹²⁴ If he had a customer for whom he thought a CBA loan would be a 'good fit', he would now need to refer the customer to another broker if the customer wished to apply for that loan.¹²⁵

Mr Huggins accepted that, in hindsight, it would have been better if CBA had not chosen volume as the basis on which to revoke accreditation, but had instead required inactive brokers to undergo more training in order to ensure the quality of their work.¹²⁶ Relatedly, Mr Huggins said that CBA was in the process of introducing new accreditation standards for brokers

¹¹⁸ Transcript, Daniel James Huggins, 15 March 2018, 270–1.

¹¹⁹ Transcript, Daniel James Huggins, 15 March 2018, 274–5.

¹²⁰ Transcript, Daniel James Huggins, 15 March 2018, 272.

¹²¹ Transcript, Daniel James Huggins, 15 March 2018, 272.

¹²² Exhibit 1.24, Witness statement of Mark Andrew Harris, 7 March 2018, 2 [7].

¹²³ Exhibit 1.24, Witness statement of Mark Andrew Harris, 7 March 2018, Exhibit MAH-1 [RCD.0014.0001.0021]; see also Transcript, Mark Andrew Harris, 14 March 2018, 218–9.

¹²⁴ Transcript, Mark Andrew Harris, 14 March 2018, 219; Exhibit 1.24, Witness statement of Mark Andrew Harris, 7 March 2018, 3 [14], also 2 [7].

¹²⁵ Exhibit 1.24, Witness statement of Mark Andrew Harris, 7 March 2018, 3 [14].

¹²⁶ Transcript, Daniel James Huggins, 15 March 2018, 274.

that focused on monitoring quality and ‘delinked the ongoing accreditation requirement from volume’.¹²⁷

Evidence subsequently provided by Mr Huggins set out the new accreditation standards, which do not require a particular volume of loans to be written by brokers.¹²⁸ However, brokers will generally need to show that they have at least two years’ face-to-face experience writing regulated residential loans.¹²⁹ Existing accredited brokers who have not written any loans in the previous 12 months will be required to complete ‘refresher e-learning modules’.¹³⁰

The particular details of CBA’s dealing with its accredited brokers is less important than observing two basic points. First, by accrediting brokers, CBA decides which third parties can submit loans to it and, hence, whether those third parties can offer borrowers loans from the largest lender in the home loan market. Second, CBA can treat those whom it accredits as *its* brokers, selling *its* products and it can and does choose to favour those brokers who send more business to it over others.

But CBA remains isolated, even insulated, from what the broker does with the borrower. The extent of that isolation was explored in Mr Huggins’ evidence.

In August 2017, a CBA Group Audit & Assurance Internal Audit¹³¹ (for which Mr Huggins was named as the accountable executive) found that CBA was not doing enough to monitor the activities of the Head Groups and the mortgage brokers who sit under those Head Groups. The audit report noted that it is not industry practice for banks to complete any form of assurance in respect of aggregators.¹³² An issues log attached to the report identified that CBA was reliant on brokers to confirm that the product offered to the

¹²⁷ Transcript, Daniel James Huggins, 15 March 2018, 269.

¹²⁸ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, Exhibit DH-3 [CBA.0001.0428.0728].

¹²⁹ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 2 [11(d)].

¹³⁰ Exhibit 1.201, Witness statement of Daniel James Huggins, 26 July 2018, 7 [31(b)].

¹³¹ Exhibit 1.38, 16 August 2017, Internal Audit Report dated 16/08/2017 [CBA.0508.0001.0029].

¹³² Exhibit 1.38, 16 August 2017, Internal Audit Report dated 16/08/2017 [CBA.0508.0001.0029 at .0035].

customer was not unsuitable.¹³³ The report found that whilst CBA had various contractual rights to audit Head Groups, it had not exercised those rights.¹³⁴ The report listed large numbers of different types of compliance issues arising in connection with home loans that brokers had submitted to CBA including:

- 1,324 instances of low income, with a net monthly surplus of \$100 or less;¹³⁵
- 191,534 approved loans with monthly living expenses that were equal to or less than the **Household Expenditure Measure (HEM)**;¹³⁶
- 83 instances of loans declined by CBA (or a branch), and then, within six months, accepted by another broker;¹³⁷ and
- 718 instances where a customer's monthly living expenses were listed as less than \$500.¹³⁸

In respect of CBA's use of the HEM, Mr Huggins' evidence was that, when assessing loan proposals, CBA always took the higher of the customer declared expenses and HEM.¹³⁹ But, as the August 2017 audit report showed, CBA did not go back to customers whose loans were submitted by a broker to challenge what was said in the application about monthly living expenses.¹⁴⁰ Instead, as the audit report recorded, CBA 'relie[d] on brokers to confirm [that the] product offered to the customer was not unsuitable at the time of the application'.¹⁴¹ It may be accepted that, as Mr Huggins said, CBA would look at primary source documents to reach

¹³³ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 2.

¹³⁴ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 1.

¹³⁵ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 18.

¹³⁶ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 18.

¹³⁷ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 19.

¹³⁸ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 20.

¹³⁹ Transcript, Daniel James Huggins, 15 March 2018, 301.

¹⁴⁰ Transcript, Daniel James Huggins, 15 March 2018, 300.

¹⁴¹ Transcript, Daniel James Huggins, 15 March 2018, 299; Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 2.

its own assessment.¹⁴² But the documents to which CBA would look were those that had been assembled by the broker. And as the audit report also recorded: ‘Gaps in the monitoring process to prevent or detect adverse broker behaviour [had] not been addressed’ by CBA.¹⁴³

2.3 What the case study showed

Four points emerged: three related more to questions of culture, governance and practice than to misconduct; one (about managing conflict of interest) related to issues about misconduct and conduct falling short of community standards and expectations. The four points can be identified as:

- how CBA sees the roles of brokers and aggregators;
- managing conflict of interest;
- what CBA tells borrowers about intermediary remuneration; and
- how important is disclosure of remuneration?

2.3.1 How does CBA see the roles of brokers and aggregators?

The two central points that emerged from Mr Huggins’ evidence have been identified earlier. CBA will deal only with brokers it has accredited. By accrediting brokers, CBA decides which third parties can offer loans to it and, hence, whether those third parties can offer borrowers loans from the largest lender in the home loan market. Second, CBA can treat those whom it accredits as *its* brokers, selling *its* products and it can and does choose to favour those brokers who send more business to it over others.

Yet, despite Mr Huggins’ evidence, CBA was at pains, in its written submissions, to deny that a broker acts for anyone but the borrower. It pointed to, and relied upon, ‘no-agency’ provisions in the agreements it makes with Head Groups. It submitted that accredited brokers do not act as the agent of CBA and that ‘[w]hen the broker submits the loan application

¹⁴² Transcript, Daniel James Huggins, 15 March 2018, 300.

¹⁴³ Exhibit 1.39, 5 September 2017, Issues Logs dated September 2017, 8.

to the lender which the customer has chosen, the broker is acting as the agent of the customer, not as agent of the lender'.¹⁴⁴

Again, two points should be made. First, as explained above, analysing the matter by reference only to questions of agency is to ask too broad a question and is, therefore, apt to mislead. Second, the relationships that are created and the tasks that are performed by broker and lender are apt to create confusion for the borrower about the roles and responsibilities of each.

2.3.2 Managing conflicts of interest

Do the matters that have been described reveal any deeper issue about conflict of interests?

CBA's characterisation of the legal relationships between broker, lender and borrower in terms of 'agency' was an essential step in denying that the remuneration arrangements that it, and all other significant industry participants, adopted for paying brokers and aggregators contravened statutory obligations to have in place adequate arrangements to manage conflicts of interest.¹⁴⁵

In its written submissions, CBA accepted that the commission structure that it now uses 'can lead to a conflict between the customer's interest and the broker's interest since the broker can maximise their income by getting the largest loan possible approved extending over the longest period of time'.¹⁴⁶ But CBA asserted that no 'conflict in law' arises between CBA and its customers, the only conflict being between the interests of the broker and the interests of the customer (and the broker is not CBA's agent).¹⁴⁷ And CBA further submitted that, in considering the position of the aggregators, or Head Groups, it is necessary to distinguish between the financial services and credit activities supplied by CBA and those supplied by a Head Group

¹⁴⁴ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 3 [11].

¹⁴⁵ Corporations Act s 912A(1)(aa), NCCP Act s 47(1)(b). There being no dispute that s 47(1)(b) applies, and there being no relevant difference between that Section and s 912A(1)(aa), it is not necessary to examine whether or when the latter provision applies. It is enough to proceed by reference only to s 47(1)(b) of the NCCP Act.

¹⁴⁶ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 2 [4(d)].

¹⁴⁷ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 3 [9], 4 [16].

and its brokers (who could be employees or credit representatives of the Head Group, but were neither employees nor credit representatives of CBA).¹⁴⁸

CBA's reference to 'conflict in law' should be explained. CBA submitted that the Explanatory Memorandum for the Bill that became the NCCP Act had described the conflicts of interest to which that Section refers as being 'conflicts of interest that arise by operation of law'. And so it did.¹⁴⁹ But what was meant by this was explained in the immediately succeeding sentence where it was said that 'It [the obligation] does not require a licensee to take action in respect of different interests of parties *where they do not constitute a conflict of interest at law*.' (emphasis added). And that is a meaning that does not accord with the implicit submission of CBA that some constrained meaning should be given to the expression 'conflict of interest' rather than understanding it according to its ordinary and well-understood usage. I say that adoption of a constrained meaning was *implicit* in CBA's submission because those submissions did not identify (at least with any clarity) what exactly it sought to convey by saying that the conflict must be a 'conflict in law'.

CBA's proposition that the financial services and credit services CBA supplies to a borrower are different from the credit activities of the aggregator and the broker may be accepted. Each plays a different role in the transactions that culminate in a loan being made. The immediate question, however, is about CBA's statutory obligation to have in place adequate arrangements to ensure that clients of CBA are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to its credit activities. Hence, the question can be restated as whether CBA made adequate arrangements to ensure that clients of CBA (its borrowers) are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to the credit activities in which CBA engages (which include being a credit provider under a credit contract, and being a mortgagee under a mortgage).

It is CBA, as lender, that fixes the remuneration that is paid to the intermediaries with which it deals. It is the very structure of the remuneration that yields the conflict between the interests of the

¹⁴⁸ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 5 [22].

¹⁴⁹ Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth) [2.115].

intermediary (to maximise its income) and the interests of the borrower (to borrow no more than is necessary, at the best long-term rate reasonably available, and to borrow on terms that minimise the cost to the borrower). That is a conflict which arises *in relation to* CBA's activity of providing credit (or, if relevant and applicable, its providing a financial service). It arises in relation to that activity because CBA sets the terms on which a broker may submit a borrower's home loan application to CBA.

CBA submitted that its monitoring of Head Groups and its monitoring of loan applications were adequate to manage any conflict of interest.¹⁵⁰ And it submitted that it disclosed the conflict to its customers but went on to acknowledge that the conflict could be better explained to customers.¹⁵¹ (This last subject is dealt with separately below).

CBA was right to observe that the remuneration arrangements it adopts are used by the whole industry. Hence, what is said about CBA in this respect must apply to all lenders who offer the same kinds of arrangement.

But whether CBA, or those other lenders, had 'adequate' arrangements in place to ensure that clients were not disadvantaged by the conflicts is not determined by observing only that, for all practical purposes, the remuneration arrangements that yield the conflict are adopted by most lenders who permit intermediaries to submit loan applications. Instead, the adequacy of the arrangements that CBA, and others, have in place should be judged against the conclusions reached by ASIC (and by CBA in its submission to the Sedgwick Review) that value-based upfront and trail commissions are reliably associated with higher leverage, and that loans written through brokers have a higher incidence of interest-only repayments, higher debt-to-income levels, higher loan to value ratios and higher incurred costs compared with loans negotiated directly with the bank.¹⁵² Those conclusions point towards (I do *not* say require) a conclusion that the lenders did not have *adequate* arrangements in place to *ensure* that clients of the lender are not disadvantaged by the conflict between the intermediary's interest in maximising income and the borrower's interest in minimising overall cost.

¹⁵⁰ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 4 [17].

¹⁵¹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 4 [17(d)].

¹⁵² ASIC, *Report 516: Review of Mortgage Broker Remuneration*, March 2017, 14 [51]–[54].

It follows that continuing to pay intermediaries a value based upfront and trail commission after these deleterious consequences had been identified *might* raise an issue about satisfaction of the lender's general obligation under Section 47(1)(b) of the NCCP Act. But it is then to be observed that the general obligations imposed by Section 47 are duties of imperfect obligation in as much as breach is neither an offence nor a matter for civil penalty. Instead, breach of the general obligations may enliven ASIC's power under Section 55 to cancel or suspend the licensee's licence. Hence, to refer this issue to ASIC would be to refer a matter that could not lead to any enforcement action other than cancellation or suspension of a licence. And where the failure (if that is what it is) is industry-wide, it would not be the occasion to consider cancellation or suspension. Moreover, any utility in referring the issue for consideration by ASIC would be overtaken by any industry-wide change to remuneration structures.

For these reasons, I go no further than noting that continuing to pay intermediaries a value-based upfront and trail commission after the deleterious consequences of the practice had been identified *might* have been a breach of Section 47(1)(b) of the NCCP Act.

There remains for separate consideration what CBA tells its borrowers about remuneration of intermediaries.

2.3.3 What CBA tells borrowers about intermediary remuneration

As noted earlier, if CBA approves a loan application, it gives customers documents including a 'Consumer Credit Contract Schedule'. One item in that document has the heading 'Commission we pay in relation to the Loan Contract' and the item is completed by naming the Head Group to which the Commission will be paid. But against the heading 'Amount' the document says only 'not ascertainable'.¹⁵³ As I have already explained, this is less than frank.

In a separate document given to borrowers, the Credit Assessment Summary, the borrower is asked to sign a declaration that says, among other things, that the borrower acknowledges that:

¹⁵³ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-8 [CBA.0507.0003.0448 at .0464].

- ‘the Bank may pay a Broker or other intermediary acting in relation to this enquiry for finance, commission or other benefits in connection with the enquiry *and that any commission is disclosed in the Consumer Credit Contract Schedule*’ (emphasis added); and that
- ‘as a broker or other intermediary may provide services to me/us, it is possible that a conflict of interest will arise. I/We consent to a broker or other intermediary acting in this way.’¹⁵⁴

Two points may be made about this second document (the Credit Assessment Summary). First, contrary to what the customer is required to declare, the commission is *not* disclosed in the Consumer Credit Contract Schedule. Second, the document proceeds from a premise about conflicts of interest that is contrary to the position that CBA adopted in its written submissions.

As already explained, the statement that the amount of the commission payable to an intermediary is ‘not ascertainable’ when the loan is first made may be literally true but, at best, it is economical with the truth. It is literally true in the sense that it cannot be known at the start of the loan term how long the loan will remain unrepaid or whether interest rates will change and, therefore, it is not possible, at the start of the loan to calculate the total amount of commission that *will* be paid. But it is certainly possible to state the criteria that are used to calculate the commissions that will be paid.

In my view, it is no answer to these criticisms to say that the broker could or should make full disclosure. CBA’s documents are less than frank and appear to require borrowers to make a declaration that does not accord with the content of the document to which the declaration refers – a document prepared by CBA.

CBA’s conduct of providing so little information about broker remuneration and requiring borrowers to sign a declaration that there has been disclosure of the commission to be paid in the Consumer Credit Schedule is conduct that falls short of community standards and expectations. The community rightly expects that an **authorised deposit-taking institution** (ADI) can and should do better.

¹⁵⁴ Exhibit 1.27, Witness statement of Daniel James Huggins, 2 March 2018, Exhibit DH-9 [CBA.0507.0004.1654 at .0658].

2.3.4 How important is disclosure of remuneration?

Documentary disclosure of information is not a universal solution for every issue that arises when a consumer deals with a **financial services entity**. But in a transaction as important for a consumer as borrowing to buy real property, the consumer should be told what the intermediary will be paid by the lender for the work that the intermediary does. If the amount cannot be calculated, the borrower should be told how it will be calculated.

Telling the borrower how intermediary remuneration is calculated does not eliminate the conflict between the intermediary's interests and the borrower's interests. Telling the borrower may not affect the borrower's decisions. But not telling the borrower means that the lender, which pays the remuneration, does not give the borrower information that the borrower might reasonably consider important.

3 Aussie Home Loans broker misconduct

3.1 Background

This case study considered the conduct of four former brokers from AHL Investments Pty Ltd (Aussie), Shiv Sahay, Emma Khalil, Madhvan Nair and Bernard Meehan, and Aussie's response, during the period from 2011 to 2015. The Commission heard evidence from Lynda Harris, the General Manager, People and Culture at Aussie, and Giles Boddy, the

Chief Financial Officer at Aussie. A witness statement was also tendered from Mr David Smith, the General Manager of Strategy and Products at Aussie.¹⁵⁵

¹⁵⁵ Exhibit 1.78, Witness statement of David Lee Smith, 6 March 2018.

3.2 Evidence

Aussie is a mortgage broking entity with over 1,000 brokers operating throughout Australia.¹⁵⁶ Since August 2017, Aussie has been a wholly-owned subsidiary of CBA. Aussie is now covered by CBA's governance framework.¹⁵⁷ In June 2018, CBA announced its intention to dispose of its interest in Aussie by including Aussie as one of a number of businesses that will form a new listed entity, the initial shareholders of which would be CBA shareholders.¹⁵⁸

The conduct of the four former brokers named above included the falsification of documents submitted to lenders in support of home loan applications, such as bank statements, payslips and letters of employment.¹⁵⁹ For each of the loans submitted to lenders by the four former brokers, Aussie would receive upfront and trail commission payments.¹⁶⁰ A portion of these commission payments was passed through to the broker and the remainder was retained by Aussie. Aussie determined the portion of the payments that would be passed through to the broker by reference to the total settled loan amounts. The higher the value of the settled loan amounts, the higher the percentage of the upfront commission passed through to the broker. Aussie brokers had a contractual obligation to introduce a minimum number of loans per month.¹⁶¹

¹⁵⁶ Exhibit 1.78, Witness statement of David Lee Smith, 6 March 2018, 2 [9].

¹⁵⁷ Exhibit 1.78, Witness statement of David Lee Smith, 6 March 2018, 2 [10].

¹⁵⁸ CBA, 'CBA Announces Intention to Demerge Wealth Management and Mortgage Broking Businesses' (Media Release, 25 June 2018) <www.commbank.com.au/guidance/newsroom/demerger-of-wealth-and-mortgage-broking-businesses-201806.html>.

¹⁵⁹ Transcript, Lynda Gay Harris, 16 March 2018, 373–4; Transcript, Lynda Gay Harris, 16 March 2018, 377 (Meehan); Transcript, Lynda Gay Harris, 15 March 2018, 318 (Sahay); Exhibit 1.64, 10 February 2015, Document Entitled Matter of Bernie Meehan, Overview; Transcript, Lynda Gay Harris, 16 March 2018, 374; Transcript, Lynda Gay Harris, 16 March 2018, 378 (Meehan).

¹⁶⁰ Exhibit 1.78, Witness statement of David Lee Smith, 6 March 2018, 7–8 [57]–[61].

¹⁶¹ Transcript, Lynda Gay Harris, 16 March 2018, 380; Exhibit 1.67, 3 September 2008, Contract between AHL and Nair, 10 [10.1].

Aussie did not detect the misconduct engaged in by three of the four former brokers, each of whom had been with Aussie for a number of years,¹⁶² despite obvious anomalies in the supporting documentation being submitted to lenders.¹⁶³ In relation to each of those three former brokers, Aussie was told by a lender that they had detected misconduct.¹⁶⁴ Aussie relied upon one or more lenders to conduct a review of the broker's files and investigate the misconduct.¹⁶⁵ Aussie terminated its relationship with each of the three former brokers because one or more lenders had told Aussie that they had, or intended to, revoke their own accreditation of the broker, which triggered a contractual right on Aussie's part to terminate its relationship with the broker.¹⁶⁶

The misconduct of the fourth broker, Mr Meehan, was detected by Aussie as part of a file review process it undertook in respect of brokers who were submitting more than 50% of their loans to one lender.¹⁶⁷ The selection of Mr Meehan's files for review was also informed by the fact that Mr Meehan was submitting more than 50% of his loans to Westpac, a lender that would accept a letter of employment to verify income (being a document that Aussie knew could be easily falsified).¹⁶⁸

¹⁶² Transcript, Lynda Gay Harris, 15 March 2018, 319 (Sahay); Transcript, Lynda Gay Harris, 16 March 2018, 381 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 378 (Nair); Exhibit 1.60, 24 June 2014, Email from Whyte to Gilbey.

¹⁶³ Transcript, Lynda Gay Harris, 16 March 2018, 348 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 365 (Nair).

¹⁶⁴ Transcript, Lynda Gay Harris, 15 March 2018, 315 (Sahay); Transcript, Lynda Gay Harris, 16 March 2018, 346–7 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 365 (Nair).

¹⁶⁵ Transcript, Lynda Gay Harris, 16 March 2018, 346 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 353 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 366 (Nair); Exhibit 1.60, 24 June 2014, Email from Whyte to Gilbey; Transcript, Lynda Gay Harris, 16 March 2018, 344 (Sahay).

¹⁶⁶ Exhibit 1.53, 10 December 2013, Email from Tomkins to Rasby dated 10/12/2013 (Sahay); Exhibit 1.55, 7 March 2014, Email from Kennedy dated 03/02/2014 (Khalil), Exhibit 1.57, 26 March 2014, Email from Howell to Whyte and Associated Emails dated 26/03/2014 (Khalil), Transcript, Lynda Gay Harris, 16 March 2018, 357 (Khalil); Exhibit 1.60, 24 June 2014, Email from Whyte to Gilbey; Transcript, Lynda Gay Harris, 16 March 2018, 366 (Nair).

¹⁶⁷ Transcript, Lynda Gay Harris, 16 March 2018, 371–2.

¹⁶⁸ Transcript, Lynda Gay Harris, 16 March 2018, 371–2; Exhibit 1.64, 10 February 2015, Document Entitled Matter of Bernie Meehan, Overview dated 10/02/2015.

Aussie did not report the misconduct of three of the four former brokers to ASIC. Instead, it submitted a standard form to ASIC stating that the brokers had ceased acting as credit representatives of Aussie.¹⁶⁹ ASIC undertook an investigation into Mr Sahay as a result of receiving a notification by a person or entity other than Aussie. As part of that investigation, Aussie told ASIC that it had terminated its relationship with Ms Khalil and Mr Nair on the basis that they were suspected of fraudulent misconduct.¹⁷⁰

Three of the four brokers were ultimately charged with criminal offences as a result of their conduct.¹⁷¹ Aussie did not report the conduct of any of the four brokers to the police.¹⁷²

Aussie also did not report the conduct of three of the four brokers to the Mortgage and Finance Association of Australia,¹⁷³ despite Aussie requiring each of its brokers to be a member of that association, because the association had powers to expel a broker for misconduct.¹⁷⁴

Aussie did not notify the customers of any of the four brokers about why it had terminated its relationship with the broker. It transferred the broker's customers to another Aussie broker. Following the termination of its relationship with Mr Sahay, Aussie was contacted by two of Mr Sahay's customers, both of whom were in a situation of distress as a result of

¹⁶⁹ Exhibit 1.58, 10 April 2014, ASIC Cessation of Credit Representative Form dated 10/04/2014 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 359 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 376 (Meehan).

¹⁷⁰ Exhibit 1.59, 14 October 2014, Aussie Response to ASIC Letter dated 13/10/2014, 2; Transcript, Lynda Gay Harris, 16 March 2018, 359.

¹⁷¹ Transcript, Lynda Gay Harris, 16 March 2018, 361 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 369 (Nair); Transcript, Lynda Gay Harris, 16 March 2018, 344 (Sahay).

¹⁷² Transcript, Lynda Gay Harris, 15 March 2018, 330 (Sahay); Transcript, Lynda Gay Harris, 16 March 2018, 378 (Meehan); Transcript, Lynda Gay Harris, 16 March 2018, 361 (Khalil); Transcript, Lynda Gay Harris, 16 March 2018, 369 (Nair).

¹⁷³ Transcript, Lynda Gay Harris, 16 March 2018, 345.

¹⁷⁴ Transcript, Lynda Gay Harris, 15 March 2018, 312; Transcript, Lynda Gay Harris, 16 March 2018, 345, 383, 381.

Mr Sahay's conduct.¹⁷⁵ Aussie chose not to advise either customer about why Mr Sahay's relationship with Aussie had been terminated.¹⁷⁶ Ms Harris suggested that Ms Khalil's customers would have been notified of the termination of her relationship with Aussie, but could not say that the circumstances would have been conveyed.¹⁷⁷

Following the termination of its relationship with Mr Nair, Aussie made an ex gratia payment to a customer who had engaged solicitors and complained about the conduct of Mr Nair.¹⁷⁸ Ms Harris was unable to explain the basis for this ex gratia payment, identify the exact sum of the payment, or provide any other details about the payment. After the conclusion of the hearings, Aussie pointed, for the first time, to documents that it said explained the payment.¹⁷⁹ Why the documents were not produced by Ms Harris, the witness put forward by Aussie as the witness able to speak about the matters the subject of the inquiry, or were not put to her by those appearing for Aussie during the course of her evidence, was not explained.

3.3 What the case study showed

3.3.1 Misconduct by the four former brokers

As noted elsewhere, CBA acknowledged during the first round of hearings, in the third response that it provided to the Commission's initial inquiries,

¹⁷⁵ Transcript, Lynda Gay Harris, 16 March 2018, 340–2; Transcript, Lynda Gay Harris, 15 March 2018, 322; Exhibit 1.42, 8 August 2013, Email from McKenzie to MacDonald dated 08/08/2013; Exhibit 1.43, 9 August 2013, Email from McKenzie dated 09/08/2013; Exhibit 1.47, 19 September 2013, Email to McKenzie and accompanying emails; Exhibit 1.52, 10 December 2013, Email from Fitzgerald to Meekin dated 10/12/2013; Exhibit 1.53, 10 December 2013, Email from Tomkins to Rasby dated 10/12/2013.

¹⁷⁶ Transcript, Lynda Gay Harris, 15 March 2018, 326; Transcript, Lynda Gay Harris, 16 March 2018, 342.

¹⁷⁷ Transcript, Lynda Gay Harris, 16 March 2018, 362.

¹⁷⁸ Transcript, Lynda Gay Harris, 16 March 2018, 370.

¹⁷⁹ Transcript, Lynda Gay Harris, 16 March 2018, 370–1; cf AHL, *Round 1 Hearing – Consumer Lending Closing Submissions, Part A*, 3 April 2018, 14–15 [44].

that the four former brokers had engaged in acts of misconduct.¹⁸⁰ More specifically, in the evidence given by Ms Harris, Aussie accepted that:

- between November 2011 and August 2013, Mr Sahay had engaged in fraudulent conduct (including falsification of home loan documents or signatures);
- between March 2013 and February 2014, Ms Khalil had engaged in fraudulent conduct (including falsification of home loan documents or signatures);
- between 2012 and 2014, Mr Nair had been guilty of fraudulent conduct (including falsification of home loan documents or signatures); and
- between January 2014 and January 2015, Mr Meehan had been guilty of fraudulent conduct (including falsification of home loan documents or signatures).

In its written submissions, Aussie accepted that the conduct of the four former brokers was 'misleading, deceptive and unconscionable'.¹⁸¹ And each of the brokers was prosecuted for, and convicted of, offences arising out of the conduct. But Aussie submitted, and I accept, that no finding of misconduct by Aussie itself should be made.

It remains important, however, to consider questions about community standards and expectations and to examine what the evidence showed about whether the systems and practices Aussie followed at the time of the events in issue were adequate. Those questions about systems and practices bear directly upon whether the misconduct of the four brokers is attributable to the particular culture and governance of Aussie or resulted from Aussie's practices, including risk management practices.

3.3.2 Systems and practices

I accept that, as Aussie submitted, it had systems and processes that, at the time, it considered adequate to prevent, detect and respond to conduct

¹⁸⁰ CBA, *Commonwealth Bank and Its Associated Australian Entities (Group)* – Revised Table (2), 22 March 2018, 1–2.

¹⁸¹ AHL, *Round 1 Hearing – Consumer Lending Closing Submissions, Part A*, 3 April 2018, 1 [1].

of the kinds in which the four brokers engaged.¹⁸² And I further accept that in Mr Meehan's case, it was Aussie that first raised questions about Mr Meehan's conduct: Aussie detected the conduct of Mr Meehan in the course of conducting a review of his files. By contrast, however, Ms Harris' evidence was that the conduct of the other three brokers was first brought to the attention of Aussie by a lender. Ms Harris said, and I accept, that Aussie first became aware of the fraudulent conduct of Mr Sahay, Ms Khalil and Mr Nair only after a lender told Aussie either that it had decided to terminate the broker's accreditation or a lender expressed concern to Aussie about the veracity of information that the broker had supplied.

The adequacy of the systems and processes that Aussie had in place when the four brokers engaged in the conduct is then to be measured against two considerations. First is the fact that there were four separate cases (between 2011 and 2015) where credit representatives of Aussie engaged in fraudulent conduct. The systems and practices did not prevent the conduct and only one of those cases was first detected by Aussie.

The second consideration was provided by the evidence of Mr Giles Boddy, the Chief Financial Officer of Aussie. When he gave his evidence, Mr Boddy was an employee of CBA seconded to Aussie.¹⁸³ Mr Boddy gave evidence about an internal audit of Aussie, conducted by CBA Group Audit and Assurance between July and December 2017.¹⁸⁴ As the report of that audit recorded, Mr Boddy was the 'Accountable Executive'.¹⁸⁵ CBA Group Audit and Assurance had conducted a similar internal audit in 2015.

The 2017 report expressed three 'ratings': about 'Control Environment', 'Management Awareness and Actions' and 'Overall Report Rating'. The ratings were red, amber or green, where red was 'unsatisfactory', amber was 'marginal' and green was 'satisfactory'. The 'Control Environment' was rated red. 'Management Awareness' was rated amber. The 'Overall Report Rating' was recorded as red. The 2017 report noted that the same ratings had been given in the 2015 internal audit report.

¹⁸² AHL, *Round 1 Hearing – Consumer Lending Closing Submissions, Part A*, 3 April 2018, 3 [7].

¹⁸³ Exhibit 1.73, Witness statement of Giles Edward Boddy, 5 March 2018, 1 [2].

¹⁸⁴ Transcript, Giles Edward Boddy, 16 March 2018, 393.

¹⁸⁵ Exhibit 1.74, 11 December 2017, Group Audit and Assurance Internal Audit Report dated 11/12/2017.

For present purposes, it is important to look principally at what the 2017 report recorded about the 'Control Environment'. The 'unsatisfactory' rating applied in the report was explained by saying that 'Controls are not appropriate for the risks being managed. There are a significant number of issues that require immediate attention'.¹⁸⁶ And the report gave further particular content to that rating by saying, as part of the 'Audit Conclusion', that:¹⁸⁷

Overall, we rated the control environment in AHL [Aussie Home Loans] as unsatisfactory due to the number of issues raised by management (77), existing issues (8) and new issues raised during our audit (17). We raised one very high and two high rated issues that were not known to AHL management of which two are repeat issues. These related to customer data not flowing correctly between AHL's Toolbox system and NextGen's Apply Online (AOL) system, *particularly dependent information and concerns over compliance with Responsible Lending obligations which are a key focus area for regulators.*

Each of those matters was then amplified under four headings:¹⁸⁸

- Controls to confirm customer declared information is completely and accurately sent to lenders through NextGen are *not robust*;
- Responsible lending obligations are *not always met*;
- Monitoring and Quality Assurance over brokers is *not robust*; and
- Risk Management activities and capabilities are *not sufficient* to provide sufficient coverage over AHL business processes.

The chief criticism levelled by the auditors at the 'monitoring and quality assurance of brokers' was that the selection process for file reviews was manual and that 'most brokers are subject to only 1 file review per year'

¹⁸⁶ Exhibit 1.74, 11 December 2017, Group Audit and Assurance Internal Audit Report dated 11/12/2017, 24.

¹⁸⁷ Exhibit 1.74, 11 December 2017, Group Audit and Assurance Internal Audit Report dated 11/12/2017, 1 (emphasis added).

¹⁸⁸ Exhibit 1.74, 11 December 2017, Group Audit and Assurance Internal Audit Report dated 11/12/2017, 1–2 (emphasis added).

representing 'less than 3% of broker loans being captured for review'.¹⁸⁹ The report recorded that, with the assistance of Aussie management, Group Audit and Assurance had developed a 'Broker Monitoring Dashboard to flag suspicious broker behaviour'¹⁹⁰ but this, of course, was a development well after the events that were the subject of the case study.

Mr Boddy did not dispute the content of the 2017 internal audit report.¹⁹¹ That being so, I am not persuaded that, in the face of that report, I can accept Aussie's submission that its systems and processes were adequate when the four brokers who were the subject of this case study engaged in the conduct they did. The systems and practices, as they stood at the end of 2017, were judged to be inadequate in the various ways described in the 2017 internal audit report (despite the efforts that had been made in the two years that had passed since the 2015 internal audit). Those deficiencies included, in particular, deficiencies in respect of the 'monitoring and quality assurance of brokers' (as well as 'concerns over compliance with responsible lending obligations').

Questions about systems and practices concern 'governance practices' but are closely related to the 'particular culture' of the entity concerned.¹⁹² One matter that emerged in evidence, relating to the steps that Aussie took after becoming aware of the four brokers' conduct, should be mentioned as pertaining to questions of 'culture'.

The communications Aussie had with lenders after questions were raised about the conduct of each of the four brokers may be read as demonstrating a concern to ensure maintenance of the stream of income from trail commissions on loans that those brokers had written. As explained earlier, Aussie took no active steps towards assessing whether loans other than those that had been identified as affected by fraud or deception might have been affected by some similar deficiency. In particular, Aussie made no inquiries of any borrower whose loan had been settled but had been arranged through one of the four brokers. But Aussie moved very quickly

¹⁸⁹ Exhibit 1.74, 11 December 2017, Group Audit and Assurance Internal Audit Report dated 11/12/2017, 2.

¹⁹⁰ Exhibit 1.74, 11 December 2017, Group Audit and Assurance Internal Audit Report dated 11/12/2017, 2.

¹⁹¹ Transcript, Giles Edward Boddy, 16 March 2018, 393.

¹⁹² Commission's Terms of Reference, (d)(i).

to 'transfer' the benefit of the trail commissions that those loans attracted to some broker other than the broker whose accreditation had been terminated.

Questions about systems and processes are important, not as themselves being possible instances of misconduct, but because the systems and processes that Aussie had at the time of the relevant events were not sufficient to prevent their occurrence and were not sufficient to detect their occurrence earlier than happened. To that extent, and in that way, the governance practices of Aussie, and its practices with respect to risk management, were a cause (I do not say *the* cause) of the misconduct of the four brokers. Further, I see no reason to doubt the conclusion reached in the 2017 internal audit report that, in December 2017, the 'control environment' at Aussie remained 'not appropriate for the risks being managed'. More particularly, as the report said, there then remained concerns over the 'monitoring and quality assurance of brokers', and there then remained concerns about compliance with responsible lending obligations. Mr Boddy gave evidence of the steps that were being taken to remedy these deficiencies. Whether, and to what extent, those steps have had the desired effects I cannot say.

3.3.3 Remediation

Put shortly, Aussie took no step to determine whether any borrower had suffered some detriment because of the conduct of any of the four brokers. Because that is so, it is not possible to say whether the misconduct of the brokers caused harm to borrowers whose loans had settled. And it also follows that it is not possible to say whether there was any occasion for Aussie to compensate borrowers whose loans had been negotiated by one of the four brokers. In particular, it is not possible to say whether the doubts the internal auditors expressed in 2017 about Aussie's compliance with responsible lending requirements had been realised in connection with loans arranged by any of the four brokers.

3.3.4 Conduct falling below community standards and expectations

Aussie's responses to being told of, or in one case discovering, misconduct by its credit representatives fell below community standards and expectations. The responses fell short in several respects.

First, there was the failure to report three of the four cases. As Ms Harris was at pains to point out, great care must be taken before saying to a third party that a person is suspected of fraud. But different considerations arise in relation to communications with ASIC as a regulatory body and communications with a professional association having disciplinary functions like the Mortgage and Finance Association of Australia. ASIC has statutory responsibilities for the licensing and supervision of credit representatives. The Mortgage and Finance Association of Australia has a legitimate interest in knowing that one of its members has been suspended or had his or her contract of engagement terminated on the ground that the member is suspected of having committed fraud.

Second, there was the failure to look at any settled loan to see whether the broker concerned had engaged in conduct that caused harm to the borrower. Ms Harris's evidence was that this was a task for the lender, not Aussie. Lenders, she said, were better set up to detect fraud than Aussie. But the issue is not only about whether the brokers had committed other acts of fraud, it is about whether borrowers had suffered as a result of the broker's conduct. And in deciding whether Aussie had any role to play it is necessary to bear at the forefront of consideration that Aussie did its best to ensure that it continued to receive the trail commission payable in respect of every loan that the defaulting brokers had arranged. The community would rightly consider that Aussie's continued receipt of payments entailed commensurate obligations to inquire whether the brokers had caused harm to borrowers.

More generally, the steps that Aussie took (and the steps it did not take) after being informed of, or in Mr Meehan's case discovering, the misconduct confirms that there was, and remains, confusion about the roles and responsibilities of lenders and intermediaries. The steps that Aussie took, and did not take, show it did not see itself as owing any obligation to protect the interests of borrowers. Its concern was to protect its income streams. Aussie acted in ways that showed that it considered that if anyone owed an obligation to borrowers, it was the lenders. That is, Aussie's conduct was consistent with answering the question 'For whom does the intermediary in a home loan act?' as 'The intermediary, no-one else'.

4 ANZ responsible lending

4.1 Background

This case study examined ANZ's lending practices in connection with home loans. The Commission heard evidence from Mr Robert Regan,¹⁹³ a customer who entered into a home loan with ANZ, and from Mr William Ranken,¹⁹⁴ the Lead of the Home Owners' Team at ANZ.¹⁹⁵

Mr Ranken is responsible for ANZ's home loan portfolio,¹⁹⁶ which is worth approximately \$265 billion.¹⁹⁷ In the year ended 30 September 2017, ANZ had approximately 1.008 million active home loan accounts,¹⁹⁸ a majority of which originated through the broker distribution channel.¹⁹⁹ In the same period, ANZ sold over \$67 billion of home loans.²⁰⁰ Of that amount, almost \$38 billion came from the broker channel.²⁰¹

4.2 Evidence

In respect of home loan applications submitted by brokers, ANZ relies heavily on brokers to make enquiries into the customer's financial situation. In general terms, the results of the broker's enquiries about the customer's financial position are provided to ANZ by way of a document referred to as a Statement of Financial Position, which is signed by both the customer and the broker.²⁰²

¹⁹³ Exhibit 1.82, Witness statement of Robert Emmett Regan, 8 March 2018.

¹⁹⁴ Exhibit 1.86, Witness statement of William Andrew Ranken, 4 March 2018.

¹⁹⁵ Transcript, William Andrew Ranken, 19 March 2018, 453.

¹⁹⁶ Transcript, William Andrew Ranken, 19 March 2018, 454.

¹⁹⁷ Transcript, William Andrew Ranken, 19 March 2018, 454.

¹⁹⁸ Transcript, William Andrew Ranken, 19 March 2018, 454.

¹⁹⁹ Transcript, William Andrew Ranken, 19 March 2018, 455.

²⁰⁰ Transcript, William Andrew Ranken, 19 March 2018, 455.

²⁰¹ Transcript, William Andrew Ranken, 19 March 2018, 455.

²⁰² Transcript, William Andrew Ranken, 19 March 2018, 458.

At the time that Mr Ranken gave evidence, ANZ did not take any steps to verify the customer's general living expenses, as declared on this form.²⁰³ Where ANZ held information about a customer's expenses that was inconsistent with information recorded on the Statement of Financial Position, it did not take any steps to identify or enquire into that inconsistency.²⁰⁴ In the words of Mr Ranken, ANZ's processes in that situation were to 'do nothing',²⁰⁵ and Mr Ranken said nothing to suggest that ANZ's processes had changed before he gave evidence.

Mr Ranken's evidence was that it would be 'highly complex, very time-consuming, very costly, and ultimately not necessarily that helpful' to undertake a manual review of paper-based bank statements in order to verify a customer's Statement of Financial Position.²⁰⁶ When asked about the requirement to take positive steps to verify under ASIC's Regulatory Guide 209, which sets out ASIC's expectations in relation to the responsible lending obligations, Mr Ranken said that there was a 'customer benefit trade-off' when considering how strictly Regulatory Guide 209 was to be complied with.²⁰⁷

Mr Ranken initially suggested that indirect verification of a customer's living expenses took place by way of comparing the customer's declared living expenses with the income-adjusted HEM benchmark and using the higher of the two.²⁰⁸ Mr Ranken subsequently accepted that the 'primary purpose' of undertaking that comparison was to assess the customer's capacity to service the loan, not to verify the customer's financial situation.²⁰⁹

More broadly, of the ANZ home loan files reviewed by KPMG in the course of the APRA targeted review process, 73% showed the customer's living

²⁰³ Transcript, William Andrew Ranken, 19 March 2018, 463–4.

²⁰⁴ Transcript, William Andrew Ranken, 19 March 2018, 469.

²⁰⁵ Transcript, William Andrew Ranken, 19 March 2018, 469.

²⁰⁶ Transcript, William Andrew Ranken, 19 March 2018, 469.

²⁰⁷ Transcript, William Andrew Ranken, 19 March 2018, 464–6.

²⁰⁸ Transcript, William Andrew Ranken, 19 March 2018, 463–4; see also Transcript, William Andrew Ranken, 19 March 2018, 471; Exhibit 1.86, Witness statement of William Andrew Ranken, 4 March 2018, 9 [54(h)].

²⁰⁹ Transcript, William Andrew Ranken, 19 March 2018, 464.

expenses defaulting to the HEM benchmark.²¹⁰ The files examined related to loans approved between 1 October 2015 and 30 September 2016.²¹¹ At the time that Mr Ranken gave evidence, he considered that approximately the same percentage of ANZ files would still default to the HEM benchmark.²¹²

As a final point relating to serviceability, under ANZ's Mortgage Credit Requirements policy, a customer's ability to repay a credit facility was assessed against a customer's uncommitted monthly income, or UMI.²¹³ A customer's UMI was 'determined by deducting from net income [a customer's] personal living expenses, credit commitments, and any other regular fixed commitments'.²¹⁴ ANZ's policy was that '[i]f the UMI is positive, then the customer is considered to have the capacity to repay'.²¹⁵ In cross-examination, it was put to Mr Ranken that ANZ's policy represented 'too broad-brush an approach', in light of Section 131 of the NCCP Act, and 'the obligation it contains to assess a credit contract as unsuitable ... if a customer could only comply with their financial obligations under the contract with substantial hardship'.²¹⁶ Mr Ranken rejected that characterisation.²¹⁷

Mr Ranken also gave evidence about the application of ANZ's processes to Mr Regan's application for a home loan. Mr Regan, a 72-year-old pensioner, sought and obtained a \$50,000 home loan from ANZ in March 2017. The loan was secured against his unencumbered home, and the application for the loan was submitted by a mortgage broker as a loan for additions and alterations to Mr Regan's house.²¹⁸ In fact, Mr Regan wanted to obtain the

²¹⁰ Transcript, William Andrew Ranken, 19 March 2018, 473; see also Exhibit 1.87, 28 April 2017, KPMG Targeted Review 2016/2017, 9.

²¹¹ Exhibit 1.87, 28 April 2017, KPMG Targeted Review 2016/2017, 18.

²¹² Transcript, William Andrew Ranken, 19 March 2018, 474.

²¹³ Transcript, William Andrew Ranken, 19 March 2018, 477.

²¹⁴ Transcript, William Andrew Ranken, 19 March 2018, 477.

²¹⁵ Transcript, William Andrew Ranken, 19 March 2018, 477.

²¹⁶ Transcript, William Andrew Ranken, 19 March 2018, 477–8.

²¹⁷ Transcript, William Andrew Ranken, 19 March 2018, 478.

²¹⁸ Transcript, Robert Emmett Regan, 16 March 2018, 436, 443.

money to send to individuals overseas.²¹⁹ Mr Regan subsequently learnt that the individuals were part of a fraud.²²⁰

At the time that Mr Regan applied for the loan, his fortnightly income was approximately \$1,229.²²¹ Mr Regan provided the broker with bank statements evidencing his income and expenditure.²²² The bank statements showed that Mr Regan had spent significant amounts of money on the scam in the previous month.²²³ Mr Regan did not discuss his expenses with the broker, but understood that the broker would calculate his expenses from his bank statements.²²⁴ The bank statements showed multiple Western Union money transactions, by which Mr Regan sent thousands of dollars to people involved in the scam.²²⁵

The Statement of Financial Position, prepared by the broker and signed by both the broker and Mr Regan,²²⁶ recorded Mr Regan's monthly expenses as \$1,140, approximately half of Mr Regan's estimated expenses.²²⁷ The Statement of Financial Position was submitted to ANZ by the broker, along with supporting documentation that included Mr Regan's bank statements and a Centrelink statement from the previous year recording Mr Regan's receipt of the aged pension.²²⁸

When ANZ assessed Mr Regan's home loan application, it only reviewed Mr Regan's bank account statements for the purposes of verifying his income.²²⁹ Mr Ranken accepted that if Mr Regan's bank account statements

²¹⁹ Transcript, Robert Emmett Regan, 16 March 2018, 435, 443.

²²⁰ Transcript, Robert Emmett Regan, 16 March 2018, 435.

²²¹ Transcript, Robert Emmett Regan, 16 March 2018, 436; Exhibit 1.82, Witness statement of Robert Emmett Regan, 8 March 2018, 1–2 [4].

²²² Transcript, Robert Emmett Regan, 16 March 2018, 437.

²²³ Transcript, Robert Emmett Regan, 16 March 2018, 438–9.

²²⁴ Exhibit 1.82, Witness statement of Robert Emmett Regan, 8 March 2018, 4 [16].

²²⁵ Transcript, Robert Emmett Regan, 16 March 2018, 438–9.

²²⁶ Exhibit 1.86, Witness statement of William Andrew Ranken, 4 March 2018, Exhibit WAR-7 [ANZ.800.141.3018 at .3020].

²²⁷ Transcript, Robert Emmett Regan, 16 March 2018, 442.

²²⁸ Exhibit 1.86, Witness statement of William Andrew Ranken, 4 March 2018, 10 [59(b)(i)], 11 [59(b)(iv)], 11 [59(b)(vi)].

²²⁹ Transcript, William Andrew Ranken, 19 March 2018, 482.

had been considered more fully, it would have taken no ‘more than a few seconds’ to notice the significant sums of money that Mr Regan lost during February 2017,²³⁰ and ‘it would have been obvious ... that Mr Regan’s expenses ... were much more than reflected in the statement of financial position’.²³¹

In assessing Mr Regan’s home loan application, an ANZ assessment officer considered that Mr Regan’s ‘exit strategy’ was for him to ‘downsize if required and pay out the loan’.²³² Mr Regan said, and I accept, that no such ‘exit strategy’ was discussed with him.²³³ Mr Regan’s age was also not considered as part of the assessment of the home loan application, other than a reference to ANZ ‘[c]onsidering only the untaxed component [of his superannuation payment because he] is aged’.²³⁴

ANZ granted the loan to Mr Regan for a 30 year term.²³⁵ Mr Regan drew down on the loan, and then transferred the majority of the funds drawn down to members of the scam in London.²³⁶ The bank employee who assisted Mr Regan to effect the international money transfer had assisted Mr Regan to obtain his home loan a few days earlier.²³⁷ The employee did not ask any questions about what Mr Regan was using the money for, despite the fact that Mr Regan was quite clearly using the loan funds for

²³⁰ Transcript, William Andrew Ranken, 19 March 2018, 482–3.

²³¹ Transcript, William Andrew Ranken, 19 March 2018, 482–3.

²³² Transcript, William Andrew Ranken, 19 March 2018, 484; Exhibit 1.90, undated, Log of Assessor’s Comments re Regan, 9–10 (entry dated 3 August 2017).

²³³ Transcript, William Andrew Ranken, 19 March 2018, 486.

²³⁴ Transcript, William Andrew Ranken, 19 March 2018, 483–4; Exhibit 1.90, undated, Log of Assessor’s Comments re Regan, 7–8 (entry dated 3 October 2017).

²³⁵ See, eg, Transcript, William Andrew Ranken, 19 March 2018, 484; Exhibit 1.86, Witness statement of William Andrew Ranken, 4 March 2018, Exhibit WAR-10 [ANZ.800.141.3233 at .3233].

²³⁶ Transcript, Robert Emmett Regan, 16 March 2018, 443; Exhibit 1.82, Witness statement of Robert Emmett Regan, 8 March 2018, 7 [27]–[29].

²³⁷ Transcript, Robert Emmett Regan, 16 March 2018, 443; Exhibit 1.82, Witness statement of Robert Emmett Regan, 8 March 2018, 7 [27]–[28].

a purpose that was different to the purpose that had been disclosed to, and approved by, ANZ.²³⁸

4.3 What the case study showed

The case study requires consideration in two distinct but related ways. First, it is necessary to say something about what the case study showed about ANZ's home lending processes generally. Second, it is necessary to deal with the particular case of Mr Regan.

4.3.1 ANZ's home lending processes

Three points of general application and importance emerged from Mr Ranken's evidence. They were:

- ANZ's reliance on brokers to enquire about a customer's outgoings;
- his resistance to comparing stated outgoings with available bank statements; and
- treating the calculated UMI as demonstrating capacity to repay.

The general tenor of Mr Ranken's evidence (and of ANZ's submissions about the case of Mr Regan) was that ANZ can rely on what is set out about a borrower's expenses in the Statement of Financial Position signed by both broker and borrower. That is, subject to using the relevant HEM as a default measure of expenses when it is higher than declared expenses, ANZ's reliance on what was said about expenses in the Statement was said to be sufficient inquiry about, and verification of, this aspect of a borrower's financial position. Yet, at the same time, Mr Regan accepted that ANZ did not rely only on what was said in the Statement about income but routinely required documentary verification of declared income. The tension between the two propositions is readily apparent.

Mr Ranken's evidence that sought to explain why verification of expenses was too hard and, as he put it, 'ultimately not necessarily that helpful', demonstrated this tension.²³⁹ And even that explanation did not deal satisfactorily with the fact that, in the particular case of Mr Regan's loan

²³⁸ Transcript, Robert Emmett Regan, 16 March 2018, 443; Exhibit 1.82, Witness statement of Robert Emmett Regan, 8 March 2018, 5 [17], 7 [27]–[28].

²³⁹ Transcript, William Andrew Ranken, 19 March 2018, 469.

application, ANZ had been provided with a bank statement that showed immediately and obviously that Mr Regan had been recently making expenditures which were much greater than the amount recorded in the Statement of Financial Position.

The procedures described by Mr Ranken do not include any verification of a borrower's expenditures. As is explained in Chapter 2, without verification of expenditures, there is no verification of a borrower's financial position. Whether procedures of the kind described by Mr Ranken are sufficient to satisfy the responsible lending provisions of the NCCP Act (and in particular Section 130(1)) is similarly dealt with in Chapter 2.

What about the particular case of Mr Regan?

4.3.2 Mr Regan's case

Mr Regan's case raised two kinds of issue: issues about the making and drawing down of the loan, and issues about subsequent steps taken by ANZ in response to hardship applications made by Mr Regan.

Consistent with the evidence given by Mr Ranken, an important, perhaps the central, point made by ANZ in answer to suggestions that it should not have made the loan to Mr Regan was that it had relied on the Statement of Financial Position that Mr Regan and the broker had signed. It submitted that, according to the Statement, it was right to conclude that he would be able to service the loan.²⁴⁰ ANZ also submitted, no doubt correctly, that the principal cause of Mr Regan's loss was the calculated and fraudulent deception of which he had been a victim. But observing this to be the cause of his loss is not to the point when considering whether ANZ should have lent the money that was stolen.

Of particular relevance to whether ANZ should have made the loan is the observation made on the bank's file that Mr Regan's 'exit strategy' would be to 'downsize'. On its face, the note is consistent with (perhaps only consistent with) the relevant bank employee concluding that compliance with the loan contract may require Mr Regan to sell his home. The combination of Mr Regan's age and his dependence on social security payments might be thought to have founded such a conclusion. But it is

²⁴⁰ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 3–4 [2.12]–[2.17].

a conclusion that, on its face, directs attention to the application of Section 131 of the NCCP Act and its provision that a loan contract will be unsuitable if it is likely that the consumer could only comply with the contract with substantial hardship. As Section 131(3) provides, if a consumer could only comply with the consumer's financial obligations under the contract by selling the consumer's principal place of residence, it is presumed that the consumer could only comply with those obligations with substantial hardship, unless the contrary is proved.

The material adduced in evidence leads me to the conclusion that ANZ might have contravened the NCCP Act by not taking reasonable steps to verify Mr Regan's financial position,²⁴¹ or by not assessing that the credit contract would be unsuitable for Mr Regan.²⁴²

4.3.3 Conduct falling short?

Mr Regan gave evidence of his drawing against the loan by asking the bank to transfer an amount drawn to London. Mr Regan said that the employee who dealt with him was the same employee who had dealt with him in connection with the loan. Mr Regan's evidence about this was not challenged and I accept it. The evidence suggests that the employee concerned either did not consider whether the drawing was consistent with the stated purpose of the loan (to make alterations and additions to the home) or ignored the evident inconsistency between that purpose and remitting funds to London. The more favourable interpretation of events would be that the employee did not 'join the dots'.

In times past, I think it probable that the community would have expected bank employees to be more keenly aware of the nature and extent of a customer's dealings with the bank than this employee may have been. But, as more and more dealings between bank and customer have been shifted away from a branch and onto the computer, I doubt that the community now expects an employee, even one who has dealt with a customer a few days earlier, to ask whether the withdrawal being made was consistent with the purpose of the loan.

²⁴¹ Contrary to s 130(1)(c) of the NCCP Act.

²⁴² Contrary to s 131(1) of the NCCP Act.

ANZ accepted that it incorrectly assessed an application for hardship relief that Mr Regan made in June 2017 and that it refused the application on the basis of that incorrect assessment.²⁴³ It further accepted that its conduct fell short of community standards and expectations.²⁴⁴ I agree.

I was troubled by the subsequent course of events that played out between ANZ and Mr Regan culminating, as it did, in ANZ making an offer to Mr Regan very soon before he was due to give evidence to the Commission. The offer ANZ then made proceeded from the implicit premise that ANZ had not breached responsible lending requirements. And, in his evidence, Mr Ranken left no doubt that he stood behind the decision to make the loan to Mr Regan.

The material that ANZ had when it decided to grant the loan was such as should have raised a very lively issue about whether the amount set out in the Statement of Financial Position signed by Mr Regan was right. And there is nothing to suggest that ANZ took any step to verify the declared expenses. All this being so, I consider that the position taken by ANZ (of requiring full repayment of the capital amount of the debt, reducing periodical payments and allowing a moratorium on those reduced payments) does not accord with what the community would expect. It is a position that assigns no responsibility to ANZ for the events which have happened. Further, and separately, if ANZ did breach its responsible lending obligations, the offer that it made was not adequate redress for that failure.

5 CBA add-on insurance

5.1 Background

This case study examined two add-on insurance policies sold by CBA to customers who did not meet the employment eligibility criteria to claim certain benefits under the policies. The two products were CreditCard Plus (CCP) insurance and Loan Protection Product (LPP) insurance. The latter

²⁴³ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 2 [2.7].

²⁴⁴ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 3 [2.9].

product comprised two separate sub-products: the Personal Loan Protection product and the Home Loan Protection product.²⁴⁵ Both CCP and LPP insurance were sold by CBA from around 2003.²⁴⁶

The Commission heard evidence from Ms Irene Savidis, a customer who had purchased CCP insurance,²⁴⁷ and from Mr Clive van Horen, the Executive General Manager for Retail Products, within the Retail Banking Services Business Unit of CBA.²⁴⁸

5.2 Evidence

5.2.1 CCP insurance

Turning first to CCP insurance, customers were offered CCP insurance as part of their application for a CBA-branded credit card.²⁴⁹ During the period from 2011 to 2015, 29.5% of CBA-branded credit cards had a CCP insurance policy attached to them.²⁵⁰

In April 2015, as a result of an internal audit, CBA determined that approximately 64,000 customers who had purchased CCP insurance may not have been eligible to claim benefits under their policy in the event that they suffered temporary or permanent disability or involuntary unemployment. This was because they were not employed when they were sold the policy.²⁵¹ Whilst customers were provided with a copy of the product disclosure statement (PDS) for the policy, CBA staff had not been required to inform them that such benefits could not be claimed if

²⁴⁵ Transcript, Clive Richard van Horen, 19 March 2018, 537.

²⁴⁶ Transcript, Clive Richard van Horen, 19 March 2018, 564.

²⁴⁷ Exhibit 1.92, Witness statement of Irene Savidis, 9 March 2018.

²⁴⁸ Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018; Exhibit 1.96, Witness statement of Clive Richard van Horen in relation to Ms Savidis, 9 March 2018; Exhibit 1.97, Witness statement of Clive Richard van Horen, 5 March 2018.

²⁴⁹ Transcript, Clive Richard van Horen, 19 March 2018, 504.

²⁵⁰ Transcript, Clive Richard van Horen, 19 March 2018, 504; Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018, 7 [28].

²⁵¹ Transcript, Clive Richard van Horen, 19 March 2018, 511; Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018, Exhibit CVH-7 [CBA.0001.0027.0002 at .0002].

they remained unemployed.²⁵² This was despite the fact that a 2011 ASIC report had recommended that sales scripts for consumer credit insurance include '[a] clear explanation of the main exclusions' in such policies.²⁵³ Mr van Horen referred to CBA's principal reliance upon the disclosures in the product disclosure statement, and the failure to refer to the employment-related exclusions in the sales scripts, as 'a flawed assumption and a flawed judgment'.²⁵⁴

In around May 2015, CBA amended its credit card sales scripts to introduce a 'knock out question' to prevent the sale of CCP insurance to people who did not meet the employment eligibility criteria.²⁵⁵ Changes were also made to the form used for online sales, but the changes did not introduce a 'knock out question'.²⁵⁶ No such question was introduced into the online form until 2017.²⁵⁷ Mr van Horen accepted that CBA erred in not introducing a 'knock out question' into the online process in 2015.²⁵⁸

Also in May 2015, CBA made a 'good governance' notification of the CCP insurance issue to ASIC.²⁵⁹ The notification substantially underestimated the number of customers affected by the problem.²⁶⁰ By the time of the hearing, CBA accepted that it should have made a significant breach notification under Section 912D of the Corporations Act in respect of the incident.²⁶¹ Mr van Horen stated that 'on balance, and taking into account ... all the considerations', he considered that the event involved a breach of CBA's and Colonial Mutual Life Assurance Ltd's obligations under Section

²⁵² Transcript, Clive Richard van Horen, 19 March 2018, 511.

²⁵³ Exhibit 1.99, October 2011, ASIC Report Numbered 256, 10; Transcript, Clive Richard van Horen, 19 March 2018, 512.

²⁵⁴ Transcript, Clive Richard van Horen, 19 March 2018, 513.

²⁵⁵ Transcript, Clive Richard van Horen, 19 March 2018, 520, 521.

²⁵⁶ Transcript, Clive Richard van Horen, 19 March 2018, 521.

²⁵⁷ Transcript, Clive Richard van Horen, 19 March 2018, 522.

²⁵⁸ Transcript, Clive Richard van Horen, 19 March 2018, 522.

²⁵⁹ Transcript, Clive Richard van Horen, 19 March 2018, 516; Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018, Exhibit CVH-9 [CBA.0001.0024.0118].

²⁶⁰ Transcript, Clive Richard van Horen, 19 March 2018, 517.

²⁶¹ Transcript, Clive Richard van Horen, 19 March 2018, 516.

912A(1)(a) of the Corporations Act to act efficiently, honestly and fairly.²⁶² Colonial Mutual Life Assurance Ltd (CMLA), sometimes referred to as CommInsure, was a company within the CBA group that issued the policies sold by CBA.

Extensive correspondence between CBA and ASIC followed, which involved negotiations over more than a year about whether CBA would remediate any customers who had been sold CCP insurance when they were unemployed, and if so, how it would remediate them. After being 'pressed' by ASIC, CBA changed its position on remediation a number of times. Initially, it did not offer to remediate consumers.²⁶³ It then offered to only remediate consumers with open policies.²⁶⁴ It ultimately agreed to remediate consumers with both open and closed policies.²⁶⁵ Similarly, CBA moved from a position of only refunding part of the premiums paid, to refunding the entirety of the premiums, at least to students.²⁶⁶ Aspects of the remediation program required customers to proactively 'opt in', in circumstances where CBA knew that the likely rate of uptake by consumers was low.²⁶⁷

Customers who purchased CCP insurance in circumstances where they did not meet the employment eligibility criterion paid \$11 million in premiums and received \$0.5 million in response to claims made.²⁶⁸ At the time of the hearing, CBA expected that the CCP insurance remediation program would lead to the remediation of approximately 64,000 customers, who would be refunded amounts totalling approximately \$10 million.²⁶⁹

As previously noted, the Commission also heard evidence from Ms Irene Savidis, a consumer who obtained CCP insurance in October 2014, at the same time that she obtained a CBA credit card.²⁷⁰ Ms Savidis attended

²⁶² Transcript, Clive Richard van Horen, 19 March 2018, 518.

²⁶³ Transcript, Clive Richard van Horen, 19 March 2018, 528.

²⁶⁴ Transcript, Clive Richard van Horen, 19 March 2018, 528.

²⁶⁵ Transcript, Clive Richard van Horen, 19 March 2018, 528.

²⁶⁶ Transcript, Clive Richard van Horen, 19 March 2018, 529.

²⁶⁷ Transcript, Clive Richard van Horen, 19 March 2018, 532–4.

²⁶⁸ Transcript, Clive Richard van Horen, 19 March 2018, 534–5.

²⁶⁹ Transcript, Clive Richard van Horen, 19 March 2018, 535.

²⁷⁰ Transcript, Irene Savidis, 19 March 2018, 496.

a CBA branch as part of the credit card approval process. While at the branch, Ms Savidis had a conversation with a CBA staff member about CCP insurance. The CBA staff member told Ms Savidis that she should take out CCP insurance because it would be ‘good for [her]’, it would ‘benefit’ her, and it would ‘help [her] in the long run if anything happened to [her]’.²⁷¹ Ms Savidis informed the CBA staff member that she was not working at that time, but the CBA staff member told Ms Savidis that she could ‘still claim’ under the policy.²⁷²

5.2.2 LPP insurance

Turning to LPP insurance, customers were offered LPP insurance as part of their application for either a CBA home loan or a CBA personal loan.²⁷³ During the period from 2011 to 2017, 42.64% of CBA personal loans had an associated Personal Loan Protection policy, and 10.34% of CBA home loans had an associated Home Loan Protection policy.²⁷⁴

The exclusions from LPP insurance were similar, but not identical, to the exclusions from the CCP product.²⁷⁵ Only customers who met the employment eligibility criterion could claim loan repayment cover in the event of disability or involuntary unemployment.²⁷⁶

As it had done in May 2015 for the CCP product, in October 2015, CBA amended its sales scripts to introduce a ‘knock out’ question in respect of the sale of LPP insurance.²⁷⁷ CBA provided an additional document to the Commission on 1 May 2018 that made it clear that the knock out question was added in about October 2015. Here too, the introduction of the ‘knock out’ question meant that an application for LPP insurance would not proceed if the employment eligibility criterion was not met.²⁷⁸

²⁷¹ Transcript, Irene Savidis, 19 March 2018, 495.

²⁷² Transcript, Irene Savidis, 19 March 2018, 495.

²⁷³ Transcript, Clive Richard van Horen, 19 March 2018, 537.

²⁷⁴ Transcript, Clive Richard van Horen, 19 March 2018, 538.

²⁷⁵ Transcript, Clive Richard van Horen, 19 March 2018, 539.

²⁷⁶ Transcript, Clive Richard van Horen, 19 March 2018, 539.

²⁷⁷ Transcript, Clive Richard van Horen, 19 March 2018, 539.

²⁷⁸ Transcript, Clive Richard van Horen, 19 March 2018, 539.

An equivalent question was again not introduced into the digital online application form until June 2017.²⁷⁹

From at least October 2015, CBA knew that there was a problem with LPP insurance being sold to people who did not meet the employment eligibility criterion.²⁸⁰ However, CBA did not report the issue to ASIC at that time, nor take steps to identify how many customers were affected by the issue.²⁸¹ Instead, CBA made a decision to 'sort out CCP first and then move on to [LPP]'.²⁸² CBA decided to 'prioritise' the CCP issue on the mistaken assumption 'that the scale of the issues in relation to the LPP matter would be less than for the CCP problem'.²⁸³

Approximately two years after CBA amended its LPP sales scripts to introduce a 'knock out question' into the non-digital channels, as CBA was preparing to notify ASIC of the LPP issue, ASIC raised the issue with CBA.²⁸⁴ ASIC raised the issue after having received information from a CBA customer about being sold LPP insurance in circumstances where the customer did not meet the employment eligibility criterion.²⁸⁵ That customer complaint had resulted in an ex gratia payment by CBA.²⁸⁶ The quantum of the ex gratia payment is not known.²⁸⁷

At ASIC's request,²⁸⁸ in October 2017 CBA made a significant breach notification to ASIC under Section 912D of the Corporations Act.²⁸⁹ In

²⁷⁹ Transcript, Clive Richard van Horen, 19 March 2018, 541.

²⁸⁰ Transcript, Clive Richard van Horen, 19 March 2018, 543.

²⁸¹ Transcript, Clive Richard van Horen, 19 March 2018, 543, 546.

²⁸² Transcript, Clive Richard van Horen, 19 March 2018, 545; see also 544.

²⁸³ Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018, 17 [98]; Transcript, Clive Richard van Horen, 19 March 2018, 546.

²⁸⁴ Transcript, Clive Richard van Horen, 19 March 2018, 548.

²⁸⁵ Transcript, Clive Richard van Horen, 19 March 2018, 549.

²⁸⁶ Transcript, Clive Richard van Horen, 19 March 2018, 549.

²⁸⁷ Transcript, Clive Richard van Horen, 19 March 2018, 549.

²⁸⁸ Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018, Exhibit CVH-25 [CBA.0001.0025.0606].

²⁸⁹ Transcript, Clive Richard van Horen, 19 March 2018, 552; Exhibit 1.95, Witness statement of Clive Richard van Horen, 9 March 2018, Exhibit CVH-26 [CBA.0001.0027.3043].

that notification, CBA and CMLA accepted that they had ‘breached the efficiently, honestly and fairly obligation’, being a condition of their financial services licences.²⁹⁰

At the time of the hearing, CBA’s estimate was that the LPP insurance issue had affected more customers than the CCP insurance issue.²⁹¹

As at 5 March 2018, CBA estimated that it would be communicating with approximately 140,000 customers in relation to the LPP issue.²⁹² In its initial submission to the Commission dated 29 January 2018, CBA had told the Commission that it had identified only 20,000 customers eligible for refunds.²⁹³

Shortly prior to the commencement of the hearings, CBA decided to cease selling CCP insurance, and to stop selling the Personal Loan Protection stream of LPP insurance.²⁹⁴ Mr van Horen accepted that CBA made this decision at least in part because the products would not be ‘economically viable’ after ‘the implementation of a deferred sales model’, which was expected to extend from credit card sales to personal loan sales.²⁹⁵ At the time of the hearings, CBA intended to continue to sell the Home Loan Protection stream of LPP insurance, which provided a larger stream of premiums to CBA than the CCP and the Personal Loan Protection products.²⁹⁶

5.3 What the case study showed

In its written submissions, CBA accepted that CCP and LPP insurance were sold to customers who did not, at the time of their application, meet the employment eligibility criteria applicable to those products.²⁹⁷ CBA

²⁹⁰ Transcript, Clive Richard van Horen, 19 March 2018, 553.

²⁹¹ Transcript, Clive Richard van Horen, 19 March 2018, 546.

²⁹² Transcript, Clive Richard van Horen, 19 March 2018, 557; Exhibit 1.97, Witness statement of Clive Richard van Horen, 5 March 2018, 1 [4].

²⁹³ Transcript, Clive Richard van Horen, 19 March 2018, 558; see also Exhibit 1.107, 29 January 2018, Paragraphs 131 to 138 of CBA Group Response, 2 [137].

²⁹⁴ Transcript, Clive Richard van Horen, 19 March 2018, 558–9.

²⁹⁵ Transcript, Clive Richard van Horen, 19 March 2018, 563–4; see also Exhibit 1.111, 5 March 2018, Life Product Strategy Bank Channel Distribution dated 05/03/2018, 2 [3.3].

²⁹⁶ Transcript, Clive Richard van Horen, 19 March 2018, 570.

²⁹⁷ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 13 [63].

accepted that, despite ASIC's published recommendation to include in formal sales scripts 'a clear explanation of the main exclusions that apply',²⁹⁸ CBA's 'assisted sales scripts did not sufficiently highlight to those customers that they may be ineligible for certain benefits under those policies if they continued not to meet the employment eligibility criteria'.²⁹⁹ CBA further accepted that it thereby breached its obligation under Section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that it provided the CCP and LPP products efficiently, honestly and fairly in respect of those customers.³⁰⁰ And CBA also accepted that it thereby failed to adhere to the obligation imposed by the Code of Banking Practice to act fairly and reasonably towards its customers in a consistent and ethical manner.³⁰¹ CBA thus accepted that its conduct amounted to misconduct. I agree.

It follows that, in the case examined in evidence (concerning Ms Savidis), the sale to her of CCP was a particular example of the breaches described.

Five further issues must then be examined. The first focuses on one aspect of the events examined: where a so-called 'knock-out question' was added to the scripts used when a customer spoke to a bank representative in a branch or at a call centre, but no equivalent change was made in the 'digital channel' of sale. The second directs attention to the fact that CBA has dealt with issues about CCP and LPP one after the other, instead of together, despite the issues being substantially identical in origin. The third issue concerns the application of the requirement to report breaches or likely breaches of CBA's obligations under Section 912A of the Corporations Act to ASIC in accordance with Section 912D. The fourth concerns the course of remediation negotiations between CBA and ASIC. The fifth (and most general) issue asks, in effect, what is to be made of the fact that CBA determined, a few days before this case study was to be examined by the Commission, that it would stop selling CCP and LPP.

²⁹⁸ Exhibit 1.99, October 2011, ASIC Report Numbered 256, 23 [89].

²⁹⁹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 13 [63].

³⁰⁰ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 13 [63].

³⁰¹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 15 [75].

5.3.1 Changing scripts

CBA accepted that it should have amended the application form in the digital channel concurrently with the changes it made in the other sales channels.³⁰² In his evidence, Mr van Horen acknowledged that, in hindsight, the delay in implementing changes to the digital processes was an error, and that CBA had remediated customers who applied through the digital channel up to the time that the change was made.³⁰³

To that extent at least, CBA's acknowledgment, and Mr van Horen's evidence, qualified what he said had been the explanation, at the time, for treating the channels differently: that there was less risk of ineligible customers taking out the product through the digital channel because they could read the application in their own time. I do not think this explanation is persuasive, but be that as it may, by its subsequent actions, CBA chose not to advance it as sufficient justification for its acting as it did.

By acknowledging that, at least in hindsight, the delay was an error, it seems to me that CBA thereby acknowledges that its conduct in not making alterations in the digital channel at the same time that it made changes to the other channels fell below community standards and expectations required. I agree.

5.3.2 Dealing with CCP and LPP sequentially

CBA acknowledged that it did not commence its investigation of the LPP issues soon enough and that, as a consequence, it neither formulated nor implemented a remediation program 'as early as it could have done'.³⁰⁴ CBA said that it approached the LPP issue 'as a follow up to the CCP issue in 2017, rather than as a distinct problem that required a concurrent investigation'.³⁰⁵ And it did this on the premise that the LPP issue was smaller (in the sense that it affected fewer customers) than the CCP issue. Subsequent investigations have shown that this premise was not right. As noted above, the estimates that CBA gave at the time of the hearings were that it would refund about \$10 million to about 64,000 customers who

³⁰² CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 16 [77].

³⁰³ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 16 [77].

³⁰⁴ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 16 [79].

³⁰⁵ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 11 [58].

had taken out CCP insurance, but that it expected to communicate with about 140,000 customers in relation to the LPP issue.

Even if CBA had been right to think that fewer customers may have been sold LPP than had been sold CCP without attention being drawn expressly to the eligibility requirements of the relevant policy, the comparative size of the affected groups was not relevant to determining what action CBA should take. The underlying issue was identical. Recognising that the sale of CCP without express reference to eligibility requirements was inappropriate entailed that the sale of LPP without express reference to eligibility requirements was also inappropriate. And CBA acknowledged that it 'knew that eligibility issues might have arisen for the LPP products in the same way as for the CCP products'.³⁰⁶ But CBA did not investigate the LPP issue. Mr van Horen said that there was no 'deliberate choice' not to investigate.³⁰⁷ But deliberate or not, the fact was that there was no investigation.

All of those affected by the issue had to be identified if the extent of the problem was to be assessed and adverse consequences remedied. Let it be assumed that dealing with the whole problem would have required more resources than were applied to dealing only with CCP (and CBA did not suggest that it would). This would not be reason enough for an entity the size of CBA to deal with the issue piecemeal. And even if the assumption described is made, it would provide no reason to wait until a consumer had complained to ASIC about LPP before telling ASIC that the problem CBA had identified extended beyond CCP. Yet this is what CBA did. Knowing there to be an issue, CBA did not try to find out its extent. CBA did not try to find out whether, or how many, customers other than those who had taken out CCP were affected.

This was conduct that falls below community standards and expectations.

5.3.3 Section 912D and notifying ASIC about LPP

CBA accepted that its conduct with respect to LPP breached the requirement imposed by Section 912A(1)(a) to 'do all things necessary to ensure that the financial services [provided by CBA] are provided

³⁰⁶ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 12 [61(b)].

³⁰⁷ Transcript, Clive Richard van Horen, 19 March 2018, 544.

efficiently, honestly and fairly'.³⁰⁸ In its written submissions, CBA accepted that it 'did not notify ASIC quickly enough of the LPP issue',³⁰⁹ and that consequently, its conduct³¹⁰ (which is to say 'its notification to ASIC of the LPP issue') fell below community standards and expectations.³¹¹ But it submitted that there should be no finding that CBA contravened Section 912D by failing to provide a written report to ASIC within the prescribed time.

It is to be recalled that Section 912D obliges a **financial services licensee**, as CBA is and was, to report a breach or likely breach of its obligations under Section 912A if the breach or likely breach is 'significant'. CBA accepted that its acknowledged breach of Section 912A(1)(a) with respect to LPP was significant. The time prescribed by Section 912D for reporting a breach or likely breach that is significant is very short. A report must be made 'as soon as practicable and in any case within 10 business days after becoming aware of the breach or likely breach'.

If, as I accept, CBA was right to acknowledge that its conduct fell below community standards and expectations because it did not notify ASIC of its breach with respect to LPP quickly enough, I do not see how it is said that there was no breach of Section 912D. And, in its written submissions, CBA offered no resolution of the evident tension between the competing positions it adopted when it said that its conduct breached what the community would expect to have been a timely notification to ASIC, while also saying that there was no breach of the law that required notification to ASIC within no more than 10 business days.

What CBA acknowledged compels the further conclusion that CBA might have contravened Section 912D by not notifying ASIC of the issues about LPP sooner than it did.

³⁰⁸ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 13 [63].

³⁰⁹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 16 [80].

³¹⁰ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 16 [80].

³¹¹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 16 [79], [80].

5.3.4 The course of the remediation negotiations

Negotiations between ASIC and CBA about how to identify and remediate customers affected by what had occurred in respect of CCP took far too long. The succession of positions taken by CBA in the course of those discussions with ASIC point towards CBA being unwilling to accept that it had not acted efficiently, honestly and fairly, and point towards its offering to do as little as it thought it could persuade ASIC to be sufficient.

When negotiating with ASIC about how to deal with the consequences of its conduct, an entity accused of inappropriate conduct may see itself as treading a fine line between protecting the interests of its shareholders (by minimising the cost of the default) and the interests of its customers (by providing all who deserve compensation fair and just recompense). Perhaps the course of negotiations about CCP could be interpreted as CBA seeking to prefer the former rather than the latter interests.

But an assumption of conflict in interests is properly seen to be misplaced, no matter whether the assumption is measured against the letter of the law or against community standards and expectations. Abiding long term considerations about the continuing health and reputation of the business dictate that a business (any business) treats its customers fairly. And those are considerations that inform directly the content and application of the duties and obligations of directors and officers of a company and, through that mechanism, the duties and obligations of those whom the company employs. And the community expects no less.

Hence, when discussing with ASIC what processes should be followed to remedy default, the community rightly expects that the dominant consideration for both parties to that discussion should be to achieve a fair and just outcome. The succession of offers made by CBA suggest either that it did not sufficiently consider what would be a fair and just outcome or it was brought to that point reluctantly. In either case, CBA's conduct fell short of community standards and expectations. More particularly, proposing an 'opt-in' arrangement, in circumstances where CBA knew that the likely rate of consumers opting in would be low, was to propose a form of remediation that would not provide all who deserved compensation fair and just recompense. To make that particular proposal was also conduct that fell short of community standards and expectations.

5.3.5 Stopping selling CCP and LPP

No doubt CBA made the decision it did, to stop selling CCP and LPP insurance in respect of personal loans, for what it perceived to be good commercial reasons. The chief stated reason was that changes to the Code of Banking Practice would require or likely require selling the policies under a 'deferred sales model', and that this would require or likely require substantial changes that resulted in CCP being 'no longer economically viable in its current form'.³¹² In addition, CBA anticipated that ASIC might 'reopen previously settled remediation activities or add new requirements'.³¹³

Four points may be made. First, add-on insurance of the kind described is a very profitable form of insurance for the insurer. As previously noted, the policies that CBA sold had been issued by CMLA. CBA had acquired CMLA in 2000, and it began to sell these policies in about 2003.³¹⁴ CBA had agreed to sell CMLA to AIA Insurance before CBA decided to stop selling the policies.³¹⁵

Second, insurance of the relevant kinds is profitable because the amount of total premiums received is much larger than the amount of total claims paid. The disparity suggests, strongly, that the policies are worth far less to policy-holders as a group than the overall cost to that group. And it is, therefore, necessary to ask why it is worth the while of an individual policy-holder to take the insurance. For some, it may provide peace of mind. For some, however, the risk of occurrence of events to which the policy will respond is likely to be low, even very low. And other, more broadly focused, forms of insurance (including types of life insurance) may be more suitable.

Third, for a long time, CBA (and other large ADIs) rewarded staff who sold the policies. There have been recent changes in remuneration arrangements and those changes are considered elsewhere, but it is possible that often (perhaps very often) those who sold the customer a policy did so because the person making the sale benefited, not because

³¹² Transcript, Clive Richard van Horen, 19 March 2018, 563.

³¹³ Transcript, Clive Richard van Horen, 19 March 2018, 566.

³¹⁴ Transcript, Clive Richard van Horen, 19 March 2018, 564.

³¹⁵ Transcript, Clive Richard van Horen, 19 March 2018, 563.

either the seller or the customer had made an informed decision about whether the customer needed the policy.

Fourth, Mr van Horen said that CBA intended to build new products with AIA.³¹⁶ But ending the sale of CCP and LPP without having a substitute product built and ready to launch does point towards a conclusion that the products that will no longer be sold were not needed by CBA's customers. Rather, the products were sold because they were profitable for the CBA group as a whole, not because they met any person's need of insurance.

6 CBA personal overdrafts

6.1 Background

This case study concerned a programming error in the automated serviceability calculator that CBA used to assess certain applications for personal overdrafts. CBA discovered the error in September 2015. As a result of the error, between July 2011 and September 2015, CBA failed to take into consideration the declared housing and living expenses of approximately 11,059 consumers,³¹⁷ resulting in breaches of CBA's responsible lending obligations under the NCCP Act.

6.2 Evidence

The Commission heard evidence from Mr Clive van Horen, CBA's Executive General Manager for Retail Products within CBA's Retail Banking Services Business unit. Mr van Horen described the process by which customers applied for a personal overdraft in respect of their existing transaction account, by way of either a long form or short form application. Long form applications were required for customers whose income or other information was not readily ascertainable by CBA, for example, through

³¹⁶ Transcript, Clive Richard van Horen, 19 March 2018, 568.

³¹⁷ Taking into account that some applications were submitted jointly by more than one customer: Exhibit 1.113, Witness statement of Clive van Horen, 9 March 2018, 7 [31].

existing transaction accounts.³¹⁸ Short form applications were used for customers in respect of whom CBA internally held certain data.³¹⁹

In July 2011, CBA commenced using an automated decision-making system to assess serviceability and risk³²⁰ as part of its assessment of long form applications.³²¹ The system's serviceability assessment took into account both the customer's financial position and the customer's 'servicing surplus', being the customer's net disposable income derived by deducting from the customer's income their rent, existing debt repayments and the higher of their declared living expenses or a benchmark used by CBA.³²²

In July 2015, while engaging with ASIC in relation to its short form application process, CBA undertook a review of the personal overdraft product, including both short form and long form application processes.³²³ During this review, in the course of updating the decision-making platform, CBA discovered a programming error that resulted in certain data from customers' long form applications not being included in the serviceability calculations within the automated decision-making system.³²⁴ In particular, rental expenses declared by a customer were not deducted from the customer's declared income in the automated decision-making system.³²⁵ The automated decision-making tool excluded the declared amount, replacing it with a 'nil' amount for housing expenses.³²⁶ As a result of the error, the customer's total living expenses were calculated incorrectly, at the lower amount, and CBA's policy was to adopt the modified HEM, if it was higher.³²⁷

³¹⁸ Transcript, Clive Richard van Horen, 20 March 2018, 585.

³¹⁹ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 1 [7].

³²⁰ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 2 [11(d)].

³²¹ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 2 [8].

³²² Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 2 [11(d)(i)].

³²³ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 4 [15].

³²⁴ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 5 [21].

³²⁵ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 5 [21(a)]; Transcript, Clive Richard van Horen, 20 March 2018, 586.

³²⁶ Transcript, Clive Richard van Horen, 20 March 2018, 590.

³²⁷ Transcript, Clive Richard van Horen, 20 March 2018, 593.

During the relevant period, 10,593 long form applications were affected by the error, of which 1,128 personal overdrafts were approved by CBA at a higher limit than for which the customer would otherwise have been eligible.³²⁸ This was because CBA had underestimated the customer's expenses as a result of the error.³²⁹

CBA rectified the error on 18 September 2015 and notified ASIC at a meeting held on 5 November 2015.³³⁰ Between November 2015 and April 2016, CBA engaged with ASIC in relation to a remediation program and its proposed correspondence with clients.³³¹ Taking into account a number of joint accounts, 11,059 customers were identified as having been affected by the error, with separate remediation strategies adopted for different cohorts.³³² In total, CBA wrote off \$2.518 million in overdraft balances and also provided refunds (such as for fees and interest) totalling approximately \$216,000.³³³

In August 2016, ASIC also issued infringement notices to CBA for amounts totalling \$180,000.³³⁴

6.3 What the case study showed

6.3.1 Misconduct

Section 133 of the NCCP Act prohibits entering into credit contracts with consumers in circumstances where the contract is unsuitable. CBA accepted that it breached that prohibition in respect of the customers affected by the programming error, where the loans were in fact unsuitable for those borrowers.³³⁵ I consider that to be an appropriate acknowledgment

³²⁸ Exhibit 1.113, Witness statement of Clive van Horen, 9 March 2018, 5 [22].

³²⁹ Transcript, Clive Richard van Horen, 20 March 2018, 590; Exhibit 1.113, Witness statement of Clive van Horen, 9 March 2018, 5 [22].

³³⁰ Transcript, Clive Richard van Horen, 20 March 2018, 616.

³³¹ Exhibit 1.113, Witness statement of Clive van Horen, 9 March 2018, 6 [26].

³³² Exhibit 1.113, Witness statement of Clive van Horen, 9 March 2018, 7 [31], 6 [28].

³³³ Exhibit 1.113, Witness statement of Clive van Horen, 9 March 2018, 9 [40].

³³⁴ Transcript, Clive Richard van Horen, 20 March 2018, 589.

³³⁵ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 19 [93].

that the programming error in CBA's serviceability calculator led to misconduct on its part.

6.3.2 Conduct falling short of community expectations

CBA accepted that the programming error should not have been made and should have been picked up earlier.³³⁶ Those admissions prompt discussion of two further matters.

First, the serviceability calculator was, as Mr van Horen described it, a 'very heavily automated system'.³³⁷ The programming error that existed in the calculator resulted in CBA's credit assessment system being non-compliant with Section 133 of the NCCP Act. That error persisted for four years after the launch of the automated system.

At least a reason why the error persisted undetected for so long was the failing of CBA's oversight mechanism, which sampled consumer credit decisions for technical and documentation errors. CBA's submission that this failure was due to the 'small proportion of overall overdraft customers'³³⁸ affected is a matter of framing. 10,593 applications of 331,000³³⁹ applications is 3.2%; however, 10,593 was the number of applications actually granted to customers who should not have received that amount of credit. As a proportion of the 145,000³⁴⁰ applications approved from individuals who thereby became CBA customers, the relevant percentage is 7.3%. It is not clear that an error affecting 7.3% of customers of a CBA facility is a 'small proportion'. Moreover, the programming error affected calculations in all applications, whether or not it led to the result that that application should not have been approved.³⁴¹ An oversight mechanism that fails to detect an error of those proportions may be considered inadequate.

According to CBA's submissions, the scope of its misconduct or conduct falling short of community expectations is also limited by the fact that the systems CBA had in place were, but for the programming error, 'reasonable

³³⁶ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 19 [94].

³³⁷ Transcript, Clive Richard van Horen, 20 March 2018, 584.

³³⁸ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 19 [96].

³³⁹ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 5 [22].

³⁴⁰ Exhibit 1.113, Witness statement of Clive Richard van Horen, 9 March 2018, 5 [22].

³⁴¹ Transcript, Clive Richard van Horen, 20 March 2018, 594.

given the scale of the business'.³⁴² The issue of scalability is discussed further in the context of the next case study. It is relevant to note here, however, that scalability does not obviate the requirements of the NCCP Act. CBA's serviceability calculator was the principal means by which long form applications were approved, and the programming error was a component of the serviceability calculator from its introduction. Although CBA inquired as to applicants' expenditures, the practical effect of the programming error was that CBA did nothing with some types of such information.

7 ANZ pre-approved overdrafts

7.1 Background

Between November 2014 and January 2015, ANZ sent pre-approved offers of \$500 or \$1,000 to eligible customers in respect of the ANZ Assured overdraft product, both by post and through internet banking. Approximately 2,992 offers were taken up in the relevant period.³⁴³ ANZ did not inquire into the customers' requirements and objectives, or desired overdraft amount, prior to sending the pre-approved offers. ANZ was found by ASIC to have breached its responsible lending obligations. Evidence in this case study was given by Ms Heang Forbes, Pricing Operations Chapter Lead at ANZ. Ms Forbes had been Product Manager, Assured and Overdrafts at ANZ from around October 2014 to January 2016.³⁴⁴

7.2 Evidence

The offers sent to customers about the ANZ Assured product stated that the customer had been 'pre-approved' for eligibility to receive the ANZ Assured overdraft facility and could activate the facility by accepting the offer, either by telephone or by sending in a completed 'Activation Authority' form included with the letter.³⁴⁵ The standard 'Activation Authority' contained

³⁴² CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 19 [93].

³⁴³ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 12) [ANZ.800.077.0033]; see also Transcript, Heang Forbes, 20 March 2018, 639.

³⁴⁴ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, 2 [7].

³⁴⁵ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, 4 [26].

words by which the customer acknowledged that he or she could repay the credit limit without substantial hardship. Another part of the form stated that '[i]f your personal circumstances have changed (or are likely to change in the near future) and could adversely affect your financial position, please do not accept this offer but call us ... for a full assessment'.³⁴⁶ However, none of the relevant offers requested financial information from the customer, such as the customer's debts, income or expenses.

In December 2014, ASIC wrote to ANZ inquiring about the unsolicited offers, including about the process by which ANZ approved customers, the steps taken by ANZ after acceptance by a customer and how ANZ complied with its obligations under Section 130(1) of the NCCP Act in relation to the offers.³⁴⁷ ASIC then engaged in further correspondence with ANZ, including in relation to whether it was permissible for ANZ to make no inquiries about the customer's requirements and objectives because of the nature of the overdraft product and the limits involved.³⁴⁸ ANZ ceased sending the unsolicited overdraft offers in early 2015, with the last date for acceptance of any pre-approved offer being 27 February 2015.

Ms Forbes's evidence was that the ANZ Assured overdraft facility was intended to operate as a 'safety net' to cover customers' small and temporary cash shortfalls, rather than being designed for a specific purpose or to be drawn down and repaid over an extended period of time.³⁴⁹ Ms Forbes said that ANZ selected eligible customers to receive pre-approved offers on the basis of a number of selection criteria applied by the Analytics team to the customer database.³⁵⁰ Some selection criteria were designed to remove from the pool of eligible customers those who ANZ assessed to be at risk of carrying an overdraft balance over an

³⁴⁶ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF2 (Tab 3) [ANZ.800.255.7837]; Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF2 (Tab 28) [ANZ.800.259.0129].

³⁴⁷ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 1) [ANZ.800.077.0001].

³⁴⁸ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 6) [ANZ.800.255.9453].

³⁴⁹ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018 3 [17]; Transcript, Heang Forbes, 20 March 2018, 625.

³⁵⁰ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, 5 [35]–[36].

extended period of time.³⁵¹ In addition, some specific customer cohorts were excluded.

ANZ did not consider that its processes for the overdraft offers were in breach of the NCCP Act.³⁵² ANZ contended that since the product was a small line of credit with no particular purpose, and the line of credit was not large relative to the customer's deposit behaviour, its inquiries under the NCCP Act were scalable.³⁵³ Ms Forbes did, however, concede that ANZ did not inquire about the customer's needs or requirements at the time of making the offer,³⁵⁴ and that ANZ's eligibility assessment considered the creditworthiness of the customer and not the customer's needs or requirements.³⁵⁵

During the period from 2015 to January 2017, ASIC requested further information from ANZ in relation to the ANZ Assured overdraft product and ANZ's responsible lending obligations.³⁵⁶ By a letter dated 14 April 2016, ASIC expressed concerns that ANZ's failure to comply with its responsible lending obligations may mean that some customers were provided with the ANZ Assured product in circumstances where the facility, or the level of credit provided under the facility, was unsuitable.³⁵⁷ ASIC said that it considered it appropriate for ANZ to undertake a review of the ANZ Assured facilities provided in order to remediate customers in either situation.³⁵⁸ ANZ's response was that its previous processes were

³⁵¹ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, 5 [37(c)].

³⁵² Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, 8 [53].

³⁵³ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 2) [ANZ.800.255.7833]; see also Transcript, Heang Forbes, 20 March 2018, 630.

³⁵⁴ Transcript, Heang Forbes, 20 March 2018, 634.

³⁵⁵ Transcript, Heang Forbes, 20 March 2018, 634.

³⁵⁶ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, 9 [57].

³⁵⁷ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 25) [ANZ.800.255.8729 at .8730].

³⁵⁸ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 25) [ANZ.800.255.8729 at .8730].

reasonable and compliant with the NCCP Act, although it invited a meeting to further understand ASIC's views.³⁵⁹

On 5 February 2016, ASIC issued five infringement notices to ANZ that imposed a penalty of \$42,500 per notice (totalling \$212,500). The notices alleged contraventions of Sections 128 and 130(2) of the NCCP Act, together with Regulation 28JA of the National Consumer Credit Protection Regulations 2010 (Cth). ANZ paid the amounts set out in the infringement notices. Payment did not have the effect that ANZ would be taken to have admitted guilt, or to have been found guilty, in respect of the alleged contraventions.³⁶⁰

Thereafter, ASIC and ANZ engaged in further correspondence in relation to changes to ANZ's responsible lending processes. This culminated in ASIC writing to ANZ by letter dated 10 January 2017 stating that it did not propose to make any further inquiries at this time, but asking that ANZ provide remediation on a case-by-case basis to ANZ Assured customers approved in response to pre-approved ANZ Assured offers.³⁶¹

ANZ responded to ASIC's letter acknowledging its receipt and ASIC's request regarding case-by-case remediation.³⁶² To Ms Forbes' knowledge, no such remediation was conducted by ANZ,³⁶³ nor was Ms Forbes aware of any further correspondence with ASIC in that regard.³⁶⁴

³⁵⁹ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 26) [ANZ.800.077.0172 at .0174].

³⁶⁰ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 19) [ANZ.800.255.9022]; Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 20) [ANZ.800.255.9026]; Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 21) [ANZ.800.255.9030]; Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 22) [ANZ.800.255.9034]; Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 (Tab 23) [ANZ.800.255.9038].

³⁶¹ Exhibit 1.122, Witness statement of Heang Forbes, 1 March 2018, Exhibit HF1 [ANZ.800.255.8807].

³⁶² Exhibit 1.124, 19 January 2017, Email from ANZ to ASIC dated 19/01/2017.

³⁶³ Transcript, Heang Forbes, 20 March 2018, 645.

³⁶⁴ Transcript, Heang Forbes, 20 March 2018, 646.

7.3 What the case study showed

This case study provided a striking example of a credit licensee (ANZ) offering to make a credit contract with an existing customer without having made any inquiry of the customer about the customer's requirements or objectives, without having made any recent inquiry about the customer's financial position and without taking any step to verify the customer's financial position.

When challenged by ASIC, ANZ said (in effect) that its conduct was reasonable because it was a small amount of credit, not large relative to the customer's deposit behaviour, and that its obligations under the NCCP Act were 'scalable'. In February 2016, ASIC issued five infringement notices, and ANZ paid the penalties fixed in those notices. In January 2017, ASIC asked ANZ to provide remediation to customers 'on a case-by-case' basis. ANZ acknowledged receipt of the request but did nothing.

Two points should be made: the first about 'scalability' and the second about infringement notices.

7.3.1 Scalability

Section 130 of the NCCP Act requires 'reasonable' inquiries and 'reasonable' steps to verify. What is reasonable will vary according to the relevant circumstances. And that is what is meant when it is said that the obligations are 'scalable'. But notions of scalability do not reach so far as to say that the Act's requirements need not be observed at all.

To my mind, there can be no case where making no inquiry at all is making 'reasonable' inquiries. And likewise, to my mind, there can be no case where taking no step at all to verify is taking 'reasonable' steps to verify.

Now it may be that some of the inquiries and verification required by the Act could be made without engaging with the consumer. And, in effect, that was what ANZ said here. It said that by choosing only some consumers to receive the offer of an overdraft, through the creation and application of certain criteria, it had made sufficient inquiries. That may or may not be right. Much turns on the nature and quality of the inquiries that lie behind both the setting of the criteria and their application. And if either the criteria or their application is deficient, the deficiency in the lender's inquiries may very well not be made good by saying to the consumer 'Tell us if you think that your position has changed in some significant way'. The effect of taking

a step of that kind would no doubt depend upon assessing all of the relevant circumstances. But those circumstances are to be considered bearing in mind that the Act imposes duties on the credit licensee (the lender). The lender cannot cast performance of *its* duty onto the borrower.

Even if there may be cases in which inquiries about a consumer's financial position can be made without dealing directly with the consumer, inquiries about *the consumer's requirements and objectives* are altogether separate and different. The latter form of inquiry cannot be made without engaging with the consumer. It is not for the lender to impose its judgment of what the consumer requires or 'needs'. It is not for the lender to impose its judgment of what objectives the consumer could have (even should have) in taking up the proffered line of credit.

At least to the extent of failing to inquire about the consumer's needs and requirements, ANZ might have contravened Section 130 of the NCCP Act in making the unsolicited offers of overdrafts which it did.

7.3.2 Infringement notices

ANZ paid the penalties fixed by the infringement notices that ASIC issued in respect of these matters. By doing that, ANZ did not admit guilt of the contraventions alleged in those notices. And it is easy to imagine circumstances in which an entity would judge it commercially more sensible to pay the penalties fixed by infringement notices, without contest, even though the entity denied having contravened the law. The penalty would be treated as a cost of business and the issuing of the infringement notices treated as suggesting that any breach of law was not sufficiently significant to warrant other, more serious, action.

But a consequence of issuing infringement notices may be, as it was here, that the entity remains unpersuaded that it should take any step to see whether its conduct caused loss to any customer and, therefore, unpersuaded that it should offer any form of compensation to any who were adversely affected by what it did.

In this case at least, the issue of infringement notices brought the matter to an end without any investigation of whether, or to what extent, the conduct caused loss. If the conduct caused injury, and there was no evidence that showed that it had, there was no process for redress.

8 ANZ processing errors

8.1 Background

This case study involved a number of processing errors made by ANZ in connection with home loans since 2003. The Commission heard evidence from Ms Sarah Stubbings, ANZ's Head of Home Loan Product, Australia and New Zealand.

8.2 Evidence

The evidence established five categories of processing errors by ANZ in connection with its home loan products since 2003.

First, in the period between 2006 and July 2013, some ANZ customers 'were charged an interest rate higher than they should have been according to the ... terms and conditions' of their accounts.³⁶⁵ In the period between '2003 and December 2012, some offset accounts were not properly linked to home loans, resulting in customers being charged excess interest'.³⁶⁶ These issues were collectively referred to as the 'Item 137 issues'. Fixes in relation to these issues 'were put in place progressively from April 2012 to June 2013'.³⁶⁷

Second, in the period from July 2013 to July 2017, certain customers who had selected a particular home loan package after draw down or had linked an existing home loan to a new home loan package were not given the benefit of being linked to an offset account. This was referred to as the 'Item 138 issue'.³⁶⁸ The Item 138 issue resulted in affected customers paying excess interest. The Item 138 occurred because the fixes

³⁶⁵ Exhibit 1.127, undated, items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry, 36 [137]; Transcript, Sarah Mary Stubbings, 20 March 2018, 651.

³⁶⁶ Exhibit 1.127, undated, items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry, 36 [137]; Transcript, Sarah Mary Stubbings, 20 March 2018, 651.

³⁶⁷ Exhibit 1.126, Witness statement of Sarah Mary Stubbings, 5 March 2018, 7 [33]; Transcript, Sarah Mary Stubbings, 20 March 2018, 668.

³⁶⁸ Exhibit 1.127, undated, items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry, 36 [138]; Transcript, Sarah Mary Stubbings, 21 March 2018, 689.

implemented to address the Item 137 issues did not address this issue;³⁶⁹ in evidence, ANZ referred to the Item 138 issue as a 'recurrence' of the Item 137 issues.³⁷⁰

Third, in the period from June to December 2016, certain customers did not receive the correct interest rate margin discount on their home loan. This was referred to as the 'Item 135 issue'.³⁷¹

Fourth, between 'December 2012 and February 2016, approximately 4,800 offset accounts [were not adequately] linked to an eligible retail home loan', resulting in the customer failing to obtain the benefit of the offset.³⁷² This was referred to as the 'Item 134 issue'.

Fifth, prior to May 2015, a further processing error resulted in customers with certain 'home loan and commercial lending accounts [failing to receive] the full benefit of offset arrangements due to the way the offset subsystem calculates interest as compared to the loan subsystem'. This was referred to as the 'Item 151 issue'.³⁷³

In her evidence, Ms Stubbings accepted that it was 'unsatisfactory' that these issues – which she characterised as having a common element of 'a system or process failing'³⁷⁴ – had occurred so frequently, and affected so many customers.³⁷⁵ Ms Stubbings also accepted that the problems referred to in her statement fall short of what ANZ's customers would expect of ANZ.³⁷⁶

One theme that arose from the evidence was the extent to which ANZ sought to put in place meaningful systemic fixes upon being made aware

³⁶⁹ Transcript, Sarah Mary Stubbings, 20 March 2018, 682.

³⁷⁰ Transcript, Sarah Mary Stubbings, 21 March 2018, 695, 710.

³⁷¹ Exhibit 1.127, undated, items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry, 35 [135]; Transcript, Sarah Mary Stubbings, 20 March 2018, 652.

³⁷² Exhibit 1.127, undated, items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry, 35 [134]; Transcript, Sarah Mary Stubbings, 20 March 2018, 652.

³⁷³ Exhibit 1.127, undated, items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry [151]; Transcript, Sarah Mary Stubbings, 20 March 2018, 652.

³⁷⁴ Transcript, Sarah Mary Stubbings, 21 March 2018, 710.

³⁷⁵ Transcript, Sarah Mary Stubbings, 21 March 2018, 707.

³⁷⁶ Transcript, Sarah Mary Stubbings, 21 March 2018, 709.

of the existence of each issue. In this regard, ANZ's evidence in relation to the Item 137 issues was particularly striking. Approximately one year after the Item 137 issues had been identified as systemic, ANZ's internal auditors created a document that:

- adverted to 'the risk that the remediation approach adopted focuses on manual and detective controls, rather than investing in system-based solutions which improve customer experience and help prevent errors being made';³⁷⁷ and
- noted that '[t]he steering committee has not decided on the long-term fixes but discussions to date indicate a limited appetite for the significant technology investment', given, amongst other things, 'the required technology spend'.³⁷⁸

Perhaps unsurprisingly, as is evident from the description above, a significant number of further issues were detected after the preparation of this document.

The case study also highlighted a number of distinct issues relating to ANZ's engagement with ASIC in respect of the processing errors.

First, in respect of the Item 137 issues, ANZ first notified ASIC of those issues on 17 June 2010.³⁷⁹ This was despite the fact that ANZ could be seen to have been aware of the potential need for regulatory notification since March 2010. In April 2014, ANZ prepared a 'key learnings' document in respect of the Item 137 remediation, in which it had posed the question: 'Can you wait for detailed data to size the issue prior to [regulator] notification?'.³⁸⁰ Under cross-examination, Ms Stubbings

³⁷⁷ Transcript, Sarah Mary Stubbings, 20 March 2018, 664, 665; Exhibit 1.126, Witness statement of Sarah Stubbings, 5 March 2018, Exhibit SMS-7 [ANZ.800.223.1330 at .1335].

³⁷⁸ Transcript, Sarah Mary Stubbings, 20 March 2018, 665, 664; Exhibit 1.126, Witness statement of Sarah Stubbings, 5 March 2018, Exhibit SMS-7 [ANZ.800.223.1330 at .1335].

³⁷⁹ Exhibit 1.126, Witness statement of Sarah Stubbings, 5 March 2018, 7 [31]; ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28].

³⁸⁰ Exhibit 1.133, April 2014, Key Learnings Document dated April 2014, 19; Transcript, Sarah Mary Stubbings, 20 March 2018, 677.

confirmed that she aware of the 10 day notification requirement under Section 912A of the Corporations Act, but took the view that ‘there does have to be a level of analysis done to ... try and understand what was the root cause of the issue, to what extent the period ... extended over [and to obtain] a sense of some level of customer impact’ before ASIC is notified.³⁸¹

Second, in relation to the Item 138 issue, ANZ informed ASIC of the issue on 5 October 2017, in circumstances where the issue had been identified in approximately March 2017.³⁸²

Third, ANZ has not at any time notified ASIC in relation to the Item 135 issue.³⁸³

Fourth, ANZ has not at any time provided written notification to ASIC in respect of the Item 134 issue.³⁸⁴

Fifth, the Item 151 issue was raised by ANZ Technology in about September 2014.³⁸⁵ ASIC was only notified of the issue on 16 October 2017.³⁸⁶

8.3 What the case study showed

ANZ acknowledged that ‘the various account administration errors should not have occurred’.³⁸⁷ ANZ also accepted that it fell short of community expectations by not recognising the Item 137 issues earlier.³⁸⁸ In her evidence, Ms Stubbings described the approach ANZ took to complaints about the Item 137 issues as ‘ad hoc’; complaints began to arise years

³⁸¹ Transcript, Sarah Mary Stubbings, 20 March 2018, 677.

³⁸² Transcript, Sarah Mary Stubbings, 21 March 2018, 689–90, 694.

³⁸³ Transcript, Sarah Mary Stubbings, 21 March 2018, 699.

³⁸⁴ Transcript, Sarah Mary Stubbings, 21 March 2018, 701.

³⁸⁵ Transcript, Sarah Mary Stubbings, 21 March 2018, 704.

³⁸⁶ Transcript, Sarah Mary Stubbings, 21 March 2018, 705.

³⁸⁷ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 16 [4.25].

³⁸⁸ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.29].

before ANZ identified the issues as systemic.³⁸⁹ ANZ also accepted that it fell short of community expectations by implementing inadequate fixes for previous problems that then led to the Item 138 and 134 issues.³⁹⁰ There is no reason to doubt the appropriateness of these acknowledgments.

ANZ did not accept that its remediation of all the issues in the case study took, or was taking, too long. I consider that ANZ's conduct in relation to remediation of the issues fell short of community expectations, and I address this in more detail below.

8.3.1 What are processing errors?

In Chapter 2 of this report, I made three points about what the entities referred to as 'processing errors'. Each point is relevant here.

First, each of the issues identified in this case study related to the charging by ANZ of an incorrect rate or fee, or the failure by ANZ to provide an appropriate discount or benefit, because its systems or processes were not properly set up to charge the correct rate or fee or to provide the appropriate discount or benefit. This amounts to a failure by ANZ to perform consumer contracts according to their terms. This falls short of community expectations. It may also be that it was a breach of the 'efficiently, honestly and fairly' obligation contained in Section 912A(1)(a) of the Corporations Act, and ANZ's reporting of the Item 137 issues and Item 151 issues would suggest that it thought those issues may be a breach.

Second, ANZ's implementation of fixes was inadequate. The consequence of ANZ's inadequate fixes was that ANZ continued to sell the same or similar products, and encounter the same or similar problems, over a period of time. To do so appears to be careless of its customers' interests. ANZ had reason to doubt whether the products that it was selling could be reliably delivered without substantial changes to its systems. The internal audit report referred to above, for example, should have given ANZ cause for concern and reflection. But ANZ continued to sell the relevant products.

³⁸⁹ Transcript, Sarah Mary Stubbings, 20 March 2018, 660.25, 659.

³⁹⁰ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17–18 [4.31].

Third, because ANZ did not deliver what it had sold, ANZ should have remedied its defaults as soon as reasonably practicable. This point leads me to the question of remediation.

8.3.2 Remediation

ANZ accepted that ‘certain remediation programs took too long to complete’, and that this was ‘inconsistent’ with community expectations.³⁹¹ By this, ANZ must be referring to its remediation in respect of the Item 137 issues, and perhaps to the Item 138 and 151 issues.

In its submission, ANZ said that the delays in the Item 137 remediation were a result of the complexity of identifying and calculating each customer’s remediation,³⁹² and were not the result of any failure to invest sufficient resources in the proper resolution of the errors.³⁹³ ANZ also said that at the time it embarked on that remediation program, ANZ ‘had not conducted a remediation of [that] magnitude and complexity before’, and that it was not until PwC was engaged that the remediation progressed ‘appropriately’.³⁹⁴ There is a tension between these two submissions: if the lack of progress in the two years between ANZ’s identification of the Item 137 issues and ANZ’s engagement of PwC was purely a result of the complexity of the remediation, and not due to ANZ’s inadequate resourcing or lack of appropriate direction, then it is unclear why it took PwC’s engagement for the remediation to begin to progress ‘appropriately’.

Turning to the Item 138 and Item 151 issues, ANZ offered no explanation of the timeframes for remediation in respect of either issue. It is unclear whether ANZ considered either remediation to have been delayed. The Item 138 issues were first identified by ANZ in March 2017. At the time of the hearings, remediation of those issues was continuing, and some affected customers may not even have been aware they had been

³⁹¹ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.31].

³⁹² ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.31].

³⁹³ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 18 [4.33].

³⁹⁴ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 18 [4.34].

affected.³⁹⁵ The Item 151 issues were identified in May 2016, and at the time of the hearings, ANZ expected remediation to conclude in December 2018.³⁹⁶ Overall, I consider that remediation has been unacceptably delayed.

Before leaving this topic, I note that ANZ pointed to its swiftness in relation to the Item 134 and Item 135 issue remediations. In respect of the Item 134 issue remediation, ANZ said in its submission that it ‘began remediating customers before the issue was able to be brought to the attention of the Australia Division Risk Committee, demonstrating ANZ’s appreciation of the importance of providing timely remediation’.³⁹⁷ Whether or not such a course was desirable does not now need to be discussed. ANZ’s remediation in respect of the Item 134 issue was not complete by the time of the hearings. In the course of preparing her witness statement for the Commission, Ms Stubbings identified an issue in relation to the remediation process with respect to this item, such that some affected customers who had closed their accounts had not been remediated.³⁹⁸

8.3.3 Notification to ASIC

ANZ implicitly acknowledged that it contravened Section 912D of the Corporations Act by notifying ASIC of the Item 151 issues 12 days, rather than 10 days, after it considered that time under that section began to run.³⁹⁹

ANZ also implicitly accepted that ASIC notification was required in respect of the Item 137 and 138 issues. But on its construction of Section 912D, there was no contravention of that section. That is because ANZ’s submissions proceeded on an interpretation of Section 912D that required ANZ to report to ASIC only after internal approval for that action was given. Therefore, according to ANZ, there was no breach in relation to the Item

³⁹⁵ Transcript, Sarah Mary Stubbings, 21 March 2018, 693–4.

³⁹⁶ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 15 [4.22].

³⁹⁷ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 18 [4.32].

³⁹⁸ Transcript, Sarah Mary Stubbings, 21 March 2018, 702.

³⁹⁹ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(d)].

137 issues, because notification was given to ASIC while ANZ was still scoping the problems, and there was no breach in relation to the Item 138 issue, because a notification was given 10 days after a Stakeholder Group resolution to do so.⁴⁰⁰ In relation to the Item 151 issues, ANZ also used the relevant Stakeholder Group resolution as the trigger for the commencement of the 10 day period.⁴⁰¹

The consequences of ANZ's interpretation of Section 912D suggest that the interpretation is problematic. ANZ identified the Item 137 issues in about March 2010.⁴⁰² Despite this, on ANZ's interpretation of Section 912D, ANZ was not relevantly 'aware' of the Item 137 issues until sometime in June 2010, and it notified ASIC on 17 June 2010.⁴⁰³ A similar lag existed between identification and notification in respect of the Item 138 and Item 151 issues: the Item 138 issues were identified in March 2017⁴⁰⁴ and notified to ASIC on 5 October 2017, and the Item 151 issues, were identified in May 2016 and notified to ASIC on 16 October 2017.⁴⁰⁵

More importantly, ANZ's interpretation of Section 912D makes its application depend upon the particular internal arrangements a licensee makes for deciding whether, in its view, the events and circumstances are a breach or likely breach of its obligations that is significant. That is, it is an interpretation that has the licensee determine, by its choice of internal processes, whether and when it commits an offence. That would be a very odd result.

⁴⁰⁰ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(a)].

⁴⁰¹ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(d)].

⁴⁰² ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(a)].

⁴⁰³ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(a)].

⁴⁰⁴ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 13 [4.8]–[4.9].

⁴⁰⁵ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 14 [4.21].

ANZ submitted that Section 912D did not require ASIC to be notified in writing of either the Item 134 issue or the Item 135 issue.⁴⁰⁶ The Item 134 issue affected 4,800 offset accounts over the course of over three years. The Item 134 issue was related to fixes introduced in response to the Item 137 issues, and therefore may well have had some connection or similarities to those issues.⁴⁰⁷ I am not persuaded that it was appropriate for ANZ to make what it termed a 'verbal' notification to ASIC in those circumstances.⁴⁰⁸ The Item 135 issue affected around 2,000 customers over six months. The Item 135 issue, like the 138 issues before it, concerned the application of the correct interest rate to accounts. I am not convinced that the Item 135 issue was not significant, having regard in particular to the number and frequency of similar breaches. In all the circumstances I conclude that ANZ might not have complied with its obligations under Section 912D.

9 Westpac car loans

9.1 Background

This case study considered car loans approved by the Westpac auto finance business through dealer intermediaries. Evidence was given by Ms Nalini Thiruvangadam, a consumer who obtained a car loan from Westpac, and Mr Phillip Godkin, the General Manager, Specialist Finance Business Bank at Westpac Group.⁴⁰⁹

At the time of the hearings, loans provided by Westpac auto finance were sold under the names of St George or Bank of Melbourne.⁴¹⁰ Westpac acknowledged that 'very much the overwhelming majority' of car loans on issue by Westpac were initiated by dealers, and that the

⁴⁰⁶ cf ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(b)–(c)].

⁴⁰⁷ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(b)].

⁴⁰⁸ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 17 [4.28(b)].

⁴⁰⁹ Exhibit 1.141, Witness statement of Phillip George Godkin, 5 March 2018, 1 [3].

⁴¹⁰ Exhibit 1.141, Witness statement of Phillip George Godkin, 5 March 2018, 3 [11].

number of car loans on issue by Westpac by or through dealers in 2017 was 'well into multiple hundreds of thousands'.⁴¹¹ The quantum of car loans on issue by Westpac was in the 'multiple billions of dollars'.⁴¹² Westpac was typically number one or number two in the market for auto finance through dealer intermediaries.⁴¹³ Westpac acknowledged that it was 'heavily committed to the motor vehicle dealership model and physical point of sale model'.⁴¹⁴

9.2 Evidence

At the time of the hearings, Westpac 'reli[ed] heavily' on its dealers to 'perform a number of functions' in connection with Westpac's responsible lending obligations.⁴¹⁵ In essence, Westpac's relationship with its dealers could be summarised as Westpac and its dealers making 'an agreement which, if ... performed according to its terms, would lead to there being a loan that [was] made responsibly'.⁴¹⁶ The information that was obtained by dealers and captured in Westpac's systems was 'the primary source for Westpac evidencing whether or not reasonable inquiries have been made',⁴¹⁷ and the dealer managed communications with the customer throughout the loan application process.⁴¹⁸

Westpac then used the information captured by dealers for credit assessment purposes. Westpac undertook verification of income in all circumstances,⁴¹⁹ and used 'specific verification standards' for that purpose.⁴²⁰ Generally speaking, Westpac did not verify the information

⁴¹¹ Transcript, Phillip George Godkin, 21 March 2018, 733–4.

⁴¹² Transcript, Phillip George Godkin, 21 March 2018, 734.

⁴¹³ Transcript, Phillip George Godkin, 21 March 2018, 734.

⁴¹⁴ Transcript, Phillip George Godkin, 21 March 2018, 734.

⁴¹⁵ Transcript, Phillip George Godkin, 21 March 2018, 763–4.

⁴¹⁶ Transcript, Phillip George Godkin, 21 March 2018, 769–70.

⁴¹⁷ Transcript, Phillip George Godkin, 21 March 2018, 764–5; Exhibit 1.145, 24 February 2017, Page from the Second Line Controls Assurance Memo.

⁴¹⁸ Transcript, Phillip George Godkin, 21 March 2018, 733; Exhibit 1.141, Witness statement of Mr Phillip George Godkin dated 5 March 2018, 8–9 [36], 11–12 [47]–[48].

⁴¹⁹ Transcript, Phillip George Godkin, 21 March 2018, 776.

⁴²⁰ Transcript, Phillip George Godkin, 21 March 2018, 746; see also Transcript, Phillip George Godkin, 21 March 2018, 773–5.

submitted by Business Managers employed by dealers in respect of customer-declared expenses.⁴²¹ Westpac accepted that in the ‘vast majority of cases’, Westpac was ‘dependent on the accuracy of what the ... Business Manager’ told Westpac as regards customer expenses.⁴²² Westpac’s processes in relation to liabilities were similar to those in relation to expenses, save that Westpac could also consider a credit bureau report.⁴²³

In relation to compliance with the requirement in Section 130(1)(a) of the NCCP Act that Westpac ‘make reasonable inquiries about the consumer’s requirements and objectives’, Westpac acknowledged that it had relied upon Business Managers located within dealers ‘to have critical parts of the conversations’.⁴²⁴ In about October 2016, Westpac recognised that it was not appropriate to presume that the relevant conversation had taken place, just by virtue of the application process having been completed.⁴²⁵ Mr Godkin’s evidence was to the effect that since that time, Westpac’s ‘capability has been extended’,⁴²⁶ although the exact context of and basis for this statement was not entirely clear.

As regards the design of Westpac’s car loan products, at the time of the hearings, the standard Westpac auto finance policy permitted a maximum LVR of 180%.⁴²⁷ Westpac recognised that ‘a customer who has borrowed a higher LVR might be a little more stressed in their financial circumstances’ than a customer with a lower LVR.⁴²⁸ Westpac also acknowledged that to get a vehicle ‘out of the showroom [would] quite often take [the loan] above 100%’ of the market value of the vehicle.⁴²⁹ Westpac’s car finance policies permitted it to finance the purchase of a number of insurance

⁴²¹ Transcript, Phillip George Godkin, 21 March 2018, 745–6; see also Transcript, Phillip George Godkin, 21 March 2018, 776.

⁴²² Transcript, Phillip George Godkin, 21 March 2018, 745.

⁴²³ Transcript, Phillip George Godkin, 21 March 2018, 746.

⁴²⁴ Transcript, Phillip George Godkin, 21 March 2018, 767.

⁴²⁵ Transcript, Phillip George Godkin, 21 March 2018, 766–7.

⁴²⁶ Transcript, Phillip George Godkin, 21 March 2018, 765.

⁴²⁷ Transcript, Phillip George Godkin, 21 March 2018, 748.

⁴²⁸ Transcript, Phillip George Godkin, 21 March 2018, 750.

⁴²⁹ Transcript, Phillip George Godkin, 21 March 2018, 748.

products (other than consumer credit insurance), and the payment of brokerage and origination fees, within the loan offered to the customer.⁴³⁰

Mr Godkin gave evidence that add-on insurance, including tyre and rim insurance and gap insurance, represented an important source of income for dealers.⁴³¹ Westpac was aware of ASIC's concerns that inappropriate insurance was sold and high pressure sales tactics were used in connection with these types of insurance,⁴³² and that ASIC had 'put some steps in place to mitigate the risk of potential mis-selling in this marketplace'.⁴³³ However, Westpac declined ASIC's request to consider stopping financing add-on insurance.⁴³⁴

Westpac identified 'three key types of remuneration for car dealers'.⁴³⁵ The most 'significant' of those was the flex commission, by which a dealer was paid 'a percentage of the margin that is achieved over a base rate' of interest.⁴³⁶ This arrangement was not disclosed to customers.⁴³⁷

Westpac acknowledged that the flex commission pricing structure could 'provide[] an incentive for sales intermediaries to increase the price of the credit contract'.⁴³⁸ Westpac recognised that this created a risk of a conflict of interest between the intermediary and the customer.⁴³⁹ Westpac also acknowledged, in internal documents, that pricing structures that

⁴³⁰ Exhibit 1.141, Witness statement of Mr Phillip George Godkin dated 5 March 2018, 15 [63].

⁴³¹ Transcript, Phillip George Godkin, 21 March 2018, 782, 784; Exhibit 1.146, 22 September 2016, Memorandum to CEO Westpac Banking Corporation dated 22/09/2016, 3.

⁴³² Transcript, Phillip George Godkin, 21 March 2018, 781.

⁴³³ Transcript, Phillip George Godkin, 21 March 2018, 785.

⁴³⁴ Exhibit 1.147, undated, Page from the Board Risk and Compliance Committee dated 24/04/2017.

⁴³⁵ Transcript, Phillip George Godkin, 21 March 2018, 752.

⁴³⁶ Transcript, Phillip George Godkin, 21 March 2018, 752.

⁴³⁷ Transcript, Phillip George Godkin, 21 March 2018, 753–4.

⁴³⁸ Transcript, Phillip George Godkin, 21 March 2018, 754; see also Transcript, Phillip George Godkin, 21 March 2018, 753, 756.

⁴³⁹ Transcript, Phillip George Godkin, 21 March 2018, 757–8; see also Transcript, Phillip George Godkin, 21 March 2018, 780, 787–8.

incorporated flex commissions ‘significantly increase[d] the risk of unfair consumer outcomes whereby dealer behaviour may be influenced by commission plan design and the ability of a customer to negotiate’.⁴⁴⁰

Until August 2016, Westpac did not impose any maximum cap upon the percentage of flex commission that could be charged to a customer. At the time of the hearings, Westpac continued to allow its dealers to impose flex commissions,⁴⁴¹ and anticipated that it would not cease this practice until the date fixed by ASIC as the date by which the practice must cease.⁴⁴² This was because, in Mr Godkin’s words, it would be ‘impossible’ to stop the practice ‘unilaterally without stepping away from the market altogether’.⁴⁴³

9.2.1 Ms Thiruvangadam

The Commission heard evidence from Ms Nalini Thiruvangadam, who had entered into a car loan with one of Westpac’s subsidiaries in July 2012.⁴⁴⁴ Ms Thiruvangadam had previously tried to arrange finance from a number of major banks, including Westpac, and other sources such as car dealers.⁴⁴⁵ All of them denied her application, apparently on the basis of her credit.⁴⁴⁶ However, Ms Thiruvangadam eventually found a dealer who approved her application.⁴⁴⁷ The loan was financed by the Bank of Melbourne.⁴⁴⁸

⁴⁴⁰ Transcript, Phillip George Godkin, 21 March 2018, 756–7. Exhibit 1.144, 5 August 2015, Group Assurance Report, 4.

⁴⁴¹ Transcript, Phillip George Godkin, 21 March 2018, 753.

⁴⁴² Transcript, Phillip George Godkin, 21 March 2018, 754.

⁴⁴³ Transcript, Phillip George Godkin, 21 March 2018, 754.

⁴⁴⁴ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 6 [26], 8 [34].

⁴⁴⁵ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 2 [9]–[10].

⁴⁴⁶ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 2 [9]–[10]; Transcript, Nalini Devi Thiruvangadam, 21 March 2018, 718.

⁴⁴⁷ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 3 [11], 6 [22], 8 [34]; Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, Exhibit NDT-4 [RCD.0014.0003.0006]; Transcript, Nalini Devi Thiruvangadam, 21 March 2018, 718.

⁴⁴⁸ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 8 [34].

At the time that her car loan was approved, Ms Thiruvangadam's fortnightly repayments for her car loan totalled approximately 27% of her income.⁴⁴⁹ Ms Thiruvangadam subsequently became unable to work as a result of an injury, and suffered financial hardship as she continued to attempt to make loan repayments.⁴⁵⁰ In around November 2017, Bank of Melbourne acknowledged that Ms Thiruvangadam's loan 'should not have been approved'.⁴⁵¹

Westpac made a number of admissions in respect of the loan made to Ms Thiruvangadam.

First, Westpac acknowledged that its processes in relation to the approval of Ms Thiruvangadam's loan were deficient.⁴⁵² Among other things, Ms Thiruvangadam's loan application listed no expenses.⁴⁵³ However, Westpac gave evidence that the absence of such information 'would not have affected the assessment of serviceability',⁴⁵⁴ because 'the higher of HPI [the Henderson Poverty Index] or declared expenses were used in the assessment of serviceability' at the relevant time.⁴⁵⁵ Westpac did, however, accept that those processes permitted a situation in which it 'had no idea' what Ms Thiruvangadam's expenses were.⁴⁵⁶ Westpac also made clear that some changes had now been made to its previous position,⁴⁵⁷ although it

⁴⁴⁹ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 1 [4]–[5], 7[28].

⁴⁵⁰ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 2 [7], 9–11 [39]–[48]; Transcript, Nalini Devi Thiruvangadam, 21 March 2018, 723–5.

⁴⁵¹ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 12 [54].

⁴⁵² Exhibit 1.142, Witness statement of Phillip George Godkin, 5 March 2018, 5–6 [17]; Transcript, Phillip George Godkin, 21 March 2018, 735–8, 740; Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 1–2 [4].

⁴⁵³ Transcript, Phillip George Godkin, 21 March 2018, 736.

⁴⁵⁴ Exhibit 1.142, Witness statement of Mr Phillip George Godkin, 5 March 2018, 5 [17(e)].

⁴⁵⁵ Exhibit 1.142, Witness statement of Mr Phillip George Godkin, 5 March 2018, 5 [17(e)].

⁴⁵⁶ Transcript, Phillip George Godkin, 21 March 2018, 742–3.

⁴⁵⁷ Transcript, Phillip George Godkin, 21 March 2018, 743.

remained the case that if a consumer's 'reported expenses [were] less than HEM', Westpac would use the HEM benchmark as a default.⁴⁵⁸

Second, Westpac acknowledged that it was in breach of the obligation imposed by Sections 128(d) and 130(1)(c) of the NCCP Act to take reasonable steps to verify Ms Thiruvangadam's financial situation prior to entering into the credit contract.⁴⁵⁹

Third, Westpac acknowledged that Ms Thiruvangadam's loan was 'unsuitable', within the meaning of Section 133(2)(a) of the NCCP Act, because it was likely that Ms Thiruvangadam would be unable to comply with her financial obligations under the credit contract, or could only comply with substantial hardship.⁴⁶⁰

9.3 What the case study showed

This case study raised questions relating to dealers' remuneration, their role in Westpac's compliance with its responsible lending obligations, and the position of dealers as intermediaries between bank and customer. Those questions are dealt with first by reference to Westpac generally and second by reference to the evidence of Ms Thiruvangadam.

In its submissions, Westpac acknowledged that 'the current structure of Dealer commission carries the risk that some Dealers may prefer their own interests to the interests of customers'.⁴⁶¹ Westpac also said that 'the Dealer Agreement is an important part of the framework for ensuring Westpac meets its responsible lending obligations...'.⁴⁶² In his evidence, Mr Godkin accepted each of these propositions in a stronger form. As previously noted, he accepted that Westpac relied heavily on dealers in discharging its responsible lending obligations, including when making reasonable enquiries about customer needs.⁴⁶³ He also accepted that flex

⁴⁵⁸ Transcript, Phillip George Godkin, 21 March 2018, 744.

⁴⁵⁹ Transcript, Phillip George Godkin, 21 March 2018, 740.

⁴⁶⁰ Transcript, Phillip George Godkin, 21 March 2018, 740–1.

⁴⁶¹ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 12 [55].

⁴⁶² Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 13 [57].

⁴⁶³ Transcript, Phillip George Godkin, 21 March 2018, 764.

commissions create the risk of a conflict of interest between dealer and customer.⁴⁶⁴ One possible implication of these admissions is that Westpac believed that it could discharge its responsible lending obligations by way of representations about customers that are supplied by intermediaries whose interests, in important respects, are at odds with the customers' interests.

9.3.1 Flex commissions

I have dealt with flex commissions in Chapter 2 of this report. This case study prompts the following additional comments.

Westpac appeared to be fully apprised of the issues surrounding flex commissions. Its internal documents acknowledged that flex commissions 'significantly increase the risk of unfair outcomes'.⁴⁶⁵ In its submissions, it agreed with ASIC's conclusion that flex commissions 'provide an incentive for intermediaries to increase the price of a credit contract in a way that can depend on the negotiating skills or the vulnerability of the consumer and ... can create a risk of unfairness in any individual transaction'.⁴⁶⁶ Westpac also recognised that 'many, likely most, consumers do not understand the way in which Dealers are remunerated or the level or basis of commission paid to Dealers'.⁴⁶⁷

Nonetheless, Westpac submitted that its use of flex commissions in these circumstances was not conduct that falls short of community standards and expectations.⁴⁶⁸ That position was based on the fact that flex commissions are charged throughout the industry and that no legislative or disclosure restrictions had been placed on the practice, apart from the pending ASIC instrument.⁴⁶⁹ That pending ASIC instrument will ban the

⁴⁶⁴ Transcript, Phillip George Godkin, 21 March 2018, 758, 780, 787–8.

⁴⁶⁵ Exhibit 1.144, 5 August 2015, Group Assurance Report, 1, 4, 8.

⁴⁶⁶ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 9 [41].

⁴⁶⁷ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 11 [46].

⁴⁶⁸ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 11 [47].

⁴⁶⁹ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 11 [47].

use of flex commissions by car finance brokers from November 2018.⁴⁷⁰ When registering the instrument, ASIC stated that flex commissions 'lead to consumers paying excessive interest rates on their car loans. The ban comes after ASIC led a public consultation on banning these commissions'.⁴⁷¹ It seems to me that the ASIC instrument provides a strong indication that community standards and expectations run firmly contrary to the continued use of flex commissions.

Continued allowance of flex commissions appears to fall short of Westpac's own professed standards. Westpac submitted that 'the current approach to Dealers' commission and customer transparency should be changed',⁴⁷² and that current practices are 'out of step with other developments in the consumer credit area'.⁴⁷³ Though Westpac supported a ban on flex commissions,⁴⁷⁴ it declined to be the 'first mover', on the basis that 'it would simply leave the market to others who did not abandon the practice'.⁴⁷⁵ Westpac therefore continued, and will continue until stopped, to participate in a practice that it acknowledged created poor outcomes for consumers.

9.3.2 Responsible lending obligations and intermediaries

Car dealers are subject to the point-of-sale exemption in the NCCP Regulations and therefore do not need to hold, or comply with the requirements of, an ACL. When ACL holders provide finance through car dealers, responsible lending obligations must still be discharged by the ACL holder, but some necessary steps towards meeting those obligations, such as inquiries as to the customer's income, expenses and needs, are frequently carried out by the car dealer. Westpac accepted that 'the Dealer

⁴⁷⁰ ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780.

⁴⁷¹ Exhibit 1.158, Witness statement of Michael Saadat, 5 March 2018, Exhibit MS-5 [ASIC.0900.0001.0204].

⁴⁷² Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 11 [47].

⁴⁷³ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 11 [48].

⁴⁷⁴ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 10 [43].

⁴⁷⁵ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 10 [45].

plays an important role, but faces no regulatory consequences',⁴⁷⁶ and that 'Westpac needs and requires Dealers to comply with certain responsible lending obligations' in order to discharge its own.⁴⁷⁷ The primary mechanism by which Westpac enforced that compliance was through its agreements with dealers because, as Westpac submitted, 'the Dealer would understand that a failure to follow Westpac's processes could result in termination of the Dealer Agreement'.⁴⁷⁸

Ms Thiruvangadam's experience and the instances of misconduct relating to car finance disclosed in Westpac's submissions demonstrate that the fear of potential termination does not always inspire compliance with processes by all dealers. The incentives built into dealers' remuneration, discussed above, may well provide one explanation for this.

When a dealer fails to observe responsible lending practices, it may be in breach of its contractual obligations to Westpac, but what consequences does that have for Westpac's observance of its own NCCP Act obligations? Westpac's submissions appeared to accept that dealers' compliance with its requirements was critical to Westpac's compliance with the NCCP Act. However, in discussing Ms Thiruvangadam's case, Westpac appeared to suggest that it was misled by its dealer as to her rental expenses and, because it could not otherwise verify these, that Westpac should be considered to have complied with its obligations under Section 133 of the NCCP Act not to enter into unsuitable credit contracts with consumers.⁴⁷⁹ It must be recalled that a licensee's responsible lending obligations are non-delegable. The subcontracting, in effect, of its sales activities to intermediaries cannot be allowed to obscure this fact.

⁴⁷⁶ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 12 [53].

⁴⁷⁷ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 12 [53].

⁴⁷⁸ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 13 [57].

⁴⁷⁹ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 7 [31]–[32].

9.3.3 Ms Thiruvangadam

Westpac accepted that the loan to Ms Thiruvangadam ‘should not have been approved’.⁴⁸⁰ It accepted that ‘in light of all information now available the loan to Ms Thiruvangadam was ultimately “unsuitable”’.⁴⁸¹ Westpac also accepted that the verification of Ms Thiruvangadam’s financial situation fell short of the standard required by Clause 27 of the Code of Banking Practice, as it did not exercise of the care and skill of a diligent and prudent banker in selecting and applying its credit assessment methods and forming its opinion about the customer’s ability to repay the facility.⁴⁸² These acknowledgments were properly made.

Westpac also submitted that it was open to me on the evidence to find that it did not take reasonable steps to verify Ms Thiruvangadam’s income, and to that extent, did not meet the requirements of Section 128(a) of the NCCP Act.⁴⁸³ Again, I consider that this acknowledgment was properly made.

However, Westpac submitted that it did not fail to meet its obligations to verify Ms Thiruvangadam’s expenses. Westpac made this submission while accepting that ‘no expenses were declared in the loan application’.⁴⁸⁴ Westpac also accepted that it did not take any steps ‘to independently verify a customer’s declared, estimated expenses in the context of auto finance applications’.⁴⁸⁵ In addition, Westpac submitted that customer expenses were so difficult to verify that only customers themselves could verify their expenses as accurate.⁴⁸⁶ Against those admissions, it is difficult

⁴⁸⁰ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 8 [32].

⁴⁸¹ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 8 [35].

⁴⁸² Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 8 [37].

⁴⁸³ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 6 [24].

⁴⁸⁴ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 9 [28].

⁴⁸⁵ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 9 [28].

⁴⁸⁶ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 9 [28]–[29].

to see how Westpac could have met its obligation to verify expenses, as Westpac submitted it had done, unless Westpac considered that that obligation had no content. In Ms Thiruvangadam's case, Westpac acknowledged that instead of seeking to verify Ms Thiruvangadam's expenses, or even making further inquiries as to their improbable quantification of 'zero', Westpac used the HPI benchmark as a proxy.⁴⁸⁷ As noted in Chapter 2 of this report, use of the HEM, or an equivalent, measure does not constitute verification of a customer's expenditure. To the contrary, it may often mask a customer's true financial position. In my view, it follows that Westpac did not satisfy its obligation to verify Ms Thiruvangadam's expenditure.

The acknowledged facts are difficult to reconcile with Westpac's submission that it made reasonable inquiries about Ms Thiruvangadam's financial situation, including her expenses, through the Dealer Business Manager. According to Westpac, 'although the Dealer Business Manager asked relevant questions, he did not accurately record all of Ms Thiruvangadam's responses'.⁴⁸⁸ This seems to be an understatement. The loan application, filled out and submitted by the business manager, listed Ms Thiruvangadam's expenses as zero, listed her income and employment status in a manner that was inconsistent with the attached payslip, and understated Ms Thiruvangadam's debts.⁴⁸⁹

Three points can then be made.

First, if, as Westpac submitted, it had in 2012 'detailed policies, processes and controls in place to ensure that Dealer Business Managers made reasonable inquiries about a customer's financial situation, gathered appropriate supporting documents and information and conveyed those to [St George]',⁴⁹⁰ those policies, processes and controls appear to have failed in the case of Ms Thiruvangadam.

⁴⁸⁷ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 9 [30].

⁴⁸⁸ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 5 [20].

⁴⁸⁹ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 1–2 [4].

⁴⁹⁰ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 3 [9].

Second, if the dealer did make inquiries as to Ms Thiruvangadam's expenses and other aspects of her finances – which, according to her, he did⁴⁹¹ – those inquiries cannot be treated as fulfilling Westpac's responsible lending obligations unless the responses to those inquiries find their way into, and are considered as part of, the loan application.

Third, it flows from the previous two points that Westpac's submission that the loan to Ms Thiruvangadam was not necessarily unsuitable on the basis of the inquiries conducted at the time cannot be accepted.⁴⁹² The distinction that appears to be made in the submission between a loan that was not unsuitable when approved, but was unsuitable once all relevant information came to light, is elusive at best.

9.3.4 Redress

Ms Thiruvangadam was granted a six-week period of hardship moratoriums on her repayments, but her further requests for hardship were declined. Ms Thiruvangadam was not released from the contract and remediated until after she engaged legal assistance, approximately five years after the loan was approved. In those circumstances, I do not accept Westpac's submission that 'the mechanisms for redress in relation to Ms Thiruvangadam were effective and appropriate'.⁴⁹³

10 ANZ car loans

10.1 Background

This case study considered the provision of car finance by ANZ, particularly under the Esanda Dealer Finance portfolio. Mr Guy Mendelson, General Manager, Small Business Bank at ANZ, gave evidence in this case study.

⁴⁹¹ Exhibit 1.138, Witness statement of Nalini Devi Thiruvangadam, 15 March 2018, 5 [18]–[19].

⁴⁹² Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 8 [34].

⁴⁹³ Westpac, *Westpac Banking Corporation – Submissions on Auto Finance Case Study*, 3 April 2018, 11 [49].

10.2 Evidence

Prior to the completion of its sale to the Macquarie Group Limited in 2016, Esanda was owned by ANZ.⁴⁹⁴ Mr Mendelson gave evidence of a number of instances of possible misconduct or conduct falling below community standards and expectations that were engaged in by Esanda under ANZ's ownership.

One such instance related to loan applications submitted by car finance brokers in the name of individuals who were not going to get the benefit of the car, but rather who had agreed to guarantee the loan.⁴⁹⁵ This may have taken place because the guarantor was 'generally a better quality customer'.⁴⁹⁶ This was referred to as the 'guarantor swap' incident. ANZ acknowledged that this constituted misconduct, and that the systems Esanda had in place were 'ineffective in this regard'.⁴⁹⁷ ANZ has since discredited the responsible broker and, since 2017, has made changes to its systems so that a guarantor cannot be listed as the loan applicant.⁴⁹⁸ ANZ paid \$753,000 of remediation in relation to this issue.⁴⁹⁹

Another instance related to conduct that was the subject of recent proceedings, which I will refer to as the Esanda proceeding. In February 2018, ASIC secured civil penalties of \$5 million in respect of ANZ's breaches of the NCCP Act.⁵⁰⁰ The underlying conduct related to ANZ's failure to verify borrowers' pay slips when providing loans to 12 (representative) applicants who were introduced to ANZ by three third party intermediaries, in circumstances where Esanda had reason to doubt the reliability of that information.⁵⁰¹ ANZ accepted that during the period from July 2013 to May 2015, being the period that was the focus of the civil penalty proceeding, ANZ more generally 'failed to take

⁴⁹⁴ Transcript, Guy Samuel Mendelson, 22 March 2018, 800; Exhibit 1.149, Witness statement of Guy Samuel Mendelson, 4 May 2018, 3 [12], 4 [15].

⁴⁹⁵ Transcript, Guy Samuel Mendelson, 22 March 2018, 831.

⁴⁹⁶ Transcript, Guy Samuel Mendelson, 22 March 2018, 831.

⁴⁹⁷ Transcript, Guy Samuel Mendelson, 22 March 2018, 833.

⁴⁹⁸ Transcript, Guy Samuel Mendelson, 22 March 2018, 832–4.

⁴⁹⁹ Transcript, Guy Samuel Mendelson, 22 March 2018, 835.

⁵⁰⁰ *ASIC v Australia and New Zealand Banking Group Limited* [2018] FCA 155.

⁵⁰¹ Transcript, Guy Samuel Mendelson, 22 March 2018, 836.

reasonable steps to verify the financial situations of [other] consumers' affected by these issues.⁵⁰² ANZ expects to remediate approximately 320 customers in respect of similar conduct by the relevant third party intermediaries from 2013 to 2015, amounting to approximately \$5 million.⁵⁰³ In the evidence that it provided to the Commission, ANZ accepted that the processes it had in place to detect payslip fraud as at May 2015 were 'deficient'.⁵⁰⁴

The Commission also received evidence about ANZ's loan origination processes more generally. ANZ gave evidence that Esanda loan applications were received by ANZ by the completion of an electronic application form contained within the Esanda Lending System.⁵⁰⁵ Despite the sale of Esanda to Macquarie, at the time of the hearings, ANZ continued to use the Esanda Lending System in respect of consumer asset finance applications.⁵⁰⁶

The dealers through whom ANZ offered loans were, at least predominantly, operating under the point of sale exemption contained in Regulation 23 of the National Consumer Credit Protection Regulations 2010 (Cth).⁵⁰⁷ Much like Westpac's relationship with its dealer intermediaries, the structure of the relationship between ANZ and its dealers was such that it was necessary for dealers to '[comply] ... with their obligations to ANZ ... if ANZ was to comply with its obligations under the [NCCP Act]'.⁵⁰⁸

ANZ's processes upon receiving information from its dealer intermediaries about consumer asset finance applications can be summarised by the following general propositions. ANZ required customers to supply documentation 'to verify the income figure stated in the loan application'.⁵⁰⁹ ANZ did not have any 'formal mechanism' to verify information provided

⁵⁰² Transcript, Guy Samuel Mendelson, 22 March 2018, 836.

⁵⁰³ Exhibit 1.150, 29 January 2018, ANZ Submission, 29 January 2018, 1–2 [6.49].

⁵⁰⁴ Transcript, Guy Samuel Mendelson, 22 March 2018, 803.

⁵⁰⁵ Transcript, Guy Samuel Mendelson, 22 March 2018, 807; Exhibit 1.149, Witness statement of Guy Samuel Mendelson, 4 March 2018, 5 [19].

⁵⁰⁶ Transcript, Guy Samuel Mendelson, 22 March 2018, 807, 824.

⁵⁰⁷ Transcript, Guy Samuel Mendelson, 22 March 2018, 808.

⁵⁰⁸ Transcript, Guy Samuel Mendelson, 22 March 2018, 811.

⁵⁰⁹ Transcript, Guy Samuel Mendelson, 22 March 2018, 827.

by customers about their expenses.⁵¹⁰ It employed HEM as a benchmark, and used certain sensitised calculations in relation to housing and credit card expenses,⁵¹¹ but it did not undertake any more general 'inquiry or verification' of expenses.⁵¹²

In his evidence, Mr Mendelson addressed the remuneration structures used by ANZ both when it owned the Esanda business and at the time of the hearings. In relation to flex commissions, ANZ accepted that for the period that it permitted its intermediaries to charge those commissions, the intermediary had an incentive to increase the price of the credit contract in a way that did not 'actually relate' to the credit risk posed by the customer.⁵¹³ The only matter that was disclosed to customers in relation to flex commissions was what the applicable interest rate was.⁵¹⁴ ANZ acknowledged that while flex commissions were charged, the intermediary had a conflict of interest.⁵¹⁵ ANZ's evidence was that Esanda had some monitoring practices that may have been directed to managing that conflict of interest.⁵¹⁶ In December 2017, ANZ adopted ASIC's recommendation that interest would be charged at a transparent rate that could not be inflated, but could be deflated by the intermediary at their discretion.⁵¹⁷

Mr Mendelson also gave evidence in relation to add-on insurance offered in connection with ANZ consumer asset finance. In approximately April 2016, after the sale of the Esanda business, ANZ undertook a full review of its insurance product offerings.⁵¹⁸ As a result of that review, it withdrew from selling all but two add-on insurance products, being comprehensive car insurance and loan protection insurance.⁵¹⁹ ANZ made that decision

⁵¹⁰ Transcript, Guy Samuel Mendelson, 22 March 2018, 827.

⁵¹¹ Transcript, Guy Samuel Mendelson, 22 March 2018, 827.

⁵¹² Transcript, Guy Samuel Mendelson, 22 March 2018, 828.

⁵¹³ Transcript, Guy Samuel Mendelson, 22 March 2018, 818.

⁵¹⁴ Transcript, Guy Samuel Mendelson, 22 March 2018, 819.

⁵¹⁵ Transcript, Guy Samuel Mendelson, 22 March 2018, 820.

⁵¹⁶ Transcript, Guy Samuel Mendelson, 22 March 2018, 820.

⁵¹⁷ Transcript, Guy Samuel Mendelson, 22 March 2018, 815–16, 820.

⁵¹⁸ Transcript, Guy Samuel Mendelson, 22 March 2018, 822.

⁵¹⁹ Transcript, Guy Samuel Mendelson, 22 March 2018, 821.

because it was not ‘comfortable ... that the customer was getting value’;⁵²⁰ it took the view that the ‘claim rates on the remaining insurance products ... were nowhere near an acceptable level or an industry level’, in terms of premiums paid as against claims paid out.⁵²¹

On about 16 March 2018, approximately a week before Mr Mendelson gave evidence, ANZ announced an intention to suspend providing new secured asset finance loans for retail customers in Australia as of 30 April 2018.⁵²² In the accompanying media release, ANZ stated that the suspension would be in place ‘while it undertakes a detailed review of its business’.⁵²³

10.3 What the case study showed

ANZ accepted that the conduct the subject of the Esanda proceeding ‘fell below [community standards and expectations] and contravened ss 128 and 130(1) of the NCCP Act’.⁵²⁴ ANZ acknowledged that it ‘had reason to doubt the reliability of information it was receiving from the three third party intermediaries’ and ‘ought to have taken steps to verify the stated income figures by reference to source documentation other than payslips alone’.⁵²⁵ The acknowledged breaches of statutory provisions such as Sections 128 and 130 of the NCCP Act constituted misconduct.

As previously discussed, the Esanda proceeding involved 12 (representative) loan applications. Beyond the four corners of that proceeding, ANZ has agreed to remediate 320 customers who suffered loss by reason of the fraud of the same three intermediaries involved in that proceeding.⁵²⁶ ANZ has also agreed to compensate 70 customers in respect of the guarantor swap incident, in which finance was provided by

⁵²⁰ Transcript, Guy Samuel Mendelson, 22 March 2018, 823.

⁵²¹ Transcript, Guy Samuel Mendelson, 22 March 2018, 822; see also Transcript, Guy Samuel Mendelson, 22 March 2018, 823–4.

⁵²² Transcript, Guy Samuel Mendelson, 22 March 2018, 845–6.

⁵²³ Transcript, Guy Samuel Mendelson, 22 March 2018, 846; Exhibit 1.152, 16 March 2018, ANZ Media Release dated 16/03/2018.

⁵²⁴ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 23 [5.12].

⁵²⁵ ANZ, *ANZ’s Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 23 [5.12].

⁵²⁶ Transcript, Guy Samuel Mendelson, 22 March 2018, 842.

Esanda in circumstances where the borrower's information had been swapped with the information of a more creditworthy guarantor.⁵²⁷

ANZ submitted that neither it, nor its employees, were 'party to the frauds' the subject of the Esanda proceeding and the remediations discussed above.⁵²⁸ On that basis, it said, there could be no finding that ANZ's conduct was 'inefficient, dishonest or unfair in the provision of consumer motor vehicle asset finance'.⁵²⁹ ANZ's submission raises questions, common to all of the case studies involving intermediaries, of whether and when the defaults of intermediaries can put an ACL holder (or an AFSL holder) in breach of its statutory obligations.

ANZ's submission distinguishes between the legal consequences of dishonest behaviour by its employees and dishonest behaviour by intermediaries. That is, it seeks to attach significance to whether the wrongdoer was an employee as distinct from an intermediary. The intermediaries were expected to collect customer information and carry out most, if not all, of the customer interactions that go to fulfilling ANZ's responsible lending obligations. But the statutory obligations in issue were ANZ's. (The intermediary's obligations were contractual.) Whether the person who filled in the wrong information was an employee or not is irrelevant.

10.3.1 Flex commissions and add-on insurance

In its written submissions following the first round of hearings, ANZ submitted that the Commission had not heard evidence to support a finding that ANZ's financing of add-on insurance products fell short of community standards and expectations.⁵³⁰ Three points should be made.

First, in its initial submission to the Commission, ANZ acknowledged that the intermediary involved in the guarantor swap incident had also sold add-on products 'to some borrowers without their knowledge or consent.

⁵²⁷ Transcript, Guy Samuel Mendelson, 22 March 2018, 798.

⁵²⁸ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 23 [5.13(a)].

⁵²⁹ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 23 [5.13(a)].

⁵³⁰ ANZ, *ANZ's Submission on Findings and Questions Arising from Case Studies Involving ANZ*, 3 April 2018, 24 [5.13(f)].

The premiums inflated the amount they borrowed, thus increasing the overall amount of interest paid by borrowers.⁵³¹ ANZ's evidence was that this conduct was brought to its attention by ASIC.⁵³²

Second, also in its initial submission to the Commission, ANZ advised that Esanda identified in 2012 that its financing of tyre and rim insurance premiums was not compliant with the NCCP Act.⁵³³ As a result, it refunded about \$5.3 million to customers, and thereafter ceased funding that type of insurance.⁵³⁴

Third, in April 2016, ANZ reduced the scope of its financing of add-on insurance products, from around seven different types of products to two types.⁵³⁵ Mr Mendelson's evidence was that the reason ANZ restricted its sales of certain types of add-on insurance was that 'the claim rates on the remaining insurance products ... were nowhere near an acceptable level or an industry level'.⁵³⁶

This evidence suggests, at least, that ANZ considered it should cease providing most types of add-on insurance because it had led to conduct by others that fell short of community standards and expectations. And insofar as Esanda or ANZ's intermediaries were in breach of the NCCP Act or other laws in relation to sales of add-on insurance, this would have constituted misconduct. On balance, however, I think that ANZ was right to say that its conduct (as distinct from the conduct of its intermediaries) was not below what the community expected.

ANZ ceased offering flex commissions in December 2017. Mr Mendelson agreed unreservedly, and rightly, that an intermediary working under a flex commission had a conflict of interest.⁵³⁷ As I noted in relation to the

⁵³¹ Exhibit 1.150, 29 January 2018, ANZ Submission, 29, fn 46.

⁵³² Exhibit 1.149, Witness statement of Guy Samuel Mendelson, 4 March 2018, 18 [78].

⁵³³ ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 35 [6.86].

⁵³⁴ ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 35 [6.86].

⁵³⁵ Transcript, Guy Samuel Mendelson, 22 March 2018, 821–2.

⁵³⁶ Transcript, Guy Samuel Mendelson, 22 March 2018, 821–2.

⁵³⁷ Transcript, Guy Samuel Mendelson, 22 March 2018, 820.

Westpac case study, ASIC's pending prohibition on flex commissions is a strong indication that their use falls short of community standards and expectations.

11 CBA credit cards

11.1 Background

This case study involved CBA's lending practices with respect to credit cards and credit card limit increases. Evidence was given by Mr David Harris, who provided a public submission to the Commission, and by Mr Clive van Horen, the Executive General Manager, Retail Products within the Retail Banking Services Business Unit of CBA.

11.2 Evidence

CBA credit card applications were 'completed using either a Long Form, Medium Form or Short Form application process'.⁵³⁸ The process to be used depended upon CBA's 'assessment of the customer's eligibility, using information CBA held about an existing customer'.⁵³⁹

A CBA customer would be eligible to use the short form application if, amongst other things, their salary was deposited into a CBA account and passed CBA's credit card pre-servicing assessment.⁵⁴⁰ In the short form application, CBA would automatically derive the customer's income based on the information in their CBA account, and would ask the customer to confirm whether that derivation was correct.⁵⁴¹ The customer would then declare their expenses, liabilities and number of dependents, and would be required to pass an external credit check.⁵⁴² The process differed for

⁵³⁸ Exhibit 1.161, Witness statement of Mr Clive van Horen, 22 March 2018, 2 [12].

⁵³⁹ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 2 [12].

⁵⁴⁰ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 3 [16].

⁵⁴¹ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 3 [16]; Transcript, Clive Richard van Horen, 22 March 2018, 873.

⁵⁴² Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 3 [16], 4 [25(e)]; Transcript, Clive Richard van Horen, 22 March 2018, 873–5.

the medium form and long form applications.⁵⁴³ The detail of the differences need not be recorded here.

After collecting information from the customer, CBA would verify information provided by a customer about their liabilities against CBA's own data relating to a customer's liabilities and income, but would not verify the information against liabilities to other financial institutions, unless customers fell below a certain income or risk score threshold.⁵⁴⁴ CBA would not take any steps to verify the customer's living expenses (although the customer's declared living expenses were compared against the income-based HEM, and the higher would be used in the serviceability assessment).⁵⁴⁵

Mr van Horen was asked about CBA's compliance with ASIC Regulatory Guide 209 in connection with CBA's inquiries into a customer's discretionary spending. At [209.33(a)], the Guide provides that '[d]epending on the circumstances of the particular consumer, and the kind of credit contract ... they may acquire', reasonable inquiries as to their financial situation could include 'the consumer's other expenditure that may be discretionary (such as entertainment, take-away food, alcohol, tobacco and gambling)'.⁵⁴⁶ Mr van Horen said that 'in many cases', CBA could identify when its customers spent large sums on such discretionary products, but that it may not be possible to do so in some cases, including where customers held accounts with other banks or where the descriptions used to identify merchants are not clear.⁵⁴⁷ As to whether the bank *should* do anything when its customers spend large sums on such discretionary products, Mr van Horen referred to the concept of scalability, noting that the Regulatory Guide requires CBA to 'have regard to the complexity of the facility' and 'the size of the loan' in assessing what constitutes reasonable inquiries.⁵⁴⁸

⁵⁴³ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 3 [18]–[23].

⁵⁴⁴ Transcript, Clive Richard van Horen, 22 March 2018, 874, 881.

⁵⁴⁵ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 4 [25(g)], [25(h)]; Transcript, Clive Richard van Horen, 22 March 2018, 874, 881; see also CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 20 [99(b)].

⁵⁴⁶ ASIC Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct.

⁵⁴⁷ Transcript, Clive Richard van Horen, 22 March 2018, 877–8.

⁵⁴⁸ Transcript, Clive Richard van Horen, 22 March 2018, 878.

After gathering these types of information, CBA would undertake a serviceability assessment. This assessment was predominantly an automated process, which took into account the customer's financial position and the customer's 'servicing surplus'.⁵⁴⁹ The servicing surplus was generated by deducting expenses from income.⁵⁵⁰ CBA's minimum serviceability requirement was that a customer have a 'surplus' that was the higher of 2.5% of their credit card limit or \$25.⁵⁵¹ Mr van Horen explained that the rationale for selecting 2.5% was that the minimum repayment on any credit card is 2% of the outstanding balance, so the additional 0.5% acts as a 'small buffer'.⁵⁵² In Mr van Horen's view, it was reasonable for CBA to assess a customer's suitability for a credit card on the basis that the customer had at least a \$25 servicing surplus in their account each month.⁵⁵³ It seems to follow that CBA treated a person as not in substantial hardship if the person had \$25 surplus available after meeting expenses.

Ultimately, Mr van Horen accepted that CBA's decision as to an appropriate credit limit for a customer was based upon the assumption, subject to certain caveats, that 'the customer [was] taking a limit which if used once and once only, would take of the order of more than five years' to repay via minimum repayments.⁵⁵⁴

In relation to credit limit increases, CBA pre-assessed customers' eligibility for credit limit increases in advance of the customer applying for the credit (that is, CBA took this step of its own motion).⁵⁵⁵ In order to be eligible for a credit limit increase, CBA would assess whether the customer's average repayments in the last six months were equal to or greater than 2% of

⁵⁴⁹ Transcript, Clive Richard van Horen, 22 March 2018, 881; Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 5 [25(k)].

⁵⁵⁰ Transcript, Clive Richard van Horen, 22 March 2018, 881.

⁵⁵¹ Transcript, Clive Richard van Horen, 22 March 2018, 882; Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 5 [25(k)].

⁵⁵² Transcript, Clive Richard van Horen, 22 March 2018, 882.

⁵⁵³ Transcript, Clive Richard van Horen, 22 March 2018, 883.

⁵⁵⁴ Transcript, Clive Richard van Horen, 22 March 2018, 889.

⁵⁵⁵ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 6–7 [29], [33].

the potential new credit limit.⁵⁵⁶ CBA's credit limit increase strategy was 'built on [the] premise [that CBA] would rather start with a lower[,] more conservative credit limit ... and then, based on actual behaviour, in other words, customers demonstrating their ability to manage that debt comfortably, [CBA would] offer increases to those credit limits over time'.⁵⁵⁷

Turning to the evidence specific to Mr Harris' case, Mr Harris obtained his first credit card from CBA towards the end of 2014.⁵⁵⁸ Not long after obtaining that credit card, he began to gamble beyond his means, including by obtaining cash advances on his credit card, transferring that money to another CBA account, and then using that money for gambling purposes.⁵⁵⁹ In the course of 2015, Mr Harris obtained two further credit cards from CBA, with limits of \$7,000 and \$8,000 respectively,⁵⁶⁰ and obtained a credit card limit increase in respect of the first credit card that he obtained from CBA.⁵⁶¹

In about April 2016, Mr Harris consolidated his three CBA credit cards into one card, with a credit limit of \$27,100.⁵⁶² That month, Mr Harris also incurred his first directly gambling-related expenses on his CBA credit card.⁵⁶³

In October 2016, during a call to CBA about an unrelated matter, a CBA staff member informed Mr Harris that he was conditionally approved for a credit limit increase.⁵⁶⁴ During that phone call, Mr Harris informed CBA of

⁵⁵⁶ Exhibit 1.161, Witness statement of Clive Richard van Horen, 22 March 2018, 7 [33(d)].

⁵⁵⁷ Transcript, Clive Richard van Horen, 22 March 2018, 884; see also Transcript, Clive Richard van Horen, 22 March 2018, 886, 890.

⁵⁵⁸ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 1–2 [6]–[7]; Transcript, David James Harris, 22 March 2018, 863.

⁵⁵⁹ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 2 [10]; Transcript, David James Harris, 22 March 2018, 863–4.

⁵⁶⁰ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 2–3 [12]–[15]; Transcript, David James Harris, 22 March 2018, 864.

⁵⁶¹ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 3 [17]; Transcript, David James Harris, 22 March 2018, 864.

⁵⁶² Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 4 [20]; Transcript, David James Harris, 22 March 2018, 865.

⁵⁶³ Transcript, Clive Richard van Horen, 22 March 2018, 893.

⁵⁶⁴ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 4 [22].

his gambling problem.⁵⁶⁵ Mr van Horen admitted that the information CBA received from Mr Harris about his gambling problem was ‘not in any way passed through to credit decisioning systems’ at CBA,⁵⁶⁶ or to CBA’s ‘credit models’.⁵⁶⁷ At the time of the hearings, CBA’s systems remained unchanged in that regard, although Mr van Horen recognised that developing this level of sophistication was ‘clearly something that [CBA] need[ed] to do’.⁵⁶⁸ Mr van Horen also accepted that CBA did not use the information provided by Mr Harris about his gambling problem when assessing whether to make the subsequent credit offer referred to below.⁵⁶⁹

Ten days after the phone call, CBA sent Mr Harris a letter inviting him to increase his credit limit.⁵⁷⁰ Another similar letter was sent soon after.⁵⁷¹ In early 2017, Mr Harris applied for, and was offered, a credit limit increase of \$8,000, taking his credit limit to \$35,100.⁵⁷² Mr van Horen’s evidence was that \$8,000 was the maximum credit limit increase offered by CBA.⁵⁷³ He acknowledged that CBA should not have approved this credit limit increase to Mr Harris.⁵⁷⁴

Mr Harris has since been remediated, as described further below.

⁵⁶⁵ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 4 [22]; Transcript, David James Harris, 22 March 2018, 865.

⁵⁶⁶ Transcript, Clive Richard van Horen, 22 March 2018, 876.

⁵⁶⁷ Transcript, Clive Richard van Horen, 22 March 2018, 896.

⁵⁶⁸ Transcript, Clive Richard van Horen, 22 March 2018, 896.

⁵⁶⁹ Transcript, Clive Richard van Horen, 22 March 2018, 876.

⁵⁷⁰ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 5 [24]; Transcript, David James Harris, 22 March 2018, 865; see also Transcript, Clive Richard van Horen, 22 March 2018, 896.

⁵⁷¹ Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 5 [25]; Transcript, David James Harris, 22 March 2018, 866.

⁵⁷² Exhibit 1.160, Witness statement of David James Harris, 18 March 2018, 5 [25]; Transcript, David James Harris, 22 March 2018, 866.

⁵⁷³ Transcript, Clive Richard van Horen, 22 March 2018, 876.

⁵⁷⁴ Transcript, Clive Richard van Horen, 22 March 2018, 876.

11.3 What the case study showed

First, CBA accepted that it should have used the information Mr Harris had provided regarding his gambling problems, and his intent to get them under control before taking up any further offers of credit, before it decided whether to offer him any further credit.⁵⁷⁵

Second, CBA accepted that, 'following the particular circumstances of Mr Harris' disclosure of his gambling problem', it breached its obligation under Section 128(b) of the NCCP Act in relation to Mr Harris.⁵⁷⁶

Third, CBA accepted that in failing to make any use of Mr Harris's disclosure and his intention to take up the increase when he had his gambling under control, it did not comply with ASIC Regulatory Guide 209, and specifically RG209.90.⁵⁷⁷ As this Regulatory Guide constitutes 'a recognised and widely accepted benchmark for meeting the responsible lending obligations in the NCCP Act',⁵⁷⁸ CBA's accepted failure to comply constituted 'misconduct' within the Commission's Terms of Reference.

Fourth, CBA at least implicitly accepted that in granting a credit limit increase to Mr Harris after he disclosed his gambling problem, it failed to comply with Clause 27 of the Code of Banking Practice, which required it to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and forming an opinion about Mr Harris's ability to repay his credit card.

CBA also accepted that in inviting Mr Harris to apply for, and subsequently providing Mr Harris with, a credit limit increase after he had disclosed his gambling problem to CBA, its conduct fell short of community standards and expectations.⁵⁷⁹ CBA was right to make the admissions it made about its conduct.

⁵⁷⁵ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 22 [107].

⁵⁷⁶ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 22 [108].

⁵⁷⁷ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 22 [110]–[111].

⁵⁷⁸ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 22 [109].

⁵⁷⁹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 23 [114].

11.3.1 CBA systems

CBA accepted that its internal systems and processes, at least as they existed at the time of the hearings, were deficient as they did not ‘flag’ a self-disclosure of a gambling problem and did not operate to automatically factor in such information into CBA’s credit models.⁵⁸⁰ That is something CBA acknowledged it ‘had to work on’.⁵⁸¹

All the same, CBA did not give any indication that it was presently working, or planned to, work on this.⁵⁸² Mr Harris gave evidence that ‘two of the hardest things you can do when you are suffering from an addiction is, one, admit you have a problem and, two, reach out for help, and in the phone call with Commonwealth, I tried to do both ... I tried to reach out for help and I didn’t get any. I got the opposite.’⁵⁸³ CBA’s systems and processes, as they stood at the time of the hearings, were not equipped to adequately deal with people in situations such as Mr Harris’s, even when they explicitly sought assistance from CBA.

Furthermore, CBA’s collections systems were such that CBA continued to contact Mr Harris asking for documentation to complete his hardship agreement, despite the fact that a hardship agreement was already in place.⁵⁸⁴ Those systems also resulted in Mr Harris being sent a letter declining his hardship request, again some months after a hardship agreement had been put in place.⁵⁸⁵ CBA accepted that its collections systems ‘have not been state of the art’ and were in the process of an upgrade due to be completed in mid-2019.⁵⁸⁶

⁵⁸⁰ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 23 [119].

⁵⁸¹ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 23 [119].

⁵⁸² Mr van Horen gave evidence about a ‘very, very significant investment project’ to update its ‘collections environment’, but this evidence appeared to be confined to CBA’s collections activity: Transcript, Clive Richard van Horen, 22 March 2018, 897 line 43 to 898 line 2.

⁵⁸³ Transcript, David James Harris, 22 March 2018, 867.

⁵⁸⁴ Transcript, David James Harris, 22 March 2018, 867.

⁵⁸⁵ Transcript, Clive Richard van Horen, 22 March 2018, 897.

⁵⁸⁶ CBA, *Round 1 Hearing – Consumer Lending Closing Submissions*, 3 April 2018, 23 [120].

11.3.2 Assessment of customer's needs and requirements

The case of Mr Harris directs attention to the practices of CBA, and other banks which follow similar procedures, in pre-approving and providing credit cards and credit limit increases to customers. CBA's system sent invitations for pre-assessed credit to customers who had opted in to such correspondence. It is not clear that such an opt-in from a customer is sufficient indication that they require a line of credit in the specific form of a credit card or credit limit increase.

12 Westpac credit card limit increases

12.1 Background

In the period from September 2012 to December 2014, Westpac sent to certain existing credit card customers offers inviting them to increase their credit limit up to a maximum amount.⁵⁸⁷ Approximately 840,000 offers were sent,⁵⁸⁸ and 183,154 credit card limit increases were approved by Westpac as a result of customers accepting the offer.⁵⁸⁹ Westpac's estimate of the profits made on a particular cohort of credit limit increases, which are discussed below, was about \$23 million.⁵⁹⁰

12.2 Evidence

Mr William Malcolm, Westpac's General Manager, Credit, told the Commission that in the relevant period, Westpac relied on an automated process to determine the eligibility of customers for an increase.⁵⁹¹ The

⁵⁸⁷ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-7 [WBC.104.002.0001]; Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-8 [WBC.104.002.0003].

⁵⁸⁸ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 16 [73]; Transcript, William David Malcolm, 23 March 2018, 919.

⁵⁸⁹ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 17 [74]; Transcript, William David Malcolm, 23 March 2018, 919.

⁵⁹⁰ Exhibit 1.176, 18 June 2015, ASIC Note dated 18 June 2015 1 [4].

⁵⁹¹ Transcript, William David Malcom, 23 March 2018, 919.

process entailed an assessment of the customer's credit risk having regard to, first, the information held by Westpac across its portfolios about the customer and, second, behavioural data analytics.⁵⁹² In Westpac's view, this process allowed it to assess both the default risk associated with a potential credit limit increase and whether the increase was not unsuitable for the customer.⁵⁹³ The measure of serviceability adopted by Westpac was based on the customer's ability to make the minimum repayment if the full amount of the credit limit was withdrawn, with a buffer of 0.5%.⁵⁹⁴ This assessment was based on the average repayment made to the customer's credit card account across the previous four months.⁵⁹⁵

Customers who met certain serviceability thresholds were classified as requiring 'No Further Credit Assessment' and were sent an offer letter.⁵⁹⁶ In this situation, Westpac did not request any further information about the customer's financial situation,⁵⁹⁷ such as their employment status, income or expenses.⁵⁹⁸ A credit card limit increase was approved for each No Further Credit Assessment customer if the customer accepted Westpac's offer.⁵⁹⁹

Relevantly, the offer letter told customers to 'make sure you're comfortable with the higher monthly repayment' and to 'always aim to pay off more than your monthly minimum amount as making minimum payments is not

⁵⁹² Transcript, William David Malcom, 23 March 2018, 919; Exhibit 1.164, Witness statement of William David Malcom, 19 March 2018, 8 [32]–[33].

⁵⁹³ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 6 [26].

⁵⁹⁴ Transcript, William David Malcolm, 23 March 2018, 917–8.

⁵⁹⁵ Transcript, William David Malcolm, 23 March 2018, 918.

⁵⁹⁶ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-8 [WBC.104.002.0003]. A hard cut off also applied for customers with a low utilisation ration (defined as 10% or lower) on the basis that Westpac did not have sufficient information to conclude that the customer was capable of servicing a higher credit limit. See Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 7 [29], [31], 9–10 [41]–[42].

⁵⁹⁷ Transcript, William David Malcolm, 23 March 2018, 914.

⁵⁹⁸ Transcript, William David Malcolm, 23 March 2018, 914, 931.

⁵⁹⁹ Transcript, William David Malcolm, 23 March 2018, 914.

an effective way to manage your credit card debt'.⁶⁰⁰ The letter also told customers that if their circumstances had 'recently changed or are likely to change, or you think you wouldn't be able to afford the increased payments, you shouldn't apply for a credit limit increase'.⁶⁰¹ However, unless a customer informed Westpac of a change in their circumstances, such as by reason of contacting Westpac's Assist Team for assistance, or it was apparent from a customer's account, Westpac could generally not detect a negative change in the customer's circumstances.⁶⁰² Further, if the customer had only a credit card account with Westpac, the data held by Westpac for that customer would not inform Westpac of the customer's non-Westpac liabilities or current income. All that Westpac could know was whatever had been revealed in the initial credit card application.⁶⁰³

This process was in contrast to the approach that Westpac adopted for the other cohort of customers, who did not meet the relevant serviceability threshold. These customers, known as 'Further Credit Assessment' customers, were required to provide further financial information, including monthly salary and expenses in order to have their credit limit increase approved.⁶⁰⁴ However, the Further Credit Assessment customers comprised the minority – about 30%⁶⁰⁵ – of the total number of customers who were sent offers during the relevant period (about 1.16 million).⁶⁰⁶

Westpac considered that the totality of its automated process satisfied its obligation under the NCCP Act to make reasonable inquiries of customers, and that Westpac's inquiries were proportionate having regard to the size of the additional commitment that customers were taking on.⁶⁰⁷ Mr Malcolm expressed the view that scalability was a 'vexed area' during the relevant

⁶⁰⁰ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-8 [WBC.104.002.0003 at .0004].

⁶⁰¹ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-8 [WBC.104.002.0003 at .0004].

⁶⁰² Transcript, William David Malcolm, 23 March 2018, 920–1.

⁶⁰³ Transcript, William David Malcolm, 23 March 2018, 919.

⁶⁰⁴ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-7 [WBC.104.002.0001].

⁶⁰⁵ Transcript, William David Malcolm, 23 March 2018, 912–13.

⁶⁰⁶ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 13 [57].

⁶⁰⁷ Transcript, William David Malcolm, 23 March 2018, 919.

period of time and that ASIC's guidance in that regard required a 'degree of interpretation'.⁶⁰⁸ Westpac adopted an interpretation that resulted in minimal inquiries being made based on a perception that credit limit increases for the group in question entailed a 'low risk of default'.⁶⁰⁹

In September 2012, following discussions between ASIC and the Australian Bankers' Association, as well as directly with banks including Westpac,⁶¹⁰ ASIC wrote to the Policy Director of the Australian Bankers' Association setting out ASIC's view in relation to credit card limit increase invitations and credit providers' responsible lending obligations.⁶¹¹ ASIC's letter stated that, while it was useful to ask customers about recent or foreseeable changes to their financial circumstances, 'before approving a CLI [credit limit increase] application, card issuers should at least make inquiries about, and ascertain, a customer's current level of income and employment status'.⁶¹² As previously noted, Westpac did not make inquiries about income and employment status for the No Further Credit Assessment customers, comprising around 70% of customers to whom offers were sent.⁶¹³

Members of Westpac's credit risk, regulatory affairs and product teams discussed what approach should be adopted in respect of ASIC's letter.⁶¹⁴ In these discussions, it was noted that the cost-benefit associated with adopting changes would be 'unfavourable',⁶¹⁵ and might increase the likelihood of non-responses from customers.⁶¹⁶ The view of the product team was that Westpac should do nothing until ASIC issued a formal

⁶⁰⁸ Transcript, William David Malcolm, 23 March 2018, 929–30.

⁶⁰⁹ Transcript, William David Malcolm, 23 March 2018, 937.

⁶¹⁰ Transcript, William David Malcolm, 23 March 2018, 929.

⁶¹¹ Exhibit 1.170, 12 September 2012, Letter ASIC to ABA.

⁶¹² Exhibit 1.170, 12 September 2012, Letter ASIC to ABA, 2.

⁶¹³ Exhibit 1.171, 5 October 2012, Westpac email re ASIC Letter dated 05/10/2012; Transcript, William David Malcolm, 23 March 2018, 930–1.

⁶¹⁴ Exhibit 1.171, 5 October 2012, Westpac email re ASIC Letter dated 05/10/2012; Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-12 [WBC.099.001.2070].

⁶¹⁵ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-12 [WBC.099.001.2070 at .2074].

⁶¹⁶ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-12 [WBC.099.001.2070 at .2072].

request.⁶¹⁷ By contrast, the risk and regulatory affairs teams considered that such an approach was not an option.⁶¹⁸ In December 2012, Westpac decided that the existing process would be maintained.⁶¹⁹ Mr Malcolm accepted that the profits obtained from limit increase programs were one reason why WBC decided not to act as early as it ought to have in relation to ASIC's guidance.⁶²⁰

In early 2014, ASIC conducted an industry review focusing on credit card providers' invitations to customers to increase credit limits.⁶²¹ As part of that review, Westpac confirmed that it did not seek further income and expenditure information from 'No Further Credit Assessment' customers.⁶²² ASIC commenced an investigation into Westpac's processes in August 2014.⁶²³ In December 2014, following further amendments by ASIC to its Regulatory Guide that repeated the guidance provided by ASIC in its letter of September 2012, Westpac temporarily suspended credit limit increase invitations while it commenced implementing changes to its processes.⁶²⁴ Those changes took effect from around March 2015.⁶²⁵ Westpac's formal policies around responsible lending were not amended until 2016.⁶²⁶

⁶¹⁷ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-12 [WBC.099.001.2070 at .0271]; Transcript, William David Malcolm, 23 March 2018, 933.

⁶¹⁸ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-12 [WBC.099.001.2070 at .0270]; Transcript, William David Malcolm, 23 March 2018, 932.

⁶¹⁹ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-14 [WBC.050.097.6212].

⁶²⁰ Transcript, William David Malcolm, 23 March 2018, 954.

⁶²¹ Exhibit 1.172, 13 January 2014, ASIC Letter to Westpac.

⁶²² Exhibit 1.173, 9 September 2014, Letter Westpac to ASIC re Section 253 Notice dated 15/08/2014, 4; see also Exhibit 1.172, 13 January 2014, ASIC Letter to Westpac dated 13/01/2014, 2.

⁶²³ Exhibit 1.173, 23 August 2014, Letter Westpac to ASIC re Section 253 Notice.

⁶²⁴ Transcript, William David Malcolm, 23 March 2018, 943–4; Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 16 [71].

⁶²⁵ Transcript, William David Malcolm, 23 March 2018, 943–4.

⁶²⁶ Transcript, William David Malcolm, 23 March 2018, 944.

During 2014 and 2015, Westpac engaged in negotiations with ASIC in relation to its processes and the outcome that would follow from ASIC's investigation. In 2015, ASIC met with the Board of Westpac and its Chairman.⁶²⁷ ASIC expressed the view that Westpac had refused to change its practices until faced with the very direct threat of legal action.⁶²⁸ ASIC also considered that Westpac had ignored the position that ASIC had clearly set out in the letter of September 2012, and did not 'bother to engage with ASIC'.⁶²⁹ As a result, ASIC was unaware of Westpac's practices until it conducted its 'follow up review' 15 months later.⁶³⁰

Mr Malcolm's evidence was that, with the benefit of hindsight, the approach Westpac adopted to communicating with ASIC about the issues raised in the September 2012 letter was inappropriate in all the circumstances.⁶³¹ Mr Malcolm expressed the view that Westpac could have continued its existing practices, provided that it had informed ASIC and sought to convince ASIC that its practices were compliant.⁶³² However, Mr Malcolm also agreed that the better process would have been for Westpac to cease what it was doing and discuss its practices with the regulator.⁶³³ Mr Malcolm told the Commission that Westpac had strengthened its governance since that time.⁶³⁴

12.3 What the case study showed

Westpac accepted that its approach to engaging with ASIC 'was not appropriate'.⁶³⁵ Westpac acknowledged that the appropriate course would

⁶²⁷ Transcript, William David Malcolm, 23 March 2018, 946.

⁶²⁸ Transcript, William David Malcolm, 23 March 2018, 947; Exhibit 1.175, 28 May 2015, ASIC Speaking Notes for Meeting with Chairman of Westpac dated 28/05/2015, 1.

⁶²⁹ Exhibit 1.175, 28 May 2015, ASIC Speaking Notes for Meeting with Chairman of Westpac dated 28/05/2015, 3.

⁶³⁰ Exhibit 1.175, 28 May 2015, ASIC Speaking Notes for Meeting with Chairman of Westpac dated 28/05/2015, 3.

⁶³¹ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, 16 [68].

⁶³² Transcript, William David Malcolm, 23 March 2018, 952–3.

⁶³³ Transcript, William David Malcolm, 23 March 2018, 952.

⁶³⁴ Transcript, William David Malcolm, 23 March 2018, 950.

⁶³⁵ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 1 [3].

have been for it to have engaged with ‘more fully’ with ASIC about its views at the time.⁶³⁶ Westpac accepted that it fell short of community standards and expectations by not engaging with ASIC when it decided not to follow the guidance in ASIC’s September 2012 letter.⁶³⁷

Nonetheless, in Westpac’s submissions, Westpac emphasised that its view upon receiving the September 2012 letter was that its processes were consistent with the law.⁶³⁸ Its submissions also show that that view has not changed.⁶³⁹ But this view was seemingly not held by all within Westpac – at least, at the time that Westpac received ASIC’s letter. As Westpac’s submissions accept, in 2012, some teams believed that Westpac should change its credit limit increase processes,⁶⁴⁰ among them the risk and regulatory affairs teams. Westpac resolved the competing views on the side of profit, and did not communicate to ASIC its intention to maintain processes that were clearly contrary to guidance provided by ASIC. In doing so, Westpac may be seen to have exhibited a preference for profit over what ASIC considered to be appropriate practice.

12.3.1 Reasonable enquiries and verification

As noted above, Westpac’s position remains that offering credit limit increases based only on data it already holds about a customer is consistent with its responsible lending obligations.⁶⁴¹

Westpac submitted that the relevant standard for offering a credit limit increase to its customers was that the customer would be able to comply

⁶³⁶ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 1 [3].

⁶³⁷ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 17 [74].

⁶³⁸ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 1 [3].

⁶³⁹ See, eg, Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 14 [59], 15 [64], 16 [71].

⁶⁴⁰ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 4 [27].

⁶⁴¹ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 1 [3], 8 [34].

without ‘substantial hardship’.⁶⁴² Section 128(b) of the NCCP Act provides that an ACL holder must not increase the credit limit of a Consumer Credit Contract without, among other things, assessing that the contract will be not unsuitable for the consumer.⁶⁴³ Section 130(1)(b) and (c) requires the ACL holder to make reasonable inquiries about the consumer’s financial situation and take reasonable steps to verify their financial situation.⁶⁴⁴ Section 131 of the NCCP Act provides that a contract will be unsuitable if, at the time of the assessment, a customer will be unable to comply with their financial obligations under the contract, or could only comply with substantial hardship,⁶⁴⁵ or if the contract will not meet the consumer’s requirements or objectives.⁶⁴⁶ Section 133 provides that an ACL holder must not enter such a contract with a consumer.

The information on which Westpac based its assessment of No Further Credit Assessment customers’ potential substantial hardship was limited. Without asking those customers, Westpac could not know if the information it held was out of date or incomplete. In its submissions, Westpac submitted that according to ASIC Regulatory Guide 209, ‘in some cases no inquiries might be needed at all’,⁶⁴⁷ and ‘ASIC did not consider that it was reasonable or necessary to verify a customer’s income and employment status beyond verifying that information by asking the customer to inform the issuer of it or to ascertain that information from data held by the bank’.⁶⁴⁸ I do not agree with that reading of the Guide. The Guide relevantly states:⁶⁴⁹

We recognise that, in certain circumstances, some credit providers will be able to verify a consumer’s financial situation without receiving additional information from the consumer. For example, a bank could look at a

⁶⁴² Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 11 [49].

⁶⁴³ NCCP Act s128(b)(c), s129.

⁶⁴⁴ NCCP Act s130(1)(b)(c).

⁶⁴⁵ NCCP Act s131(2)(a).

⁶⁴⁶ NCCP Act s132(2)(b).

⁶⁴⁷ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 16 [72].

⁶⁴⁸ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 14 [61].

⁶⁴⁹ ASIC, Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct.

consumer's regular deposited salary, the timing of credit card payments, and the payment of other expenses. However, credit providers should take care relying on such information, which may not reflect the consumer's entire financial position – for example, if the consumer holds credit cards with other financial institutions.

For customers who held only a credit card with Westpac, Westpac had no access to information about their income or employment status. For customers who held credit cards or transaction accounts with other institutions, Westpac had no access to information about their other expenses. Westpac was capable of requesting this information from customers and did so from Further Credit Assessment customers. It chose not to 'burden' No Further Credit Assessment customers with this inquiry partly, if not wholly, because it did not want to reduce uptake rates for credit.⁶⁵⁰

Westpac made no inquiry at all about the requirements or objectives of No Further Credit Assessment customers before pre-approving their credit limit increases. Westpac's pre-approval of credit limit increases proceeded on the assumption that the customer needed a revolving line of credit in the form of a credit card. Yet Mr Malcolm's evidence was that credit cards ranged in their features and could have different functions for customers over time.⁶⁵¹ Mr Malcolm also recognised that a customer that wanted to borrow money for a specific purpose may be better off using a form of credit other than a credit card.⁶⁵² For this reason, and for the other reasons referred to above, I consider it problematic that Westpac's data about its customers was necessarily historical, and offered little or no understanding of the customers' requirements and objectives at the time of the credit limit increase.

Westpac submitted that its obligations to make inquiries and verify were limited by the scale of the credit limit increases, which were relatively small and simple in nature.⁶⁵³ I have discussed the concept of scalability in

⁶⁵⁰ Exhibit 1.164, Witness statement of William David Malcolm, 19 March 2018, Exhibit WDM-12 [WBC.099.001.2070].

⁶⁵¹ Transcript, William David Malcolm, 23 March 2018, 961.

⁶⁵² Transcript, William David Malcolm, 23 March 2018, 961; see also Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 18 [78].

⁶⁵³ Westpac, *Westpac Banking Corporation – Credit Card Limit Increase Submissions*, 3 April 2018, 13 [57].

Chapter 2 of this report. I note here again that responsible lending obligations cannot be scaled down to nothing. Even small credit contracts must be carried out in accordance with an entity's statutory obligations, such as those in the NCCP Act. Small credit amounts may have significant consequences for some customers.

13 Citi international transaction fees

13.1 Background

At the end of February 2018, Citi Australia (Citi) had about 1.2 million credit card accounts with a total balance of approximately \$5 billion.⁶⁵⁴ In 2017, Citi refunded approximately \$5 million to nearly 230,000 customers after it had not adequately disclosed the circumstances in which international transaction fees would be charged to its credit card holders.⁶⁵⁵ Among other things, Citi did not adequately disclose that international transaction fees would apply to transactions made in Australian dollars with merchants located in Australia, where the merchant processed the relevant payment overseas. The Commission received evidence in this case study from Citibank's Consumer Business Manager, Mr Alan Machet.

13.2 Evidence

At the time of the first round of hearings, Citi, as a member of the Visa and Mastercard card-based payment schemes, was charged a scheme foreign transaction fee when a Citi credit card customer completed a foreign currency transaction. Pursuant to its terms and conditions with customers, Citi passed on the charge to customers in the form of an international transaction fee.⁶⁵⁶

Prior to early 2016, Citi charged customers international transaction fees only on transactions denominated in a foreign currency.⁶⁵⁷ In December 2015, following changes by Visa and Mastercard to the scheme fees, Citi sent to its credit card customers a Variation Notice that informed them that

⁶⁵⁴ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 4 [17], [19].

⁶⁵⁵ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 14 [76]–[77].

⁶⁵⁶ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 5 [27]–[29].

⁶⁵⁷ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 6 [32].

Citi charged an international transaction fee on ‘any transaction made in foreign currency; or any transaction made with an overseas merchant’.⁶⁵⁸ Citi did not expressly inform customers that it would charge international transaction fees for transactions with an offshore merchant in circumstances where the website operated by the offshore merchant:

- quoted prices in Australian dollars;
- used an Australian web address; or
- otherwise contained no information to indicate that the merchant was located offshore.⁶⁵⁹

Further, Citi did not inform customers that they could be charged an international transaction fee in circumstances where the merchant was located in Australia, but the payment was processed by the merchant overseas.⁶⁶⁰

Citi began to charge customers such fees from January 2016 in relation to its Citi-branded cards and from March 2016 in relation to its partner-branded cards (which included Virgin Money, Bank of Queensland and Suncorp cards⁶⁶¹).⁶⁶²

In June 2016, Mr Machet became aware that another credit provider had made a change to its terms and conditions regarding disclosure of international transaction fees.⁶⁶³ Mr Machet understood that the effect of that change was to extend the application of the credit provider’s international transaction fees to transactions with overseas merchants.⁶⁶⁴ Mr Machet considered that as this issue was already covered by Citi’s

⁶⁵⁸ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 6 [34]; Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-3 [CIT.5200.0001.0141 at .0142].

⁶⁵⁹ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 7 [37(a)].

⁶⁶⁰ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 8 [37(b)].

⁶⁶¹ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 2 [7].

⁶⁶² Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 6–7 [34]–[35].

⁶⁶³ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 8 [39].

⁶⁶⁴ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 8 [39].

disclosure of its international transaction fees, no change was required to Citi's disclosures.⁶⁶⁵

In August 2016, ASIC contacted Citi about the circumstances in which it was charging international transaction fees.⁶⁶⁶ At this time, Mr Machet 'first became aware that there may be areas where [Citi's] disclosure to its customers' in relation to international transaction fees 'could be and should be improved'.⁶⁶⁷ Citi informed ASIC that it would update its terms and conditions regarding the disclosure.⁶⁶⁸ This amendment took place in January 2017.⁶⁶⁹ However, at that stage, aside from having refunded the fees paid by four or so customers, and recognising that more customers may need to be refunded, Citi did not propose undertaking any formal remediation program.⁶⁷⁰

Citi met with ASIC on 19 September 2016 to discuss remediation.⁶⁷¹ After discussions with ASIC, Citi and ASIC agreed upon the scope of Citi's remediation program.⁶⁷² Citi identified affected customers with Citi-branded and Citi partner-branded credit cards, and thereafter refunded customers the amount of the fee charged plus interest.⁶⁷³ In February and March 2017,

⁶⁶⁵ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 8 [39].

⁶⁶⁶ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-4 [CIT.5200.0001.0158].

⁶⁶⁷ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 8 [41].

⁶⁶⁸ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 10 [53]; Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-5 [CIT.5200.0001.0151 at .0153–.0154].

⁶⁶⁹ Citi, *Response of Citigroup Pty Limited and Associated Entities*, 29 January 2018, 20–1 [75(b)].

⁶⁷⁰ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 10 [53]; Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-5 [CIT.5200.0001.0151 at .0153].

⁶⁷¹ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 11 [55].

⁶⁷² Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-8 [CIT.5200.0001.0137]; Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-9 [CIT.5200.0002.1393].

⁶⁷³ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-10 [CIT.5200.0002.1400]; Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, Exhibit AM-10 [CIT.5200.0002.1402].

remediation payments totalling approximately \$5 million were made to 229,936 customers.⁶⁷⁴

13.3 What the case study showed

In Citi's initial submission to the Commission, this matter was identified as a 'reportable matter', being a matter that Citi considered might constitute misconduct or conduct falling below community standards and expectations.⁶⁷⁵ In supplementary submissions provided by Citi, Citi emphasised that it erred on the side of caution when determining what matters to include in its initial response.⁶⁷⁶ Citi said that it did not follow from the matter's inclusion in its initial submissions that Citi considered the matter to constitute misconduct or a breach of community expectations.⁶⁷⁷

In my view, however, Citi's conduct might have constituted misconduct: either because Citi's conduct might have breached the licensee's obligation under Section 47(1)(a) of the NCCP Act to do all things necessary to ensure that the credit activities authorised by its credit licence were engaged in efficiently, honestly and fairly, or because Citi's conduct might have breached Clause 3.2 of the Code of Banking Practice, in that Citi failed to act fairly and reasonably towards its customers in a consistent and ethical manner. Contrary to Citi's submissions, I am not persuaded that any moral turpitude, capricious dealing or lack of good faith is required for breaches of these provisions to be established.⁶⁷⁸ The touchstone of both provisions is fairness.

There is a genuine question whether Citi acted fairly when it did not clearly identify (whether in its contractual documents or otherwise)

⁶⁷⁴ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 14 [76]–[77]; see also Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 14 [72].

⁶⁷⁵ Citi, *Response of Citigroup Pty Limited and Associated Entities*, 29 January 2018, 3 [5], 20–1 [75(b)].

⁶⁷⁶ Citi, *International Transaction Fees Case Study Supplementary Submission*, 6 August 2018, 1 [2].

⁶⁷⁷ Citi, *International Transaction Fees Case Study Supplementary Submission*, 6 August 2018, 1 [2].

⁶⁷⁸ Citi, *Citi International Transaction Fees Case Study*, 3 April 2018, 6 [20], 7 [23]; Citi, *International Transaction Fees Case Study Supplementary Submission*, 6 August 2018, 5 [16(d)].

the circumstances in which customers would be charged international transaction fees. In this connection, it may be relevant to refer to Citi's Variation Notice, and its Notice sent to Partner Card customers, recording that international transaction fees would be charged on 'any transaction made with an overseas merchant', when the fact was that customers could also be charged an international transaction fee if the merchant was located in Australia, but processed the relevant payment overseas.⁶⁷⁹ Citi's recognition that its customers may have had difficulties identifying when they were transacting with an overseas merchant, or conducting a transaction that would be processed overseas,⁶⁸⁰ underscores the need for it to have used clearer and more precise language.

If these matters do not constitute misconduct, I consider that they do amount to conduct falling below community standards and expectations. Citi did not tell customers, clearly and accurately, the nature of, and basis for, the imposition of international transaction fees. As a result customers were not aware of international transaction fees being payable before the fees were charged. In its submissions, Citi accepted that its disclosure was 'imperfect',⁶⁸¹ but stated that the 'community does not expect perfection'.⁶⁸² I agree that the community does not and cannot expect perfection. But, in my view, the community does expect, and is entitled to expect, that terms and conditions relating to charges are sufficiently clear for customers to understand, in advance, the circumstances in which they will be charged fees. Citi did not do this.

⁶⁷⁹ Exhibit 1.183, Witness statement of Alan Saul Machet, 28 February 2018, 6–7 [34]–[35].

⁶⁸⁰ Citi, *International Transaction Fees Case Study Supplementary Submission*, 6 August 2018, 3 [8].

⁶⁸¹ Citi, *Citi International Transaction Fees Case Study*, 3 April 2018, 8 [26].

⁶⁸² cf Citi, *Citi International Transaction Fees Case Study*, 3 April 2018, 8 [28]; see also Citi, *International Transaction Fees Case Study Supplementary Submission*, 6 August 2018, 5 [17].

Case studies: Financial advice

1 Fees for no service: AMP

1.1 Background

The first case study in the second round of hearings concerned the charging of fees for no service by AMP Limited (AMP). Evidence was given by Mr Anthony (Jack) Regan, the AMP Group Executive of Advice and New Zealand. Mr Regan was the senior executive within the AMP Group responsible for the management of AMP's Advice business.¹

The Commission's initial inquiries into AMP's conduct centred on two types of misconduct: the charging of fees for no service and the reporting of that conduct to the regulator. In the course of the hearings, the second of those subjects widened to reveal larger issues connected with AMP's dealings with ASIC in respect of the fee for no service issue.

The case study revealed a number of important issues. The first was the application of internal 'business rules' in a manner inconsistent with the law and in a manner that Mr Regan accepted was contrary to commercial morality. The second concerned misleading the regulator when reporting identified or potential statutory contraventions. The third concerned the nature and extent of the involvement of senior officers within AMP in the preparation of a report that, when provided to ASIC, was said to have been described as external and independent.

I will deal in turn with each issue.

¹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 3 [1]; Transcript, Anthony Regan, 16 April 2018, 1053, 1056.

1.2 Ongoing service fee conduct

1.2.1 Nature of the relationship

As already noted, AMP operates a network of approximately 2,800 financial advisers, with around 90% of those advisers appointed as authorised representatives of the AMP Advice Licensees.² The AMP Advice Licensees include, relevantly, AMP Financial Planning Pty Ltd (AMPFP), Charter Financial Planning Limited (Charter), Hillross Financial Services Limited (Hillross) and iPac Securities Limited (iPac Securities), each of which is a subsidiary of AMP and the holder of an **Australian financial services licence** (AFSL).³ To the extent advisers are employed by AMP, they predominantly work in the iPac Securities business.⁴

Many authorised representatives of an AMP Advice Licensee have an ongoing service arrangement in place with some of their clients. Ongoing service fees are charged to clients, and remitted to advisers, through certain products and platforms issued or approved by AMP.⁵ The fees are charged for services that the adviser has agreed to provide.⁶ The terms of the ongoing fee arrangement are generally set out in documents such as Ongoing Fee Agreements, Statements of Advice and Fee Disclosure Statements.⁷ Typically, the ongoing services include services such as access to the adviser through meetings or phone calls, and the offer, and the undertaking, of a full or partial review of the client's portfolio at a determined frequency.⁸

The interval at which, and way in which, the ongoing service fee is charged depends on the type of fee, and the agreement between the adviser and

² Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 8 [20], [21], 14–15 [53]–[55], [58].

³ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 6–8 [19(a)(ix)], [21]–[22]; AMP, *AMP Group Submission*, 29 January 2018, 6 [4.8.3].

⁴ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 8 [22], 15 [60].

⁵ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 16 [67]–[68], 17–18 [70]–[71].

⁶ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 16 [68].

⁷ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 16 [62], 18 [74].

⁸ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 18–19 [75].

client.⁹ Since the **Future of Financial Advice** (FoFA) legislative reforms, the ongoing service fees have been ‘opt-in’, with the agreement lapsing every two years, and like all fee proposals, needing to be disclosed to the client by the adviser.¹⁰

1.3 Conduct in issue

The Commission’s inquiries into AMP’s fee for no service conduct were not primarily connected with the failure of advisers within AMP’s network to provide advice, but rather with decisions made by AMP senior management in connection with the exercise and implementation of rights arising from contractual arrangements between AMP Advice Licensees and their authorised representatives. The relevant contractual arrangements had different names within the different AMP Advice Licensees.¹¹ In AMPFP it was called the ‘**buyer of last resort**’ policy, or the BOLR policy.¹² It is convenient to refer to the arrangements as ‘the BOLR policy’.

It was not in dispute that the relevant AMP Advice Licensees (AMPFP, Hillcross, Charter and iPac Securities) had charged fees to clients in circumstances where they did not, and could not, provide services to the

⁹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 19–20 [79].

¹⁰ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 20 [80]–[82].

¹¹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 31 [151]; AMP, *AMP Group Submission*, 29 January 2018, 11 [5.4.10].

¹² Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 31 [151]; Transcript, Anthony Regan, 16 April 2018, 1061.

clients for those fees. So much was acknowledged by AMP.¹³

The acknowledged conduct was connected with, and arose out of, the implementation of the BOLR policy.

1.4 The BOLR policy

It is necessary to describe the BOLR policy. I will do that without descending into the detail of the contractual provisions, except to the extent strictly necessary. In general terms, the 2012 version of the BOLR policy enabled an authorised representative to sell a book of clients to another authorised representative, and, subject to certain conditions being satisfied, allowed and required AMP to buy the book of clients if the authorised representative was unable to sell it to another authorised representative.¹⁴

Under the BOLR policy, a book of clients was typically valued on the basis of a four-times multiple of ongoing revenue earned from those clients. The revenue subject to this four-times multiplier included the advice fees that had been automatically deducted from the client's products in the 12 months preceding the valuation.¹⁵

¹³ Transcript, Anthony Regan, 16 April 2018, 1062–3; in Mr Regan's statement, Mr Regan refers to the 'broad understanding' held in the AMP Advice Licensees from about June 2011 that the Advice Licensees were not capable of providing certain services the subject of ongoing service fees to customers while the customers were in the BOLR pool or the subject of ringfencing: see Exhibit 2.13, 16 April 2018, Witness statement of Anthony Regan, 42 [215]; AMP admits that it charged fees to clients while they were in the BOLR pool: see AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, [16]; AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3–4 [3(a)–(e)]; AMP, *AMP Group Submission*, 29 January 2018, 11–12 [5.4.14]–[5.4.15]; see also the five breach reports made by AMP to ASIC on 27 May 2015: Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 24) [AMP.6000.0001.1469], on 5 December 2016: Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 29) [AMP.6000.0001.3573], on 3 May 2017: Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 30) [AMP.6000.0001.1894]; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 31) [AMP.6000.0001.3575], on 8 June 2017: Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 32) [AMP.6000.0001.3577]; AMP has now changed its off-boarding processes: see Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 38–9 [193]–[197].

¹⁴ Transcript, Anthony Regan, 16 April 2018, 1062; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 30 [146].

¹⁵ Transcript, Anthony Regan, 16 April 2018, 1062, 1066.

Where AMP acquired a book of clients, it would seek to on-sell that book to another authorised representative. If the ongoing fee agreements with clients were terminated before the on-sale, AMP would not be able to realise the capitalised value of those ongoing fees and thus it would not recoup the price it had paid for the book.¹⁶ It was, therefore, in the financial interests of the AMP Advice Licensee, and of AMP as the intending vendor of the book of clients, to continue the ongoing fee arrangement with the client after the client book had been purchased by AMP.

Generally, if a client was on a register acquired by AMP under the BOLR policy, the client was moved into what was known as the 'BOLR pool'. Mr Regan's evidence was that, until very recently, AMP had no capacity to provide services to clients who were in the BOLR pool.¹⁷

A practice developed within AMP to place clients into the BOLR pool, and not 'dial down' the fees charged to those clients. In this context 'dial down' was a euphemism for 'stop charging' the ongoing service fees. That is, AMP would intentionally keep the ongoing service fee arrangement on foot notwithstanding that it could not provide service to the BOLR pool clients.

In addition, even when AMP intended to 'dial down' fees for clients who were in the BOLR pool, it did not have adequate systems in place to ensure that this occurred.

AMP first reported to the Australian Securities and Investments Commission (ASIC) that it had systematically failed to 'dial down' ongoing service fees for clients in the BOLR pool in a report made under Section 912D(1B) of the *Corporations Act 2001* (Cth) (the Corporations Act) on 15 January 2009.¹⁸ That breach report identified that the breach had occurred in September 2007, and that AMPFP first became aware of the breach in September 2008.

The fact that AMP reported that conduct to ASIC did not put a stop to the conduct.¹⁹ Internal AMP documents from 2013 and earlier suggest that,

¹⁶ Transcript, Anthony Regan, 16 April 2018, 1067–8.

¹⁷ Transcript, Anthony Regan, 16 April 2018, 1062–3, 1084.

¹⁸ Transcript, Anthony Regan, 16 April 2018, 1079; Exhibit 2.13, Witness statement of Anthony Reagan, 11 April 2018, Exhibit AGR-1 (Tab 33) [AMP.9000.0001.1460].

¹⁹ Transcript, Anthony Regan, 16 April 2018, 1081.

over time, a general rule developed where fees would be left on for clients for up to 90 days after the clients had been moved into the BOLR pool.²⁰

In January 2014, following the implementation of the FoFA reforms, a business rule referred to as the '90 Day Exception' developed.²¹ Mr Regan referred to the 90 Day Exception as an exception to the BOLR policy granted by the Managing Director of the AMP Advice Licensee.²²

The nature of the 90 Day Exception may have changed over time; internal AMP documents created after January 2014 appear to describe the rule in different ways. It is unclear to what extent the 90 Day Exception was applied after January 2014. The evidence before me suggests that the 90 Day Exception ceased being applied in about November 2016.²³ AMPFP did not, until 17 October 2016, notify ASIC of the deliberate decision to continue to charge fees for no service by application of the 90 Day Exception.

1.5 Ringfencing

There was a further business rule by which AMP made deliberate decisions to charge clients fees for the provision of no service. This was known as 'ringfencing'. Ringfencing occurred as early as 2013. A formal process for ringfencing decisions was put into place in 2014 following the

²⁰ See, eg, Exhibit 2.14, 14 January 2011, Emails of January 2011 concerning approval of dial-up fees for buyer of last resort, 1; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 34) [AMP.6000.0011.8670 at .8672, .8691]; Exhibit 2.33, 14 June 2013, Emails Rakich to Parra and others, 1–2; Exhibit 2.35, 30 August 2013, Emails between Byrne and Marsh and others, 1; Exhibit 2.36, undated, PowerPoint presentation client transfer policies and processes.

²¹ Transcript, Anthony Regan, 17 April 2018, 1121–2; Exhibit 2.29, 11 November 2016, Emails between Marsh, Collins and others dated 11/11/2016, 1.

²² Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 35 [174].

²³ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 29 [133], 36 [178]; Transcript, Anthony Regan, 17 April 2018, 1073; AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 8 [26]; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 28) [AMP.6000.0042.0001]; see also Letter from AMP to ASIC confirming that a direction was sent to the relevant teams in AMP advising that the 90 Day Exception was to cease immediately; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 43) [AMP.6000.0010.0015].

recommendations of an internal audit report.²⁴ Ringfencing occurred where, for some books of clients purchased by AMP, AMP would make the decision to 'ringfence' the clients, meaning that they would not be placed into the BOLR pool and the register would be kept separate for later sale as a whole. The 'ringfenced' clients would continue to pay fees, without receiving any services, whilst they were held separate from the BOLR pool.²⁵ It is unclear whether there was any 90-day limit on the period over which the clients would continue to pay fees.²⁶ It appears that, at least from June 2015, joint approval of both the Managing Director of the relevant AMP Advice Licensee and the Head of Licensee Value Management was required for ringfencing a book of clients.²⁷

AMP did not report its ringfencing conduct to ASIC until 3 May 2017 – though, at that time, AMP did not describe the conduct as a business practice.²⁸ It is not clear when the ringfencing practice ceased. Mr Regan's evidence was that it ceased in November 2016.²⁹ However, an email referred to in the report prepared by Clayton Utz dated 16 October 2017

²⁴ Exhibit 2.29, 11 November 2016, Emails between March, Collins and others, 1: '5. In this period it appears likely that there were instances where rather than enter the BOLR ID, registers were retained in seller IDs to facilitate a sale ... and incidents where part (only) of registers were transferred to buyers or transactions did not complete' – 'this period' appears to refer to a time after January 2014. However, note that a Clayton Utz report dated 16 October 2017 indicated that a decision to 'ringfence' clients was made by Michael Guggenheimer on 4 July 2011, Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 3) [AMP.6000.0010.0440 at 0462].

²⁵ Transcript, Anthony Regan, 16 April 2018, 1070.

²⁶ See Clayton Utz report, Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 3) [AMP.6000.0010.0440 at 0465]: 'However, unlike at least the 90 Day Exception, it is not clear that a 3 month limit was necessarily imposed ... there is no express time limit for these registers to be ring-fenced'.

²⁷ Transcript, Anthony Regan, 17 April 2018, 1123; Exhibit 2.29, 11 November 2016, Emails between Marsh, Collins and others, 1.

²⁸ Breach reports from AMP to ASIC: Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 30) [AMP.6000.0001.1894]; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 31) [AMP.6000.0001.3575]; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 29 [134], [136], 36 [179], 37 [183], 38 [189].

²⁹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 29 [134]; Transcript, Anthony Regan, 17 April 2018, 1114.

(Clayton Utz Report), to which I will come, shows that the Managing Director of AMPFP approved a ringfencing exception on 18 January 2017.³⁰

1.6 Ongoing service fee conduct

By both the ringfencing conduct and the various permutations of the 90 Day Exception, AMP decided to continue to charge ongoing service fees to clients in circumstances where it would not be providing and could not provide services for those fees.

In addition, when AMP charged fees for service to clients in the BOLR pool because it did not have adequate systems in place to 'dial down' fees, AMP was accepting payment for financial services that it had no reasonable grounds to believe it would supply to the clients.

In AMP's initial submissions to the Commission in January and February 2018, it acknowledged that, 'during the period from (relevantly) 1 January 2013':

- First, it had engaged in conduct of charging of ongoing service fees in circumstances where services were not and could not be provided. AMP said that this conduct was due, in part,³¹ to the application of the 90 Day Exception and ringfencing practices.³²
- Second, it had charged ongoing service fees to clients after an adviser's authorisation had been terminated by an AMP Advice Licensee.³³
- Third, it had inadequate processes to ensure delivery of ongoing services where it bought a book of clients and the client was in the BOLR pool.³⁴

³⁰ See [46] and footnote 38 of the Clayton Utz Report, Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 3) [AMP.6000.0010.0440 at .0462].

³¹ AMP also attributed this conduct to 'systems and process errors': see AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3(a)].

³² AMP, *AMP Group Submission*, 29 January 2018, 12 [5.4.15]; AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3], [3(a)], [3(b)].

³³ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 4 [3(c)].

³⁴ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 4 [3(d)].

- Fourth, it had charged ongoing service fees in circumstances where the services would not be provided.³⁵
- Fifth, it had engaged in ‘possible misconduct’ in relation to the ‘extent and nature of AMP’s reporting to ASIC in relation to Fees for No Service (Licensees)’.³⁶

In its 13 February 2018 submissions to the Commission, AMP acknowledged that it had engaged in fees for no service conduct from 1 January 2013, which, in its words, ‘involves possible contravention of Sections 180, 912A(1)(a), 952E, 961B, 961K, 962P, 1041H and 1308’ of the Corporations Act, and ‘Sections 12CA, 12CB, 12DA, 12DB, 12DF and 12DI’ of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act).³⁷ AMP stated that the breaches or contraventions may have been made by either of the relevant AMP Advice Licensee, or a director or an employee of AMP.

Since the 15 January 2009 breach report made to ASIC, AMP has issued five separate breach reports pursuant to Section 912D(1B) of the Corporations Act to ASIC, notifying it of breaches of Section 912A(1)(a) of the Corporations Act in relation to the charging of fees for no service: one on 27 May 2015, one on 5 December 2016, two on 3 May 2017 and one on 8 June 2017.³⁸

In his oral evidence, Mr Regan:

- accepted that there was no lawful basis for the carrying out of the 90 Day Exception or ringfencing business rules.³⁹ Indeed, he accepted that it was obvious that charging clients fees for services that are intentionally

³⁵ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 4 [3(e)].

³⁶ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3], 4.

³⁷ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3].

³⁸ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 3 [3(a)], 3 [3(b)], 3 [3(c)], 4 [3(d)], 4 [3(e)].

³⁹ Transcript, Anthony Regan, 16 April 2018, 1072, 1085.

and knowingly not being provided was both unlawful, and ethically and morally wrong;⁴⁰

- admitted that AMP had made 20 statements to ASIC regarding the ongoing service fee conduct that were false or misleading;⁴¹ and
- conceded that he felt a 'level of discomfort' in the fact that AMP had met with ASIC and represented to it that the Clayton Utz report was an external and independent report.⁴²

Despite all of this, in AMP's 4 May submissions, AMP submitted that 'mere knowledge of the existence of the 90 Day Exception should therefore be sufficient to understand that it was illegal' was an 'oversimplification of the position that AMP employees and executives found themselves in at the time'.⁴³ AMP argued that 'Mr Regan's answers were given with the benefit of having seen legal advice on the question'⁴⁴ and that the 90 Day Exception and ringfencing generally applied where there was an expectation that the client register would be on-sold to another adviser 'within a reasonable timeframe'.⁴⁵

In those circumstances (the submission continued) 'if there was an expectation that an incoming planner would be in a position to provide the service (that is, the annual review) within the timeframe that it was due to be provided (that is, within 12 months of the last review or initial advice) it is less obvious, in the absence of legal advice on the question, that a customer without an Adviser for a short period would be paying fees for a service they did not receive, in contravention of the law'.

These submissions by AMP are inconsistent with contemporaneous internal AMP communications. They are also inconsistent with the breach reports made to ASIC during the period 15 January 2009 to 8 June 2017, which

⁴⁰ Transcript, Anthony Regan, 16 April 2018, 1073, 1085.

⁴¹ Transcript, Anthony Regan, 17 April 2018, 1127.

⁴² Transcript, Anthony Regan, 16 April 2018, 1196.

⁴³ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 19 [65].

⁴⁴ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 19 [66].

⁴⁵ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 19–20 [67].

each expressly acknowledged that the conduct was in breach of identified provisions of the Corporations Act or the ASIC Act.⁴⁶

In light of the admissions that I have referred to, and the evidence that I have set out above, I accept that, by applying the 90 Day Exception to clients in the BOLR pool, or ringfencing clients, AMP and the AMP Advice Licensees knew that they would continue to charge fees for services that they would not and could not provide. And I also accept that there was a failure to have adequate systems to turn off ongoing fees for all clients in the BOLR pool.

When clients subject to the 90 Day Exception or ringfencing paid fees for ongoing services, there was no authorised representative of the relevant AMP Advice Licensee assigned to supply those services. And in at least some of those cases, there was no basis for believing that the AMP Advice Licensees would, or would be able to, supply the agreed financial services before the clients in question were 'sold' to another authorised representative. And in at least some of those cases there was no basis for making any prediction about when a sale might happen.

In these circumstances, I consider that, as AMP recorded in its breach notifications to ASIC and in written submissions to the Commission,⁴⁷ the AMP Advice Licensees may have breached their statutory obligations under Section 912A(1)(a),⁴⁸ (c)⁴⁹ and (ca)⁵⁰ of the Corporations Act, and the AMP Advice Licensees may have engaged in conduct contrary to Sections 12DI(1) and 12DI(3)⁵¹ of the ASIC Act in relation to the acceptance of payment from clients subject to the 90 Day Exception and ringfencing and Section 12DI(3) of the ASIC Act in relation to acceptance of payment for advice services from any client in the BOLR pool.

⁴⁶ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 5 [18] and 21 [73].

⁴⁷ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 20 [73].

⁴⁸ The obligation upon licensees to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly.

⁴⁹ The obligation upon licensees to comply with financial services law.

⁵⁰ The obligation upon licensees to take reasonable steps to ensure that their representatives comply with the financial services laws.

⁵¹ The prohibition on accepting payment without intending or being able to supply the relevant financial services.

The AMP Advice Licensees were aware of the application of a 90 Day Exception since January 2014. Despite lodging a report with ASIC about the conduct on 27 May 2015, the AMP Advice Licensees did not notify ASIC of the extent and the nature of the 90 Day Exception conduct until 26 November 2016. The AMP Advice Licensees were aware of the ringfencing conduct by at least May 2015 but did not notify ASIC of it until 3 May 2017. In each aspect of this matter there appears to have been significant delay in the AMP Advice Licensees reporting to ASIC the ongoing service fee conduct. It follows that AMP and the AMP Advice Licensees may have breached their statutory obligation under Section 912D(1B)⁵².

There is also evidence to suggest that, by charging fees to clients in the BOLR pool in circumstances where no service could be provided, AMP's and its Advice Licensees' conduct might have been, in all of the circumstances, unconscionable. This conduct may have been contrary to Section 12CB of the ASIC Act.

1.7 Culture and governance practices

Why then did AMP engage in the conduct that I have described?

The evidence of Mr Regan demonstrated that senior management and employees of AMP Advice Licensees were aware that the conduct was a breach of their financial services licenses but continued to engage in the conduct.⁵³

In particular, in June 2015, after AMP had made its first breach notification to ASIC, explicit reference to the fact that ringfencing a client was conduct that would breach AMPFP's financial services licence was made in internal AMP communications: in an email seeking approval to ringfence a client, Ms Wolff, the Registers and Transfers Manager of AMP Advice, stated that '[p]lease ensure that when seeking approval from [Michael Guggenheimer, the then-Managing Director of AMPFP and Hillross] he acknowledges that by ring fencing the registers and not hav[ing] the ongoing fees dialled down

⁵² The obligation on licensees to, as soon as practicable and in any case within 10 business days after becoming aware of the breach or likely breach, lodge a written report on the matter with ASIC.

⁵³ Transcript, Anthony Regan, 17 April 2018, 1113.

that we are in breach of our licence'.⁵⁴ That email was then sent on to Mr Guggenheimer by another employee, in which that employee again made clear that '[i]t must be noted that [the ringfencing] is in breach of our licence as fees are not dialled down'.⁵⁵ Despite two clear statements of the position by those employees, Mr Guggenheimer, and Mr Morgan, the Head of Licensee Value Management of AMP, saw no issue with the conduct – Mr Guggenheimer approved the ringfencing request 'so [AMP] did not lose the value of the service fees'.⁵⁶

These communications show that, despite attempts from more junior staff to convince senior management of AMP Advice Licensees to cease charging fees for no service, they continued to do so.⁵⁷

Mr Regan said that this conduct showed that the culture at AMP was 'not as robust as it should be'. He agreed that it showed a culture in which conscious decisions were made to protect the profitability of AMP, and said that AMP had put the interests of shareholders first, at the expense both of the interests of clients and of complying with the law.⁵⁸

A further and important question is raised by the approach of AMP's submission. It can be expressed as a question: Why did AMP place the emphasis it did in its submissions to the Commission upon whether an employee or executive had received legal advice explaining that it was unlawful to charge for fees for no service?

Unless the explanation is to be found in the culture of AMP's business, it is not at all easy to understand why so many employees and executives at AMP were unable to recognise that to charge fees for services that will not, and cannot, be provided is not just unlawful, but also ethically and morally wrong. It was plain to Mr Regan. It is plain to anyone who pauses to think about the proposition.

⁵⁴ Exhibit 2.26, 12 June 2015, Emails between Morgan, Guggenheimer and others, 2; Transcript, Anthony Regan, 17 April 2018, 1110–11.

⁵⁵ Exhibit 2.26, 12 June 2015, Emails between Morgan, Guggenheimer and others, 2; Transcript, Anthony Regan, 17 April 2018, 1111.

⁵⁶ Exhibit 2.26, 12 June 2015, Emails between Morgan, Guggenheimer and others, 1; Transcript, Anthony Regan, 17 April 2018, 1112.

⁵⁷ Transcript, Anthony Regan, 17 April 2018, 1111–12.

⁵⁸ Transcript, Anthony Regan, 17 April 2018, 1113.

Was it that the ongoing services were of no value? Was it that the maintenance of the flow of income was, without more, a sufficient answer to whether the customer should be charged the fees? Was it because, through the long-established system of receiving upfront and trail commissions, the receipt of payments from clients without the necessity to provide any accompanying service has been, and continues to be, fundamental to the way in which the financial advice industry does business?

As to commissions, evidence was received that a substantial proportion of AMP's income in connection with its clients continues to come from grandfathered commissions.⁵⁹ In that respect, the charging of fees for no service may to some extent be seen as analogous to the historical method of income generation by financial advice entities.

In AMP's 4 May submissions, AMP accepted that it was open to the Commission to find that the fees for no service conduct was attributable, at least in part, to the culture and governance practices within AMP.⁶⁰ I make that finding.

1.8 Ongoing service fee systems

Mr Regan was asked about AMP's systems for determining whether ongoing service clients received the services to which they were contractually entitled. Mr Regan accepted that, unless there was a client complaint, the only way AMP could detect that advisers were not providing services in exchange for fees was through audits, which AMP did not consistently and regularly undertake.⁶¹

In AMP's 4 May submissions, AMP rejected the proposition that it was open to find that the fees for no service conduct was attributable to poor risk management practices within the AMP Advice Licensees.

AMP submitted that it has 'made a series of enhancements to governance, systems, processes and controls to improve its detection of fees for no service activities' as a result of external reviews undertaken by PwC in 2015

⁵⁹ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, 19–21 [77].

⁶⁰ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 21 [77]–[78].

⁶¹ Transcript, Anthony Regan, 16 April 2018, 1060–1, 1070; Transcript, Anthony Regan, 17 April 2018, 1167–8.

and 2017.⁶² AMP listed particular enhancements made to improve the detection of fees for no service activity, including the introduction of risk-based auditing approaches, where higher risk advisers are specifically targeted (using data analytics and the development of key risk indicators).

PwC's 2017 review⁶³ followed PwC's earlier, 2015, review.⁶⁴ The 2015 review was prompted by a request from AMP to PwC in September 2014 to evaluate the control framework that existed within the AMP Advice business.⁶⁵ That review made a number of findings and recommendations.⁶⁶ As a result of that review, AMP developed the 'Advice Controls Improvement Program' (ACI Program), the primary focus of which was to implement activities rated as 'High Importance' by PwC.⁶⁷ Mr Regan could offer no details of work undertaken by AMP to address the issues that PwC identified.⁶⁸

The purpose of the PwC 2017 review was to review selected key processes to understand the effectiveness of the controls implemented as a result of the ACI Program and to consider the impact of the increased regulatory expectations.⁶⁹

In its review, PwC found that AMP had implemented or taken steps to implement a number of the recommendations included within the ACI

⁶² AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 22 [83].

⁶³ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018].

⁶⁴ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 18) [AMP.6000.0003.8310].

⁶⁵ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 18) [AMP.6000.0003.8310 at .8312]; Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5022].

⁶⁶ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 18) [AMP.6000.0003.8310 at 8317–8320]; Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5022].

⁶⁷ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5022].

⁶⁸ Transcript, Anthony Regan, 17 April 2018, 1106–7.

⁶⁹ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5022].

Program.⁷⁰ That included the development and use of key risk indicators, risk rating advisers to target monitoring and supervision efforts and the use of analytics to assess the key risk indicators.⁷¹ However, PwC also noted that the file audit process continued to form a critical part of AMP's monitoring activity, and that there continued to be inconsistencies in the performance of audits.⁷²

PwC stated that AMP's use of data analytics and key risk indicators, used to identify high-risk advisers and to inform audit focus, was in pilot phase at the time of the PwC 2017 review, and had been implemented post-PwC's testing period.⁷³ PwC noted that '[i]f this approach is successfully implemented and outlined to PwC during [the] review, it will deliver a market-leading monitoring and supervision capability'.⁷⁴

The key issue here is that, although there is evidence to support AMP's submission that enhancements have been made to improve the detection of fees for no service conduct, AMP took a long time to make the changes it did.

1.9 Misleading statements conduct

The second line of inquiry pursued at the hearing concerned AMP's reporting to or dealings with ASIC.

There were two types of conduct falling into this category: (1) statements made to ASIC regarding the ongoing service fee conduct; and (2) what was said to ASIC about the nature of the Clayton Utz Report. I will deal with these issues in turn.

⁷⁰ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5024–.5027].

⁷¹ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5025].

⁷² Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5025].

⁷³ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5046].

⁷⁴ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5046].

In AMP's initial submissions to the Commission, AMP admitted that it engaged in '[p]ossible misconduct in relation to the extent and nature of [its] reporting to ASIC in relation to' the fees for no service conduct.⁷⁵

Those statements may be summarised as follows:

- Three statements were made to ASIC in the 27 May 2015 breach notification:
 - It was said that the services that were not being provided, for which ongoing fees were being charged, 'did not include the provision of personal advice by way of a review or any other scenario of personal advice'. Mr Regan accepted that this was not true.⁷⁶
 - It was said that '[i]nternal protocols had been in place ... to turn off fees when a financial planning register had been purchased by an advice licensee' and that the 'processes' had failed in some instances. Mr Regan accepted that this was false or misleading and that AMP had made a deliberate decision to retain the fees of some of these clients.⁷⁷
 - It was said that the issue was 'initially identified' about a month earlier 'as it ha[d] taken some time to identify if there actually was an issue'. Again, Mr Regan accepted that this was not true.⁷⁸
- On 19 June 2015, following the 25 May 2015 breach notification, AMP sent a letter to ASIC. That letter made the following statements:
 - First, that AMP was in the process of reviewing approximately 29,000 client files dating back to July 2010 on the basis that AMP's 'processes' may have failed, which failures caused fees

⁷⁵ AMP, *Schedule A to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 4.

⁷⁶ Transcript, Anthony Regan, 16 April 2018, 1090; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 24) [AMP.6000.0001.1469 at .1470].

⁷⁷ Transcript, Anthony Regan, 16 April 2018, 1090; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 24) [AMP.6000.0001.1469 at .1470].

⁷⁸ Transcript, Anthony Regan, 16 April 2018, 1091; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 24) [AMP.6000.0001.1469 at .1471].

not to be turned off. Mr Regan accepted that this statement was misleading.⁷⁹

- Second, that '[i]nterim processes ha[d] been put in place to ensure that no new clients [were] added' during the remediation period. Mr Regan accepted that this was, at the time, misleading. Mr Regan accepted that AMP continued to apply the 90 Day Exception and to engage in ringfencing.⁸⁰
- On 23 June 2015, AMP sent a letter to ASIC that contained the following statements:
 - First, that an audit program conducted by PwC had 'not identified any systemic issues regarding the provision of ongoing services by AMP advisers'. The audit being undertaken did not identify any systemic issues, because the audit was not conducted with the purpose or intention of seeking to identify systemic issues.⁸¹
 - Second, that the fees for which clients were continuing to be charged without receiving services 'did not relate to providing personal advice or annual advice reviews but to services such as retainer services and other support services to clients'. Mr Regan accepted that the statement was not true.⁸²
- On 17 August 2015, AMP sent a letter to ASIC, in which it said that '[r]equests were made to product issuers by the licensees to have service fees turned off' and that 'fees continued to be deducted after the servicing arrangement had' ended on the basis of errors. Again, Mr Regan accepted that this statement was misleading.⁸³

⁷⁹ Transcript, Anthony Regan, 16 April 2018, 1091; Exhibit 2.19, 19 June 2015, Letter AMP to ASIC, 1.

⁸⁰ Transcript, Anthony Regan, 16 April 2018, 1091; Exhibit 2.19, 19 June 2015, Letter AMP to ASIC, 3.

⁸¹ Transcript, Anthony Regan, 17 April 2018, 1108–9; Exhibit 2.25, 23 June 2015, Letter AMP to ASIC, 1.

⁸² Transcript, Anthony Regan, 17 April 2018, 1110; Exhibit 2.25, 23 June 2015, Letter AMP to ASIC, 2.

⁸³ Transcript, Anthony Regan, 16 April 2018, 1096; Exhibit 2.21, 17 August 2015, Letter AMP to ASIC dated 17/08/2015, 9.

- On 31 August 2015, AMP sent a letter to ASIC, in which it said that '[s]ince January 2014 the commercial practice changed and fee arrangements have been cancelled immediately [when] the Licensee acquires the account'. Mr Regan accepted that this statement was not true.⁸⁴
- On 9 September 2015, AMP sent an email to ASIC saying that the breach (being the application of the 90 Day Exception) 'relate[d] to an administrative error in not turning off the fees on terminated agreements'. Mr Regan accepted that this was false or misleading;⁸⁵ the conduct was deliberate.
- A PowerPoint presentation prepared for a meeting between AMP and ASIC on 17 September 2015, regarding ongoing service fee remediation, contained the following statements:
 - First, there was a statement in a template letter, which AMP said to ASIC would be sent to clients, that said '[a]s AMP will no longer be able to provide' the client with all of the additional services it negotiated, 'the planner service fee will be removed'. Mr Regan accepted that this was misleading as the letters were not sent to all relevant clients.⁸⁶
 - Second, the PowerPoint presentation said that '[w]hen licensees purchase register rights, the normal process is for the ongoing service agreements to be terminated and the ongoing service fees to be turned off'. Mr Regan accepted that the statement was misleading.⁸⁷

⁸⁴ Transcript, Anthony Regan, 16 April 2018, 1092–3; Exhibit 2.20, 31 August 2015, Letter AMP to ASIC dated 31/08/2015, 2.

⁸⁵ Transcript, Anthony Regan, 17 April 2018, 1117; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 3) [AMP.6000.0010.0440 at .0501].

⁸⁶ Transcript, Anthony Regan, 16 April 2018, 1096–7; Exhibit 2.22, 16 April 2018, PowerPoint presentation AMP to ASIC dated 17/09/2015, 6.

⁸⁷ Transcript, Anthony Regan, 16 April 2018, 1097; Exhibit 2.22, 16 April 2018, PowerPoint presentation AMP to ASIC dated 17/09/2015, 3.

- On 1 October 2015,⁸⁸ AMP sent a letter to ASIC in response to a notice of direction issued under Section 912C(1) of the Corporations Act:
 - The letter described various failures in administrative processes as the reasons why clients were charged fees for no service. However, as Mr Regan accepted, failures in administrative processes were not the reasons why some clients were charged fees for no service.⁸⁹
 - The letter also said that, when authorised representatives of AMP sold their books of clients to AMP under the BOLR policy, the ongoing fee arrangements would terminate. But by reason of the 90 Day Exception and ringfencing, that was not always so. Mr Regan accepted that the statement was false.⁹⁰
- On 26 November 2015, AMP sent a letter to ASIC, which provided an assurance that ‘a process was in place to inform customers that services would no longer be provided’. Mr Regan accepted that the statement was false or misleading.⁹¹
- On 14 December 2015, AMP sent a letter to ASIC:
 - The letter attributed the conduct of continuing to charge clients ongoing service fees in circumstances where they were in the BOLR pool to an administrative error. But, as Mr Regan accepted, the statement was misleading⁹² because the conduct was in part due to the deliberate decision of AMP to continue to charge fees to those clients while knowing it could not provide services.

⁸⁸ Clayton Utz Report, Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 3) [AMP.6000.0010.0440 at 0462].

⁸⁹ Transcript, Anthony Regan, 16 April 2018, 1098; Exhibit 2.23, undated, Letter AMP to ASIC, 3.

⁹⁰ Transcript, Anthony Regan, 16 April 2018, 1098–9; Transcript, Anthony Regan, 17 April 2018, 1103–5; Exhibit 2.23, undated, Letter AMP to ASIC, 4–5.

⁹¹ Transcript, Anthony Regan, 17 April 2018, 1117–8; Exhibit 2.27, 26 November 2015, Letter AMP to ASIC, 2.

⁹² Transcript, Anthony Regan, 17 April 2018, 1118–9; Exhibit 2.28, 14 December 2015, Letter AMP to ASIC dated 14/12/2015, 2.

- The 14 December letter also said that the fact of the charging of ongoing service fees was due to the failure on the part of the client, who, after receiving a letter from AMP, was to contact the external provider to request that the fees be turned off. Mr Regan again accepted that the statements were misleading in two respects.⁹³ The continued charging of ongoing fees was, in some cases, due to a deliberate decision of AMP and AMP had not sent all clients letters of the kind described.⁹⁴
- On 23 November 2016, AMP sent a letter to ASIC that failed to explain that there had been a change regarding the 90 Day Exception after January 2014, and failed to identify the ringfencing business practice of AMP. Mr Regan accepted that by failing to identify these matters, AMP made a misleading statement to ASIC.⁹⁵
- Finally, on 3 May 2017, AMP issued a further breach notification to ASIC. The breach notification said that AMP’s discovery of the ringfencing practice occurred only after it had started to investigate the 90 Day Exception. Mr Regan accepted that was false or misleading because ringfencing had been identified before the 23 November 2016 letter was sent to ASIC.⁹⁶

In AMP’s submissions to the Commission in respect of this case study dated 4 May 2018, AMP submitted that, on the evidence,⁹⁷ AMP made seven misrepresentations in 12 communications to ASIC, rather than, as Counsel Assisting had submitted, and Mr Regan had accepted, 20 misleading statements or representations.⁹⁸ AMP did not seek to explain why the misleading statements or representations, as characterised by

⁹³ Transcript, Anthony Regan, 17 April 2018, 1119–20; Exhibit 2.28, 14 December 2015, Letter AMP to ASIC dated 14/12/2015, 2.

⁹⁴ Transcript, Anthony Regan, 17 April 2018, 1120.

⁹⁵ Transcript, Anthony Regan, 17 April 2018, 1125; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 43) [AMP.6000.0010.0015].

⁹⁶ Transcript, Anthony Regan, 17 April 2018, 1126–7; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 30) [AMP.6000.0001.1894].

⁹⁷ AMP relied on the way in which those misrepresentations were characterised in the report prepared by Clayton Utz dated 16 October 2017: see AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 8 [30].

⁹⁸ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 8 [30].

Counsel Assisting, were not properly considered to be separate or distinct misleading statements or representations. As AMP's proposition of seven misrepresentations in 12 communications shows, it seems that AMP sought to count only the number of different *kinds* of misrepresentation made rather than, as I think more relevant, the number of occasions on which AMP made false and misleading statements to ASIC.

1.10 What the case study showed

1.10.1 Misleading statements as to ongoing service fee conduct

Through AMP's dealings with ASIC regarding both the extent and nature of its fee for no service reporting, AMP adopted an attitude toward the regulator that appears to me, and at the time appeared to ASIC, not to be forthright and honest. Indeed, the statements made could be seen as a deliberate attempt to mislead.

I see no reason to doubt Mr Regan's evidence that between 27 May 2015 and 3 May 2017, AMP and the AMP Advice Licensees may have made as many as 20 false or misleading statements to ASIC about ongoing service fee conduct.⁹⁹

The conduct described by Mr Regan both reflected and was attributable to the culture and governance practices of AMP. As later recorded in relation to the Clayton Utz Report, there were senior persons within AMP (I make no finding more precisely than that) who knew of the charging of fees for no service. Internal lawyers warned that it was a breach of law. Despite all of this, AMP provided ASIC with information that was false or misleading. Senior management and executives who contributed to the misleading of ASIC over a two-year period had knowledge of the true extent and nature of the conduct, and, in at least some cases, were warned by junior staff about it being a breach, but continued with a misleading narrative to ASIC.

The culture and governance practices within AMP revealed by the conduct reflects insufficient concern for adherence to the law. On its face it reflects a persistent and prevalent attitude of senior persons within AMP that it is acceptable to deal with ASIC other than frankly and candidly.

⁹⁹ Mr Regan's admissions span the following pages of the transcript: Transcript, Anthony Regan, 16 April 2018, 1090–9; Transcript, Anthony Regan, 17 April 2018, 1103–27.

1.10.2 Conduct in connection with the Clayton Utz Report

What AMP did not acknowledge, but which formed a large part of the cross-examination of Mr Regan, was potential misconduct in connection with the Clayton Utz Report, a report, prepared for AMP by Clayton Utz and submitted to ASIC, about an investigation into the application of the BOLR policy and the misreporting of that conduct to ASIC.

On 5 June 2017, AMP appointed Clayton Utz to prepare a report into what can collectively be described as the ‘BOLR matters’. The letter of instructions, by which Clayton Utz were appointed, instructed the firm to ‘undertake an external and independent investigation’ into the BOLR matters. The letter said the investigation was to be ‘entirely independent of the business and [was] commissioned exclusively by the Board through [the Chair] and the CEO’.¹⁰⁰

The letter of instructions also stated that at ‘the conclusion of the investigation, Clayton Utz would provide to the AMP Board the final report which set out [its] findings and advice in accordance with the terms of reference provided to Clayton Utz’.¹⁰¹

The central thrust of AMP’s 4 May submissions¹⁰² was directed to making two propositions:

- first that Clayton Utz were acting as AMP’s lawyers and were known to be AMP’s lawyers; and
- second, that there is nothing to suggest that Clayton Utz disagreed with any of the suggestions that had been made to it about the content of its report.

The conclusion that AMP sought to draw from these two propositions was that AMP had done nothing wrong. Yet, nowhere in its submissions did AMP address what would appear, on its face, to be an unresolved tension

¹⁰⁰ Transcript, Anthony Regan, 17 April 2018, 1173; Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 2) [AMP.6000.0033.0001 at 0002].

¹⁰¹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 (Tab 2) [AMP.6000.0033.0001 at .0003].

¹⁰² AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, [31]–[58].

between saying, as it did, that the extent of the involvement that the then-Group General Counsel of AMP, Mr Salter, had in the preparation of the report was ‘surprising’ to the Board of AMP, that the Board was ‘unaware of the extent and the nature of the exchanges between Mr Salter and [Clayton Utz]’ and that the ‘Board had no reason to suspect that the report may not have been prepared in accordance with their instructions’, while at the same time impliedly asserting that Mr Salter’s numerous interventions in the drafting process were not untoward.¹⁰³

Nowhere in its submissions did AMP directly address whether the report that was handed to ASIC (with the letter of instructions originally given to Clayton Utz) was, as the instructions said, a report of ‘an external and independent investigation’ of the relevant matters ‘entirely independent of the business and ... commissioned exclusively by the [B]oard through [the Chair] and CEO’. In particular, AMP did not make any submission that showed how it said the references to independence should be understood. Instead AMP made only the negative proposition that ‘[t]he relationship between AMP and Clayton Utz was such that there could be no expectation, by AMP or ASIC that any report prepared by Clayton Utz could have been intended to be independent within the meaning of [ASIC’s] Regulatory Guide 112’.¹⁰⁴

AMP’s reference to the Regulatory Guide is not unimportant. The guide explains how ASIC interprets the requirement that an expert is independent of the party that commissions an expert report.¹⁰⁵ No reference had been made to the guide in evidence or in submissions by Counsel Assisting and it was raised for the first time by AMP. But the guide serves to emphasise the distinction that has long been drawn in company law¹⁰⁶ between a report that is independent of the party commissioning it and a report that may set out views with which the author agrees but which are *not* formed independently of the party commissioning it.

¹⁰³ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, [55]–[56].

¹⁰⁴ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, [100].

¹⁰⁵ ASIC, Regulatory Guide 112: Independence of Experts, March 2011
<<https://download.asic.gov.au/media/3336169/rg112-published-25-august-2015.pdf>>.

¹⁰⁶ See, eg, *Phosphate Co-Operative Co of Australia Pty Ltd v Shears* [1989] VR 665.

Although AMP said (in effect) that references to independence in the letter of instructions was not to be understood as requiring a report that was independent of the party commissioning it, AMP offered no competing view of the meaning of the letter of instructions. And AMP made no submission denying that the letter of instructions was supplied to ASIC with the final Clayton Utz Report. (An email sent by AMP on the day after the relevant meeting with ASIC had attached, as 'soft copies', both the letter of instructions and the report as documents that had been produced to ASIC during the meeting.)¹⁰⁷

It may be accepted, for present purposes that, as AMP submitted, the Clayton Utz Report was 'uncompromisingly direct and comprehensive in its assessment of the matter'¹⁰⁸. It may further be accepted that the report was 'the result of multiple employee interviews'¹⁰⁹ and that the report may have been of material assistance to ASIC.¹¹⁰ It is also right to observe, as AMP did, that ASIC was not 'required to accept or rely on any of [the report's] findings, and was free to, and in fact did, continue with its investigation'.¹¹¹ And although AMP did not make this point expressly, it may also be accepted that, as the solicitor retained by AMP, Clayton Utz were bound to act in accordance with the client's lawful instructions.

Yet there is evidence that suggests that to describe the report as a report of an 'external and independent' investigation may not have been accurate:

- Clayton Utz provided AMP with numerous drafts of the report. (It was suggested to Mr Regan that 25 drafts were supplied. The better view appears to be, and I proceed on the assumption, that the correct figure is 22 different drafts.)

¹⁰⁷ Exhibit 2.43, 17 October 2017, Emails between Baker Cook and Zhang, 1.

¹⁰⁸ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 3 [4], 15 [57].

¹⁰⁹ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 3 [4]

¹¹⁰ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 15 [57].

¹¹¹ AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 15 [57].

- AMP made many suggestions about the content of the drafts. Some of those suggestions were made in two telephone calls on 21 September 2017¹¹² and a further telephone call after 25 September 2017.¹¹³
- AMP sent numerous emails to Clayton Utz with marked up drafts or suggested amendments to the draft.¹¹⁴
- The amendments proposed appear on their face to suggest alterations to what findings were made in the report about the extent of the knowledge and involvement of particular executives of AMP in the impugned ongoing service fee conduct.¹¹⁵
- Particular changes were made with respect to references to Mr Meller, the then-CEO of AMP and with respect to Mr Caprioli, another senior executive of AMP.
- In drafts provided before 21 September 2017, it was said that Mr Meller had been interviewed.
- On 21 September 2017, Mr Regan and others from AMP discussed the then-draft report with Clayton Utz.¹¹⁶

¹¹² AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 12 [46].

¹¹³ Transcript, Anthony Regan, 17 April 2018, 1178, 1179, 1182; Exhibit 2.55, 4 October 2017, Emails between Mavrakis and Salter dated 04/10/2017, 1.

¹¹⁴ See, eg, Transcript, Anthony Regan, 17 April 2018, 1176; Exhibit 2.48, 17 April 2018, Emails between Salter and Mavrakis dated 18/09/2017, 1; Transcript, Anthony Regan, 17 April 2018, 1176–8; Exhibit 2.49, 17 April 2018, Emails between Mavrakis and Salter dated 19/09/2017, 1.

¹¹⁵ Transcript, Anthony Regan, 17 April 2018, 1184, 1185; Exhibit 2.56, 17 April 2018, Emails between Salter and Mavrakis dated 04/10/2017, 1, Exhibit 2.57, 17 April 2018, Draft Clayton Utz report with annotations by Salter, 36, 41; Transcript, Anthony Regan, 17 April 2018, 1185, 1186, 1187; Exhibit 2.58, 17 April 2018, Emails between Salter and Mavrakis dated 05/10/2017, 1; Exhibit 2.59, 17 April 2018, Draft Clayton Utz report with annotations by Salter dated 05/10/2017, 35, 36; Transcript, Anthony Regan, 17 April 2018, 1187, 1188; Exhibit 2.60, 17 April 2018, Emails between Salter and Mavrakis, undated, 1; Exhibit 2.61, 17 April 2018, Drafts sent by Salter to Mavrakis attached to Exhibit 2.60, 3–5.

¹¹⁶ Transcript, Anthony Regan, 17 April 2018, 1178; AMP, *AMP Group Submission Case Study 1: Fees for No Service*, 4 May 2018, 12 [46].

- On 24 September 2017, a further draft report was sent to AMP. The preceding draft had said that ‘After we commenced the investigation, we identified the following additional personnel involved in either the BOLR decision making and/or the internal process to report to ASIC following the 2015 Breach Report’. Mr Meller was named in the attached list. The new draft read ‘After we commenced the investigation, we identified the following additional personnel who we identified could assist us with our investigation’. Mr Meller’s name was the only name removed from the list.¹¹⁷
- On 4 October 2017, a further draft was sent to AMP. This draft said that ‘it is likely that Mr Caprioli was shown or provided the information contained in Mr Morgan’s email of 19 May 2015 in this memorandum’ and that ‘Mr Caprioli does not appear to have received any of the internal legal advices. However, he was provided with Mr Morgan’s summary of the Turner 19 May advice email as explained in paragraph 83 to 85 above’. Following a number of communications between AMP and Clayton Utz, the first of these sentences was changed to read ‘It is *possible* that ...’ and to add ‘though we have no direct evidence on this point’. The second sentence was changed by adding, after ‘internal legal advices’, ‘and he cannot recollect receiving any of them’. The third sentence, about Mr Caprioli having been provided with Mr Morgan’s summary of the Turner 19 May advice, was deleted. Clayton Utz proposed to add some additional qualifying sentences but these, too, were the subject of further suggestions from AMP.¹¹⁸
- On 5 and 6 October there were still further exchanges between AMP and Clayton Utz about the text of the report.¹¹⁹

¹¹⁷ Exhibit 2.52, 24 September 2017, Draft Clayton Utz report mark up dated 24/09/2017, 9; Transcript, Anthony Regan, 17 April 2018, 1180.

¹¹⁸ Transcript, Anthony Regan, 17 April 2018, 1186; Exhibit 2.59, 5 October 2017, Draft Clayton Utz report with annotations by Salter dated 05/10/2017, 35, 36.

¹¹⁹ Transcript, Anthony Regan, 17 April 2018, 1187–8; Exhibit 2.60, 6 October 2017, Emails between Salter and Mavrakakis, undated, 1; Exhibit 2.61, undated, Drafts sent by Salter to Mavrakakis attached to Exhibit 2.60, 3–5.

- On 6 October 2017, Clayton Utz sent AMP a signed final report.¹²⁰ On 11 October 2017, an email was sent to Clayton Utz asking it to make some further changes to the report to include some words suggested by the then-Chair of the Board of AMP. Among other things, Clayton Utz were asked to ‘include a statement to the effect that [Mr Meller, the then-CEO] was unaware of the practices or their illegality’.¹²¹
- A further signed final report was supplied to AMP on 16 October 2017.

On 15 October 2017, two days before the 17 October meeting between representatives of AMP and ASIC, Mr Salter, the then-Group General Counsel of AMP sent an email to the then-Chair and Deputy Chair of ASIC saying that they would recall being told that ‘the AMP Limited Board had instructed Clayton Utz to undertake an independent investigation of (in brief) the circumstances behind the continued charging of ongoing service fees’ to certain clients. The email said that the Chair of AMP and the author of the email ‘would like to meet with both [the Chair and Deputy Chair of ASIC] ... to provide ASIC with a copy of the report’.¹²²

On 16 October 2017, AMP met with ASIC and presented the report from Clayton Utz and its letter of instructions to Clayton Utz. Given the sequence set out above, it may be open to find that AMP implicitly or explicitly misled ASIC as to the character of the Clayton Utz Report at that meeting.¹²³ In producing the Clayton Utz Report and the letter of instructions to ASIC

¹²⁰ Transcript, Anthony Regan, 17 April 2018, 1189; Exhibit 2.62, undated, Bundle of documents relating to final report comprising email Mavrakis to Brenner submitting final BOLR report 6 October 2017, Letter Clayton Utz to Brenner and report.

¹²¹ Transcript, Anthony Regan, 17 April 2018, 1191; Exhibit 2.63, 11 October 2017, Email Salter to Mavrakis dated 11/10/2017, 1.

¹²² Transcript, Anthony Regan, 17 April 2018, 1192–3 and Exhibit 2.65, 4 October 2017, Email Salter to Medcraft, Brenner and others.

¹²³ Transcript, Anthony Regan, 17 April 2018, 1172–3; Exhibit 2.43, 17 October 2017, Emails between Baker Cook and Zhang dated 17/10/2017.

under a Section 33 notice on 16 October 2017, AMP may have represented to ASIC that the report was 'external and independent'.¹²⁴

On the basis of the evidence set out above, I consider that AMP may have made false representations to ASIC about the character of the Clayton Utz Report.

In particular, having regard to the number and nature of the changes made to drafts of the report, it may be open to conclude that AMP knew that the report was not an independent report. Conduct of that kind, if established, might be misconduct.

As these matters are now under active consideration by ASIC, the entity having primary responsibility to enforce relevant provisions of the law,¹²⁵ I need not consider whether it is appropriate to refer the matters to ASIC for consideration. Having not heard evidence from Ms Brenner, Mr Meller, Mr Salter, or from any partner of Clayton Utz, I make no findings about their conduct.

2 Fees for no service: CBA

2.1 Background

The second fees for no service case study concerned CBA.

Ms Marianne Perkovic gave evidence on behalf of CBA. Ms Perkovic is an Executive General Manager and a Director of Commonwealth Private Ltd.¹²⁶ She previously had overall responsibility for each of CBA's AFSL holding subsidiaries that together constitute the Advice Licensees, including:¹²⁷

¹²⁴ AMP also represented this to ASIC in other ways, including in an email dated 4 October 2017: see Exhibit 2.65, 4 October 2017, Email Salter to Medcraft, Brenner and others. The representation made to ASIC in this email was consistent with the representation made to ASIC at the 16 October meeting: see Transcript, Anthony Regan, 17 April 2018, 1193.

¹²⁵ Corporations Act s 1315.

¹²⁶ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 1 [1]; see also Transcript, Marianne Perkovic, 18 April 2018, 1269.

¹²⁷ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 1 [2].

- Commonwealth Financial Planning Limited (CFPL);
- Count Financial Limited (Count); and
- BW Financial Advice Limited (BWFA).

2.2 The Advice Licensees

CBA, through its Advice Licensees, conducts¹²⁸ a very substantial financial advice business.

CBA's largest Advice Licensee by number of employed financial advisers is CFPL. In each year between 31 December 2008 and 31 December 2017, CFPL employed more than 500 financial advisers,¹²⁹ in some years more than 700. CFPL also had a smaller, but growing, number of authorised representatives.¹³⁰ As at 31 December 2017, CFPL had 99 authorised representatives.¹³¹

Of CBA's Advice Licensees, Count is the largest by number of authorised representatives. Between 31 December 2008 and 31 December 2017, it always had more than 500 authorised representatives, in some years many more.¹³² Count does not employ financial advisers.¹³³

BWFA was a subsidiary of Bankwest. Upon CBA's acquisition of Bankwest, BWFA also became a wholly owned subsidiary of CBA. BWFA was a comparatively smaller business than CFPL and Count. It employed financial advisers but did not have authorised representatives. Between 2009 and

¹²⁸ Or, in the case of BWFA Limited, conducted.

¹²⁹ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 2 [14].

¹³⁰ Authorised representatives are not employees but instead are authorised to provide financial services on behalf of an Australian financial services licence holder – in this case, CFPL. This term has this meaning for where it is used throughout this section of the report.

¹³¹ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 2 [14].

¹³² Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, 2 [13].

¹³³ Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, 2 [12].

2016, when BWFA ceased trading, it generally employed between 20 and 40 financial planners.¹³⁴

2.3 Ongoing service arrangements

Each Advice Licensee offered ongoing service arrangements to its clients.

The fees payable by clients for all packages were generally deducted on a monthly basis from clients' product accounts by the platform operator and then remitted to the relevant Advice Licensee.¹³⁵

I outline below the arrangements particular to the packages offered by each Advice Licensee.

2.3.1 CFPL

CFPL's ongoing service packages have changed over time. Between 1 January 2008 and June 2013, it offered what was then known as the Ongoing Service package, but is now known as the Legacy Ongoing Service package. The exact services offered in that package varied from year to year, but always included an annual review meeting.¹³⁶ Other services included investment monitoring, 'priority access to financial planners' and alerts to new investment opportunities.¹³⁷ The Legacy Ongoing Service package was charged at different rates depending on the platform used, with rates being as high as 0.94% of funds under management.¹³⁸

For some of the period that the Legacy Ongoing Service package was offered, another ongoing service package, the 'Standard Service' package, was also offered. It consisted of three components: access to an adviser for routine administrative enquiries, notification by the adviser when a product

¹³⁴ Exhibit 2.78, Witness statement of Marianne Perkovic, 9 April 2018, 2 [10].

¹³⁵ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 5 [28], 6 [30], [36], 7 [38], [45], [47], 8 [54], [56].

¹³⁶ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 4 [24].

¹³⁷ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 5 [27].

¹³⁸ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 5 [29].

on CFPL's approved product list had been downgraded to 'Sell' or 'Sell on Review' and retention of client records by the adviser.¹³⁹

The Standard Service package fee was 0.44% of funds invested subject to a cap of 'around \$5,000 per annum'.¹⁴⁰

Between July 2013 and November 2016, CFPL offered the Central Ongoing Service package. It entitled clients to an 'annual "health check" call and offer of a phone-based review', phone access to an adviser and e-newsletters.¹⁴¹

The Central Ongoing Service package was charged at a flat rate ranging from \$400 to \$1,499 per year.¹⁴²

The final package offered by CFPL is the 'Local Ongoing Service' package. That package has been available since June 2013 and was still offered when Ms Perkovic gave her evidence. The components of the package are the offer of an annual review, a mid-year 'health check' phone call, access to a financial adviser for service and support that is reasonably required, proactive contact regarding investments, and newsletters and invitations to seminars.¹⁴³

The Local Ongoing Service package is charged on a fixed fee that can range from \$1,500 to \$21,600 per annum.¹⁴⁴ Ms Perkovic explained that a number of factors are taken into account by a computer 'advice valuation tool', which calculates the fee. Those factors include funds under management and the complexity of the advice required.¹⁴⁵

In the period from 2008, CFPL earned very significant amounts from ongoing service fees, ranging from in excess of \$38 million in 2008 to more than \$100 million in each of 2014 and 2015. In 2017 it earned more than \$85 million in ongoing service fees.¹⁴⁶

¹³⁹ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 6 [35].

¹⁴⁰ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 6 [37].

¹⁴¹ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 7 [44].

¹⁴² Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 7 [46].

¹⁴³ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 8 [52]–[53].

¹⁴⁴ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 8 [55].

¹⁴⁵ Transcript, Marianne Perkovic, 18 April 2018, 1292–3.

¹⁴⁶ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 11 [78].

In the year ending 31 December 2017, CBA had 582 financial advisers and during that year those advisers had more than 190,000 clients.¹⁴⁷

2.3.2 BWFA

BWFA offered similar packages to CFPL from November 2010 until it ceased trading.

Each package included a phone-based annual review and ancillary services.¹⁴⁸ The total value of ongoing service fees charged by BWFA ranged from approximately \$216,000 in 2010 to approximately \$1.3 million in 2015.¹⁴⁹

2.3.3 Count

Count did not offer set ongoing service packages. Each adviser firm was free to structure ongoing service arrangements or packages in the way that it thought most appropriate.¹⁵⁰

The amount of ongoing service fees charged by Count was significant, ranging from more than \$24 million in 2009 to more than \$45 million in 2017.¹⁵¹

2.4 The fees for no service conduct

In its response to the Commission's initial letter, CBA identified the fee for no service issue in respect of CFPL, BWFA and Count and pointed to its breach notifications to ASIC. It said that deficiencies in the provision of ongoing advice had been an industry-wide issue, and gave some details about its remediation program and the amounts paid or offered at that date.¹⁵²

¹⁴⁷ Exhibit 2.74, Witness statement of Marianne Perkovic, 9 April 2018, 7–9 [46]. The number of clients is calculated as clients who had an ongoing service agreement.

¹⁴⁸ Exhibit 2.78, Witness statement of Marianne Perkovic, 9 April 2018, 5–6 [29]–[33].

¹⁴⁹ Exhibit 2.78, Witness statement of Marianne Perkovic, 3 April 2018, 5–6 [34].

¹⁵⁰ Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, 3 [19].

¹⁵¹ Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, 5–6 [34].

¹⁵² CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, 11–13 [39]–[45].

CBA attributed the conduct to 'inadequate risk management framework and processes, which meant it was not possible to effectively monitor the provision of ongoing services.'¹⁵³

The clients who were charged fees for no service by CBA entities fell into two categories.

The first category comprised clients who were allocated to a financial adviser, but the financial adviser failed to provide ongoing services to the client,¹⁵⁴ and for whom the relevant Advice Licensee had no systems in place to ensure the services were delivered.¹⁵⁵ Both CFPL and BWFA had clients in this category.¹⁵⁶

The second category of clients charged fees for no service were 'orphaned' clients. Orphaned clients were no longer allocated to a planner and there was therefore no possibility that advice would be, or could be, provided to them. CFPL¹⁵⁷, BWFA¹⁵⁸ and Count¹⁵⁹ each charged this category of client fees without providing services.

The extent of any conduct by Count within the first category is unclear. Count did not acknowledge a systemic problem with the charging of fees to this first category of clients.¹⁶⁰ CBA maintained the position in the submissions it filed after the completion of the second round of hearings ('CBA's 4 May submissions') that Count did not have a systemic problem that was separate to the orphan client issue raised in the notification it made to ASIC.¹⁶¹ However, the Commission received evidence about a number of

¹⁵³ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, 12 [41].

¹⁵⁴ Transcript, Marianne Perkovic, 18 April 2018, 1269.

¹⁵⁵ Transcript, Marianne Perkovic, 18 April 2018, 1312.

¹⁵⁶ Transcript, Marianne Perkovic, 18 April 2018, 1270.

¹⁵⁷ Transcript, Marianne Perkovic, 18 April 2018, 1269.

¹⁵⁸ Exhibit 2.78, Witness statement of Marianne Perkovic, 9 April 2018, [58]; Transcript, Marianne Perkovic, 18 April 2018, 1270.

¹⁵⁹ Transcript, Marianne Perkovic, 18 April 2018, 1270.

¹⁶⁰ Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, [80].

¹⁶¹ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 3 [9].

Count advisers, identified in a Count Risk and Compliance Forum, who were not providing services in exchange for the fees they were charging.¹⁶² When questioned about this, Ms Perkovic said that, in 2014, ASIC had requested that CBA undertake sample testing in relation to both Count and another CBA licensee, Financial Wisdom.¹⁶³ Work in response to this request was ongoing, but Ms Perkovic said that she understood the fail rates for both licensees to be less than 2%.¹⁶⁴

2.5 How the issue was identified and reported

Each of CFPL, BWFA and Count gave notice to ASIC pursuant to Section 912D of the Corporations Act of their possible breaches arising from their fees for no service conduct in the second half of 2014.¹⁶⁵

The first documented instance of a CFPL client paying for, but not receiving, service arose from a customer complaint in July 2008.¹⁶⁶ CFPL received complaints in each of the years from 2008 to 2014 about fees being charged but no services being provided.¹⁶⁷

In April 2012, CBA conducted high level analysis with a view to determining whether there were any ongoing service fee issues within the CBA advice business, including CFPL.¹⁶⁸ That analysis identified 257 clients who were paying ongoing service fees but were not attached to a planner. Various systemic failings were identified, including that:¹⁶⁹

¹⁶² Transcript, Marianne Perkovic, 19 April 2018, 1339, 1340, 1341.

¹⁶³ Transcript, Marianne Perkovic, 19 April 2018, 1338.

¹⁶⁴ Transcript, Marianne Perkovic, 19 April 2018, 1339.

¹⁶⁵ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 2 [7]; see also CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, 12 [40].

¹⁶⁶ Exhibit 2.87, Undated, Appendix 1 to CFPL Response to Notice of Direction, 4.

¹⁶⁷ Exhibit 2.87, Undated, Appendix 1 to CFPL Response to Notice of Direction, 55–65; Transcript, Marianne Perkovic, 19 April 2018, 138–9.

¹⁶⁸ Exhibit 2.81, 18 April 2018, Memorandum from Henderson to Chambers and others dated 12/04/2012.

¹⁶⁹ Exhibit 2.81, 18 April 2018, Memorandum from Henderson to Chambers and others dated 12/04/2012.

- There was no supervision or monitoring to identify whether ongoing service obligations were being met by planners.¹⁷⁰
- There were CFPL clients who were not assigned to an active adviser.
- There was no single source of data by which the status of ongoing service fee clients could be identified.
- Financial planners were not required to maintain a register of their ongoing service clients.
- The position of ongoing service fee clients could only be ascertained through manual searches across a number of systems.

From at least May 2012, a number of senior people within the CBA advice business, including the Group Executive, were aware of these issues. The possible exposure arising from the issues was estimated at the time as being at least \$6 million.¹⁷¹

At around this time, Count was also asked to consider whether it could have similar issues.¹⁷²

In May 2012, Count identified that it had an orphan client list that earned fee income of between \$1.5 and \$2 million per annum, and that the clients on this list did not receive any type of review.¹⁷³

In June 2012, Deloitte issued a draft of a report commissioned by CBA that found that a potential issue for CFPL was that '[s]ystems to identify clients that have signed up to, and/or receive, ongoing service arrangements are inadequate.'¹⁷⁴

Deloitte issued a further report in July 2012. Deloitte concluded that clients in ongoing service programs were at risk of not receiving contracted services, and controls had not been designed to ensure the provision of

¹⁷⁰ Transcript, Marianne Perkovic, 18 April 2018, 1297.

¹⁷¹ Exhibit 2.83, 11 May 2012, Email from Perkovic to Spring and others dated 11/05/2012, 1.

¹⁷² Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, 8 [47].

¹⁷³ Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018, 8 [49].

¹⁷⁴ Exhibit 2.84, 6 June 2012, Draft Report of Deloitte, 17.

ongoing reviews.¹⁷⁵ Deloitte identified over \$700,000 in ongoing service fees being charged on an annual basis to over 1,050 clients allocated in the system to over 50 inactive planners.¹⁷⁶ The risk of ineffective provision of ongoing service was rated by Deloitte as 'very high'.¹⁷⁷

Ms Perkovic agreed that, at the time of Deloitte's July 2012 report, CBA did not know whether services were being provided or not. She agreed that:

- CFPL did not have effective controls in place to prevent ongoing service fees being charged inappropriately.
- CFPL did not have effective controls in place to assess whether clients were receiving the services for which they were being charged.
- CFPL did not know what advice was being given to clients who were paying for ongoing advice.
- CFPL did not have controls in place to ensure that, when an adviser left, the adviser's clients were moved to a new adviser.
- CFPL did not have controls in place to stop ongoing service fees being charged to clients who became orphaned.
- CFPL did not have controls in place to ascertain whether clients were being notified of significant events that may require action to be taken to protect their position.
- CFPL used ad hoc systems to store data that could not be centrally checked except by manual processes.¹⁷⁸

CBA accepted in its 4 May submissions that it is open to find that before October 2013, CFPL did not have in place systems that enabled timely and comprehensive checks of whether services were being provided for ongoing service fees charged.¹⁷⁹ CBA also accepted that it is open to find that before

¹⁷⁵ Exhibit 2.85, 19 July 2012, Business Issues Management Report of Deloitte's, 4.

¹⁷⁶ Exhibit 2.85, 19 July 2012, Business Issues Management Report of Deloitte's, 4.

¹⁷⁷ Exhibit 2.85, 19 July 2012, Business Issues Management Report of Deloitte's, 6.

¹⁷⁸ Transcript, Marianne Perkovic, 18 April 2018, 1317–18.

¹⁷⁹ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 19 [61].

mid-2014, CFPL's internal systems were inadequate to identify and report contravening conduct.¹⁸⁰ In particular, CBA acknowledged that, by mid-2012, CFPL:

- was aware that its systems and controls for managing the provision of ongoing service required improvement;¹⁸¹ and
- other than by manually reviewing tens of thousands of client files, CFPL had no way to identify which clients were ongoing service clients, how many of those clients were attached to an active adviser or how many were not receiving services.¹⁸²

In addition to the two reports Deloitte had provided about CFPL (in June and July 2012) CBA asked Deloitte to provide a report in relation to Count. Deloitte issued a draft report on 20 November 2012, which noted that as at September 2012, Count had an orphan client book that held approximately 10,200 'policies' (an expression that seemed to be used as a synonym for 'clients').¹⁸³

CFPL first notified ASIC of a suspected breach on 11 July 2014.¹⁸⁴ That was not a formal notification pursuant to Section 912D of the Corporations Act, but an 'early warning'. CFPL advised that it had identified 5,838 clients who had paid ongoing service fees amounting to \$12.9 million in revenue and was investigating the circumstances of each customer.

CFPL then made a formal notification to ASIC pursuant to Section 912D on 13 August 2014.¹⁸⁵

¹⁸⁰ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 19 [62].

¹⁸¹ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 11 [31].

¹⁸² CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 10–11 [29].

¹⁸³ Exhibit 2.89, 20 November 2012, Draft Deloitte Report concerning Count, Business Issue Management, 14

¹⁸⁴ Exhibit 2.73, Witness statement of Marianne Perkovic, [124]; Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, MP-2 [CBA.9000.0006.0001].

¹⁸⁵ Exhibit 2.73, Witness statement of Marianne Perkovic, [125]; Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, MP-3 [CBA.0001.0039.0453].

Count made a formal notification on 9 September 2014.¹⁸⁶

2.6 What the case study showed

2.6.1 Fees for no service: Misconduct and causes

The charging of fees without providing contracted services is self-evidently a breach of duty and a form of misconduct. Ms Perkovic's evidence was that CBA had put in place extensive reforms to prevent, or at least minimise the prospect of, such conduct occurring again.

CBA acknowledged that the Advice Licensees engaged in misconduct by charging fees for no service and that the conduct contravened Section 912A(1)(a) of the Corporations Act.¹⁸⁷ CBA also acknowledged that the conduct continued over an extended period.¹⁸⁸ CBA further acknowledged that CFPL and BWFA did not have adequate supervisory arrangements to monitor the ongoing service obligations.¹⁸⁹

Ms Perkovic's evidence was that CBA had paid or offered to pay about \$118.5 million in refunds, including interest, to clients who had been charged fees for no service by CFPL, Count and BWFA.¹⁹⁰

In its 4 May submissions, CBA sought to contextualise the amount refunded, by explaining that it had remediated clients in circumstances where the evidence was inconclusive as to whether services had been provided, where the client had been offered an annual review but had

¹⁸⁶ Exhibit 2.75, Witness statement of Marianne Perkovic, 3 April 2018 (Tab 2) [CBA.0508.0008.0008].

¹⁸⁷ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 2 [7]; see also CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, 12 [40].

¹⁸⁸ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 2–3 [7]–[8].

¹⁸⁹ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 4–5 [13]; see also CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, 12 [41].

¹⁹⁰ Transcript, Marianne Perkovic, 18 April 2018, 1270; see also CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, [39].

declined, and where the financial adviser had not be able to contact the client to offer of the annual review.¹⁹¹ That is, and contrary to Ms Perkovic's evidence, in framing its remediation program CBA did not act on the basis that an *offer* to conduct a review warranted charging the ongoing service fee.

The larger question is how it came to be that the Advice Licensees charged fees for no service to such a significant extent and over so long a period. Ms Perkovic accepted that CFPL's remuneration and performance targets were not aligned so as to ensure delivery of service.¹⁹² An external audit by PwC in 2014 had identified this as an issue.¹⁹³ In 2015 CFPL changed its remuneration policy in ways intended to align remuneration and performance targets to ensure delivery of service.

In CBA's 4 May submissions, CBA pointed to the 'Variable Remuneration Plan' that CFPL has had in place since 1 July 2013, and to the changes that were later made to CBA's Advice Licensees' remuneration structures to implement a 'balanced scorecard system'. Since 2015, the risk management component of the balanced scorecard has included 'ensuring delivery of ongoing service to all customers' as a mandatory threshold.¹⁹⁴ While those remuneration structures properly emphasised the necessity for the delivery of contracted services, absent systems capable of monitoring that conduct, their utility is necessarily diminished.

The culture of the organisation, and the attitude of those charged with delivery and supervision of ongoing services is also of direct relevance to the question. There appears to have existed a cultural tolerance on the part of CBA and its Advice Licensees of risks and conduct that were potentially detrimental to clients but that were to the financial advantage of CBA through its Advice Licensees. CBA denied that the evidence established a culture where CBA directed, encouraged or tolerated the identified failings

¹⁹¹ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 2–3 [8].

¹⁹² Transcript, Marianne Perkovic, 19 April 2018, 1343.

¹⁹³ Transcript, Marianne Perkovic, 19 April 2018, 1343.

¹⁹⁴ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 17 [51]–[52].

or a culture that led to their occurrence.¹⁹⁵ However, the cultural tolerance is highlighted by several aspects of Ms Perkovic's evidence.

Ms Perkovic agreed that CFPL not implementing a practice of providing fee disclosure statements during the period between enactment of the FoFA reforms and them coming into operation a year later reflected an attitude that, unless required by law to provide fee disclosure statements, CFPL would not do so.¹⁹⁶ While such an attitude does not reveal misconduct – indeed on one view it reflects no more than a willingness to adhere to the law – it does bespeak an unwillingness to provide relevant information to clients in a readily comprehensible form without legislative intervention. That does not reflect what was described at various points in the hearings as a 'customer centric' culture.

Another aspect that may speak to the culture of CBA's financial advice business is the attitude to grandfathered commissions. CFPL continues to receive grandfathered commissions from clients who entered into commission arrangements before 1 July 2013. Ms Perkovic said that CFPL has given no consideration to dialling down those commissions to zero. Her explanation was that 'grandfathering arrangements allow us some relief'.¹⁹⁷ Whilst Ms Perkovic said that CFPL was considering applying opt-in requirements to pre-1 July 2013 clients, at the time of the hearing of the case study in April 2018, CFPL had been considering that possibility for six months without arriving at a decision.¹⁹⁸ Again, there is nothing wrong in that conduct, but not deciding whether the 'relief' afforded by the law is appropriate, or whether there is a more appropriate way of managing historic **conflicted remuneration**, reveals a culture that is heavily weighted toward revenue maximisation while placing less emphasis on client outcomes.

Finally, in more recent years CFPL has acted in ways that appear likely to lessen, rather than increase, the prospects of clients receiving meaningful services. In the period from 2008 to 2017, the number of financial planners

¹⁹⁵ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 18 [56].

¹⁹⁶ Transcript, Marianne Perkovic, 19 April 2018, 1344.

¹⁹⁷ Transcript, Marianne Perkovic, 19 April 2018, 1345.

¹⁹⁸ Transcript, Marianne Perkovic, 19 April 2018, 1345.

employed by CFPL fell by approximately 25% but the number of clients increased by almost 100%.¹⁹⁹ The service packages offered by CFPL were also recast. Up to 2013, the critical element of the Legacy Ongoing Service package was an annual review. The equivalent package now offered by CFPL, and indeed the only package now offered by CFPL, the Local Ongoing Service package, provides for an *offer* of an annual review rather than an annual review.²⁰⁰

Taken together, these matters suggest a culture at CFPL that is more focused upon maximising revenue streams than providing the best possible professional service to its clients.

By engaging in the fee for no service conduct identified above, the Advice Licensees failed to do all things necessary to ensure the financial services covered by its licence are provided efficiently, honestly and fairly. So much was acknowledged and accepted by CBA.²⁰¹

Moreover, there is ample evidence to support the finding that, at the time of the fees for no service conduct, the Advice Licensees did not have adequate resources to carry out their supervisory arrangements. By failing to implement systems capable of monitoring the provision of ongoing services, each Advice Licensee breached its obligation to have available adequate resources, including technological resources, to carry out supervisory arrangements.

In its 4 May submissions, CBA accepted that CFPL and BWFA (but not Count)²⁰² had inadequate supervisory arrangements, namely IT systems, in

¹⁹⁹ Exhibit 2.74, Witness statement of Marianne Perkovic, 4 April 2018, 1–2 [5].

²⁰⁰ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 8 [53]; Transcript, Marianne Perkovic, 18 April 2018, 1287.

²⁰¹ See CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 2 [7]; see also CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission*, 29 January 2018, [40].

²⁰² CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 4–5 [13].

place to monitor their ongoing service obligations.²⁰³ That acknowledgment was properly made and accorded with Ms Perkovic's evidence that:

- CFPL did not have systems to supervise and monitor the effective provisioning of ongoing service;²⁰⁴
- CFPL's systems were so inadequate that it had no idea what was going on in its business;²⁰⁵ and
- as at 2012, the only system that CFPL had in place in respect of ongoing service arrangements that was effective in any way was a system for charging clients.²⁰⁶

Ms Perkovic also sought to explain the failure to give earlier notification of significant breaches to ASIC as being due to a 'known problem' that some licensees had no systems to identify whether services had been delivered with the consequence that CBA could not know for how many clients its licensees had failed to deliver ongoing services.²⁰⁷ It follows from the evidence to which I have referred that CFPL and BWFA did not have available adequate resources, including technological and human resources, to carry out necessary supervisory arrangements. It follows that each of CFPL and BWFA may have contravened Section 912A(1)(d) of the Corporations Act.

In respect of orphan clients, it appears that at least CFPL and BWFA accepted payment for financial services that they were not then able to supply to the client.

CBA submitted that none of CFPL, BWFA or Count had breached Section 12DI(3) of the ASIC Act.²⁰⁸ CBA accepted that CFPL and BWFA had accepted payment for the ongoing services, but it denied that there

²⁰³ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 4–5 [13].

²⁰⁴ Transcript, Marianne Perkovic, 18 April 2018, 1316.

²⁰⁵ Transcript, Marianne Perkovic, 18 April 2018, 1312.

²⁰⁶ Transcript, Marianne Perkovic, 18 April 2018, 1319.

²⁰⁷ Transcript, Marianne Perkovic, 18 April 2018, 1312, 1323.

²⁰⁸ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 5–7 [16]–[21].

were reasonable grounds at the requisite time for believing that either entity would not be able to supply the financial services within a reasonable time.²⁰⁹ CBA denied that Count accepted payment.²¹⁰

In light of the **enforceable undertaking** offered and accepted very shortly before the Commission began the relevant round of hearings, it is neither necessary nor appropriate to resolve these issues. Before dealing with that enforceable undertaking, one other feature of the matter should be considered.

2.6.2 Reporting: Misconduct and causes

It would appear from Ms Perkovic's evidence that, for at least 18 months before the breach notifications were given to ASIC, senior management of CBA, CFPL and Count were either aware of the fact that clients were being charged fees and not provided with services or aware of the likelihood that ongoing services were not being provided to clients who were being charged ongoing service fees.

In CBA's 4 May submissions, it submitted that it was not open to find that CFPL or Count had breached Section 912D(1B).²¹¹ It did so on the basis that the evidence before me did not establish that either CFPL or Count had actual knowledge of a significant breach or likely significant breach.²¹² CBA did, however, acknowledge that the time taken to identify and address the ongoing service issues was conduct that may fall below community standards and expectations.²¹³

Ms Perkovic explained that determining the number of clients affected was important to determining the significance of the breach.²¹⁴ Each of the CBA

²⁰⁹ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 5–7 [16], [19]–[20].

²¹⁰ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 5 [17].

²¹¹ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 7–8 [22]–[26].

²¹² CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 7–8 [23]–[25].

²¹³ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 8 [26], 13 [36], 16 [48].

²¹⁴ Transcript, Marianne Perkovic, 19 April 2018, 1336.

advice licensees has many clients, many more than the number of clients that a small independent operator would have. In the case of an authorised representative of Count, the evidence suggests that if that authorised representative was consistently failing to provide service to ongoing service clients then that might be a significant failure at the level of the individual authorised representative but would not be treated, under CBA's governance practices, as a significant breach at the level of Count. Therefore, so the argument ran, the size of CBA may reduce the likelihood that ASIC received timely notice under Section 912D of risks to members of the public who were dealing with CBA or its subsidiary licensees.

In CBA's 4 May submissions, it accepted that it was open to find that the number of advisers and clients within CBA's licensees was a factor in the length of time it took those licensees to become aware that a significant breach had occurred.²¹⁵ However, CBA submitted that this was contemplated and permitted by the legislative regime for breach reporting, as it then stood, because the size of the licensee is one of the factors that may inform the decision-making process of the particular licensee as to when a reportable breach has occurred.²¹⁶ CBA further reasoned that, as no misconduct occurred with respect to CBA's reporting of the misconduct, there was no causal relationship between the size of CBA's Advice Licensees and any misconduct alleged.²¹⁷

As events have turned out, the amount of money paid as compensation for clients who had been charged fees for no service shows plainly that the breaches that occurred were significant by any measure. There would likely be a real and lively debate about when this was, or should have become, apparent to the management of CBA or the management of the relevant advice licensees. And there may well have been an equally real and lively debate about the proper construction of the relevant provisions of Section 912D.

²¹⁵ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 19 [59].

²¹⁶ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 18–19 [58].

²¹⁷ CBA, *Round 2 Hearing – Financial Advice Closing Submissions – Part A Wealth Management*, 4 May 2018, 19 [59].

It is, however, neither necessary nor appropriate for me to enter upon those issues. First, they have been overtaken by the enforceable undertaking negotiated between CBA and ASIC. Second, if the recommendations of the ASIC Enforcement Review are implemented, Section 912D will be amended. As noted elsewhere in this report,²¹⁸ the negotiation of an enforceable undertaking as a response to the charging by CBA subsidiaries of fees for no service invites attention to whether the undertaking was a sufficient acknowledgment by the entities concerned that what they had done was contrary to law and contrary to basic standards of honesty. It also invites attention to whether the consequences exacted (a 'community benefit payment' of \$3 million) were adequate. And when considering the adequacy of that payment it would be relevant to notice that ANZ, which had had to pay only about half the amount of compensation that CBA had to pay, was also required, under its enforceable undertaking, to make the same 'community benefit payment' of \$3 million.

3 Bad advice: Westpac

3.1 Background

The Commission heard evidence about Westpac's financial advice business, and the conduct of two financial advisers employed by Westpac: Mr Ramakrishnan Mahadevan and Mr Andrew Smith. Two witnesses gave evidence in relation to these matters: Mrs Jacqueline McDowall, who received financial advice from Mr Mahadevan in 2015; and Mr Michael Wright, who is the National Head of Westpac's financial advice business, BT Financial Advice.

On 29 March 2018, before the second round of the Commission's hearings began, the Solicitor Assisting the Commission wrote to Mr Smith and notified him that his conduct may be the subject of a case study to be heard by the Commission. The same day, the Commission spoke with Mr Smith and explained the substance of the evidence concerning his conduct. On 11 April, the Commission sent Mr Smith an email attaching a copy of Mr Wright's statement. On 13 April, Mr Smith was granted leave to appear

²¹⁸ Chapter 3.

at the hearings. Despite being granted leave, Mr Smith did not appear in person and was not represented during the hearings.

At the time of the second round of the Commission's hearings, Mr Mahadevan was still employed by Westpac. He was notified of the evidence concerning his conduct through his employer.

3.2 Evidence

3.2.1 Mr Mahadevan and Mr and Mrs McDowall

Mrs McDowall approached Westpac in April 2015 seeking financial advice about a retirement strategy for her and her husband.²¹⁹ She was referred to Mr Mahadevan, a Senior Financial Planner with BT Financial Group.²²⁰

On 29 April 2015, Mr and Mrs McDowall met with Mr Mahadevan at a suburban Westpac branch.²²¹ At that meeting, they told Mr Mahadevan that they wanted to purchase a property that they could use to live in and operate a bed and breakfast in their retirement.²²² They explained to Mr Mahadevan that they had a number of debts, including a mortgage over their home, and that the only money they had available to contribute to the purchase of the property was their combined superannuation balance of around \$200,000.²²³ They told Mr Mahadevan that they wanted to establish a self-managed superannuation fund (SMSF) and use that fund to take out a loan to purchase the property to live and run the bed and breakfast in.²²⁴ They said that they expected the property would cost around \$1 million.²²⁵

²¹⁹ Transcript, Jacqueline McDowall, 19 April 2018, 1355.

²²⁰ Transcript, Jacqueline McDowall, 19 April 2018, 1355; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037 at .0037].

²²¹ Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, 2 [10].

²²² Transcript, Jacqueline McDowall, 19 April 2018, 1356.

²²³ Transcript, Jacqueline McDowall, 19 April 2018, 1355–6; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-1 [WIT.0900.0001.0001].

²²⁴ Transcript, Jacqueline McDowall, 19 April 2018, 1355, 1357.

²²⁵ Transcript, Jacqueline McDowall, 19 April 2018, 1356.

At that meeting, Mr Mahadevan introduced Mr and Mrs McDowall to Mr Karl Sleiman, a business banker, who told them that they could borrow enough money to achieve their goal.²²⁶

Following the meeting, Mr Mahadevan told Mr and Mrs McDowall to put their home on the market, which they did.²²⁷

In June 2015, Mr Mahadevan provided Mr and Mrs McDowall with a statement of advice.²²⁸ He recommended that they establish an SMSF, roll over their existing superannuation balances into that fund, and each take out life insurance and income protection insurance (through Westpac insurance products) at a level that would cover the debt they expected to incur to purchase the bed and breakfast property.²²⁹ Mr Mahadevan did not expressly provide Mr and Mrs McDowall with any advice about whether their retirement strategy – borrowing through an SMSF to purchase a property to live in and operate a bed and breakfast – was viable.²³⁰

For this advice, Mr Mahadevan proposed to charge Mr and Mrs McDowall up-front fees of \$5,280, plus a \$3,000 fee for ‘ongoing advice’.²³¹ Mr Wright could not explain what the ‘ongoing advice’ would have involved. He said that the purpose of ongoing advice is to ‘hav[e] an adviser to help and reassure you to achieve your goals’,²³² and that the \$3,000 ongoing fee charged by Mr Mahadevan was ‘the charge that would be paid after the initial advice to help [Mr and Mrs McDowall] realise their dreams over the

²²⁶ Transcript, Jacqueline McDowall, 19 April 2018, 1359.

²²⁷ Transcript, Jacqueline McDowall, 19 April 2018, 1360.

²²⁸ Transcript, Jacqueline McDowall, 19 April 2018, 1360; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037].

²²⁹ Transcript, Jacqueline McDowall, 19 April 2018, 1361–2; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037 at .0043–.0049].

²³⁰ Transcript, Michael Wright, 19 April 2018, 1394–5.

²³¹ Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037 at .0059].

²³² Transcript, Michael Wright, 19 April 2018, 1396.

journey'.²³³ Mr and Mrs McDowall would also have to pay \$3,905 to a third party to establish the SMSF.²³⁴

In the course of preparing the statement of advice for Mr and Mrs McDowall, a paraplanner (who assisted planners by preparing draft statements of advice) had warned Mr Mahadevan that he should advise Mr and Mrs McDowall to delay establishing the SMSF and taking out new insurance policies until after a suitable property had been found, but Mr Mahadevan overrode the paraplanner.²³⁵

Mr and Mrs McDowall authorised Mr Mahadevan to implement the advice,²³⁶ subject to a change to some of the recommended insurance policies.²³⁷ Westpac received \$17,600 in upfront commissions as a result of the implementation of the advice,²³⁸ and this contributed to Mr Mahadevan receiving a monthly bonus following the implementation of the advice.²³⁹ Mr and Mrs McDowall sold their home in the expectation that they would soon purchase and move into the bed and breakfast property.²⁴⁰ They moved into short-term rental accommodation, and used the proceeds of the sale to pay off a number of their debts.²⁴¹

In November 2015, Mr and Mrs McDowall again met with Mr Mahadevan and Mr Sleiman. At that meeting, Mr and Mrs McDowall showed Mr Mahadevan and Mr Sleiman information about two properties that they were thinking of purchasing, but Mr Sleiman told them that they could not borrow

²³³ Transcript, Michael Wright, 19 April 2018, 1396.

²³⁴ Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037 at .0059].

²³⁵ Transcript, Michael Wright, 19 April 2018, 1403–4; Exhibit 2.102, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-2 (Tab 41) [WBC.503.003.1200].

²³⁶ Transcript, Jacqueline McDowall, 19 April 2018, 1363.

²³⁷ Transcript, Michael Wright, 19 April 2018, 1397.

²³⁸ Transcript, Michael Wright, 19 April 2018, 1397.

²³⁹ Transcript, Michael Wright, 19 April 2018, 1398–9.

²⁴⁰ Transcript, Jacqueline McDowall, 19 April 2018, 1364.

²⁴¹ Transcript, Jacqueline McDowall, 19 April 2018, 1364.

enough to buy those properties.²⁴² He told Mr and Mrs McDowall that they could only borrow around \$200,000.²⁴³ Mrs McDowall gave evidence that:²⁴⁴

I felt very upset. And I just said to them, 'So what do we do now? Where do we go from here?' And [Mr Mahadevan] said, 'But you can still buy an investment property.' I said, 'Well, I don't think that that makes any sense.' I said, 'We sold our family home on your advice. We now don't have a family home to live in. So why would we then buy an investment property to rent to someone else when we haven't even got a property to live in our self?'

Mr and Mrs McDowall's retirement strategy was never viable.²⁴⁵ As they had told Mr Mahadevan, the only money that Mr and Mrs McDowall had available to contribute to the purchase of the bed and breakfast property was their combined superannuation balance of around \$200,000.²⁴⁶ This was not sufficient to allow them to borrow to purchase a property worth \$1 million, let alone to meet the added burdens imposed by the premiums on their new insurance policies.

Mr Wright accepted that Westpac's best interests duty policy required Mr Mahadevan to explain to Mr and Mrs McDowall at the first opportunity that their strategy was not viable.²⁴⁷ He also accepted that the financial advice that Mr Mahadevan gave to Mr and Mrs McDowall was poor, and was not in their best interests.²⁴⁸

Subsequently, Mr and Mrs McDowall made a complaint to Westpac about Mr Mahadevan's advice.²⁴⁹ The complaint was assigned to a

²⁴² Transcript, Jacqueline McDowall, 19 April 2018, 1364–5.

²⁴³ Transcript, Jacqueline McDowall, 19 April 2018, 1365.

²⁴⁴ Transcript, Jacqueline McDowall, 19 April 2018, 1365.

²⁴⁵ Transcript, Michael Wright, 19 April 2018, 1394–5.

²⁴⁶ Transcript, Jacqueline McDowall, 19 April 2018, 1355; see also Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-1 [WIT.0900.0001.0001 at .0008, .0017].

²⁴⁷ Transcript, Michael Wright, 19 April 2018, 1400.

²⁴⁸ Transcript, Michael Wright, 19 April 2018, 1400.

²⁴⁹ Transcript, Jacqueline McDowall, 19 April 2018, 1366; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-3 [WIT.0900.0001.0076].

Westpac employee to investigate.²⁵⁰ On 22 December 2015, the Westpac employee investigating the complaint sent an email to her manager, in which she said:²⁵¹

I believe there are a number of issues with the advice. Overall, I think [Mr Mahadevan] has put the customers in a worse off position.

In another email to her manager in January 2016, the same Westpac employee expressed the view that 'There isn't any lender in the market that would provide credit for this type of purchase'.²⁵²

In early 2016, Westpac made offers to settle the complaint, but Mr and Mrs McDowall rejected these offers.²⁵³

In March 2016, Mr and Mrs McDowall made a complaint to the Financial Ombudsman Service (FOS).²⁵⁴ Almost 18 months later, in August 2017, FOS determined the complaint in Mr and Mrs McDowall's favour, requiring Westpac to pay them \$107,475.²⁵⁵

In his evidence, Mr Wright accepted that Westpac's complaints handling process 'got it wrong', and that the complaint 'should never have gone to FOS'.²⁵⁶

Although the Westpac employee who investigated Mrs McDowall's complaint formed the view in December 2015 that Mr Mahadevan had

²⁵⁰ Transcript, Michael Wright, 19 April 2018, 1407.

²⁵¹ Transcript, Michael Wright, 19 April 2018, 1408; Exhibit 2.102, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-2 (Tab 11) [WBC.104.003.7373 at .7376].

²⁵² Transcript, Michael Wright, 19 April 2018, 1408; Exhibit 2.102, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-2 (Tab 11) [WBC.104.003.7373 at .7374].

²⁵³ Transcript, Jacqueline McDowall, 19 April 2018, 1366–7; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-4 [WIT.0900.0001.0078]; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-5 [WIT.0900.0001.0085].

²⁵⁴ Transcript, Jacqueline McDowall, 19 April 2018, 1367; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-6 [WIT.0900.0001.0088].

²⁵⁵ Transcript, Jacqueline McDowall, 19 April 2018, 1368–9; Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-8 [WIT.0900.0001.0101].

²⁵⁶ Transcript, Michael Wright, 19 April 2018, 1413.

put Mr and Mrs McDowall 'in a worse off position',²⁵⁷ and Westpac made offers to settle the complaint in early 2016,²⁵⁸ Westpac did not discipline Mr Mahadevan until October 2017, more than 18 months later.²⁵⁹ Mr Wright accepted that this was not adequate.²⁶⁰ Westpac did not report Mr Mahadevan's conduct to a professional association or to ASIC.²⁶¹

3.2.2 Mr Smith

Mr Smith was also a Senior Financial Planner employed by Westpac.²⁶²

During the time that Mr Smith was employed by Westpac, between 2008 and 2015,²⁶³ there were several issues with the advice that he provided. Later investigations by Westpac concluded that, among other things, Mr Smith had: recommended strategies or investments that were too risky for customers; transacted without customers' authority; charged ongoing advice fees without providing the promised services; and provided inappropriate financial advice to customers.²⁶⁴

Westpac's investigations of those matters were hampered by the 'haphazard' way in which Mr Smith kept his client files.²⁶⁵ In particular, contrary to Westpac's internal policies, Mr Smith had failed to use Westpac's electronic file management system.²⁶⁶ This made it difficult for the investigators to confirm conclusively that the advice given by Mr Smith was appropriate for his clients.²⁶⁷ The investigations found that Mr Smith's client files showed: inadequate investigation into clients' circumstances,

²⁵⁷ Transcript, Michael Wright, 19 April 2018, 1408.

²⁵⁸ Exhibit 2.102, Witness statement of Michael Wright, 5 April 2018, 6–7 [23].

²⁵⁹ Transcript, Michael Wright, 19 April 2018, 1408–9, 1411.

²⁶⁰ Transcript, Michael Wright, 19 April 2018, 1409.

²⁶¹ Transcript, Michael Wright, 19 April 2018, 1412.

²⁶² Transcript, Michael Wright, 19 April 2018, 1414–5.

²⁶³ Transcript, Michael Wright, 19 April 2018, 1414, 1425.

²⁶⁴ Transcript, Michael Wright, 19 April 2018, 1430; Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, 84–86 [379]–[385].

²⁶⁵ Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 86) [WBC.100.004.9464 at .9465].

²⁶⁶ Transcript, Michael Wright, 19 April 2018, 1426.

²⁶⁷ Transcript, Michael Wright, 19 April 2018, 1429.

needs and objectives; potential poor advice practices, particularly in relation to consideration of alternative strategies; inadequate record management; and failure to provide advice documents at the right time or at all.²⁶⁸

The main points to be made about the financial advice provided by Mr Smith concern the consequences (or lack of consequences) that Westpac attached to his conduct.

Mr Wright gave evidence about Westpac's consequence management policy, and how that policy applied to Mr Smith. Under the consequence management policy in force at the relevant time, financial advisers at Westpac began with a total of 60 points, and had points deducted for non-compliant activities, such as poor audit results.²⁶⁹ The number of points that an adviser had determined the adviser's 'risk rating', which in turn determined the level of regional manager supervision to which the adviser was subject,²⁷⁰ and whether the adviser received a monthly bonus.²⁷¹

Between 2011 and 2015, Mr Smith was subject to a number of audits, and had points deducted as a result of poor ratings on a number of those audits.²⁷² However, until 2015, the number of points deducted was never high enough for Mr Smith to be ineligible for a monthly bonus, or for

²⁶⁸ Transcript, Michael Wright, 19 April 2018, 1429; Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 86) [WBC.100.004.9464 at .9464].

²⁶⁹ Transcript, Michael Wright, 19 April 2018, 1390–1; see Exhibit 2.109, 25 February 2015, Westpac Consequence Management Policy dated 25/02/2015; Exhibit 2.115, December 2012, Bank Financial Planning Consequence Management Policy dated December 2012.

²⁷⁰ See Exhibit 2.116, February 2013, Bank Financial Planning Regional Manager Supervision Policy and Processes.

²⁷¹ Transcript, Michael Wright, 19 April 2018, 1389–91, 1417–19; see Exhibit 2.107, October 2014 to September 2015, BT Financial Group Financial Planner Incentive Scheme; Exhibit 2.108, 1 April 2015, Bank Financial Planner Remuneration and Benefits Policy and Financial Incentives Payment Plan; Exhibit 2.109, 25 February 2015, Westpac Consequence Management Policy dated 25/02/2015.

²⁷² Transcript, Michael Wright, 19 April 2018, 1419–21; see Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 110) [WBC.501.031.5905]; Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 111) [WBC.501.031.5893]; Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 112) [WBC.501.031.5886]; Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 113) [WBC.501.025.5095].

Mr Smith to be subject to increased regional manager supervision.²⁷³ This was in part because these audits were held more than six months apart and, under the consequence management policy as it then stood, points deducted were restored every six months.²⁷⁴ Mr Wright agreed that Westpac's monitoring and supervision failed in relation to Mr Smith.²⁷⁵

In 2015, Mr Smith's poor audit results caused him to be identified as 'extremely high risk'.²⁷⁶ Westpac then conducted an investigation into Mr Smith's conduct. Following that investigation, Westpac put a series of allegations of misconduct to Mr Smith,²⁷⁷ and Mr Smith resigned.²⁷⁸

After Mr Smith's resignation, Westpac continued to investigate the advice that Mr Smith had provided while employed by Westpac. As noted above, Westpac later found that Mr Smith had: recommended strategies or investments that were too risky for customers; transacted without customers' authority; charged ongoing advice fees without providing the promised services; and provided inappropriate advice to customers.²⁷⁹ Westpac has since paid \$1.6 million in remediation to 32 former clients of Mr Smith and has provisioned a further \$600,000 to remediate a further 59 former clients.²⁸⁰

Although Westpac made allegations of misconduct against Mr Smith that could have resulted in his termination, it did not report Mr Smith to ASIC as a Serious Compliance Concern.²⁸¹ Westpac did not file a significant breach notification with ASIC until November 2015, several months after

²⁷³ Transcript, Michael Wright, 19 April 2018, 1419–21.

²⁷⁴ Transcript, Michael Wright, 19 April 2018, 1390–1, 1422.

²⁷⁵ Transcript, Michael Wright, 19 April 2018, 1422.

²⁷⁶ Transcript at 1424; Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 114) [WBC.501.025.5070].

²⁷⁷ Transcript, Michael Wright, 19 April 2018; 1425; see Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, Exhibit MW-1 (Tab 96) [WBC.500.021.6797].

²⁷⁸ Transcript, Michael Wright, 19 April 2018, 1424–5.

²⁷⁹ Transcript, Michael Wright, 19 April 2018, 1430. Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, 84–6 [379]–[385].

²⁸⁰ Transcript, Michael Wright, 19 April 2018, 1430–1.

²⁸¹ Transcript, Michael Wright, 19 April 2018, 1433.

receiving the reports of its investigations into Mr Smith.²⁸² Mr Wright did not know whether Westpac reported Mr Smith's conduct to any professional association.²⁸³

When Mr Smith's new licensee, Dover Financial Services, asked Westpac for information about Mr Smith's conduct, Westpac did not provide any information, beyond stating that there was an ongoing investigation and Westpac had 'concerns' about Mr Smith's conduct.²⁸⁴ Mr Wright was not aware of Westpac ever communicating the results of its investigations to Dover.²⁸⁵

3.2.3 Westpac's financial advice business

Mr Wright also gave evidence about Westpac's financial advice business more generally. Importantly, Mr Wright gave evidence that the current remuneration framework at Westpac – with its emphasis on revenue measures – could place the interests of customers at risk.²⁸⁶

Mr Wright acknowledged that Westpac does not do enough to ensure that financial advisers are recognised and rewarded when they tell a customer that he or she is doing the right thing, and did not need to make any changes in their relevant financial arrangements.²⁸⁷

Mr Wright gave evidence about some recent reports concerning Westpac's financial advice business. One of these was a draft report prepared by Deloitte in April 2018.²⁸⁸ Westpac engaged Deloitte to assess the design of its advice and service delivery framework to determine whether the advice process and control environment were adequate to provide quality advice outcomes. The draft report identified issues with Westpac's policies, including that policies are not 'supported by practical guidance to enable

²⁸² Transcript, Michael Wright, 20 April 2018, 1440–1.

²⁸³ Transcript, Michael Wright, 20 April 2018, 1444.

²⁸⁴ Transcript, Michael Wright, 20 April 2018, 1459–62.

²⁸⁵ Transcript, Michael Wright, 20 April 2018, 1463.

²⁸⁶ Transcript, Michael Wright, 20 April 2018, 1455.

²⁸⁷ Transcript, Michael Wright, 20 April 2018, 1448.

²⁸⁸ Exhibit 2.121, April 2018, Deloitte Report – Advice Services Review – BTFA Assessment – April 2018.

advisers to understand what is required of them'.²⁸⁹ Mr Wright accepted that Westpac is 'very poor' at showing its advisers how to comply with its policies.²⁹⁰

Another report was an internal report prepared in January 2018 that assessed the controls, processes and governance mechanisms in place across Westpac that could impact the provision of appropriate advice to customers.²⁹¹ This report identified that there are still significant weaknesses in Westpac's consequence management system.²⁹²

The Commission also heard evidence that, despite the changes that Westpac has made to its risk and compliance systems since 2015, in January 2018, the Risk Forum for Westpac's advice business assessed the residual risk of adverse consequences resulting from the provision of inappropriate advice to Westpac customers as remaining 'High'²⁹³ – the same level at which the Risk Forum had assessed the risk of such consequences in July 2015.²⁹⁴ Further, the Risk Forum assessed the likelihood of those consequences as having increased in recent years from 'Possible' to 'Likely' – that is, between 50% and 85%.²⁹⁵

Mr Wright was asked some more general questions about the financial advice industry. He said that he saw the financial advice industry as being 'on the cusp of becoming a true profession'.²⁹⁶ He accepted that the public do not place their trust in financial advisers in the same way they place their trust in other professions and said that this was because financial advisers 'haven't earned it yet'.²⁹⁷

Mr Wright discussed the grandfathering arrangements in relation to the payment and receipt of conflicted remuneration. He said that the financial

²⁸⁹ Transcript, Michael Wright, 20 April 2018, 1466.

²⁹⁰ Transcript, Michael Wright, 20 April 2018, 1467.

²⁹¹ Exhibit 2.125, 26 January 2018, Risk 24 Deep Dive Observations.

²⁹² Transcript, Michael Wright, 20 April 2018, 1475.

²⁹³ Exhibit 2.123, 31 January 2018, Report to BT Advice Risk Forum dated 31/01/2018, 13.

²⁹⁴ Exhibit 2.122, 14 July 2015, Report to BT Advice Risk Forum dated 14/07/2015, 1, 9.

²⁹⁵ Transcript, Michael Wright, 20 April 2018, 1470–1, 1473.

²⁹⁶ Transcript, Michael Wright, 20 April 2018, 1444.

²⁹⁷ Transcript, Michael Wright, 20 April 2018, 1445.

advice industry needed to have a debate about the grandfathering arrangements,²⁹⁸ and said that he ‘can’t wait [for] the day when [financial advisers] are fully fee for service for insurance and super’.²⁹⁹ However, Mr Wright noted that any organisation that unilaterally decided to stop paying grandfathered commissions would place itself at a significant competitive disadvantage.³⁰⁰ He also noted that removing grandfathered commissions might affect the viability of small businesses that employ financial advisers.³⁰¹ The general tenor of his evidence was, however, that he saw the difficulties presented by retaining grandfathered conflicted remuneration and that he favoured removing those arrangements as soon as reasonably practicable.

3.3 What the case study showed

3.3.1 Mr Mahadevan and Mr and Mrs McDowall

In its second submission to the Commission, in February 2018, Westpac acknowledged that the conduct of Mr Mahadevan amounted to misconduct.³⁰² In his evidence, Mr Wright accepted that the financial advice that Mr Mahadevan gave to Mr and Mrs McDowall was not in their best interests.³⁰³ He described the advice as ‘poor’,³⁰⁴ noting that Mr Mahadevan should have – but did not – make it clear to Mr and Mrs McDowall that their retirement strategy was not viable.³⁰⁵

In its submissions in response to this case study, Westpac accepted that the advice given by Mr Mahadevan to Mr and Mrs McDowall was poor and was inappropriate to their circumstances.³⁰⁶ It accepted that Mr Mahadevan’s failure to address whether Mr and Mrs McDowall’s plan was achievable had

²⁹⁸ Transcript, Michael Wright, 20 April 2018, 1445.

²⁹⁹ Transcript, Michael Wright, 20 April 2018, 1446.

³⁰⁰ Transcript, Michael Wright, 20 April 2018, 1446.

³⁰¹ Transcript, Michael Wright, 20 April 2018, 1446.

³⁰² Westpac, *Table Entitled BTFG – General*, 13 February 2018, 78 [314].

³⁰³ Transcript, Michael Wright, 19 April 2018, 1400.

³⁰⁴ Transcript, Michael Wright, 19 April 2018, 1394–5.

³⁰⁵ Transcript, Michael Wright, 19 April 2018, 1394–5.

³⁰⁶ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 3 [4].

serious consequences for the McDowalls and accepted that Westpac was responsible for Mr Mahadevan's advice.³⁰⁷

Mr Wright's characterisation of the advice provided by Mr Mahadevan is plainly right. It was poor advice and was not in Mr and Mrs McDowall's best interests. Not only did Mr Mahadevan fail to explain to Mr and Mrs McDowall that their retirement strategy was not viable, he advised them to enter into new insurance policies – with high premiums – before it was necessary for them to enter into those policies. This advice contributed to Mr Mahadevan receiving a monthly bonus.

It follows that Mr Mahadevan may have breached his obligation under Section 961B(1) of the Corporations Act to act in the best interests of Mr and Mrs McDowall in relation to the advice that he gave to them, and may have breached his obligation under Section 961G of the Corporations Act only to provide advice to Mr and Mrs McDowall if it would be reasonable to conclude that the advice was appropriate to them.

3.3.2 Mr Smith

In its second submission to the Commission, in February 2018, Westpac acknowledged that the conduct of Mr Smith amounted to misconduct.³⁰⁸ Mr Wright accepted that the financial advice that Mr Smith gave to certain clients was inappropriate, and that in other cases it was not possible to tell whether the advice that Mr Smith had given was appropriate.³⁰⁹ Among other things, Mr Wright accepted that Mr Smith recommended strategies or investments that were too risky for customers, transacted without customers' authority, and charged ongoing advice fees without providing the promised services.³¹⁰

In its submissions in response to this case study, Westpac accepted that Mr Smith may have engaged in misconduct in connection with the giving of financial advice by: failing adequately to investigate clients' circumstances,

³⁰⁷ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 4 [6].

³⁰⁸ Westpac, *Table Entitled BTFG – General*, 13 February 2018, 11 [53], 57 [244] and 74 [300].

³⁰⁹ Transcript, Michael Wright, 19 April 2018, 1430.

³¹⁰ Transcript, Michael Wright, 19 April 2018, 1430.

needs and objectives; failing to identify and take steps that were in the clients' best interests; recommending investments or strategies that were inappropriate for clients because they were inconsistent with those clients' risk profiles; and transacting without clients' authority.³¹¹

Although he did not appear at the hearings, or seek to cross-examine Mr Wright, Mr Smith did make a submission to the Commission. Mr Smith submitted that, although he is not without fault, he did not act dishonestly and at all times acted in the best interests of his clients.³¹² He accepted that his files were 'inadequately kept', but said that this was due to Westpac's poor systems.³¹³ He also said that, since leaving Westpac in 2015, there have been no complaints in relation to his conduct or capacity as a financial adviser.³¹⁴

I do not see any sufficient reason to doubt the evidence given by Mr Wright in relation to Mr Smith's conduct while he was employed by Westpac. I agree that Mr Smith provided advice to certain clients that was inappropriate, and that in other cases it was not possible to tell whether the advice that Mr Smith had given was appropriate. It follows that Mr Smith may have breached his obligation under Section 961B(1) of the Corporations Act to act in the best interests of certain clients in relation to the advice that he gave to them, and may have breached his obligation under Section 961G of the Corporations Act only to provide advice to clients if it would be reasonable to conclude that the advice was appropriate to the clients.

3.3.3 Westpac

Both Mr Mahadevan and Mr Smith gave inappropriate advice to clients. At the time they did so, they were both providing financial advice on behalf of

³¹¹ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 5 [12].

³¹² Andrew Smith, *Submissions by Andrew Smith, Person Affected by the Evidence of Westpac*, 4 May 2018, 1 [7].

³¹³ Andrew Smith, *Submissions by Andrew Smith, Person Affected by the Evidence of Westpac*, 4 May 2018, 3 [18].

³¹⁴ Andrew Smith, *Submissions by Andrew Smith, Person Affected by the Evidence of Westpac*, 4 May 2018, 4 [28].

Westpac. Westpac did not prevent Mr Mahadevan and Mr Smith from providing inappropriate advice.

Part of the reason that Mr Mahadevan and Mr Smith provided inappropriate advice was that, at the relevant times, Westpac had in place a remuneration system that rewarded the provision of advice of the kinds that Mr Mahadevan and Mr Smith gave their clients. As has been explained, the McDowalls' acceptance of Mr Mahadevan's advice resulted in significant financial benefits to Mr Mahadevan and to Westpac.

As Mr Wright explained, Mr Mahadevan and Mr Smith were both entitled to participate in an incentive scheme that rewarded financial advisers with a monthly bonus calculated as a percentage of the revenue that they generated above particular target thresholds.³¹⁵ Financial advisers were entitled to up to 24% of the revenue that they generated above a target revenue hurdle, and entitled to up to 44% of the revenue that they generated above a separate high performance target hurdle.³¹⁶ The revenue that counted towards this calculation included fees paid by customers and commissions paid to Westpac by product providers.³¹⁷

This remuneration scheme applied over the whole of the period covered by this case study. It created an incentive for financial advisers to recommend strategies and products to customers that increased the revenue earned by Westpac, and therefore increased the potential share of revenue earned by the financial adviser. By incentivising only the generation of revenue, it created a risk that customers would not be provided with financial advice that was in their best interests. Mr Wright said that, in his view, one of the reasons Mr Smith gave inappropriate advice was for the purpose of maximising his share of revenue under this scheme.³¹⁸ Westpac also acknowledged this in its submissions in response to this case study.³¹⁹

As already noted, Mr Wright acknowledged that Westpac still does not do enough to ensure that financial advisers are recognised and rewarded when

³¹⁵ Transcript, Michael Wright, 19 April 2018, 1385–8, 1415.

³¹⁶ Transcript, Michael Wright, 19 April 2018, 1387–8.

³¹⁷ Transcript, Michael Wright, 19 April 2018, 1389.

³¹⁸ Transcript, Michael Wright, 20 April 2018, 1449.

³¹⁹ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 9 [32].

they tell a customer that he or she is doing the right thing, and needs to make no changes.³²⁰ And, until at least 2017, although financial advisers were disqualified from participating in the variable remuneration scheme if they failed certain compliance measures, those compliance measures were inadequate to prevent even high risk advisers like Mr Smith from receiving a share of revenue.

Another part of the reason that Mr Mahadevan and Mr Smith provided inappropriate advice was that, at the relevant times, Westpac's internal systems failed to prevent them from providing poor advice.

In particular, until at least April 2017, Westpac's consequence management system did not ensure that advisers who failed to follow Westpac's policies and procedures, or failed to comply with financial services laws, were subject to increased regional manager supervision and appropriate disciplinary processes (including ineligibility to receive variable remuneration). Westpac did not structure its consequence management system in a way that would bring advisers who represented compliance concerns to the attention of management. This meant that, even where Westpac's monitoring activities (such as compliance audits) identified advisers who represented a risk to customers, nothing was done to reduce that risk.

Mr Wright accepted that Westpac relied too heavily on its system of demerit points to identify financial advisers who represented compliance concerns.³²¹ He also accepted that the system had design flaws,³²² and that, particularly before the FoFA reforms, Westpac's control environment in relation to financial advisers was not strong enough or robust enough.³²³ In its submissions in relation to this case study, Westpac accepted that there were failings in its consequence management system, some of which were illustrated by the evidence in relation to Mr Smith.³²⁴

³²⁰ Transcript, Michael Wright, 20 April 2018, 1448.

³²¹ Transcript, Michael Wright, 19 April 2018, 1423.

³²² Transcript, Michael Wright, 19 April 2018, 1422.

³²³ Transcript, Michael Wright, 19 April 2018, 1421.

³²⁴ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 8 [28].

Further, in relation to Mr Mahadevan, the use of a paraplanner was not sufficient to prevent Mr Mahadevan from providing the poor advice. Although the paraplanner identified that, if Mr and Mrs McDowall were to pursue the course recommended to them, their interests would be better served by delaying the establishment of the SMSF and the implementation of new insurance policies until after a suitable property had been located, Mr Mahadevan overrode that the paraplanner's recommendations.

It follows from the above that, at least in the cases of Mr Mahadevan and Mr Smith, Westpac may not have done all things necessary to ensure that the financial services covered by its financial services licence were provided efficiently, honestly and fairly. To the extent that other inappropriate advice was provided by representatives of Westpac in the same period, and is attributable to the same causes, the same conclusion could be drawn in relation to that advice.

Further, it may be arguable that the maintenance of a remuneration system that created a risk that customers would be provided with poor advice, coupled with the absence of effective measures to prevent the provision of poor advice, amounted to a failure by Westpac to take reasonable steps to ensure that its representatives complied with financial services laws – in particular, Sections 961B and 961G of the Corporations Act.

It follows from the above that, in the period of time considered in this case study, Westpac may have breached its obligation under Section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly, and its obligations under Sections 912A(1)(ca) and 961L of the Corporations Act to take reasonable steps to ensure that its representatives complied with Sections 961B and 961G of the Corporations Act.

In relation to Mr Smith, Westpac took a long time to provide a notification to ASIC under Section 912D of the Corporations Act. Mr Wright gave evidence that Westpac prepared one investigation report in relation to Mr Smith in May 2015 and another in July 2015, both containing findings about Mr Smith's advice and practices.³²⁵ Westpac also prepared interim compliance assessments in May and September 2015, and a final compliance

³²⁵ Transcript, Michael Wright, 20 April 2018, 1441.

assessment in October 2015.³²⁶ However, it was not until after the final compliance assessment that Westpac reported a significant breach under Section 912D of the Corporations Act in relation to Mr Smith.

In circumstances where Westpac had a number of investigation reports and interim compliance reports identifying issues with Mr Smith's advice and possible weaknesses in Westpac's controls well before November 2015, it may be that Westpac breached its statutory obligation under Section 912D to report a significant breach to ASIC within 10 business days after becoming aware of the breach, in relation to the conduct of Mr Smith.

Further, having identified that Mr Smith had received consistently poor audit ratings and breached a number of internal Westpac policies, and having made serious allegations of misconduct against Mr Smith, Westpac:

- did not report Mr Smith to ASIC in response to a notice given by ASIC under Section 912C of the Corporations Act in July 2015; and
- did not provide any detailed information about those matters to Dover Financial Services Pty Ltd, Mr Smith's new licensee. All it said was that it had 'concerns' and that it was investigating matters further.

These failures by Westpac fell below community standards and expectations. Where a **financial services licensee** identifies serious concerns in relation to the conduct of a financial adviser – as Westpac did in its letter to Mr Smith alleging that he had engaged in misconduct, and in its investigation report of May 2015 – the community expects the licensee to bring that conduct to the attention of the regulator in a timely manner, and to bring that conduct to the attention of any other financial services licensee that seeks information about the adviser. Minds may differ about the sufficiency of the information that Westpac gave to Dover. I cannot say that the community would have expected more. But, by contrast, I do think that the community would have expected better, and more timely, communication with the regulator.

³²⁶ Transcript, Michael Wright, 20 April 2018, 1440.

3.4 Causes of the conduct

As explained above, one of the causes of the inappropriate advice provided by Mr Mahadevan and Mr Smith was Westpac's remuneration practices for its employed financial advisers.

Although in March 2018 Westpac announced plans to shift to a new variable remuneration model for financial advisers, the new system will not commence operation until October 2018.³²⁷ Further, that variable remuneration model will continue to have a component – 20% – that directly rewards the generation of revenue by employed financial advisers.

Further, as explained above, another of the causes of the inappropriate advice provided by Mr Mahadevan and Mr Smith was the inadequacy of Westpac's internal controls – in particular, in the case of Mr Smith, Westpac's consequence management system. In its submissions in response to this case study, Westpac pointed out that it had taken steps to improve its consequence management system. In 2017, it increased the number of demerit points received for a 'requires improvement' audit result, and it has put in place a monthly review of advisers' consequence management points over a longer (two year) period.³²⁸

3.5 Effectiveness of mechanisms for response and redress

Westpac did not adequately respond to the detriment suffered by Mr and Mrs McDowall. Having identified that Mr Mahadevan provided advice to Mr and Mrs McDowall that left them 'in a worse off position', Westpac:

- made inadequate offers of compensation, resulting in Mr and Mrs McDowall needing to make a complaint to FOS to attain appropriate redress; and
- did not impose any disciplinary consequences on Mr Mahadevan until almost two years after Mrs McDowall made a complaint.

In its submissions in response to this case study, Westpac accepted that its offers of compensation to Mr and Mrs McDowall were inadequate and that

³²⁷ Exhibit 2.101, Witness statement of Michael Wright, 5 April 2018, 23 [75].

³²⁸ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 8 [28].

this resulted in Mr and Mrs McDowall needing to make a complaint to FOS in order to obtain appropriate redress. Westpac accepted that, in that regard, its conduct fell below community standards and expectations.³²⁹

4 Bad Advice: ANZ

4.1 Background

The Commission heard evidence about ANZ's financial advice business, and the conduct of three financial advisers: Mr John Doyle, who was an authorised representative of RI Advice Group Pty Ltd (RI Advice Group); Mr Christopher Harris, who was an authorised representative of Millennium3 Financial Services Pty Ltd (Millennium3); and 'Mr A', who was also an authorised representative of Millennium3.

At the times relevant to this case study, ANZ provided financial advice services to its customers through four entities: ANZ Financial Planning, which operated under ANZ's financial services licence,³³⁰ and three 'Aligned Dealer Group' entities owned by ANZ: RI Advice Group, Millennium3 and Financial Services Partners Pty Ltd.³³¹ Both RI Advice Group and Millennium3 were wholly owned subsidiaries of ANZ, and each had its own financial services licence.³³²

Three witnesses gave evidence in relation to these matters: Mr Darren Whereat, the General Manager Aligned Licensees and Advice Standards at ANZ; Ms Kylie Rixon, the Chief Risk Officer for Digital & Wealth Australia at ANZ; and Mr Kieran Forde, the head of Wealth Solutions and Partnerships at ANZ.

On 2 April 2018, before the second round of the Commission's hearings began, the Solicitor Assisting the Commission wrote to Mr Doyle and notified him that his conduct may be the subject of a case study to be heard by the Commission. On 4 April, the Commission spoke with Mr Doyle and

³²⁹ Westpac, *Westpac Banking Corporation – Submissions on Financial Advice Case Study*, 4 May 2018, 11 [38].

³³⁰ Transcript, Darren Whereat, 20 April 2018, 1486–7.

³³¹ Transcript, Darren Whereat, 20 April 2018, 1487.

³³² Transcript, Darren Whereat, 20 April 2018, 1487.

explained the substance of the evidence concerning his conduct. On 10 April, the Commission sent Mr Doyle an email attaching a copy of Mr Whereat's statement. On 13 April, Mr Doyle was granted leave to appear at the hearings. Despite being granted leave, Mr Doyle did not appear in person and was not represented during the hearings.

On 29 March 2018, the Solicitor Assisting the Commission wrote to Mr Harris and notified him that his conduct may be the subject of a case study to be heard by the Commission. On 3 April, the Commission spoke with Mr Harris and explained the substance of the evidence concerning his conduct. On 10 April, the Commission sent Mr Harris an email attaching a copy of Mr Whereat's statement. Mr Harris did not seek leave to appear at the hearings, and did not provide submissions.

Before the second round of the Commission's hearings began, the Solicitor Assisting the Commission took steps to contact Mr A, but was unable to contact him. As a result, the Commissioner made a non-publication direction in relation to information revealing the identity of Mr A.

4.2 Evidence

4.2.1 Mr Doyle

In around March and April 2013, shortly before the date on which the FoFA reforms would come into effect with the ban on many forms of conflicted remuneration, RI Advice Group actively sought to recruit Mr Doyle and other financial advisers who were authorised representatives of another financial services licensee, Australian Financial Services Pty Ltd.³³³ The targeted advisers were selected because they held \$677 million in funds under management in a product issued by an entity associated with ANZ, and ANZ wanted to retain those funds in ANZ products.³³⁴ The targeted advisers included Mr Doyle, who had \$60 million in funds under management in the

³³³ Transcript, Darren Whereat, 20 April 2018, 1493; Exhibit 2.132, 22 March 2013, Memorandum AFS Retention Strategy dated 22/03/2013; Exhibit 2.134, 15 April 2013, Email Younger to Williams dated 15/04/2013 and attachment.

³³⁴ Transcript, Darren Whereat, 20 April 2018, 1491, 1493.

product.³³⁵ RI Advice Group offered these advisers monetary incentives, including upfront payments, to move to RI Advice Group.³³⁶

At the time it pursued these advisers, RI Advice Group was aware that ASIC had imposed additional conditions on Australian Financial Services' licence as a result of adviser misconduct.³³⁷ In April 2013, ASIC contacted RI Advice Group to express concerns about the recruitment of these advisers, and RI Advice Group assured ASIC that it would only 'on-board' advisers who met enhanced due diligence standards.³³⁸ One element of the enhanced due diligence standards that ANZ said it would apply was a competency and knowledge test, which was to be administered before RI Advice Group entered into agreements with advisers.³³⁹

In May 2013, after entering into a Commitment Deed under which RI Advice Group agreed to pay Mr Doyle an upfront payment for becoming an authorised representative,³⁴⁰ Mr Doyle entered into an Authorised Representative Agreement with RI Advice Group.³⁴¹ It was only a few months later, in July 2013, that Mr Doyle completed a competency and knowledge test. Mr Doyle failed the test and was assessed as not yet competent.³⁴²

Despite ASIC having contacted RI Advice Group to convey its concerns about former Australian Financial Services advisers in April 2013,³⁴³ despite Mr Doyle having failed his competency test in July 2013, and

³³⁵ Transcript, Darren Whereat, 20 April 2018, 1492, 1495.

³³⁶ Transcript, Darren Whereat, 20 April 2018, 1491, 1497; Exhibit 2.132, 22 March 2013, Memorandum AFS Retention Strategy dated 22/03/2013; Exhibit 2.136, 6 May 2013, Commitment Deed dated 06/05/2013, 5.

³³⁷ Transcript, Darren Whereat, 20 April 2018, 1493, 1495.

³³⁸ Transcript, Darren Whereat, 20 April 2018, 1494.

³³⁹ Transcript, Darren Whereat, 20 April 2018, 1496.

³⁴⁰ Transcript, Darren Whereat, 20 April 2018, 1497; Exhibit 2.136, 6 May 2013, Commitment Deed dated 06/05/2013.

³⁴¹ Transcript, Darren Whereat, 20 April 2018, 1488–9.

³⁴² Transcript, Darren Whereat, 20 April 2018, 1498; Exhibit 2.137, 15 July 2013, Doyle exam results for financial planning knowledge dated 15/07/2013.

³⁴³ Transcript, Darren Whereat, 20 April 2018, 1494; see Exhibit 2.133, 29 May 2013, Advice and distribution risk and compliance board committee papers dated 29/05/2013, 22.

despite RI Advice Group having received a complaint about Mr Doyle in August 2013,³⁴⁴ RI Advice Group did not apply any enhanced monitoring or supervision of Mr Doyle after he commenced as an authorised representative.³⁴⁵

Indeed RI Advice Group did not audit any files of Mr Doyle until February 2015, nearly two years after he commenced with RI Advice Group.³⁴⁶ Contrary to ordinary practice, Mr Doyle selected the files to be audited.³⁴⁷ Even so, Mr Doyle failed this audit, receiving the worst possible rating.³⁴⁸ Mr Doyle's poor audit results were so significant that they skewed the audit results across the RI Advice Group business.³⁴⁹ Issues identified with Mr Doyle's advice included recommendation of products not included on RI Advice Group's approved product list,³⁵⁰ which RI Advice Group had deemed inappropriate due to their complexity.³⁵¹

As a result of the February 2015 audit, RI Advice Group required Mr Doyle to submit all of his advice documents to a vetting officer for review, prior to the advice being provided to clients.³⁵² It also required that Mr Doyle be subject to more frequent supervision by his practice development manager.³⁵³ Mr Whereat agreed, however, that the increased supervision was not successful.³⁵⁴

³⁴⁴ Transcript, Darren Whereat, 20 April 2018, 1499–500; Exhibit 2.138, 7 August 2013, Complaint letter concerning Doyle dated 07/08/2013.

³⁴⁵ Transcript, Darren Whereat, 20 April 2018, 1498, 1527.

³⁴⁶ Transcript, Darren Whereat, 20 April 2018, 1499.

³⁴⁷ Transcript, Darren Whereat, 20 April 2018, 1501.

³⁴⁸ Transcript, Darren Whereat, 20 April 2018, 1501–2; Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-1 [ANZ.100.008.0935_0001].

³⁴⁹ Transcript, Darren Whereat, 20 April 2018, 1504.

³⁵⁰ Transcript, Darren Whereat, 20 April 2018, 1503.

³⁵¹ Transcript, Darren Whereat, 20 April 2018, 1516.

³⁵² Transcript, Darren Whereat, 20 April 2018, 1503–5; Exhibit 2.139, May 2013, Advice vetting standard dated May 2013, 4–6.

³⁵³ Transcript, Darren Whereat, 20 April 2018, 1505.

³⁵⁴ Transcript, Darren Whereat, 20 April 2018, 1505.

In May 2015, there was a further targeted audit of Mr Doyle's client files.³⁵⁵ The results of this audit were worse than the February 2015 audit.³⁵⁶ Again, an issue identified by the audit was the recommendation of products that were not on RI Advice Group's approved product list.³⁵⁷

Following the May 2015 audit, Mr Doyle recommended that a number of his clients invest in Macquarie Flexi 100 structured products.³⁵⁸ These products were not on RI Advice Group's approved product list at the time Mr Doyle recommended them. They were not on the approved product list because of the degree of complexity and risk associated with the products,³⁵⁹ and ANZ later found that these products were not appropriate for the clients to whom Mr Doyle recommended them.³⁶⁰

In June 2015, RI Advice Group gave notice that it terminated the authorised representative status of Mr Doyle's company Carrington Corporation Pty Ltd, with effect from December 2015.³⁶¹ Mr Whereat said that RI Advice Group gave six months' notice of the termination (as would be required under the agreement for termination without cause) because it could not work out at the time whether it had reason to terminate for cause.³⁶² With the benefit of hindsight, Mr Whereat accepted that RI Advice Group in fact had sufficient information in June 2015 to terminate for cause.³⁶³ Mr Whereat also accepted that, at that time, RI Advice Group could have exercised its right under Mr Doyle's Individual Representative Deed to

³⁵⁵ Transcript, Darren Whereat, 20 April 2018, 1505.

³⁵⁶ Transcript, Darren Whereat, 20 April 2018, 1505–6.

³⁵⁷ Transcript, Darren Whereat, 20 April 2018, 1506.

³⁵⁸ Transcript, Darren Whereat, 20 April 2018, 1522, 1523.

³⁵⁹ Transcript, Darren Whereat, 20 April 2018, 1516.

³⁶⁰ Transcript, Darren Whereat, 20 April 2018, 1522, 1523.

³⁶¹ Transcript, Darren Whereat, 20 April 2018, 1506–7.

³⁶² Transcript, Darren Whereat, 20 April 2018, 1507.

³⁶³ Transcript, Darren Whereat, 20 April 2018, 1507.

suspend Mr Doyle with immediate effect.³⁶⁴ Mr Whereat was not sure why RI Advice Group did not take this course.³⁶⁵

In August 2015, following another audit that had been conducted in July 2015, and that had identified further issues, RI Advice Group suspended Mr Doyle's appointment under the Individual Representative Deed with immediate effect.³⁶⁶ However, contrary to the terms of the Individual Representative Deed,³⁶⁷ RI Advice Group permitted Mr Doyle to continue providing advice to approximately 700 of his existing clients while he was suspended.³⁶⁸ Mr Whereat accepted that it was 'a mistake' and 'unacceptable' to allow Mr Doyle to continue to provide advice to clients during this period.³⁶⁹

During the period when he was suspended, RI Advice Group required Mr Doyle to submit any advice that he provided to existing clients to a vetting officer.³⁷⁰ Yet by this time, RI Advice Group had already identified that pre-vetting of advice was not an effective control because it could be and had been circumvented.³⁷¹ And, in fact, Mr Doyle did circumvent this control, by providing advice to clients without submitting it for pre-vetting.³⁷² Mr Whereat accepted that the measures that RI Advice Group put in place to protect Mr Doyle's clients while he was suspended were inadequate.³⁷³

When Mr Whereat gave evidence, RI Advice Group had not yet completed its review and remediation of Mr Doyle's clients.³⁷⁴ It had assigned this task

³⁶⁴ Transcript, Darren Whereat, 20 April 2018, 1508; see Exhibit 2.140, 8 May 2013, Individual representative's deed with Doyle, 9.

³⁶⁵ Transcript, Darren Whereat, 20 April 2018, 1508.

³⁶⁶ Transcript, Darren Whereat, 20 April 2018, 1511.

³⁶⁷ Transcript, Darren Whereat, 20 April 2018, 1512; Exhibit 2.140, 8 May 2013, Individual representative's deed with Doyle, 9.

³⁶⁸ Transcript, Darren Whereat, 20 April 2018, 1511–13.

³⁶⁹ Transcript, Darren Whereat, 20 April 2018, 1512.

³⁷⁰ Transcript, Darren Whereat, 20 April 2018, 1512.

³⁷¹ Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-48 [ANZ.800.225.1484 at 1500].

³⁷² Transcript, Darren Whereat, 20 April 2018, 1518.

³⁷³ Transcript, Darren Whereat, 20 April 2018, 1518.

³⁷⁴ Transcript, Darren Whereat, 20 April 2018, 1522–3, 1524.

a low priority, and at the time Mr Whereat gave evidence RI Advice Group had contacted only a very small number of Mr Doyle's clients to determine whether they had suffered detriment.³⁷⁵ Mr Whereat acknowledged that it was unacceptable that it had taken two to three years to identify and remediate clients found to have been given inappropriate advice.³⁷⁶

4.2.2 Mr Harris

Mr Harris became an authorised representative of Millennium3 in October 2008.³⁷⁷

In July 2013, Millennium3 conducted an audit of Mr Harris' files, for which Mr Harris received the lowest available score.³⁷⁸ As a result of the audit, Mr Harris was required to submit his advice for pre-vetting.³⁷⁹ Mr Harris' conduct was discussed at at least six Consequence Management Committee meetings held in 2013 and 2014.³⁸⁰ In July 2014, Mr Harris passed an audit, and in August 2014 the Consequence Management Committee decided to 'close the incident' in relation to Mr Harris.³⁸¹ Mr Harris was not audited again until July 2015.³⁸²

Mr Whereat gave evidence about the financial advice that Mr Harris gave to two clients in the period between the July 2014 and July 2015 audits.³⁸³ The first of these clients was an elderly widow, who received advice from Mr Harris in April 2015 in relation to the investment of a \$32,000 term deposit.³⁸⁴ Mr Harris' advice was to invest in a wrap account, the result of which was that the client incurred high upfront and ongoing costs, with no

³⁷⁵ Transcript, Darren Whereat, 20 April 2018, 1520–1.

³⁷⁶ Transcript, Darren Whereat, 20 April 2018, 1523.

³⁷⁷ Transcript, Darren Whereat, 20 April 2018, 1528.

³⁷⁸ Transcript, Darren Whereat, 20 April 2018, 1529.

³⁷⁹ Transcript, Darren Whereat, 20 April 2018, 1529.

³⁸⁰ Transcript, Darren Whereat, 20 April 2018, 1530–2; Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, 22–4 [5.7]–[5.11].

³⁸¹ Transcript, Darren Whereat, 20 April 2018, 1532.

³⁸² Transcript, Darren Whereat, 20 April 2018, 1532.

³⁸³ Transcript, Darren Whereat, 20 April 2018, 1532–5.

³⁸⁴ Transcript, Darren Whereat, 20 April 2018, 1532–3.

distinguishable benefits.³⁸⁵ The second client was advised to roll her superannuation into a new account in order to save approximately \$238 per year. Mr Harris charged \$3,330 for this advice and signed the client up to a \$3,790 ongoing service fee.³⁸⁶ Mr Whereat agreed that the advice given to both of these clients was inappropriate.³⁸⁷

Mr Whereat also gave evidence that, between the July 2014 and July 2015 audits, a customer had made a complaint about Mr Harris, questioning the fee she was charged and claiming the advice she received did not meet her needs.³⁸⁸ Following this complaint, a State Development Manager met with Mr Harris.³⁸⁹ She expressed concerns after this meeting about the risk that Mr Harris posed to Millennium3 and about Mr Harris' attitude to compliance,³⁹⁰ and noted that she had raised these concerns previously. These concerns were forwarded to the CEO and COO of Millennium3.³⁹¹ Despite the recommendation of the State Development Manager that Mr Harris' authorisation be terminated, Millennium3 instead decided to issue Mr Harris with a letter of censure, which imposed certain requirements on Mr Harris, including pre-vetting of his advice.³⁹² Mr Whereat acknowledged that Mr Harris did not always comply with the requirement to submit advice for pre-vetting.³⁹³

In February 2016, further concerns were raised about Mr Harris' practices, including a failure to provide ongoing services for which clients were paying fees.³⁹⁴ Millennium3 attempted to access the files of Mr Harris but was

³⁸⁵ Transcript, Darren Whereat, 20 April 2018, 1533–4.

³⁸⁶ Transcript, Darren Whereat, 20 April 2018, 1534.

³⁸⁷ Transcript, Darren Whereat, 20 April 2018, 1533–4.

³⁸⁸ Transcript, Darren Whereat, 20 April 2018, 1535.

³⁸⁹ Transcript, Darren Whereat, 20 April 2018, 1535.

³⁹⁰ Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-41 [ANZ.800.382.0918]; Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-45 [ANZ.800.386.0176]; Transcript, Darren Whereat, 20 April 2018, 1535–7, 1543.

³⁹¹ Transcript, Darren Whereat, 20 April 2018, 1536, 1537.

³⁹² Transcript, Darren Whereat, 20 April 2018, 1537–8.

³⁹³ Transcript, Darren Whereat, 20 April 2018, 1539.

³⁹⁴ Transcript, Darren Whereat, 20 April 2018, 1539.

unable to do so for over a year.³⁹⁵ Mr Whereat acknowledged that it took Millennium3 'far too long' to access the client files, and that the process they adopted to gain access to the files was not 'strong enough'.³⁹⁶ Despite being on Millennium3's watch list for two to three years, receiving the lowest possible scores on at least two audits and the serious concerns raised by the State Development Manager, Mr Harris was permitted to continue providing advice to clients during the 13 months that Millennium3 was attempting to access Mr Harris' files.³⁹⁷

In 2016 and early 2017, there were a number of meetings at which Mr Harris was discussed. The report of a targeted review, which had been requested in November 2016, was not provided until April 2017. It identified a number of issues with Mr Harris, including non-delivery of ongoing services, failure to provide fee disclosure statements, and the provision of inappropriate advice and advice outside authorisation.³⁹⁸ It also identified that, of the 28 client files reviewed, there was potential client detriment in relation to 25 of those files.³⁹⁹

Millennium3 decided to terminate Mr Harris' status as an authorised representative in April 2017.⁴⁰⁰ In July 2017, Millennium3 sent a letter to ASIC about Mr Harris' conduct, but did not identify that conduct as involving a significant breach under Section 912D of the Corporations Act.⁴⁰¹

As at the time of Mr Whereat's evidence, none of Mr Harris' clients had been remediated for inappropriate advice or for having been charged fees without receiving services.⁴⁰² This included the two clients to whom Mr Harris gave inappropriate advice in April and May 2015.⁴⁰³ Mr Whereat

³⁹⁵ Transcript, Darren Whereat, 20 April 2018, 1539.

³⁹⁶ Transcript, Darren Whereat, 20 April 2018, 1540.

³⁹⁷ Transcript, Darren Whereat, 20 April 2018, 1543.

³⁹⁸ Transcript, Darren Whereat, 20 April 2018, 1544–5.

³⁹⁹ Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-86 [ANZ.800.382.0765 at .0765–.0766].

⁴⁰⁰ Transcript, Darren Whereat, 20 April 2018, 1545.

⁴⁰¹ Transcript, Darren Whereat, 20 April 2018, 1545.

⁴⁰² Transcript, Darren Whereat, 20 April 2018, 1545–6.

⁴⁰³ Transcript, Darren Whereat, 20 April 2018, 1546.

acknowledged that it had taken Millennium3 far too long to remediate Mr Harris' clients, and apologised for that.⁴⁰⁴

After Millennium3 terminated its relationship with Mr Harris, Mr Harris became an authorised representative for Dover Financial Services Pty Ltd.⁴⁰⁵ In response to a request by Dover for information about Mr Harris in May 2017,⁴⁰⁶ Millennium3 referred to instances of inappropriate charging of fees, client complaints, failure to provide ongoing services, and issues with fee disclosure statements.⁴⁰⁷ However, Millennium3 did not mention that Mr Harris had three audits with the lowest possible ratings, that there had been a targeted review of 28 client files that found that there was potential client detriment in relation to 25 of those files, or that Millennium3 had made a notification to ASIC in relation to Mr Harris.⁴⁰⁸ Mr Whereat could not explain why these matters had been omitted.⁴⁰⁹ He was also not aware of any evidence that Millennium3 had reported Mr Harris' conduct to any professional association.⁴¹⁰

4.2.3 Mr A

Mr A became an authorised representative of Millennium3 in 2009.⁴¹¹

Although Millennium3 did not permit Mr A to provide advice to customers to invest in particular properties,⁴¹² he contacted a number of his clients in 2011, in his capacity as an authorised representative of Millennium3, in relation to a potential property investment.⁴¹³ Mr A informed the clients that, although the initial price of the property was over \$2 million, he had

⁴⁰⁴ Transcript, Darren Whereat, 20 April 2018, 1546.

⁴⁰⁵ Transcript, Darren Whereat, 20 April 2018, 1546.

⁴⁰⁶ Exhibit 2.148, 24 May 2017, Letter from Dover Financial Advisers to Millenium3 Financial Services.

⁴⁰⁷ Exhibit 2.149, undated, Letter from Millenium3 to Dover in reply.

⁴⁰⁸ Transcript, Darren Whereat, 20 April 2018, 1547; Exhibit 2.149, undated, Letter from Millenium3 to Dover in reply.

⁴⁰⁹ Transcript, Darren Whereat, 20 April 2018, 1548.

⁴¹⁰ Transcript, Darren Whereat, 20 April 2018, 1545.

⁴¹¹ Transcript, Kieran Forde, 24 April 2018, 1711.

⁴¹² Transcript, Kieran Forde, 24 April 2018, 1713.

⁴¹³ Transcript, Kieran Forde, 24 April 2018, 1712–13.

negotiated a lower purchase price,⁴¹⁴ and believed that the property could soon be sold at a profit. He told the clients that he required \$600,000 from investors for the deposit and stamp duty.⁴¹⁵

Mr A convinced five of his clients to invest through their SMSFs: four invested \$100,000 and the fifth \$200,000.⁴¹⁶ The clients believed that they were subscribing for units in a unit trust that would acquire the property.⁴¹⁷ However, Mr A acquired the property in the name of a company of which he was the sole director,⁴¹⁸ and not the unit trust.

The Commission heard evidence about audits of Mr A's practice that had been conducted shortly prior to these events. In February 2011, Millennium3 audited five of Mr A's files, each of which was rated as 'very poor advice',⁴¹⁹ the lowest possible rating.⁴²⁰ Mr A did not face any disciplinary consequences as a result of these results.⁴²¹ In November 2011, four files were rated 'very poor advice' and the fifth was rated 'poor advice'.⁴²² Again, Mr A did not face any disciplinary consequences as a result of this audit result. The only step Millennium3 took was to require Mr A to submit his advice for pre-vetting before providing it to clients.⁴²³

In 2012, after a further poor audit, Mr A's status as an authorised representative of Millennium3 was terminated.⁴²⁴ Despite the poor audit results and the termination of Mr A's authorised representative status,

⁴¹⁴ Transcript, Kieran Forde, 24 April 2018, 1712.

⁴¹⁵ Transcript, Kieran Forde, 24 April 2018, 1712–13.

⁴¹⁶ Transcript, Kieran Forde, 24 April 2018, 1713.

⁴¹⁷ Transcript, Kieran Forde, 24 April 2018, 1714.

⁴¹⁸ Transcript, Kieran Forde, 24 April 2018, 1717.

⁴¹⁹ Transcript, Kieran Forde, 24 April 2018, 1711.

⁴²⁰ Transcript, Kieran Forde, 24 April 2018, 1711.

⁴²¹ Transcript, Kieran Forde, 24 April 2018, 1711–12.

⁴²² Transcript, Kieran Forde, 24 April 2018, 1714.

⁴²³ Transcript, Kieran Forde, 24 April 2018, 1715.

⁴²⁴ Transcript, Kieran Forde, 24 April 2018, 1715–16.

Millennium3 did not investigate any of Mr A's other client files to determine whether any of his clients had been given inappropriate advice.⁴²⁵

In September 2013, one of the clients who had invested \$100,000 in the purchase of the property sent a complaint to Millennium3 about Mr A, noting that they had lost the \$100,000.⁴²⁶ In December 2013 and January 2014, Millennium3 identified the four other SMSFs that were listed as unitholders in the unit trust and were clients of Mr A's when he was an authorised representative of Millennium3.⁴²⁷ Neither Millennium3 nor ANZ attempted to contact those clients or to investigate whether they had suffered any loss,⁴²⁸ but instead left it to those clients to come forward and prove they had suffered loss.⁴²⁹ Mr Forde said this had occurred because Millennium3 had prioritised its commercial interests of the interests of its clients.⁴³⁰ Neither ANZ nor Millennium3 had access to Mr A's files, which Mr Forde accepted would have made it very difficult to determine whether any of Mr A's clients had suffered loss.⁴³¹

In 2016 and 2017, further complaints were made by former clients of Mr A, relating to unauthorised withdrawals from SMSFs and investments in the unit trust.⁴³²

In August 2017, ANZ appointed McGrathNicol to conduct an investigation into Mr A's conduct.⁴³³ Following receipt of their report, ANZ decided to have its Advice Review Team review advice given by Mr A to 103 customers during his time as an authorised representative of Millennium3.⁴³⁴ When Mr Forde gave evidence (in April 2018), ANZ was still reviewing the files and had not determined how many

⁴²⁵ Transcript, Kieran Forde, 24 April 2018, 1715–16.

⁴²⁶ Transcript, Kieran Forde, 24 April 2018, 1717–18.

⁴²⁷ Transcript, Kieran Forde, 24 April 2018, 1719.

⁴²⁸ Transcript, Kieran Forde, 24 April 2018, 1719.

⁴²⁹ Transcript, Kieran Forde, 24 April 2018, 1720.

⁴³⁰ Transcript, Kieran Forde, 24 April 2018, 1724.

⁴³¹ Transcript, Kieran Forde, 24 April 2018, 1719.

⁴³² Transcript, Kieran Forde, 24 April 2018, 1721.

⁴³³ Transcript, Kieran Forde, 24 April 2018, 1721.

⁴³⁴ Transcript, Kieran Forde, 24 April 2018, 1723.

customers were affected by Mr A's conduct.⁴³⁵

In February 2018, ANZ notified the Western Australian police of allegations made by three of Mr A's clients, that he withdrew funds totally \$234,590 from their accounts between March 2011 and February 2012 without their authority.⁴³⁶

4.2.4 ANZ's financial advice business

Ms Rixon gave evidence about the remuneration and incentives that apply to advisers employed by ANZ Financial Planning. Until 2018, the calculation of bonuses for advisers included a component determined by the revenue that the financial adviser generated.⁴³⁷ Further, leaderboards were published that ranked advisers on various criteria, including amount of revenue generated.⁴³⁸ Ms Rixon accepted that this reflected a culture of emphasising the growth of business more than the best interests of the client.⁴³⁹ The Commission also heard that the calculation of bonuses for management within the advice business still includes a revenue component, as does the calculation of bonuses for advisers in ANZ's Aligned Dealer Groups.⁴⁴⁰

Ms Rixon also gave evidence about the importance of uniformity between advice practices in monitoring the control environment.⁴⁴¹ She said that some controls are more difficult to implement in the Aligned Dealer Group businesses than with employed financial advisers.⁴⁴² She acknowledged that, during the 18 months before she gave evidence, ANZ had recognised how important it was for advisers in the Aligned Dealer Groups to be on a

⁴³⁵ Transcript, Kieran Forde, 24 April 2018, 1723.

⁴³⁶ Transcript, Kieran Forde, 24 April 2018, 1724; Exhibit 2.194, Witness statement of Kieran Forde, 12 April 2018, 15 [44].

⁴³⁷ Transcript, Kylie Rixon, 23 April 2018, 1559.

⁴³⁸ Transcript, Kylie Rixon, 23 April 2018, 1562; Leaderboards were published up until 2018: see Exhibit 1.151, April 2018, Updates to 2018 performance assessment framework, 4.

⁴³⁹ Transcript, Kylie Rixon, 23 April 2018, 1560–1.

⁴⁴⁰ Transcript, Kylie Rixon, 23 April 2018, 1561.

⁴⁴¹ Transcript, Kylie Rixon, 23 April 2018, 1564.

⁴⁴² Transcript, Kylie Rixon, 23 April 2018, 1565.

centralised advice system.⁴⁴³ Mr Whereat explained that it would not be until 30 June 2018 that it would be mandatory for all advisers in the Aligned Dealer Groups to use ANZ's electronic document management system, XPLAN.⁴⁴⁴ Ms Rixon acknowledged that ANZ could have commenced its program to move Aligned Dealer Group advisers onto XPLAN earlier than it did.⁴⁴⁵

Mr Rixon gave evidence about the decline in the number of financial advisers employed or authorised by ANZ and the Aligned Dealer Group businesses over the past 10 years. She said that part of the explanation for this was that the standards expected of new advisers have changed. She considered that this change in standards was a response to the regulatory requirements, as well as ANZ's own desire to create a client-centric culture. She acknowledged that ANZ had not always had such a culture in the past.⁴⁴⁶

Ms Rixon acknowledged that, in some instances, and for some periods, ANZ's compliance systems and processes had deficiencies.⁴⁴⁷ She also acknowledged that, in some cases, there had been a lack of investment by ANZ in the systems and processes needed to ensure compliance.⁴⁴⁸ She gave the delays in encouraging all advisers to use XPLAN as an example, and accepted that that could have occurred as early as 2013.⁴⁴⁹

The audit results across ANZ Financial Planning and the Aligned Dealer Group businesses between 1 June 2013 and 30 June 2015 showed that, over that period, around 5% of the files sampled from ANZ Financial Planning, RI Advice Group and Millennium3 failed to meet the requirement that the advice is likely to be in the best interests of the client.⁴⁵⁰ Over the same period, around 10% of the files sampled from Millennium3 failed to

⁴⁴³ Transcript, Kylie Rixon, 23 April 2018, 1565.

⁴⁴⁴ Transcript, Darren Whereat, 20 April 2018, 1541.

⁴⁴⁵ Transcript, Kylie Rixon, 23 April 2018, 1568.

⁴⁴⁶ Transcript, Kylie Rixon, 23 April 2018, 1566.

⁴⁴⁷ Transcript, Kylie Rixon, 23 April 2018, 1568.

⁴⁴⁸ Transcript, Kylie Rixon, 23 April 2018, 1568.

⁴⁴⁹ Transcript, Kylie Rixon, 23 April 2018, 1568.

⁴⁵⁰ Transcript, Kylie Rixon, 23 April 2018, 1573–4; Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-48 [ANZ 800.225.1484 at .1507].

meet the requirement that the adviser had taken appropriate steps to conduct relevant product research.⁴⁵¹ Ms Rixon acknowledged that the files sampled were intended to be representative of what was occurring across the business.⁴⁵² She said that these results were very regrettable, and acknowledged that the results indicated that, in the period prior to 2015, there were deficiencies in many of ANZ's systems and processes to ensure that customers received appropriate advice.⁴⁵³

Ms Rixon gave evidence that, at the time of her evidence to the Commission, ANZ had sold the majority of the businesses that made up its Wealth division to purchasers. She said that this was part of ANZ's strategy to return to its core business of banking, and to improve its capital efficiency.⁴⁵⁴

4.3 What the case study showed

4.3.1 Mr Doyle

ANZ acknowledged in its 13 February 2018 submission to the Commission that conduct engaged in by Mr Doyle amounted to misconduct.⁴⁵⁵

Mr Whereat accepted that the advice that Mr Doyle gave to certain clients to invest in the Macquarie Flexi 100 products was inappropriate.⁴⁵⁶ These products were too complex and risky for the clients to whom Mr Doyle recommended them.⁴⁵⁷ Mr Whereat also accepted that the advice that Mr Doyle gave to certain clients in April 2016 to remain invested in InStreet products was inappropriate.⁴⁵⁸ In both of these cases, Mr Doyle provided advice to clients without preparing the required advice document.

⁴⁵¹ Transcript, Kylie Rixon, 23 April 2018, 1575; Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-48 [ANZ 800.225.1484 at .1508].

⁴⁵² Transcript, Kylie Rixon, 23 April 2018, 1575.

⁴⁵³ Transcript, Kylie Rixon, 23 April 2018, 1575.

⁴⁵⁴ Transcript, Kylie Rixon, 23 April 2018, 1569.

⁴⁵⁵ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, 9 [26].

⁴⁵⁶ Transcript, Darren Whereat, 20 April 2018, 1523, 1526.

⁴⁵⁷ See, eg, Exhibit 2.129, Witness statement of Darren Whereat, 5 April 2018, Exhibit DJW-17 [ANZ.800.163.3325 at .3328].

⁴⁵⁸ Transcript, Darren Whereat, 20 April 2018, 1518.

In its submissions in response to this case study, RI Advice Group did not make any substantive submissions about the findings that could be made in relation to Mr Doyle.⁴⁵⁹

Mr Doyle denied that the advice he gave was inappropriate.⁴⁶⁰ Nonetheless, I see no sufficient reason to doubt Mr Whereat's characterisation of the advice provided by Mr Doyle. The advice that Mr Doyle gave to his clients to invest in the Macquarie Flexi 100 products, and to remain invested in the InStreet products, was seen by Mr Whereat as advice that was not in the best interests of those clients, and was not appropriate for those clients because the products were too complex and risky for those clients.

In the circumstances, I consider that the material I have shows that Mr Doyle may have breached his obligation under Section 961B(1) of the Corporations Act to act in the best interests of the relevant clients in relation to the advice that he gave to them, and may have breached his obligation under Section 961G of the Corporations Act only to provide advice to those clients if it would be reasonable to conclude that the advice was appropriate to them.

Further, I accept Mr Whereat's evidence that, in providing advice to those clients about the Macquarie Flexi 100 products and the InStreet products, Mr Doyle did not provide the required advice documents. If that is so, it would follow that Mr Doyle may also have breached his obligation under Section 946A(1) of the Corporations Act to give those clients a statement of advice.

4.3.2 RI Advice Group

At the time Mr Doyle provided the advice described above, he was providing financial advice on behalf of RI Advice Group. RI Advice Group did not stop Mr Doyle providing the advice he gave.

⁴⁵⁹ Millennium 3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 14 [65].

⁴⁶⁰ John Doyle, Written submissions in relation to the matter of Mr John Doyle, 4 May 2018, 1–2 [7].

Mr Whereat acknowledged that RI Advice Group needed to accept responsibility for the fact that Mr Doyle provided the advice that Mr Whereat considered to be inappropriate.⁴⁶¹ He accepted that:

- because Mr Doyle had been recruited from Australian Financial Services Pty Ltd, there was a need for increased vigilance in relation to Mr Doyle from the start of his time with RI Advice Group, but RI Advice Group failed to impose that increased vigilance;⁴⁶²
- RI Advice Group should not have permitted Mr Doyle to provide advice in circumstances where he had failed his competency test at the start of his time with RI Advice Group;⁴⁶³
- RI Advice Group had not audited Mr Doyle's client files for two years after Mr Doyle joined RI Advice Group;⁴⁶⁴
- when Mr Doyle was audited, and received very poor results, this should have resulted in stronger action from RI Advice Group. In particular, it should have resulted in immediate suspension, and not merely the giving of six months' notice of an intention to terminate his authorisation;⁴⁶⁵
- when RI Advice Group did suspend Mr Doyle, it should have stopped him from providing advice to clients, as its contractual documents required, instead of allowing him to continue to provide advice to existing clients;⁴⁶⁶
- requiring Mr Doyle to submit his advice to pre-vetting was not an effective control mechanism for Mr Doyle;⁴⁶⁷ and
- RI Advice Group took longer than it should have to identify clients of Mr Doyle who required remediation and to remediate them.⁴⁶⁸

⁴⁶¹ Transcript, Darren Whereat, 20 April 2018, 1525.

⁴⁶² Transcript, Darren Whereat, 20 April 2018, 1527.

⁴⁶³ Transcript, Darren Whereat, 20 April 2018, 1525.

⁴⁶⁴ Transcript, Darren Whereat, 20 April 2018, 1525.

⁴⁶⁵ Transcript, Darren Whereat, 20 April 2018, 1525.

⁴⁶⁶ Transcript, Darren Whereat, 20 April 2018, 1525.

⁴⁶⁷ Transcript, Darren Whereat, 20 April 2018, 1526.

⁴⁶⁸ Transcript, Darren Whereat, 20 April 2018, 1526.

In the case of Mr Doyle, RI Advice Group did not do all things necessary to ensure that the financial services covered by its financial services licence were provided efficiently, honestly and fairly.

Further, in the case of Mr Doyle, it is arguable that the failings of RI Advice Group acknowledged by Mr Whereat – especially the failure to audit Mr Doyle in his first two years with RI Advice Group, and the failure to prevent Mr Doyle from providing advice to clients after RI Advice Group had identified serious deficiencies in his advice – amounted to a failure by RI Advice Group to take reasonable steps to ensure that its representatives complied with financial services laws – in particular, Sections 946A, 961B and 961G of the Corporations Act.

RI Advice Group submitted that it was not open to the Commission to find that it might have breached its obligations under Sections 912A(1)(a), 912A(1)(ca), 961L or 952H of the Corporations Act. In relation to Sections 912A(1)(a), 912A(1)(ca) and 961L, it submitted that the fact that additional steps might now, with the benefit of hindsight, be identified as having been desirable did not mean that RI Advice Group had breached its obligations at the time of Mr Doyle's conduct.⁴⁶⁹ In relation to Section 952H, it submitted that RI Advice Group took reasonable steps to ensure that Mr Doyle provided statements of advice to clients.⁴⁷⁰

There may be force in what RI Advice Group says about some of these provisions. I need not decide, however, more than that I consider that, during the time considered in this case study, RI Advice Group may have breached its obligation under Section 912A(1)(a) of the Corporations Act to do all things to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly.

I also consider that RI Advice Group's failure to prevent Mr Doyle from providing advice to existing clients after it had repeatedly identified issues with Mr Doyle's advice was conduct that fell below community standards and expectations. The community expects that, when a financial services licensee identifies issues with an adviser's conduct that are sufficient for the

⁴⁶⁹ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 11–12 [52]–[55], 15 [68].

⁴⁷⁰ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 11–12 [52]–[57], 15 [69].

licensee to suspend the adviser's authority, the licensee will not allow the adviser to continue providing financial advice under its licence while the suspension remains in force. Allowing Mr Doyle to continue to provide advice placed the commercial interests of RI Advice Group and Mr Doyle ahead of the interests of Mr Doyle's existing clients.

Despite Mr Whereat's acknowledgment that, when RI Advice Group did suspend Mr Doyle, it should have stopped him from providing advice to clients,⁴⁷¹ RI Advice Group submitted in response to this case study that it had taken adequate steps to protect clients of Mr Doyle from receiving inappropriate advice after it had repeatedly identified issues with his advice.⁴⁷² I do not agree with that submission.

I also consider that the conduct of RI Advice Group in connection with the review and remediation of Mr Doyle's clients fell short of community standards and expectations. In its submission in response to this case study, RI Advice Group accepted that it was open to me to make this finding.⁴⁷³ RI Advice Group has taken too long to implement a review and remediation program. The majority of Mr Doyle's clients' files had not yet been reviewed when the Commission took evidence about these matters, two years after RI Advice Group decided to terminate Mr Doyle's authorised representative status. The community expects that, when a licensee identifies that an adviser may have provided inappropriate advice, the licensee will investigate the matters and, if appropriate, take any necessary remedial action in a more timely manner.

4.3.3 Mr Harris

ANZ acknowledged in its 13 February 2018 submissions to the Commission that conduct engaged in by Mr Harris amounted to misconduct.⁴⁷⁴ In its submissions in response to this case study, Millennium3 did not make any

⁴⁷¹ Transcript, Darren Whereat, 20 April 2018, 1525.

⁴⁷² Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 11–13 [52]–[56], 15 [68], [71].

⁴⁷³ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 15–16 [72].

⁴⁷⁴ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, 6–7 [15].

substantive submissions about the findings that could be made in relation to Mr Harris.⁴⁷⁵

Mr Whereat accepted that the advice the Mr Harris gave to one client in April 2015 in relation to a term deposit, and the advice that he gave to another client in May 2015 in relation to a superannuation account, was inappropriate.⁴⁷⁶

I agree with Mr Whereat. The advice given in April 2015 was not in the client's best interests. It resulted in the client investing her money in an account with high up-front and ongoing fees for no discernible benefit. The advice given in May 2015 was also not in the client's best interests, as Mr Harris charged the client more than \$3,000 in up-front fees for advice that would save her less than \$250 per year.

It follows from the above that Mr Harris may have breached his obligation under Section 961B(1) of the Corporations Act to act in the best interests of those clients, and may have breached his obligation under Section 961G of the Corporations Act only to provide advice to those clients if it would be reasonable to conclude that the advice was appropriate to them.

4.3.4 Mr A

ANZ acknowledged in its submissions to the Commission that conduct engaged in by Mr A amounted to misconduct.⁴⁷⁷ In its submissions in response to this case study, Millennium3 did not make any substantive submissions about the findings that could be made in relation to Mr A.⁴⁷⁸

The evidence before the Commission showed that Mr A convinced a number of his clients to invest in units in a unit trust, on the basis that the unit trust would purchase a property at a marina, which could be re-sold at a profit. Contrary to what Mr A had told the investors, the property was not purchased by the trustee of the unit trust, but instead by another company

⁴⁷⁵ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 9 [40].

⁴⁷⁶ Transcript, Darren Whereat, 20 April 2018, 1533–4.

⁴⁷⁷ ANZ, *ANZ Response to the Commission's Letter of 2 February 2018*, 13 February 2018, 5 [9].

⁴⁷⁸ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 5 [21].

associated with Mr A. Mr A later told the customers that their money had been lost. The evidence before the Commission also indicated that Mr A had made unauthorised withdrawals from accounts belonging to some of his clients.

Mr A's conduct in telling the clients that the property would be purchased through the unit trust – when in fact it was purchased by a different company associated with Mr A – appears to have been misleading and deceptive, and may have been dishonest.

It follows from the above that Mr A may have breached his obligation under Section 1041H(1) of the Corporations Act and Section 12DA of the ASIC Act not to engage in conduct that is misleading or deceptive or likely to mislead or deceive. Further, Mr A may have breached his obligation under Section 1041G(1) of the Corporations Act not to engage in dishonest conduct in relation to a **financial product** or financial service.

4.3.5 Millennium3

At the time Mr Harris and Mr A provided the advice described above, they were both providing financial advice on behalf of Millennium3. Millennium3 did not stop Mr Harris from providing the advice he gave, and did not stop Mr A from providing the advice he gave or engaging in the conduct he did.

4.3.6 Mr Harris

Mr Whereat acknowledged a number of failings on the part of Millennium3 in connection with the advice given by Mr Harris.

Despite the poor audit results that Mr Harris received between 2013 and 2015, and strong concerns raised by Mr Harris' State Development Manager about his conduct, the only disciplinary action that Millennium3 took in relation to Mr Harris in 2015 was to send him a letter of censure, requiring him to submit his advice for pre-vetting.⁴⁷⁹ This letter was sent only a month after ANZ had identified pre-vetting as an ineffective control,⁴⁸⁰ and Mr Whereat acknowledged that the letter of censure was not an appropriate response to the concerns raised by Mr Harris' State Development

⁴⁷⁹ Transcript, Darren Whereat, 20 April 2018, 1538–9.

⁴⁸⁰ Transcript, Darren Whereat, 20 April 2018, 1539.

Manager.⁴⁸¹ Mr Whereat also accepted that, like Mr Doyle, Mr Harris did not always comply with the requirement to submit advice for pre-vetting.⁴⁸²

After further issues with Mr Harris' practice were identified in February 2016, it then took Millennium3 over a year to gain access to Mr Harris' client files for the purpose of conducting a review.⁴⁸³ Mr Whereat acknowledged that it took Millennium3 'far too long' to access the client files, and that the process they adopted to gain access to the files was not 'strong enough'.⁴⁸⁴ Part of the reason why it took so long for Millennium3 to access these files was because Mr Harris did not store the relevant information in XPLAN. It was not mandatory at that time for Millennium3 advisers to use XPLAN. Ms Rixon acknowledged that ANZ should have commenced its program to move Aligned Dealer Group advisers onto XPLAN earlier than it did,⁴⁸⁵ and accepted that this could have occurred as early as 2013.⁴⁸⁶

During the whole period that Millennium3 was attempting to access Mr Harris' client files, it did not suspend Mr Harris or terminate his authorisation.⁴⁸⁷ Instead, it allowed him to continue providing advice to clients. During this time, a number of internal forums and bodies discussed whether further steps should be taken, but no decision was made to terminate Mr Harris' authority until April 2017, after the client files had been accessed and a targeted review had been conducted.⁴⁸⁸ Mr Whereat agreed that it was 'absolutely not' acceptable that it had taken so long for Millennium3 to terminate Mr Harris' authorisation.⁴⁸⁹ He could not explain why action was not taken sooner.⁴⁹⁰

⁴⁸¹ Transcript, Darren Whereat, 20 April 2018, 1538.

⁴⁸² Transcript, Darren Whereat, 20 April 2018, 1539.

⁴⁸³ Transcript, Darren Whereat, 20 April 2018, 1539.

⁴⁸⁴ Transcript, Darren Whereat, 20 April 2018, 1540.

⁴⁸⁵ Transcript, Kylie Rixon, 23 April 2018, 1568.

⁴⁸⁶ Transcript, Kylie Rixon, 23 April 2018, 1568.

⁴⁸⁷ Transcript, Darren Whereat, 20 April 2018, 1543.

⁴⁸⁸ Transcript, Darren Whereat, 20 April 2018, 1545.

⁴⁸⁹ Transcript, Darren Whereat, 20 April 2018, 1545.

⁴⁹⁰ Transcript, Darren Whereat, 20 April 2018, 1545.

In its submissions in response to this case study, Millennium3 submitted that it was not open to the Commission to find that it might have breached its obligations under Sections 912A(1)(a), 912A(1)(ca), 912A(1)(d) or 912A(1)(h) of the Corporations Act, or ASIC class order CO 14/923.⁴⁹¹ In relation to Sections 912A(1)(a) and 912A(1)(ca), it submitted that the fact that different decisions could have been made with the benefit of hindsight did not mean that the steps taken at the time involved a breach of those provisions.⁴⁹² In relation to Section 912A(1)(h), it submitted that the conduct of Mr Harris did not throw light on the adequacy of its risk management systems.⁴⁹³ In relation to CO 14/923, it submitted that it was sufficient for Millennium3 to rely on its contractual right to access Mr Harris' records.⁴⁹⁴

In the case of Mr Harris, Millennium3 did not do all things necessary to ensure that the financial services covered by its financial services licence were provided efficiently, honestly and fairly.

Further, the maintenance of a consequence management system under which serious concerns about an adviser could be met with inadequate responses, coupled with an inability to access client files for the purposes of review and remediation, might amount to a failure by Millennium3 to take reasonable steps to ensure that its representatives complied with financial services laws – in particular, Sections 961B and 961G of the Corporations Act.

It follows that, contrary to Millennium3's submissions, in the period of time considered in this case study, Millennium3 may have breached its obligation under Section 912A(1)(a) of the Corporations Act to do all things to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly, and its obligations under Sections 912A(1)(ca) and 961L of the Corporations Act to take reasonable steps to ensure that

⁴⁹¹ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 5 [22]–[23], 9 [41]–[42].

⁴⁹² Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 10 [43].

⁴⁹³ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 10 [45]–[46].

⁴⁹⁴ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 10 [47].

its representatives complied with Sections 961B and 961G of the Corporations Act.

Further, Millennium3's inability to access Mr Harris' client files appears, in itself, to have fallen short of the standards of record-keeping required of financial services licensees. As early as September 2011, ASIC expressed concerns about licensees relying on contractual arrangements with advisers to ensure that the licensees had access to client records.⁴⁹⁵ In July 2013, ASIC recommended that licensees take steps such as using electronic storage platforms to ensure that they had access to client records.⁴⁹⁶ In respect of the period after October 2016, Millennium3 may have breached its statutory obligation under Section 912G of the Corporations Act – set out in ASIC Class Order (CO 14/923) – to ensure that it kept client records in such a way that they were accessible to Millennium3 at all times in a way that enabled Millennium3 to produce the records.

As discussed above, the community expects that, when a licensee identifies that an adviser may have provided inappropriate advice, the licensee will investigate and remediate in a more timely manner. Mr Whereat acknowledged that it had taken Millennium3 far too long to remediate Mr Harris' clients, and apologised for that.⁴⁹⁷ The conduct of Millennium3 in connection with the review and remediation of Mr Harris' clients fell short of community standards and expectations. In its submissions in response to this case study, Millennium3 accepted that it was open to the Commission to make this finding.⁴⁹⁸

4.3.7 Mr A

Mr Forde acknowledged a number of failings on the part of Millennium3 in connection with the advice given by Mr A.

After Millennium3 terminated Mr A's authorised representative status, it did not conduct an investigation into his client files to see whether any of his

⁴⁹⁵ Exhibit 2.145, September 2011, ASIC Report 251: Review of Financial Advice Industry Practice, 7 [24], 22 [70].

⁴⁹⁶ Exhibit 2.146, July 2013, ASIC Report 362: Review of Financial Advice Industry Practice, 10, 25 [91]–[92].

⁴⁹⁷ Transcript, Darren Whereat, 20 April 2018, 1546.

⁴⁹⁸ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 11 [50].

clients had been given inappropriate advice.⁴⁹⁹ Mr Forde could not explain why this was not done. He accepted that, given Mr A's very poor audit results, Millennium3 should have conducted a review of Mr A's files at that time.⁵⁰⁰

After Millennium3 received a complaint from one of the clients of Mr A who had invested in the unit trust, it identified the four other SMSFs that were listed as unitholders in the unit trust and were clients of Mr A's when he was an authorised representative of Millennium3.⁵⁰¹ However, Millennium3 did not attempt to contact those clients or to investigate whether they had suffered any loss,⁵⁰² but instead left it to those clients to come forward and prove they had suffered loss.⁵⁰³ Mr Forde said this had occurred because Millennium3 had prioritised its commercial interests over the interests of its clients.⁵⁰⁴ Mr Forde acknowledged that Millennium3 should have reached out to those clients and found out more information about their circumstances,⁵⁰⁵ and that, if it had done so, it could have identified Mr A's misconduct earlier than it did.⁵⁰⁶ He accepted that, where an adviser is terminated with extremely poor audit results and there are complaints that the adviser has misled and deceived customers, the community would expect the licensee to conduct an investigation.⁵⁰⁷ In its submissions in response to this case study, Millennium3 accepted that it was open to me to find that its conduct in not taking steps to investigate whether any of Mr A's clients had suffered detriment as a result of his advice fell short of community standards and expectations in respect of the period up to May 2017.⁵⁰⁸

⁴⁹⁹ Transcript, Kieran Forde, 24 April 2018, 1716.

⁵⁰⁰ Transcript, Kieran Forde, 24 April 2018, 1716.

⁵⁰¹ Transcript, Kieran Forde, 24 April 2018, 1719.

⁵⁰² Transcript, Kieran Forde, 24 April 2018, 1719.

⁵⁰³ Transcript, Kieran Forde, 24 April 2018, 1720.

⁵⁰⁴ Transcript, Kieran Forde, 24 April 2018, 1724.

⁵⁰⁵ Transcript, Kieran Forde, 24 April 2018, 1720.

⁵⁰⁶ Transcript, Kieran Forde, 24 April 2018, 1724.

⁵⁰⁷ Transcript, Kieran Forde, 24 April 2018, 1724.

⁵⁰⁸ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 7 [33].

Neither ANZ nor Millennium3 had access to Mr A's files, which Mr Forde accepted would have made it very difficult to determine whether any of Mr A's clients had suffered loss.⁵⁰⁹ Mr Forde accepted that Millennium3 should have retained copies of the customer files when it terminated Mr A's authorised representative status.⁵¹⁰

I consider that Millennium3's failure to retain copies of Mr A's client files, and its repeated failures to investigate whether any of Mr A's clients may have suffered detriment as a result of inappropriate advice provided by Mr A, amount to conduct falling short of community standards and expectations. In its submissions in response to this case study, Millennium3 accepted that it was open to me to make this finding in respect of the period from December 2013 to May 2017 in relation to clients who invested in the unit trust.⁵¹¹ Millennium3 should have conducted such an investigation when it terminated Mr A's authorisation. That it did not do so even after it had identified specific clients who were likely to have suffered detriment fell well short of the standards that the community would expect.

4.4 Causes of the conduct

4.4.1 Risk management practices

One cause of the inappropriate advice provided by Mr Doyle and Mr Harris was the inadequacy of the risk management and control systems of ANZ and its Aligned Dealer Groups.

Ms Rixon gave evidence that, since January 2014, the residual risk of adverse consequences resulting from customers of ANZ and its Aligned Dealer Groups receiving inappropriate financial advice has remained 'High'.⁵¹² For a period of more than four years, covering the whole of the period in which Mr Doyle and Mr Harris provided the advice that was the subject of the case study, ANZ's risk management committee continued to accept that 'High' risk, and to approve risk treatment plans that, as events

⁵⁰⁹ Transcript, Kieran Forde, 24 April 2018, 1719.

⁵¹⁰ Transcript, Kieran Forde, 24 April 2018, 1719.

⁵¹¹ Millennium3 and RI Advice Group, *M3 and RI Submissions Arising from Case Studies Involving Mr A, Mr Harris and Mr Doyle*, undated, 10 [33].

⁵¹² Transcript, Kylie Rixon, 23 April 2018, 1575–89.

turned out, did not reduce that risk below its 'High' level.⁵¹³ Ms Rixon accepted that it was 'very regrettable' that ANZ had recognised that there was a high systemic risk and continued to approve treatment plans that did not reduce the risk over four consecutive years.⁵¹⁴

These continuing high levels of risk were at least in part the result of underinvestment by ANZ in the systems and processes necessary to improve its control environment and ensure that customers of ANZ, RI Advice Group and Millennium3 were receiving appropriate advice. In November 2016, more than two years after ANZ first approved a risk treatment plan in relation to the risk of adverse consequences resulting from customers receiving inappropriate financial advice, an internal audit report noted that a 'quantum shift in investment' was required to enable the Aligned Dealer Groups to meet regulatory expectations, deliver on customer remediation programs and improve the control environment.⁵¹⁵

Ms Rixon acknowledged that one example of where there had been a lack of investment by ANZ in the systems and processes needed to ensure compliance was the delays in encouraging all advisers to use XPLAN.⁵¹⁶

4.4.2 Adequacy of internal control systems

Another cause of the inappropriate advice provided by Mr Doyle and Mr Harris was the inadequacy of the internal control systems of RI Advice Group and Millennium3. As explained above:

- both RI Advice Group and Millennium3 allowed high risk advisers to continue to provide advice to customers subject to a requirement that the advice be subject to pre-vetting, in circumstances where they knew that pre-vetting could be circumvented and was ineffective as a control;
- because of the complex internal structure for decision-making about consequence management, Millennium3 delayed imposing consequences on Mr Harris, even after he was identified as being a high risk to customers; and

⁵¹³ Transcript, Kylie Rixon, 23 April 2018, 1581–9.

⁵¹⁴ Transcript, Kylie Rixon, 23 April 2018, 1585.

⁵¹⁵ Transcript, Kylie Rixon, 23 April 2018, 1587.

⁵¹⁶ Transcript, Kylie Rixon, 23 April 2018, 1568.

- Millennium3 did not take adequate steps to ensure that its authorised representatives kept client files in a way that would enable them to be easily reviewed to identify whether inappropriate advice had been provided to customers.

4.4.3 Recruitment practices

Another cause of the inappropriate advice provided by Mr Doyle was the inadequacy of RI Advice Group's recruitment processes.

As explained above, RI Advice Group actively sought to recruit Mr Doyle and other authorised representatives of Australian Financial Services Pty Ltd,⁵¹⁷ because they held \$677 million in funds under management in a product issued by an entity associated with ANZ, which ANZ wanted to retain.⁵¹⁸ RI Advice Group was aware at the time it pursued these advisers that ASIC had imposed additional conditions on Australian Financial Services' licence as a result of adviser misconduct.⁵¹⁹ Although RI Advice Group assured ASIC that it would only 'on-board' advisers who met enhanced due diligence standards,⁵²⁰ it failed to apply those standards in relation to Mr Doyle, and did not carry out enhanced monitoring or supervision of Mr Doyle after he commenced with RI Advice Group.⁵²¹

4.5 Effectiveness of response and redress

Neither RI Advice Group nor Millennium3 responded effectively or adequately to the potential detriment suffered by customers of Mr Doyle, Mr Harris and Mr A.

In the case of Mr Doyle, RI Advice Group assigned the review and remediation of his customers a 'low' priority, in circumstances where it had not yet taken adequate steps to determine whether Mr Doyle's customers had suffered detriment. As a result, the files of the majority of Mr Doyle's customers have not yet been reviewed, over two years after an internal

⁵¹⁷ Transcript, Darren Whereat, 20 April 2018, 1493; Exhibit 2.132, 22 March 2013, Memorandum AFS Retention Strategy dated 22/03/2013; Exhibit 2.134, 20 April 2018, Email Younger to Williams dated 15/04/2013 and attachment.

⁵¹⁸ Transcript, Darren Whereat, 20 April 2018, 1491, 1493.

⁵¹⁹ Transcript, Darren Whereat, 20 April 2018, 1493, 1495.

⁵²⁰ Transcript, Darren Whereat, 20 April 2018, 1494.

⁵²¹ Transcript, Darren Whereat, 20 April 2018, 1498, 1527.

investigation identified that there was a risk that Mr Doyle's clients had suffered detriment as a result of his advice.

In the case of Mr Harris, despite audit reports over a period of several years indicating serious deficiencies in the adviser's processes and practices, it was not until March 2017 that Millennium3 undertook a targeted review of Mr Harris' client's files. That review identified the potential for client detriment in almost all of the files reviewed, but ANZ's remediation program in respect of Mr Harris' clients remains in the 'scoping and investigation' stage over a year later. As Mr Whereat acknowledged, it took Millennium3 far too long to remediate Mr Harris' clients, and Mr Whereat apologised for that.⁵²²

In the case of Mr A:

- having terminated Mr A in circumstances where he had received extremely poor audit results, Millennium3 took no steps to investigate whether any of his clients had suffered detriment as a result of his advice; and
- even after identifying specific clients of Mr A who may have suffered loss because of Mr A's conduct, Millennium3 took no steps to contact those clients or investigate whether they had suffered detriment as a result of Mr A's advice.

The responses made by RI Advice Group and Millennium3 were inadequate.

5 Bad advice: AMP

5.1 Background

The Commission heard evidence of the conduct of three authorised representatives of AMP's financial advice business: Mr E, who was an authorised representative of AMP Financial Planning Pty Ltd; Ms Jennifer Coleman, who was an authorised representative of Charter Financial Planning Ltd (Charter); and Mr Adam Palmer, who was an authorised representative of Genesys Wealth Advisers Ltd (Genesys).

⁵²² Transcript, Darren Whereat, 20 April 2018, 1546.

At the times relevant to the evidence, AMP Financial Planning, Charter and Genesys were each wholly owned subsidiaries of AMP, and each had its own financial services licence.⁵²³

One witness gave evidence in relation to these matters: Ms Sarah Britt, Head of Compliance at AMP Limited.

Before the second round of the Commission's hearings began, the Solicitor Assisting the Commission took steps to contact Mr E, but was unable to contact him. As a result, the Commissioner made non-publication directions in relation to information revealing the identity of Mr E.

On 3 April 2018, before the second round of the Commission's hearings began, the Solicitor Assisting the Commission wrote to Ms Coleman and notified her that her conduct may be the subject of a case study to be heard by the Commission. On 9 April, the Commission spoke with Ms Coleman and explained the substance of the evidence concerning her conduct. On 10 April, the Commission sent Ms Coleman an email attaching a copy of Ms Britt's statement. Ms Coleman did not seek leave to appear at the hearings and did not provide submissions.

On 3 April 2018, the Solicitor Assisting the Commission wrote to Mr Palmer and notified him that his conduct may be the subject of a case study to be heard by the Commission. On 10 April, the Commission spoke with Mr Palmer and explained the substance of the evidence concerning his conduct. The same day, the Commission sent Mr Palmer an email attaching a copy of Ms Britt's statement. Mr Palmer did not seek leave to appear at the hearings but did provide submissions.

5.2 Evidence

5.2.1 Mr E

In November 2016, Mr E provided advice to a married couple, who were seeking advice to improve the performance of their superannuation funds to meet their long-term goal of accumulating more wealth.⁵²⁴ Mr E recommended that the married couple roll over their superannuation

⁵²³ Transcript, Sarah Britt, 23 April 2018, 1593, 1594.

⁵²⁴ Transcript, Sarah Britt, 23 April 2018, 1594; Exhibit 2.161, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 3) [AMP.6000.0037.1463 at .1466].

benefits from their existing funds (which were not owned by AMP) into MyNorth Super, a fund owned by AMP.⁵²⁵ The effect of that advice was that the husband sacrificed approximately \$16,000, close to 25% of the balance of the fund, on the transfer to MyNorth Super.⁵²⁶ Ms Britt conceded that, in making this recommendation, there was no attempt by Mr E to compare the husband's likely returns if he were to remain in his current funds with the likely returns from moving to MyNorth Super.⁵²⁷ Another consequence of the advice was that the wife would be required to pay a higher ongoing fee than she was required to pay to her existing superannuation fund.⁵²⁸

Ms Britt acknowledged that Mr E's advice was inappropriate,⁵²⁹ and that it resulted in financial detriment to the clients.⁵³⁰

Mr E was first audited by AMP Financial Planning in September 2016, about two months before giving the advice to the married couple.⁵³¹ He received a C rating for that audit, on a scale of A (the highest rating) to E (the lowest rating).⁵³² Although the audit revealed deficiencies in Mr E's advice of the same kind as affected the advice that he ultimately provided to the married couple, Ms Britt accepted that the remedial action that followed the audit did not prevent Mr E from continuing to provide inappropriate advice.⁵³³ Mr E was audited again in March 2017, and this time received an E rating.⁵³⁴ Following this audit, Mr E failed to comply with the required remedial actions.⁵³⁵

⁵²⁵ Transcript, Sarah Britt, 23 April 2018, 1595–6.

⁵²⁶ Transcript, Sarah Britt, 23 April 2018, 1596, 1598.

⁵²⁷ Transcript, Sarah Britt, 23 April 2018, 1597.

⁵²⁸ Transcript, Sarah Britt, 23 April 2018, 1600; Exhibit 2.161, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 2) [AMP.6000.0028.0440 at .0446–.0447].

⁵²⁹ Transcript, Sarah Britt, 23 April 2018, 1598.

⁵³⁰ Transcript, Sarah Britt, 23 April 2018, 1598.

⁵³¹ Transcript, Sarah Britt, 23 April 2018, 1598; Exhibit 2.162, 22 September 2016, Quality Review and Statement of Actions dated 22/09/2016, 1.

⁵³² Transcript, Sarah Britt, 23 April 2018, 1599.

⁵³³ Transcript, Sarah Britt, 23 April 2018, 1606.

⁵³⁴ Transcript, Sarah Britt, 23 April 2018, 1599.

⁵³⁵ Transcript, Sarah Britt, 23 April 2018, 1601.

Subsequently, Advice Governance (a body internal to AMP that provides advice and guidance on regulatory and compliance issues)⁵³⁶ recommended that Mr E's personal authorisation be revoked and his agreement with AMP Financial Planning be terminated immediately.⁵³⁷ However, AMP Financial Planning did not support the recommendation to terminate the adviser.⁵³⁸ Ms Britt conceded that there was 'certainly some discomfort' around that decision.⁵³⁹ After a further review of Mr E's files identified further inappropriate advice provided by Mr E, Mr E's employer (an authorised representative of AMP Financial Planning) decided to terminate his employment.⁵⁴⁰ After this occurred, AMP Financial Planning revoked Mr E's personal authorised representative status.⁵⁴¹

At the time that Ms Britt gave evidence, AMP Financial Planning had been aware of Mr E's misconduct for over 12 months. Despite this, when Ms Britt gave evidence, AMP Financial Planning had not even contacted the clients who had been given the advice, let alone offered to remedy the consequences.⁵⁴² Ms Britt acknowledged that it was not acceptable that these clients had not yet been told that they had received inappropriate advice.⁵⁴³

5.2.2 Ms Coleman

In February 2016, Ms Coleman gave financial advice to a de facto couple.⁵⁴⁴ The couple had recently had a child, and they were seeking insurance advice to ensure that their family would be secure in the event anything happened to either parent.⁵⁴⁵ Ms Coleman recommended that the male

⁵³⁶ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 15) [AMP.6000.0001.2246 at .2248].

⁵³⁷ Transcript, Sarah Britt, 23 April 2018, 1602.

⁵³⁸ Transcript, Sarah Britt, 23 April 2018, 1602.

⁵³⁹ Transcript, Sarah Britt, 23 April 2018, 1602.

⁵⁴⁰ Transcript, Sarah Britt, 23 April 2018, 1603.

⁵⁴¹ Transcript, Sarah Britt, 23 April 2018, 1603–4.

⁵⁴² Transcript, Sarah Britt, 23 April 2018, 1598, 1606.

⁵⁴³ Transcript, Sarah Britt, 23 April 2018, 1607.

⁵⁴⁴ Transcript, Sarah Britt, 23 April 2018, 1612; Exhibit 2.161, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 5) [AMP.6000.0037.0118].

⁵⁴⁵ Transcript, Sarah Britt, 23 April 2018, 1612–3.

client replace each of his existing insurances (with a non-AMP insurer), with AMP insurance policies said to be cheaper by just less than \$1,000 per annum.⁵⁴⁶ However, Ms Coleman's advice:

- misquoted the insurance premiums – they were higher than the amounts stated in the advice;⁵⁴⁷
- did not disclose that the premiums were going to be paid by way of withdrawals from the couples' superannuation funds;⁵⁴⁸
- did not disclose the exit fees that would apply to each withdrawal from the clients' superannuation funds to pay the insurance premiums;⁵⁴⁹ and
- did not disclose that Ms Coleman may receive an activation payment (a commission) in respect of one of the products that she recommended.⁵⁵⁰

Ms Britt accepted that Ms Coleman 'got it wrong',⁵⁵¹ and, in particular, accepted that the clients had been misled by Ms Coleman about the amount of money it would cost to replace their existing insurance policies with the ones recommended by Ms Coleman.⁵⁵²

Ms Britt accepted that Ms Coleman had not documented the scope of the advice, or the clients' needs and circumstances.⁵⁵³ Ms Britt acknowledged that this meant it was not possible to determine whether the advice was in the best interests of the clients.⁵⁵⁴

⁵⁴⁶ Transcript, Sarah Britt, 23 April 2018, 1613–4.

⁵⁴⁷ Transcript, Sarah Britt, 23 April 2018, 1614.

⁵⁴⁸ Transcript, Sarah Britt, 23 April 2018, 1615.

⁵⁴⁹ Transcript, Sarah Britt, 23 April 2018, 1615.

⁵⁵⁰ Transcript, Sarah Britt, 23 April 2018, 1615.

⁵⁵¹ Transcript, Sarah Britt, 23 April 2018, 1614.

⁵⁵² Transcript, Sarah Britt, 23 April 2018, 1615.

⁵⁵³ Transcript, Sarah Britt, 23 April 2018, 1616.

⁵⁵⁴ Transcript, Sarah Britt, 23 April 2018, 1616.

On 6 June 2016, Charter audited Ms Coleman.⁵⁵⁵ She received a D rating.⁵⁵⁶ This was Ms Coleman's third consecutive D rating.⁵⁵⁷ Following this audit, the Issues Panel (a body internal to AMP that reviews adviser and practice issues)⁵⁵⁸ determined to revoke Ms Coleman's authorisation.⁵⁵⁹ Ms Coleman's corporate authority was terminated in June 2016,⁵⁶⁰ and Ms Coleman resigned from Charter in July 2016.⁵⁶¹

On 6 July 2016, the matter of Ms Coleman was passed to the AMP Review and Remediation program for review.⁵⁶² At the time of Ms Britt's evidence, almost two years had passed since the matter was referred. However, when Ms Britt gave evidence, none of Ms Coleman's clients had been contacted by AMP about the advice they received from Ms Coleman, and none had been offered any compensation.⁵⁶³ Ms Britt agreed that, if the insurance policies were renewable annually, that, by the time she gave evidence, the couple would have missed their opportunity to elect not to renew the policies.⁵⁶⁴ Ms Britt also agreed that, if the policies were being renewed annually, it would be better for the clients to know about the inappropriate advice they received before renewal, so that they may be able to make decisions about whether or not to renew the policies.⁵⁶⁵ But none of this was possible when the clients had not been told that the advice given was inappropriate.

⁵⁵⁵ Transcript, Sarah Britt, 23 April 2018, 1615.

⁵⁵⁶ Transcript, Sarah Britt, 23 April 2018, 1615.

⁵⁵⁷ Transcript, Sarah Britt, 23 April 2018, 1616.

⁵⁵⁸ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 15) [AMP.6000.0001.2246 at .2251].

⁵⁵⁹ Transcript, Sarah Britt, 23 April 2018, 1616.

⁵⁶⁰ Transcript, Sarah Britt, 23 April 2018, 1616.

⁵⁶¹ Transcript, Sarah Britt, 23 April 2018, 1616.

⁵⁶² Transcript, Sarah Britt, 23 April 2018, 1617.

⁵⁶³ Transcript, Sarah Britt, 23 April 2018, 1617.

⁵⁶⁴ Transcript, Sarah Britt, 23 April 2018, 1618.

⁵⁶⁵ Transcript, Sarah Britt, 23 April 2018, 1618.

5.2.3 Mr Palmer

Mr Palmer became an authorised representative of Genesys in May 2013.⁵⁶⁶ Before joining Genesys, Mr Palmer was an authorised representative of Australian Financial Services Pty Ltd, the same licensee as Mr Doyle in the ANZ case study. As already noted, ASIC had imposed restrictions on Australian Financial Services' licence in 2011 as a result of misconduct by its advisers.⁵⁶⁷

Mr Palmer had a significant and valuable client base that he was willing to transfer to Genesys – he indicated this to Genesys in his application form by recording that he had \$30 million worth of funds under management.⁵⁶⁸

Ms Britt accepted that the interview and appointment process of Genesys conducted with respect to Mr Palmer was deficient.⁵⁶⁹ Among other things, as discussed in more detail below, Mr Palmer had disclosed that he was not qualified to provide financial advice in relation to particular areas in which he said he intended to provide advice. Despite this, Mr Palmer was not required to submit any files for vetting until February 2014, approximately 10 months after he commenced with Genesys.⁵⁷⁰ There was no audit of his files until July 2014, over 12 months after he started with Genesys.⁵⁷¹

In the July 2014 audit, Mr Palmer received an E rating,⁵⁷² the lowest possible rating.⁵⁷³ In one of the files the subject of the audit, Mr Palmer had given advice to a couple who wanted to renovate their home. He advised the couple to establish an SMSF, roll over their superannuation into the

⁵⁶⁶ Exhibit 2.161, Witness statement of Sarah Britt, 10 April 2018, 10–11 [37].

⁵⁶⁷ Transcript, Sarah Britt, 23 April 2018, 1623; Exhibit 2.131, 7 November 2011, ASIC Media Release concerning Australian Financial Services Limited.

⁵⁶⁸ Transcript, Sarah Britt, 23 April 2018, 1628–9; see Exhibit 2.166, 4 January 2013, Authorised Representative Application by Palmer.

⁵⁶⁹ Transcript, Sarah Britt, 23 April 2018, 1630, 1631.

⁵⁷⁰ Transcript, Sarah Britt, 23 April 2018, 1631.

⁵⁷¹ Transcript, Sarah Britt, 23 April 2018, 1632–3, 1636; Exhibit 2.161, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 25) [AMP.6000.0028.0841].

⁵⁷² Transcript, Sarah Britt, 23 April 2018, 1636.

⁵⁷³ Transcript, Sarah Britt, 23 April 2018, 1636.

fund, and purchase an investment property.⁵⁷⁴ The audit identified a number of problems with this advice, including that:⁵⁷⁵

- there was no evidence of any assessment of the couple's risk tolerance;
- the advice fell outside the scope of Mr Palmer's accreditations (as he did not have SMSF or gearing accreditations); and
- Mr Palmer was providing advice that could be deemed property advice (again, an area of advice for which he was not qualified and for which he was not authorised).

The audit also identified that, when giving the advice to buy an investment property, Mr Palmer had a conflict of interest. Mr Palmer had a direct interest (60% ownership) in a property business, which acted as a buyer's advocate, and to which he referred clients to assist with the purchase of properties.⁵⁷⁶

Ms Britt accepted that Mr Palmer's conduct could be interpreted as dishonest.⁵⁷⁷ Ms Britt also agreed that Mr Palmer's case was an example where, had Genesys followed adequate procedures at the time or immediately after Mr Palmer was made an authorised representative of Genesys, it would have rung alarm bells.⁵⁷⁸

Following the audit in July 2014, Mr Palmer's matter was considered by the AMP Issues Panel, and a decision was made to terminate Mr Palmer. However, Mr Palmer resigned before he was terminated.⁵⁷⁹

In October 2014, Mr Palmer moved to Dover Financial Advisers Pty Ltd.⁵⁸⁰ Ms Britt was not aware of any evidence that Dover requested a reference in relation to Mr Palmer, and had not seen anything to indicate that Genesys

⁵⁷⁴ Transcript, Sarah Britt, 23 April 2018, 1636; Exhibit 2.161.6, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 25) [AMP.6000.0028.0841 at .0843].

⁵⁷⁵ Transcript, Sarah Britt, 23 April 2018, 1637.

⁵⁷⁶ Transcript, Sarah Britt, 23 April 2018, 1637.

⁵⁷⁷ Transcript, Sarah Britt, 23 April 2018, 1639.

⁵⁷⁸ Transcript, Sarah Britt, 23 April 2018, 1638.

⁵⁷⁹ Transcript, Sarah Britt, 23 April 2018, 1639.

⁵⁸⁰ Transcript, Sarah Britt, 23 April 2018, 1640.

reached out to Dover to inform it of Mr Palmer's conduct.⁵⁸¹ In 2016 and 2017, ASIC conducted a review of Mr Palmer's files at Dover and identified multiple breaches of the Corporations Act in connection with those files.⁵⁸²

In October 2014, a member of the Issues Panel prepared a breach assessment in respect of Mr Palmer. The assessment was that Mr Palmer's conduct did not constitute a breach reportable under Section 912D of the Corporations Act, and AMP did not resolve to report his conduct as a Serious Compliance Concern. Ms Britt accepted that the decision not to report Mr Palmer's conduct as a Serious Compliance Concern was not 'a decision [she] would [make] today, based on everything [she] has seen', particularly as he was later notified to ASIC as a Serious Compliance Concern.⁵⁸³

In July 2015, in response to a request by ASIC for information about advisers in respect of whom Genesys had identified serious compliance concerns, Genesys reported Mr Palmer's conduct to ASIC.⁵⁸⁴ The report was made 12 months after Mr Palmer had received the E rated audit.

Ms Britt accepted that Genesys' process for conducting due diligence on Mr Palmer failed. She also accepted that Genesys failed to provide adequate training to Mr Palmer regarding the best interests duty and related obligations,⁵⁸⁵ and that Genesys' process for ensuring that Mr Palmer only provide advice in areas for which he was accredited to provide advice had failed.⁵⁸⁶

Since terminating Mr Palmer's authorisation in September 2014, no client has received remediation for inappropriate advice given by Mr Palmer.⁵⁸⁷ Although AMP has commenced its review of Mr Palmer's files, a number are still yet to be received and Ms Britt could not provide a date for when the

⁵⁸¹ Transcript, Sarah Britt, 23 April 2018, 1641.

⁵⁸² Exhibit 2.161.40, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 40) [AMP.6000.0043.2824].

⁵⁸³ Transcript, Sarah Britt, 23 April 2018, 1642–3.

⁵⁸⁴ Transcript, Sarah Britt, 23 April 2018, 1643–4.

⁵⁸⁵ Transcript, Sarah Britt, 23 April 2018, 1644.

⁵⁸⁶ Transcript, Sarah Britt, 23 April 2018, 1644.

⁵⁸⁷ Transcript, Sarah Britt, 23 April 2018, 1645.

assessment of those files will be complete.⁵⁸⁸ Ms Britt's evidence was that AMP has not made any specific provision for compensation for any of Mr Palmer's clients.⁵⁸⁹

5.3 What the case study showed

5.3.1 Mr E

Ms Britt accepted that the advice that Mr E gave to the married couple referred to above was inappropriate,⁵⁹⁰ and that it resulted in financial detriment to the clients.⁵⁹¹ AMP acknowledged in its submissions to the Commission that Mr E's conduct more generally had given rise to serious compliance concerns.⁵⁹² I agree that the advice that Mr E gave to the married couple was inappropriate. It was not in their best interests and caused them detriment. In giving that advice, Mr E may have breached his obligation under Section 961B(1) of the Corporations Act to act in the best interests of his clients, and may have breached his obligation under Section 961G of the Corporations Act only to provide advice if it would be reasonable to conclude that the advice was appropriate to the clients. In its submissions in response to this case study, AMP accepted that it was open for the Commission to find that Mr E had breached his statutory obligations.⁵⁹³

5.3.2 AMP Financial Planning

At the time that Mr E gave the inappropriate advice referred to above, he was an authorised representative of AMP Financial Planning. AMP Financial Planning did not prevent Mr E providing the inappropriate advice.

AMP acknowledged this in its submissions in response to this case study. It also acknowledged that, with the benefit of hindsight, the remedial actions

⁵⁸⁸ Transcript, Sarah Britt, 23 April 2018, 1645.

⁵⁸⁹ Transcript, Sarah Britt, 23 April 2018, 1645.

⁵⁹⁰ Transcript, Sarah Britt, 23 April 2018, 1598.

⁵⁹¹ Transcript, Sarah Britt, 23 April 2018, 1598.

⁵⁹² AMP, *Annexure to Schedule B to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 2.

⁵⁹³ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 4 [9].

required of Mr E following the September 2016 audit did not appear to be adequate. However, AMP did not accept that the evidence in relation to Mr E provided a basis for finding that there was a systemic inadequacy in AMP Financial Planning's systems that could amount to a breach of Sections 912A(1)(a), 912A(1)(ca), 912A(1)(h) or 961L of the Corporations Act.⁵⁹⁴

Ms Britt gave evidence that audits are the principal method by which AMP ensures that appropriate advice is given by AMP's authorised representatives.⁵⁹⁵

One cause of Mr E providing the inappropriate advice he did was the inadequacy of the audit processes within AMP Financial Planning.

In particular, although an audit conducted two months before Mr E provided the inappropriate advice identified similar deficiencies in other advice provided by Mr E, Mr E received a C rating for that audit. Ms Britt accepted that the remedial action that AMP Financial Planning required Mr E to undertake following that audit did not prevent Mr E from continuing to provide inappropriate advice of that kind.⁵⁹⁶

A review conducted by PwC in November 2017 of AMP's advice control framework identified file audits and vetting as two high priority areas for improvement.⁵⁹⁷ In particular, PwC expressed concerns about inconsistencies between the audit scores reached by the AMP auditor and the audit scores reached by PwC.⁵⁹⁸ PwC's conclusion was that the approach was very sensitive, and the difference between an A, B and C result could be quite subjective – in PwC's words, 'a small discrepancy in interpretation [could] lead to a vastly different audit outcome'.⁵⁹⁹

⁵⁹⁴ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 10–11 [24].

⁵⁹⁵ Transcript, Sarah Britt, 23 April 2018, 1646.

⁵⁹⁶ Transcript, Sarah Britt, 23 April 2018, 1606.

⁵⁹⁷ Transcript, Sarah Britt, 23 April 2018, 1646; Exhibit 2.171.19, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5033].

⁵⁹⁸ Transcript, Sarah Britt, 23 April 2018, 1646–7.

⁵⁹⁹ Transcript, Sarah Britt, 23 April 2018, 1647.

PwC concluded that this was because auditors had a discretion to determine the materiality of different issues in an audit. That is, if a 'High' weighted issue – such as a failure to demonstrate compliance with the best interests obligation – was not regarded as material, this could result in the adviser receiving a substantially better grade than if the 'High' weighted issue was regarded as material.⁶⁰⁰ And this is what occurred in the case of the C rating that Mr E received in September 2016.⁶⁰¹ The auditor decided that Mr E had failed to comply with the best interests duty but that the failure was not a material issue. Ms Britt said that she could not justify that decision.⁶⁰²

As PwC observed, the file audit process is critical to AMP's monitoring activity, and said that 'if its consistency and quality varies, then it has the potential to undermine a significant portion of AMP's monitoring and supervision activity'.⁶⁰³

In Mr E's case, AMP Financial Planning may not have done all things necessary to ensure that the financial services covered by its financial services licence were provided efficiently, honestly and fairly.

Although AMP submitted to the contrary, I consider that it is arguable that, by maintaining an audit system that had the characteristics identified by PwC, AMP Financial Planning failed to maintain adequate risk management systems, and failed to take reasonable steps to ensure that its representatives complied with financial services laws – in particular, Sections 961B and 961G of the Corporations Act.

AMP Financial Planning's conduct in not contacting the couple who received advice from Mr E, despite forming the view that the advice was not appropriate, fell short of what the community would expect. To allow more than 12 months to elapse was not what the community would expect. To not even contact the clients before the matter was examined, when coupled with the already long delay in raising the matter with them shows little or no care or concern for the financial well-being of the clients.

⁶⁰⁰ Transcript, Sarah Britt, 23 April 2018, 1620–2.

⁶⁰¹ Transcript, Sarah Britt, 23 April 2018, 1620.

⁶⁰² Transcript, Sarah Britt, 23 April 2018, 1621.

⁶⁰³ Transcript, Sarah Britt, 23 April 2018, 1647; Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-2 (Tab 19) [AMP.6000.0006.5018 at .5047].

5.3.3 Ms Coleman

Ms Britt conceded that Ms Coleman misled the de facto couple referred to above about the amount of money it would cost to replace their existing insurance policies with the ones recommended by Ms Coleman.⁶⁰⁴ As already noted, Ms Britt acknowledged that, because Ms Coleman failed to document the scope of the advice, or the clients' needs and circumstances, it was not possible to determine whether the advice was in the best interests of the clients.⁶⁰⁵ AMP accepted in its submissions to the Commission that Ms Coleman's conduct more generally had given rise to serious compliance concerns.⁶⁰⁶ In its submissions in response to this case study, AMP accepted that it was open for the Commission to find that Ms Coleman had breached her statutory obligations.⁶⁰⁷

In circumstances where Ms Coleman did not document the scope of the advice, or the clients' needs and circumstances, misquoted insurance premiums, and failed to disclose a number of material matters, it is not possible to say on the evidence that the advice would have satisfied the 'safe harbour' requirements in Section 961B(2) of the Corporations Act prescribing steps that, if taken, will satisfy the best interests duty. It is troubling that one of the matters that Ms Coleman failed to disclose was that she would receive an activation payment, and it is also troubling to observe that the client was advised to terminate non-AMP policies and take out new AMP policies. However, it is not possible to say on the evidence that Ms Coleman did not act in the clients' best interests.

It is enough to say that I consider that AMP was right to acknowledge that Ms Coleman's conduct had given rise to serious compliance concerns. The events described in evidence may or may not be particular examples of those concerns.

⁶⁰⁴ Transcript, Sarah Britt, 23 April 2018, 1615.

⁶⁰⁵ Transcript, Sarah Britt, 23 April 2018, 1616.

⁶⁰⁶ AMP, *Annexure to Schedule B to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 11.

⁶⁰⁷ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 4, [9].

5.3.4 Charter

At the time that Ms Coleman gave the advice referred to above, she was an authorised representative of Charter. Charter did not prevent Ms Coleman from giving the advice described in evidence or engaging in the conduct that underpinned AMP's giving notice of serious compliance concerns.

At the time that Ms Coleman provided the advice, the audit processes used by Charter were relevantly the same as those used by AMP Financial Planning, as described above. The conclusions that have been expressed about those processes apply equally to Charter and need not be repeated.

Further, I consider that Charter's failure to remediate the de facto couple, or even to contact them about the advice that they received, despite having referred the matter to the AMP Review and Remediation program almost two years ago, amounts to conduct falling short of community standards and expectations. This is particularly so in circumstances where, if the insurance policies were renewable annually, the clients would now have missed their opportunity to elect not to renew the policies.

5.3.5 Mr Palmer

Ms Britt accepted that there were several deficiencies in relation to the advice that Mr Palmer provided to the couple who wanted to renovate their home. She accepted that there was no evidence of Mr Palmer having assessed the clients' risk tolerance,⁶⁰⁸ that Mr Palmer was not accredited to provide the advice that he gave to the couple,⁶⁰⁹ and that Mr Palmer had failed to disclose his conflict of interest in relation to the advice that he gave.⁶¹⁰ She also accepted that Mr Palmer had engaged in similar conduct in respect of nine other clients.⁶¹¹

AMP also acknowledged in its submissions to the Commission that Mr Palmer's conduct more generally had given rise to serious compliance concerns.⁶¹² Further, in its submissions in response to this case study, AMP

⁶⁰⁸ Transcript, Sarah Britt, 23 April 2018, 1637.

⁶⁰⁹ Transcript, Sarah Britt, 23 April 2018, 1637.

⁶¹⁰ Transcript, Sarah Britt, 23 April 2018, 1637–8.

⁶¹¹ Transcript, Sarah Britt, 23 April 2018, 1638.

⁶¹² AMP, *Annexure to Schedule B to AMP Group Response to Letter dated 2 February 2018*, 13 February 2018, 15.

accepted that it was open for the Commission to find that Mr Palmer had breached his statutory obligations.⁶¹³

Mr Palmer submitted that no findings of misconduct should be made against him because the matters in question were investigated by ASIC in 2017. Mr Palmer said that, other than requiring remediation of four client files, ASIC took no further action following that investigation.⁶¹⁴

In circumstances where Mr Palmer did not assess the clients' risk tolerance, failed to disclose his conflict of interest, and stood to benefit through his property business if the clients implemented the advice, it is not possible to say on the evidence that the advice would have satisfied the 'safe harbour' requirements in Section 961B(2) of the Corporations Act. Further, it is arguable that, in providing advice to these clients, Mr Palmer gave priority to his own interests, and the interests of his property business, over his clients' interests. However, it is not possible to say on the evidence that Mr Palmer did not act in the clients' best interests.

It is enough to say that I consider that AMP was right to acknowledge that Mr Palmer's conduct had given rise to serious compliance concerns. The events described in evidence may or may not be particular examples of those concerns.

5.3.6 Genesys

At the time that Mr Palmer gave the advice referred to above, he was an authorised representative of Genesys. Genesys did not prevent Mr Palmer from providing that advice, or other advice that it identified as having been inappropriate.

At the time that Mr Palmer provided the advice, the audit processes used by Genesys were relevantly the same as those used by AMP Financial Planning and Charter, as described above. The conclusions that have been expressed about those processes apply equally to Genesys and need not be repeated.

⁶¹³ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 4 [9].

⁶¹⁴ Adam Palmer, *Palmer Submission*, 4 May 2018, 1–2 [4].

Further, Ms Britt accepted that the interview and appointment process that Genesys conducted in relation to Mr Palmer was deficient.⁶¹⁵

In particular:

- At the interview in December 2012, Mr Palmer disclosed that he did not hold the relevant qualifications for the services he was to carry out.⁶¹⁶ He did not provide at interview, as later, a copy of his previous audit or the audit rating achieved.⁶¹⁷ He disclosed that he was the subject of a complaint.⁶¹⁸ Despite all this, the interviewer recommended that Mr Palmer 'proceed to application stage'.⁶¹⁹
- In Mr Palmer's authorised representative application form, in respect of the areas of advice that he wished to appear on his **Financial Services Guide** (FSG), Mr Palmer ticked most areas, including SMSFs.⁶²⁰ The form required that specialist qualifications accompany the application for this area of advice. Mr Palmer did not however provide any evidence of specialist qualifications.⁶²¹ Indeed, he did not list any financial planning industry qualifications in his application form.⁶²²
- Mr Britt accepted that it was inadequate to take Mr Palmer at his word on what his last audit rating was, and not to exercise greater care in circumstances where Mr Palmer was coming from Australian Financial Services Pty Ltd.⁶²³

Despite the fact that Genesys was aware of these issues at the time Mr Palmer commenced as an authorised representative of Genesys,

⁶¹⁵ Transcript, Sarah Britt, 23 April 2018, 1630, 1631.

⁶¹⁶ Transcript, Sarah Britt, 23 April 2018, 1626–7; Exhibit 2.165, 10 December 2012, Advice assessment re Palmer dated 10/12/2012, 1.

⁶¹⁷ Transcript, Sarah Britt, 23 April 2018, 1626.

⁶¹⁸ Transcript, Sarah Britt, 23 April 2018, 1625.

⁶¹⁹ Transcript, Sarah Britt, 23 April 2018, 1627.

⁶²⁰ Transcript, Sarah Britt, 23 April 2018, 1627; Exhibit 2.166, 4 January 2013, Authorised Representative Application by Palmer, 3.

⁶²¹ Transcript, Sarah Britt, 23 April 2018, 1627–8.

⁶²² Transcript, Sarah Britt, 23 April 2018, 1629.

⁶²³ Transcript, Sarah Britt, 23 April 2018, 1631.

Mr Palmer was not required to submit any files for vetting until February 2014, approximately 10 months after he commenced with Genesys.⁶²⁴ There was no audit of his files until July 2014, over 12 months after he started with Genesys.⁶²⁵

In its submissions in response to this case study, AMP accepted that: there were errors in the way in which Mr Palmer was accepted as an authorised representative of Genesys; as a result of these errors, Genesys was unaware that Mr Palmer may have provided inappropriate advice before joining Genesys, and that he was not accredited to provide SMSF advice; following Mr Palmer's acceptance as a Genesys adviser, he was erroneously not required to undertake mandatory training in the best interests duty; and, when Mr Palmer failed to submit information for vetting, this was not followed up as it should have been.⁶²⁶

Although AMP accepted that these failings were serious, it submitted that they were not systemic or representative of the normal operation of Genesys' systems and processes at the time. On this basis, AMP submitted that there was no basis to find that Genesys breached its statutory obligations.⁶²⁷

The fact remains that the failings identified above occurred, and Genesys' systems and processes did not prevent them. By allowing Mr Palmer to provide advice about self-managed superannuation without the necessary accreditation, at least in his case, Genesys failed to ensure that its representatives were adequately trained to provide the financial services under its licence. Further, by maintaining a recruitment system that had the deficiencies identified in relation to Mr Palmer's recruitment, it is arguable that Genesys may have breached its general obligation under Section 912A(1)(f) of the Corporations Act to ensure that its representatives are adequately trained, and are competent, to provide the financial services under its licence.

⁶²⁴ Transcript, Sarah Britt, 23 April 2018, 1631.

⁶²⁵ Transcript, Sarah Britt, 23 April 2018, 1632–3, 1636; Exhibit 2.161, Witness statement of Sarah Britt, 10 April 2018, Exhibit SCB-2 (Tab 25) [AMP.6000.0028.0841].

⁶²⁶ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 15 [31].

⁶²⁷ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 16 [34].

Further, I consider that Genesys' failure to finish reviewing Mr Palmer's client files, or make any specific provision for compensation for any of his clients – despite having terminated Mr Palmer's authorisation in September 2014 – is conduct that falls short of community standards and expectations. In its submissions in response to this case study, AMP acknowledged that there had been an unacceptable delay in identifying and remediating clients who have suffered financial loss as a result of inappropriate advice, and accepted that it was open to the Commission to find that this amounted to conduct falling short of community standards and expectations.⁶²⁸

5.4 Causes of the conduct

As explained above, one of the causes of the inappropriate or deficient advice given by Mr E was the issues with the audit processes within AMP's licensees.

Further, as also explained above, one of the causes of the inappropriate or deficient advice given by Mr Palmer was the issues with Genesys' recruitment processes in relation to Mr Palmer.

5.5 Effectiveness of mechanisms for response and redress

AMP and its licensees did not respond adequately to the detriment suffered by the clients of the advisers considered in this case study.

As noted earlier, AMP and its licensees have not remediated any of the clients considered in this case study:

- In the case of Mr E, at the time of Ms Britt's evidence, AMP Financial Planning has been aware of the conduct for over 12 months, yet no notification has been given to them of the inappropriate advice, and no remediation of the clients has occurred.
- For Ms Coleman's clients who received inappropriate advice, almost two years have passed with no contact, or remediation, from Charter about this conduct.

⁶²⁸ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 19 [51]–[52].

- For Mr Palmer’s clients, nearly four years have passed since Genesys became aware of the inappropriate advice that potentially required customer remediation, and no client has yet received remediation for his conduct. AMP offered Mr Palmer’s clients who were the subject of this case study a review of their advice, but did not explain to the clients that they may be entitled to compensation.⁶²⁹

Ms Britt gave evidence that the remediation program of AMP was moving very slowly. She attributed this to the size and scale of the remediation program at AMP, and the complexity of some of the remediation issues.⁶³⁰ Ms Britt was able to say that AMP had completed the remediation of 14 adviser books, but was unable to give any specific information about how many further clients were in the pool, yet to be remediated or contacted about the possible inappropriate advice of which they had been the victim.⁶³¹ Essentially, as Ms Britt put it, AMP had ‘underestimated’ the size of the task.⁶³²

As noted above, in its submissions in response to this case study, AMP acknowledged that there had been an unacceptable delay in identifying and remediating clients who have suffered financial loss as a result of inappropriate advice.⁶³³ AMP was right to describe the delay as ‘unacceptable’.

6 Bad advice: NAB

6.1 Background

The Commission heard evidence about the incorrect witnessing of binding beneficiary nomination forms by financial advisers at NAB. One witness gave evidence in relation to this matter: Mr Andrew Hagger, the Chief

⁶²⁹ Transcript, Sarah Britt, 23 April 2018, 1645.

⁶³⁰ Transcript, Sarah Britt, 23 April 2018, 1607, 1609–10, 1619.

⁶³¹ Transcript, Sarah Britt, 23 April 2018, 1607.

⁶³² Transcript, Sarah Britt, 23 April 2018, 1610.

⁶³³ AMP, *AMP Group Submission Case Study 3: Inappropriate Financial Advice*, 4 May 2018, 20 [52].

Customer Officer in the Consumer Banking and Wealth Management Division at NAB.

6.2 Evidence

The incorrect witnessing of beneficiary nomination forms by financial advisers at NAB was first identified as an issue in connection with the conduct of one particular financial adviser, Mr Bradley Meyn.

On 10 April 2018, before the second round of the Commission's hearings began, the Commission spoke with Mr Meyn and notified him that his conduct may be the subject of a case study to be heard by the Commission. On the same day, the Commission sent Mr Meyn a copy of Mr Hagger's statement. Mr Meyn did not seek leave to appear at the hearings and did not provide submissions.

In 2016, Mr Meyn met with two customers, who agreed that Mr Meyn would provide them with advice in relation to their superannuation and insurance.⁶³⁴ Mr Meyn presented the customers with a statement of advice,⁶³⁵ including a recommendation to reduce their level of life insurance cover to \$200,000, and switch to paying the premiums for that cover through their superannuation.⁶³⁶

The customers completed insurance application forms.⁶³⁷ In those forms, they chose to make non-lapsing binding death benefit nominations, each nominating the other as the beneficiary under the life insurance policy.⁶³⁸

⁶³⁴ Transcript, Andrew Paul Hagger, 23 April 2018, 1656–7; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 32) [NAB.080.016.5587 at .5588–.5589].

⁶³⁵ Transcript, Andrew Paul Hagger, 23 Apr 2018, 1657; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 32) [NAB.080.016.5587 at .5590].

⁶³⁶ Transcript, Andrew Paul Hagger, 23 Apr 2018, 1657; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 32) [NAB.080.016.5587 at .5590].

⁶³⁷ Transcript, Andrew Paul Hagger, 23 April 2018, 1658; Exhibit 2.180, 23 April 2018, MLC Application Form; Exhibit 2.181, 23 April 2018, MLC Application Form; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 32) [NAB.080.016.5587 at .5591].

⁶³⁸ Transcript, Andrew Paul Hagger, 23 April 2018, 1658–60; Exhibit 2.180, 23 April 2018, MLC Application Form, 16–17; Exhibit 2.181, 23 April 2018, MLC Application Form, 16–17.

However, the customers did not fill in the space in the form identifying the portion of the benefit that the other should receive.⁶³⁹ Although the form required that the customers' signatures on the binding nomination be witnessed by two people, only Mr Meyn witnessed the customers' signatures.⁶⁴⁰

Subsequently, Mr Meyn's client service officer noticed that the forms had not been witnessed by the required second witness. Even though the client service officer was not present at the time the customers signed the forms, Mr Meyn asked her to witness their signatures, which she did. She also noticed that the customers had not completed the percentage of benefit in relation to their nominations.⁶⁴¹ Mr Meyn completed this figure himself, and wrote the clients' initials against the information he added (in fact he wrote the husband's initials on the wife's form and vice versa).⁶⁴²

The failure to comply with the witnessing requirements for a non-lapsing binding death nomination created the potential for the beneficiary nomination form to be treated as invalid, and opened up the possibility that the trustee would allocate funds differently to the wishes expressed by the client.⁶⁴³

The following month, during a routine compliance check of Mr Meyn's files,⁶⁴⁴ a Regional Wealth Executive noticed the irregularity in the initialling on the forms.⁶⁴⁵ Mr Meyn admitted to initialling the forms himself and to asking the client service officer to witness the forms even though she was

⁶³⁹ Transcript, Andrew Paul Hagger, 23 April 2018, 1661; Exhibit 2.180, 23 April 2018, MLC Application Form, 16; Exhibit 2.181, 23 April 2018, MLC Application Form, 16.

⁶⁴⁰ Transcript, Andrew Paul Hagger, 23 April 2018, 1661.

⁶⁴¹ Transcript, Andrew Paul Hagger, 23 April 2018, 1661; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 32) [NAB.080.016.5587 at .5591].

⁶⁴² Transcript, Andrew Paul Hagger, 23 April 2018, 1661–2; Exhibit 2.182, 23 April 2018, MLC application form as amended; Exhibit 2.183, 23 April 2018, MLC application form as amended.

⁶⁴³ Transcript, Andrew Paul Hagger, 23 April 2018, 1663.

⁶⁴⁴ Transcript, Andrew Paul Hagger, 24 April 2018, 1668.

⁶⁴⁵ Transcript, Andrew Paul Hagger, 24 April 2018, 1668.

not present when they were signed.⁶⁴⁶ NAB suspended Mr Meyn, and later it terminated his employment.⁶⁴⁷

In January 2017, NAB's Breach Review Committee considered Mr Meyn's conduct. It determined that his conduct did not fit the Serious Compliance Concern criteria, and did not report him to ASIC at this time.⁶⁴⁸ Mr Hagger said that he thought this decision was wrong, and accepted that NAB should have reported Mr Meyn's conduct to ASIC as a Serious Compliance Concern at this time.⁶⁴⁹ NAB did not report Mr Meyn's conduct to the Financial Planning Association of Australia (FPA).⁶⁵⁰

Between February and May 2017, NAB identified other financial advisers who had been involved in incorrectly witnessing beneficiary nomination forms.⁶⁵¹

On 23 May 2017, a memorandum was prepared for NAB's Breach Review Committee.⁶⁵² The memorandum recorded that NAB employees believed that incorrect witnessing of beneficiary nomination forms was 'common practice' and that employees 'did not understand the seriousness of their actions'.⁶⁵³ Mr Hagger said that the incorrect witnessing of beneficiary nomination forms had become a 'social norm' within NAB.⁶⁵⁴ He accepted that such behaviour was evidence of a failure of discipline and a failure of

⁶⁴⁶ Transcript, Andrew Paul Hagger, 24 April 2018, 1668.

⁶⁴⁷ Transcript, Andrew Paul Hagger, 24 April 2018, 1669–70; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 31) [NAB.080.016.5585 at .5586]; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 33) [NAB.080.016.5593 at .5594].

⁶⁴⁸ Transcript, Andrew Paul Hagger, 24 Apr 2018, 1673; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 37) [NAB.005.164.0004 at .0006].

⁶⁴⁹ Transcript, Andrew Paul Hagger, 24 April 2018, 1674.

⁶⁵⁰ Transcript, Andrew Paul Hagger, 24 April 2018, 1671.

⁶⁵¹ Transcript, Andrew Paul Hagger, 24 April 2018, 1675.

⁶⁵² Transcript, Andrew Paul Hagger, 24 April 2018, 1675; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 43) [NAB.020.009.9493].

⁶⁵³ Transcript, Andrew Paul Hagger, 24 April 2018, 1675–6; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 43) [NAB.020.009.9493 at .9495–.9496].

⁶⁵⁴ Transcript, Andrew Paul Hagger, 24 April 2018, 1676–7.

culture at NAB.⁶⁵⁵ He did not accept that it was a failure of education because, in his view, the requirement to have two witnesses was very clear from the beneficiary nomination form.⁶⁵⁶ However, he acknowledged that the conduct of the advisers – including disobeying a clear instruction on the face of the form – was very serious.⁶⁵⁷

On 31 May 2017, NAB's Breach Review Committee decided that the incorrect witnessing of beneficiary nomination forms represented a significant breach and was therefore reportable to ASIC.⁶⁵⁸ On 5 June 2017, about six months after it had terminated Mr Meyn's employment, NAB included Mr Meyn in a list that it gave to ASIC naming advisers about whom there were compliance concerns.⁶⁵⁹ Mr Hagger said that NAB made a wrong judgment in not reporting Mr Meyn's conduct to ASIC earlier.⁶⁶⁰

On 15 June 2017, NAB lodged a significant breach notification with ASIC in relation to the issue of invalid binding nomination witnessing, on the basis that there had been a breach or likely breach of NAB's obligations under Sections 912A(1)(a) and 1041H of the Corporations Act and Section 12DA of the ASIC Act.⁶⁶¹ By this time, NAB had identified 325 staff who were involved in incorrectly witnessing beneficiary nomination forms, 204 of whom were financial advisers employed by NAB. Mr Hagger accepted that, by issuing a notification under Section 912D, NAB had acknowledged that the conduct in relation to beneficiary nomination forms was at least partly attributable to failings by NAB.⁶⁶²

⁶⁵⁵ Transcript, Andrew Paul Hagger, 24 April 2018, 1677.

⁶⁵⁶ Transcript, Andrew Paul Hagger, 24 April 2018, 1677.

⁶⁵⁷ Transcript, Andrew Paul Hagger, 24 April 2018, 1677.

⁶⁵⁸ Transcript, Andrew Paul Hagger, 24 April 2018, 1686; Exhibit 2.185, 24 April 2018, Minutes of the Breach Review Committee dated 31/05/2017, 2.

⁶⁵⁹ Transcript, Andrew Paul Hagger, 24 April 2018, 1688; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 40) [NAB.065.002.5881 at .5883–.5884].

⁶⁶⁰ Transcript, Andrew Paul Hagger, 24 April 2018, 1689.

⁶⁶¹ Transcript, Andrew Paul Hagger, 24 April 2018, 1687; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 45) [NAB.005.021.0488 at .0492].

⁶⁶² Transcript, Andrew Paul Hagger, 24 April 2018, 1690.

In March 2018, NAB provided a further update to ASIC about this matter. By that time, NAB had identified that 2,520 clients were affected by invalid binding nomination witnessing.⁶⁶³

Mr Hagger gave evidence about the steps that NAB then took to obtain re-execution of forms, thus ensuring that the incorrect witnessing of beneficiary nomination forms did not affect clients' estate planning wishes.⁶⁶⁴

Mr Hagger also gave evidence about the consequences that have been imposed on financial advisers and their managers at NAB as a result of this conduct. Financial advisers who self-reported having been involved in incorrect witnessing received an irreversible Amber Conduct Gate, which reduced their short term incentive payment for one year by 25%.⁶⁶⁵ Managers in NAB's financial advice business also had their bonuses reduced as a result of the incorrect witnessing of beneficiary nomination forms.⁶⁶⁶ There were different reductions for managers at different levels of seniority, from the Regional Wealth Executives who directly managed financial advisers, to more senior members of the leadership team in NAB's financial advice business, to Mr Hagger himself.⁶⁶⁷ Those who were involved in the issue had somewhere between 20% and 100% of their bonuses reduced for the year.⁶⁶⁸

6.3 What the case study showed

NAB terminated Mr Meyn's employment on the basis that he had falsified details on the beneficiary nomination forms for two clients, had forged those

⁶⁶³ Transcript, Andrew Paul Hagger, 24 April 2018, 1689; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 50) [NAB.005.150.0016 at .0016].

⁶⁶⁴ Transcript, Andrew Paul Hagger, 24 April 2018, 1690–1.

⁶⁶⁵ Transcript, Andrew Paul Hagger, 24 April 2018, 1684; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 42) [NAB.005.137.0535 at .0536].

⁶⁶⁶ Transcript, Andrew Paul Hagger, 24 April 2018, 1694–1702.

⁶⁶⁷ Transcript, Andrew Paul Hagger, 24 April 2018, 1694–5, 1701–2; Exhibit 2.186, 2 November 2017, Wealth Advice Leadership Consequence Management, 2.

⁶⁶⁸ Transcript, Andrew Paul Hagger, 24 April 2018, 1700; Exhibit 2.189, 24 April 2018, Emails between Hagger and Thorburn of 3 and 6 November 2017, 1.

clients' initials in an attempt to represent that the clients had considered and approved the amendments, had failed to have the beneficiary nomination forms correctly witnessed, and had requested a colleague to sign the forms as a witness despite acknowledging that she was not present when the clients signed the forms.⁶⁶⁹ Mr Hagger did not dispute that Mr Meyn engaged in that conduct, and I accept that it occurred.

In its notification to ASIC under Section 912D of the Corporations Act concerning the incorrect witnessing of beneficiary nomination forms at NAB, NAB indicated that there had been a breach or likely breach of Sections 912A(1)(a) and 1041H of the Corporations Act and Section 12DA of the ASIC Act.⁶⁷⁰ As noted above, Mr Hagger accepted that the widespread incorrect witnessing of beneficiary nomination forms represented a failure of discipline and failure of culture at NAB.⁶⁷¹ Further, NAB acknowledged in its submissions to the Commission in January 2018 that the incorrect witnessing of beneficiary nomination forms might have amounted to misconduct.⁶⁷²

In its submissions in response to this case study, NAB said that it did not necessarily follow from the fact that NAB had made a notification under Section 912D that NAB had in fact breached its obligations under Section 912A(1)(a) or Section 912A(1)(ca).⁶⁷³ Although it said that it did not seek to resile from the position that the beneficiary nomination event 'raised concerns' about the adequacy of its supervision and monitoring process,⁶⁷⁴

⁶⁶⁹ Transcript, Andrew Paul Hagger, 24 April 2018, 1670; Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 33) [NAB.080.016.5593 at .5593].

⁶⁷⁰ Exhibit 2.178, Witness statement of Andrew Paul Hagger, 5 April 2018, Exhibit AH-1 (Tab 45) [NAB.005.021.0488 at .0492].

⁶⁷¹ Transcript, Andrew Paul Hagger, 24 Apr 2018, 1677.

⁶⁷² NAB, *NAB Group's Response dated 29 January 2018 to the Commission's Letter dated 15 December 2017*, 29 January 2018, 14.

⁶⁷³ NAB, *Submissions of National Australia Bank – Improper Conduct Case Study*, 4 May 2018, 11–13 [42]–[51].

⁶⁷⁴ NAB, *Submissions of National Australia Bank – Improper Conduct Case Study*, 4 May 2018, 11 [44].

NAB said that the principal reason that the issue remained undetected for a period of time was that the conduct was difficult to detect.⁶⁷⁵

The fact that over 200 financial advisers engaged in the incorrect witnessing of beneficiary nomination forms, coupled with the fact that advisers described the incorrect witnessing of such forms as ‘common practice’, points towards NAB not having done all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly. It also indicates that it is at least arguable that NAB did not take reasonable steps to ensure that its representatives complied with the financial services laws – in particular, Section 1041H or the Corporations Act and Section 12DA of the ASIC Act.

6.4 Causes of the conduct

NAB recognised that the widespread incorrect witnessing of beneficiary nomination forms within its financial advice business was attributable to the internal culture of the financial advice business. As discussed above, Mr Hagger described the incorrect witnessing of beneficiary nomination forms as having become a ‘social norm’ within NAB.⁶⁷⁶ He accepted that such behaviour was evidence of a failure of discipline and a failure of culture at NAB.⁶⁷⁷ It was at least partly in recognition of this failure of culture that NAB took steps to impose consequences on the leaders of the financial advice business, who were responsible for that culture.

In its submissions in response to this case study, NAB submitted that these matters do not provide a sufficient evidentiary basis on which a finding could be made about a broader culture within NAB’s advice business.⁶⁷⁸

In November 2015, NAB received a report of a review it had commissioned from ThreeSixty Research (a part of NAB that does research into products). The review looked at conflicts of interest within ThreeSixty Research and

⁶⁷⁵ NAB, *Submissions of National Australia Bank – Improper Conduct Case Study*, 4 May 2018, 11–12 [45].

⁶⁷⁶ Transcript, Andrew Paul Hagger, 24 April 2018, 1676–7

⁶⁷⁷ Transcript, Andrew Paul Hagger, 24 April 2018, 1677.

⁶⁷⁸ NAB, *Submissions of National Australia Bank – Improper Conduct Case Study*, 4 May 2018, 14 [56].

conflicts between ThreeSixty Research and its internal stakeholders.⁶⁷⁹ The review also examined the culture of each of the organisations with which ThreeSixty dealt. The reviewer found that there was a ‘widespread absence of knowledge of [NAB’s] Code of Conduct and expected behaviour standards’. The report also noted that ‘[t]here is a prevailing assumption that employees are driven by their own sense of what is right and wrong rather than being driven by how the organisation has defined appropriate conduct’.⁶⁸⁰ Mr Hagger gave evidence that he was not provided this report in 2015⁶⁸¹ and had only recently become aware of its existence.⁶⁸² Mr Hagger agreed that, in understanding the culture of an organisation, it is relevant to know whether the organisation positively shows its employees how commonly accepted standards apply and are to be given effect in commonly encountered circumstances, particularly in a context where the employees are engaged to give advice to third parties.⁶⁸³

Although the incorrect witnessing of beneficiary nomination forms was first identified in connection with one adviser, it later became clear that the practice of incorrectly witnessing such forms was widespread in NAB’s financial advice business. Many employees explained that they engaged in the practice of incorrectly witnessing beneficiary nomination forms – or asked others to do so – because they believed that it was ‘common practice’.

A culture of non-compliance can develop even though what is required is obvious. What is revealed is that culture depends on showing that compliance always matters. There are no short cuts.

⁶⁷⁹ Exhibit 2.184, 27 November 2015, Managing Values Report.

⁶⁸⁰ Exhibit 2.184, 27 November 2015, Managing Values Report, 8.

⁶⁸¹ Transcript, Andrew Paul Hagger, 24 April 2018, 1678–9.

⁶⁸² Transcript, Andrew Paul Hagger, 24 April 2018, 1679.

⁶⁸³ Transcript, Andrew Paul Hagger, 24 April 2018, 1681.

7 Bad advice: Henderson Maxwell

7.1 Background

The Commission heard evidence about the financial advice that Ms Donna McKenna received from Henderson Maxwell, and Ms McKenna's subsequent complaint to the FPA. Three witnesses gave evidence in relation to these matters: Ms Donna McKenna, who received financial advice from Henderson Maxwell in 2016; Mr Sam Henderson, who at the time he gave evidence was the Chief Executive Officer of Henderson Maxwell, and had provided the advice to Ms McKenna; and Mr Dante De Gori, the Chief Executive Officer of the Financial Planning Association of Australia.

7.2 Evidence

In late 2016, Ms McKenna approached Henderson Maxwell for financial advice. She had seen Mr Henderson on television and had read articles he had written in publications.⁶⁸⁴ Ms McKenna told Mr Henderson that she was seeking advice about her superannuation contributions ahead of the changes in taxation laws that were to take effect on 1 July 2017. She also sought advice about potentially buying property.⁶⁸⁵

In November 2016, Ms McKenna met with Mr Henderson and provided him with details about her financial situation, including details about her State Authorities Superannuation Scheme (SASS) account.⁶⁸⁶ At that meeting, Mr Henderson asked Ms McKenna whether she would be interested in establishing an SMSF. Ms McKenna said that she told Mr Henderson that she had no interest in establishing such a fund,⁶⁸⁷ but that Mr Henderson persisted in promoting the benefits of SMSFs.⁶⁸⁸

⁶⁸⁴ Transcript, Donna McKenna, 24 April 2018, 1727.

⁶⁸⁵ Transcript, Donna McKenna, 24 April 2018, 1727.

⁶⁸⁶ Transcript, Donna McKenna, 24 April 2018, 1730–1, 1733–4; Exhibit 2.197, Witness statement of Donna McKenna, 16 April 2018, Exhibit DMcK-2 [WIT.0900.0002.0001].

⁶⁸⁷ Transcript, Donna McKenna, 24 April 2018, 1732.

⁶⁸⁸ Transcript, Donna McKenna, 24 April 2018, 1732–3.

Following the meeting, one of Mr Henderson's employees telephoned Ms McKenna's superannuation fund to confirm the details of her accounts. The Commission heard an edited audio recording of that conversation in which Mr Henderson's employee impersonated Ms McKenna while speaking with SASS. The SASS representative explained that, if Ms McKenna were to access the funds in her SASS account earlier than age 58, she would be entitled to about \$500,000 less than if she were to wait until age 58 and be permanently retired.⁶⁸⁹ Mr Henderson's employee impersonated Ms McKenna in several other telephone calls to superannuation funds.⁶⁹⁰

Mr Henderson did not conduct any other research into superannuation funds for Ms McKenna and did not conduct any research into whether managed accounts other than the Henderson Maxwell managed account might be more suitable in Ms McKenna's particular circumstances.⁶⁹¹

In December 2016, Mr Henderson presented Ms McKenna with a statement of advice.⁶⁹² Mr Henderson recommended that Ms McKenna establish a SMSF, roll over her superannuation into the fund, and set up a Henderson Maxwell managed account.⁶⁹³ Had Ms McKenna implemented this advice, she would immediately have forfeited her entitlement to around \$500,000 in her SASS account.⁶⁹⁴ Ms McKenna described the advice as 'risible'.⁶⁹⁵

For this advice, Mr Henderson charged a plan preparation fee of \$4,950. Had the plan been implemented, he would have charged an establishment fee to set up the Henderson Maxwell managed account of \$1,980, brokerage fees of \$4,105 and an ongoing fee of \$14,642 for investment

⁶⁸⁹ Transcript, Sam Henderson, 24 April 2018, 1756–7; Exhibit 2.204, 7 November 2016, Telephone recording.

⁶⁹⁰ Transcript, Sam Henderson, 24 April 2018, 1765.

⁶⁹¹ Transcript, Sam Henderson, 24 April 2018, 1760–1.

⁶⁹² Transcript, Donna McKenna, 24 April 2018, 1736; Exhibit 2.197, Witness statement of Donna McKenna, 16 April 2008, Exhibit DMcK-6 [FPA.0011.0003.0007].

⁶⁹³ Transcript, Donna McKenna, 24 April 2018, 1737.

⁶⁹⁴ Transcript, Donna McKenna, 24 April 2018, 1739; Transcript, Sam Henderson, 24 April 2018, 1762.

⁶⁹⁵ Transcript, Donna McKenna, 24 April 2018, 1737.

management services.⁶⁹⁶ The fee for investment management services was materially higher than the fees Ms McKenna was paying on her existing superannuation accounts.⁶⁹⁷

Ms McKenna met with Mr Henderson again in January 2017.⁶⁹⁸

Ms McKenna said that, at this meeting, Mr Henderson accepted that his advice would have caused Ms McKenna to lose about \$500,000.⁶⁹⁹

However, Mr Henderson claimed the statement of advice was only a draft, and told Ms McKenna she could still implement the advice when she turned 58.⁷⁰⁰ Mr Henderson offered Ms McKenna a refund of her advice fees.⁷⁰¹

Ms McKenna made a complaint about Mr Henderson to the FPA.⁷⁰² In responding to this complaint, Mr Henderson described Ms McKenna as aggressive and nit-picking.⁷⁰³ While the complaint was being investigated, Mr Henderson contacted Mr de Gori saying he was very disappointed with the process and the FPA's treatment of members. Mr Henderson described the complaint as 'a seemingly minor matter'.⁷⁰⁴

In October 2017, the FPA's investigating officer concluded that that Mr Henderson had a case to answer in relation to a number of breaches of

⁶⁹⁶ Transcript, Sam Henderson, 24 April 2018, 1762

⁶⁹⁷ Transcript, Sam Henderson, 24 April 2018, 1763.

⁶⁹⁸ Transcript, Donna McKenna, 24 April 2018, 1739.

⁶⁹⁹ Transcript, Donna McKenna, 24 April 2018, 1739; Exhibit 2.197, Witness statement of Donna McKenna, 16 April 2018, 7 [40].

⁷⁰⁰ Transcript, Donna McKenna, 24 April 2018, 1739–40.

⁷⁰¹ Transcript, Donna McKenna, 24 April 2018, 1740.

⁷⁰² Transcript, Donna McKenna, 24 April 2018, 1741.

⁷⁰³ Transcript, Sam Henderson, 24 April 2018, 1770–1; Exhibit 2.209, 24 April 2018, Emails between Murphy and Henderson, 5.

⁷⁰⁴ Transcript, Sam Henderson, 24 April 2018, 1773, Exhibit 2.211, 24 April 2018, Emails between Henderson and De Gori of FPA, 1.

the FPA Code of Ethics and Practice Standards.⁷⁰⁵ The investigating officer said, among other things:⁷⁰⁶

In all the circumstances I contend there is a strong and reasonable inference that the Member's conduct stemmed from a lack of objectivity or a conscious decision to place his own interests before those of the client, when the client trusted otherwise. It is not apparent that the Member would not have made the same recommendations, if not for his conflicts. It is not apparent that the Member based all judgements on the Complainant's relevant circumstances.

Mr Henderson provided a response to the investigating officer's report.⁷⁰⁷ Despite asking for his response, Ms McKenna was not provided with the document, or given an opportunity to be heard in connection with the disciplinary proceedings.⁷⁰⁸

In November 2017, the FPA commenced disciplinary proceedings against Mr Henderson.⁷⁰⁹ Following a negotiation, Mr Henderson agreed to accept a number of findings, including that he had failed to take due care in delivering professional services, failed to consider whether Ms McKenna's current superannuation strategy could have reasonably met her objectives, needs and priorities, and failed to identify why the Henderson Maxwell managed account service was suitable for Ms McKenna.⁷¹⁰ Mr Henderson also agreed to a series of sanctions on the basis that the FPA would not publish his name in connection with the disciplinary proceedings.⁷¹¹

In March 2018, that negotiated agreement was submitted to the Conduct Review Commission, the independent disciplinary body connected with

⁷⁰⁵ Transcript, Sam Henderson, 24 April 2018, 1774; Exhibit 2.212, 24 April 2018, Report to the Conduct Review Commission.

⁷⁰⁶ Transcript, Sam Henderson, 24 April 2018, 1775; Exhibit 2.212, 24 April 2018, Report to the Conduct Review Commission, 23.

⁷⁰⁷ Transcript, Sam Henderson, 24 April 2018, 1775.

⁷⁰⁸ Transcript, Donna McKenna, 24 April 2018, 1741.

⁷⁰⁹ Transcript, Sam Henderson, 24 April 2018, 1776.

⁷¹⁰ Transcript, Sam Henderson, 24 April 2018, 1776; Exhibit 2.214, 24 April 2018, Email and attachment concerning agreed disposal of CRC disciplinary proceedings, 2, 3, 7.

⁷¹¹ Transcript, Sam Henderson, 24 April 2018, 1777; Exhibit 2.214, 24 April 2018, Email and attachment concerning agreed disposal of CRC disciplinary proceedings, 10.

the FPA.⁷¹² The Chair of the Conduct Review Commission proposed an additional sanction that Mr Henderson not be permitted to engage in public media appearances for 12 months.⁷¹³ Mr Henderson asked for some modification to that sanction and later resiled from his previous acceptance of the proposed findings against him.⁷¹⁴ Instead, he proposed that the Conduct Review Commission would not make any findings against him, and that the matter would be summarily disposed of 'on the basis that the FPA expresses concerns regarding Mr Henderson's conduct and that he acknowledges those concerns and agrees to certain sanctions'.⁷¹⁵

At the time of Mr Henderson's evidence, there had not been a formal resolution to Ms McKenna's complaint in the Conduct Review Commission.⁷¹⁶

7.3 What the case study showed

Mr Henderson provided financial advice to Ms McKenna that, if implemented, would have caused Ms McKenna immediately to forfeit her entitlement to approximately \$500,000. For that reason alone, the advice was not in Ms McKenna's best interests. Mr Henderson acknowledged this in his oral evidence.⁷¹⁷

In addition, Mr Henderson recommended that Ms McKenna invest in a Henderson Maxwell managed account. That product had significantly higher fees than Ms McKenna's existing superannuation accounts, and Mr Henderson did not conduct any adequate research to determine whether any benefits associated with the Henderson Maxwell managed account would have justified that increase in fees. Mr Henderson did not seek to explain why that product was otherwise suitable for Ms McKenna.

⁷¹² Transcript, Sam Henderson, 24 April 2018, 1777.

⁷¹³ Transcript, Sam Henderson, 24 April 2018, 1777.

⁷¹⁴ Transcript, Sam Henderson, 24 April 2018, 1777–8; Exhibit 2.215, 24 April 2018, Email of 13 April 2018 and revised summary disposal agreement.

⁷¹⁵ Exhibit 2.215, 24 April 2018, Email of 13 April 2018 and revised summary disposal agreement, 1.

⁷¹⁶ Transcript, Sam Henderson, 24 April 2018, 1778.

⁷¹⁷ Transcript, Sam Henderson, 24 April 2018, 1762.

Further, although one of the main reasons that Ms McKenna came to Mr Henderson for financial advice was to find out about changes she could make to the contributions to her current superannuation account, Mr Henderson did not provide Ms McKenna with advice about this. He acknowledged that he ‘probably’ should have done so.⁷¹⁸

In his submissions in response to this case study, Mr Henderson submitted that he had satisfied the ‘safe harbour’ requirements in Section 961B(2) in relation to the advice that he gave to Ms McKenna.⁷¹⁹ Despite having acknowledged in oral evidence that the statement of advice was presented to Ms McKenna as his recommendations,⁷²⁰ Mr Henderson submitted that the statement of advice was not ‘advice’, because it was a ‘draft’ and had not been signed by Ms McKenna.⁷²¹

I do not accept those submissions. In particular, I do not accept that a financial adviser can avoid responsibility for defective advice by claiming that the advice is a ‘draft’. A financial adviser has an obligation to exercise due care and skill in the preparation of advice. A customer is entitled to expect that, when he or she is presented with a statement of advice that is ready to be signed, the statement of advice will contain the advice prepared by the adviser. The statement of advice that Mr Henderson presented to Ms McKenna on 14 December 2016 represented the advice that he intended to give to her. For the reasons given above, that advice was not in Ms McKenna’s best interests, and was not appropriate to Ms McKenna.

If Ms McKenna had implemented Mr Henderson’s advice, Mr Henderson would have benefited from it. Not only would his company, Henderson Maxwell, have received up-front fees of almost \$7,000 and brokerage of over \$4,000, it would have received ongoing investment management fees of over \$14,000 per annum. Further, if Ms McKenna had elected to use the

⁷¹⁸ Transcript, Sam Henderson, 24 April 2018, 1763–4.

⁷¹⁹ Henderson Maxwell Entities, *Submissions on Behalf of Sam Henderson, Henderson Maxwell Financial Planning Pty Ltd and Henderson Maxwell Pty Ltd*, 4 May 2018, 4–9 [9]–[16].

⁷²⁰ Transcript, Sam Henderson, 24 April 2018, 1764.

⁷²¹ Henderson Maxwell Entities, *Submissions on Behalf of Sam Henderson, Henderson Maxwell Financial Planning Pty Ltd and Henderson Maxwell Pty Ltd*, 4 May 2018, 2–3 [3], [5], 9 [16].

services of Henderson Maxwell Accounting Pty Ltd to open an SMSF, that company would also have received fees for providing that service.⁷²²

Mr Henderson's recommendations to Ms McKenna if accepted, would have increased the fees payable to his companies. The investigating officer of the FPA concluded that there was a strong and reasonable inference that Mr Henderson's conduct stemmed from a lack of objectivity or from a conscious decision to prefer his own interests to those of the client. Whether consciously or carelessly, Mr Henderson's advice did prefer his interests to those of the client.

It follows from the above that Mr Henderson may have breached his obligation under Section 961B(1) of the Corporations Act to act in the best interests of Ms McKenna in relation to the advice that he gave her, and his obligation under Section 961G of the Corporations Act only to provide advice to Ms McKenna if it would be reasonable to conclude that the advice was appropriate to her. Mr Henderson may also have breached his obligation under Section 961J(1) of the Corporations Act to give priority to Ms McKenna's interests over his own interests and the interests of Henderson Maxwell.

The Commission received in evidence a FSG issued by Henderson Maxwell, dated 20 January 2016.⁷²³ The FSG stated, among other things, that Mr Henderson had a Masters of Commerce.⁷²⁴ However, Mr Henderson accepted that he did not have a Masters of Commerce at that time, and that the FSG was inaccurate.⁷²⁵ Henderson Maxwell may have committed an offence under Section 952E(1) of the Corporations Act, by giving a defective FSG.

Henderson Maxwell's conduct fell short of community standards and expectations in another important respect.

Mr Henderson accepted that an employee of Henderson Maxwell had made a number of telephone calls to Ms McKenna's superannuation funds, in

⁷²² Transcript, Sam Henderson, 24 April 2018, 1748–9.

⁷²³ Exhibit 2.203, 24 April 2018, Henderson Maxwell Financial Services Guide.

⁷²⁴ Exhibit 2.203, 24 April 2018, Henderson Maxwell Financial Services Guide, 3.

⁷²⁵ Transcript, Sam Henderson, 24 April 2018, 1754.

which the employee impersonated Ms McKenna.⁷²⁶ He accepted that the conduct was ‘inexcusable’, and ‘most definitely the wrong thing to do’, and that the employee engaged in that conduct ‘under [his] responsibility’.⁷²⁷

It is unacceptable for an employee of a **financial services entity** to impersonate a client in a telephone call. As Mr Henderson accepted in his oral evidence⁷²⁸ (albeit not in his submissions in response to this case study), the employer, Henderson Maxwell, must take responsibility for these actions of its employee.

Contrary to Mr Henderson’s submissions in response to this case study, Mr Henderson’s conduct in response to the complaint made against him to the FPA, in particular his failure to provide adequate assistance to the FPA with its investigation, and his personal criticisms of Ms McKenna, also fell below community standards and expectations. Mr Henderson rightly accepted in his oral evidence that it was not constructive for him to respond to the FPA in that way, and that it was unfair.⁷²⁹

In June 2018 it was announced that Mr Henderson would leave the financial advice industry. At that time Henderson Maxwell merged operations with another business owned by AZ NGA, Pride Advice.

8 Bad advice: Dover

8.1 Background

The final case study in the second round of hearings concerned Dover Financial Advisers Pty Ltd (Dover). Dover has more than 400 authorised representatives, making it one of the largest licensees in Australia. Dover’s head office is in Cheltenham in Melbourne. It also has an office in Vietnam.

The Commission heard evidence from Terrence McMaster, the sole owner and one of three responsible managers of Dover Financial Advisers Pty Ltd. Mr McMaster collapsed during cross-examination. His evidence must be understood in that light.

⁷²⁶ Transcript, Sam Henderson, 24 April 2018, 1757, 1765.

⁷²⁷ Transcript, Sam Henderson, 24 April 2018, 1758.

⁷²⁸ Transcript, Sam Henderson, 24 April 2018, 1772.

⁷²⁹ Transcript, Sam Henderson, 24 April 2018, 1770.

Senior Counsel Assisting's closing submissions focused upon Dover's conduct in two respects: first, in respect of the recruitment of new authorised representatives; second: in respect of dealing with client complaints and with its liability or potential liability to the clients of authorised representatives.

8.2 Evidence

8.2.1 Conduct in respect of recruitment

In cross-examination, Mr McMaster was asked about three cases in which Dover had authorised persons as its representative without having first made contact with the licensee for whom the person had previously worked.

The first relevant authorised representative was Adam Palmer who, as noted earlier, had previously worked as an authorised representative of Genesys. Mr Palmer first made contact with Dover before 25 September 2014, the day on which he gave notice to Genesys of his intention to move to Dover.⁷³⁰ Mr Palmer forwarded that email to Dover within a minute of sending the email to Genesys. The irresistible inference is that Mr Palmer had been told before that day that Dover would accept his application. Two weeks later, on 14 October 2014, Mr Palmer completed a reference checking form in which he disclosed that his files were the subject of an audit by Genesys.⁷³¹ Mr McMaster's evidence was that before that date Mr Palmer had disclosed to Dover that he was also under investigation for matters connected with direct property investment, and that Dover had determined this would not present a problem provided those matters were disclosed in Mr Palmer's FSG and conflict register.⁷³² Notwithstanding Mr Palmer's written and oral disclosures, Dover sought no reference check from Genesys until 26 December 2014, two months after the date that Mr Palmer was authorised by Dover and three months after Mr Palmer had been told that he would be authorised by Dover.⁷³³

⁷³⁰ Transcript, Terrence McMaster, 26 April 2018, 1871; Exhibit 2.241, 25 September 2014, Emails between Palmer and Thompson.

⁷³¹ Transcript, Terrence McMaster, 26 April 2018, 1870–1.

⁷³² Transcript, Terrence McMaster, 26 April 2018, 1873

⁷³³ Transcript, Terrence McMaster, 26 April 2018, 1876–7.

The second relevant authorised representative was Julie Hamilton. Ms Hamilton was advised by Mr McMaster that she could become an authorised representative of Dover within two hours of her advising Mr McMaster that her current licensee, Financial Wisdom, intended to report her to ASIC for a 'significant breach'. Mr McMaster's response was 'I am not unduly troubled by this'. He said that 'it could not have happened at Dover because we read over every SoA [statement of advice] twice, and we would have picked up any compliance concerns early in the piece'. He offered for Dover to take Ms Hamilton on as an authorised representative 'with immediate effect'.⁷³⁴

The third relevant authorised representative was Koresh Houghton. Mr Houghton had advised Dover that Financial Wisdom had concerns about advice he had provided while an authorised representative.⁷³⁵ Dover appointed Mr Houghton as a representative on 22 January 2015.⁷³⁶ Dover first contacted Financial Wisdom by letter on 10 February 2015.⁷³⁷

Both Ms Hamilton and Mr Houghton were subsequently the subject of banning orders by ASIC, in Ms Hamilton's case for three years⁷³⁸ and in Mr Houghton's case, permanently.⁷³⁹ The banning orders related to conduct engaged in before she or he became an authorised representative of Dover. It follows that the disclosures made by Ms Hamilton and Mr Houghton to Dover about 'compliance' concerns were of matters that proved to be very serious.

The circumstances of the recruitment of each of the three authorised representatives I have mentioned demonstrates that while Dover had

⁷³⁴ Transcript, Terrence McMaster, 26 April 2018, 1879, 1880; Exhibit 2.236, Witness statement of Terrence McMaster, 10 April 2018, Exhibit TM-36 [DOV.0005.0001.1055].

⁷³⁵ Transcript, Terrence McMaster, 26 April 2018, 1884.

⁷³⁶ Exhibit 2.236, Witness statement of Terrence McMaster, 10 April 2018, Exhibit TM-54 [DOV.0005.0001.1927 at .1927]; Exhibit 2.236, Witness statement of Terrence McMaster, 10 April 2018, 7 [57].

⁷³⁷ Exhibit 2.236, Witness statement of Terrence McMaster, 10 April 2018, Exhibit TM-53 [DOV.005.0001.1897 at .1923].

⁷³⁸ Exhibit 2.242, undated, ASIC register of financial advisers record concerning Hamilton, 1.

⁷³⁹ Exhibit 2.243, undated, ASIC register of financial advisers record concerning Houghton, 1.

policies in place in respect of the recruitment and engagement of authorised representatives, the rationale for those policies was to attempt to meet the expectations of ASIC; they did not represent an opinion within Dover that proper background checking was important to any particular recruitment decision.⁷⁴⁰

In each case, circumstances had been disclosed to Dover that would cause a reasonable licensee, acting properly, to take further steps before deciding to authorise the person. Dover's failure to undertake further investigations before authorising the representatives demonstrated, at the least, a lack of care and an insufficiently cautious view of the importance of authorised representatives being capable of discharging their duties professionally and ethically.

8.2.2 Conduct in respect of liability to and complaints by clients

Mr McMaster was also asked about Dover's practices and conduct in respect of liability to and complaints by clients.

Two pieces of evidence in particular suggested an attitude of Mr McMaster, and consequently a culture within Dover, that paid insufficient regard to the interests of clients in obtaining meaningful redress for poor advice.

The first was a letter sent by FOS to ASIC in which FOS pointed to potential serious misconduct by Dover in the handling of a consumer complaint and possible systemic issues in Dover's provision of financial services 'efficiently, honestly and fairly'.⁷⁴¹

The misconduct identified by FOS arose in this way. A former client of a Dover authorised representative complained to FOS about the advice provided by the authorised representative. The client claimed that the advice provided was inappropriate. During the course of the dispute Dover, in a letter addressed to the applicant, said that making false complaints about financial advisers can give rise to an action in defamation and similar proceedings. It was also alleged that contrary to the rules governing the handling of complaints to FOS, Dover had issued correspondence to a third party identifying details of the dispute. FOS further alleged that Dover

⁷⁴⁰ Transcript, Terrence McMaster, 26 April 2018, 1867–8, 1876–7

⁷⁴¹ Exhibit 2.244, 8 December 2016, Letter from FOS to ASIC, re Dover, 2.

addressed a letter to Centrelink identifying the applicant and the third party making allegations of fraud. Issues about the correspondence to third parties not having been fully explored with Mr McMaster, I make no finding about them.

Mr McMaster did agree, however, that he had drafted and signed the letter alluding to defamation proceedings.⁷⁴² He conceded that in so doing he acted contrary to FOS's terms of reference as interpreted by its operative guidelines. He further conceded that it was an 'error' to draft and sign the letter.⁷⁴³

The second matter bearing upon Dover's practices and conduct that is relevant to liability to and complaints by clients is the Dover Client Protection Policy.⁷⁴⁴ That policy was in place until April 2018. By the policy, Dover sought to erect an elaborate web of contractual exclusions of liability for the conduct of its authorised representatives.

It is necessary to mention two provisions of the Corporations Act before coming to the terms of the policy. The first is Section 917B, which provides that a licensee is responsible, as between the licensee and the client, for the conduct of the licensee's authorised representatives, whether or not that conduct is within authority.

The second is Section 917D, which provides that, in specified circumstances, a licensee is not liable for the conduct of their representative. The circumstances are: if the conduct is not within the authorised representative's authority, that fact is disclosed by the authorised representative to the client before the client relies on the conduct, and that the clarity and prominence of the disclosure is such as a person would reasonably require for the purpose of deciding whether to acquire the financial advice.

Dover's Client Protection Policy began by stating that the document 'sets out a number of important client protections designed to ensure every Dover client gets the best possible advice and the maximum protection available under the law.' A significant number of the operative clauses of the policy

⁷⁴² Transcript, Terrence McMaster, 26 April 2018, 1888.

⁷⁴³ Transcript, Terrence McMaster, 26 April 2018, 1889.

⁷⁴⁴ Exhibit 2.245, 13 November 2017, Dover Client Protection Policy.

stood in direct opposition to that statement. By way of illustration only, Clause 1.3 stated that:

Under the Corporations Act, Dover is not responsible for anything done by your adviser which is not within the authority provided by Dover in these circumstances.

Clause 1.4 provided that:

Your adviser is only authorised to provide advice that complies with the Corporations Act and the related regulations and regulatory guidelines. Your adviser cannot provide advice or do anything else which breaches a law or an ASIC regulation ...

Clause 1.5 then set out a large number of matters not included within the authority of Dover's authorised representatives. That list included failing to adequately research a recommended financial product, failing to consider the client's circumstances when recommending a financial product or service, failing to provide personal advice in the form required by the Corporations Act, recommending a financial service that a reasonable financial adviser would not recommend, failing to advise of a negative consequence of a recommendation and, most expansively, any act that would breach the law of Australia or of an Australian State, including the law of negligence and any ASIC regulation or guideline.

Clause 4.13 of the Client Protection Policy purported to record the agreement of the client that Dover is not responsible for any losses incurred for any reason after six months from the date of the most recent statement of advice. And Clause 4.16 purported to make the client responsible for the timely implementation of any advice 'notwithstanding [that] you may have engaged us to implement it for you'.

The scope of the exclusions on the authority of Dover's authorised representatives could hardly have been more extensive. When read as a whole, it is difficult to identify any circumstance where, if the policy was legally effective, Dover would be liable for the conduct of its authorised representatives. It would be odd to read Section 917D as permitting such an extensive negation of the operation of Section 917C. It is not necessary, however, to explore that question further.

Mr McMaster accepted that Dover's position was to seek to obtain the maximum exclusion possible. He said that it sought that level of exclusion

even if some clauses of the Client Protection Policy were ultimately found to be unlawful.⁷⁴⁵

8.3 What the case study showed

Dover did not take up the Commission's invitation to disclose misconduct in which it or its authorised representatives had engaged since 2013. Nor did it admit any misconduct in its submissions filed after the round of hearings was complete.

I consider that Dover's conduct in respect of the Dover Client Protection Policy may have amounted to misconduct within the meaning of the Terms of Reference. When regard is had to the terms of that document and the effect of those terms if enforced, it may have been misleading and deceptive to describe the document as a Client Protection Policy. The wider the lawful operation of the claimed exemptions, the easier it may be to argue that the description misled or deceived. Further, by incorporating the Client Protection Policy into contracts between its authorised representatives and their clients, Dover may have failed to comply with the financial services laws, namely Section 1041H of the Corporations Act, Section 12DA of the ASIC Act or both. If that were so, Dover may have contravened Section 912A(1)(c) of the Corporations Act.

Dover's recruitment processes fell short of what the community would expect. In the three cases considered in evidence, Dover took no step to find out whether the person it appointed as an authorised representative was a person who appeared likely to be able to do the job professionally and ethically. Even if Dover did read every statement of advice twice, Dover could not reasonably be satisfied that the adviser was a proper person to act as its authorised representative.

In June 2018, ASIC and Dover announced that Dover would give up its AFSL and cease providing financial advice. Mr McMaster said that he would not take any further part in the financial advice industry. In these circumstances, it is for ASIC to decide whether taking any further steps in relation to the conduct that I have identified as possible misconduct would be worthwhile.

⁷⁴⁵ Transcript, Terry McMaster, 26 April 2018, 1897.

Case studies: Small and medium enterprises

1 Third party guarantees: Ms Flanagan and Westpac

1.1 Background

In December 2010, Carolyn Flanagan gave a guarantee to Westpac and a mortgage over her home, in order to secure a business loan obtained by a company established by her daughter and her daughter's partner.¹ When Ms Flanagan gave the guarantee and mortgage, she was suffering from a number of serious medical conditions, including nasopharyngeal cancer and poor eyesight. In 2004, part of her tongue had been removed as part of her cancer treatment and, as a result, she has difficulty speaking.² At the time she gave the guarantee, Ms Flanagan was unemployed and on a disability pension.³

Some facts surrounding Ms Flanagan's signing of the guarantee and related documents were not as clear as would be expected. In particular, there was room for debate about when Ms Flanagan signed the relevant documents and who witnessed her signature. I consider that the most likely chain of events was that Ms Flanagan attended a Westpac branch on 8 December 2010 with her daughter and later signed the guarantee⁴ and

¹ Transcript, Carolyn Joy Flanagan, 21 May 2018, 2044–5.

² Transcript, Carolyn Joy Flanagan, 21 May 2018, 2043.

³ Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, 1 [4]; Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, Exhibit CJF-1 [WBC.407.001.1003 at .1003].

⁴ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133].

mortgage⁵ on 10 December 2010 in the presence of a solicitor. There was room for debate about this being the sequence of events because the documents appeared to have been 'pre-signed' by the relevant Westpac banker as witness to Ms Flanagan's signature but the banker's signature as witness was crossed out.⁶

It is clear on the face of the documents that the banker completed the answers to the various questions in an acknowledgment form that Westpac required to ensure that Ms Flanagan was properly advised and understood the guarantee.⁷ It follows from the fact that the guarantee and acknowledgment were signed by Ms Flanagan when she attended a solicitor on 10 December that the banker had filled in these answers before Ms Flanagan saw the solicitor. Mr Alastair Welsh, General Manager, Commercial Banking at Westpac, who gave evidence to the Commission, said it was not uncommon for forms to be 'pre-filled' by the banker.⁸

The answers given in the acknowledgment were to be answers given by the intended guarantor before the guarantee was signed. The answers recorded on the acknowledgment that Ms Flanagan signed (and was dated 8 December 2010) were internally inconsistent. Question 3 in the document noted that the 'Warning' box on the front page of the guarantee stated that, before signing the guarantee, the guarantor 'should get advice from [their] own lawyer and from [their] own financial adviser (such as an accountant)'.⁹ With this introduction, the question then required the guarantor to answer 'Yes' alongside 'one of the following that is true'.¹⁰ Two choices were given: first, 'You got that advice' (which is to say both legal and financial advice), or second, 'You got advice from your own lawyer but not from your financial

⁵ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-28 [WBC.407.001.0148].

⁶ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133]; Transcript, Alastair Derek Dawson Welsh, 22 May 2018, 2129, 2131–2.

⁷ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138–.9139].

⁸ Transcript, Alastair Derek Dawson Welsh, 22 May 2018, 2126.

⁹ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138].

¹⁰ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138].

adviser'. The banker wrote 'Yes' against the first statement, thus indicating that Ms Flanagan had taken both legal and financial advice.¹¹ But nothing in the evidence suggests that she had ever taken financial advice and Westpac did not submit that she had. The next question in the form said that it needed to be answered only if the guarantor had answered 'Yes' to the second statement.¹² Even so, the banker answered the question and wrote 'Yes' to a question asking 'Do you understand that is your risk?'¹³ The reference to 'that' in the question can be understood only as meaning not taking financial advice.

1.2 The loan goes into default

From early 2012, Westpac sent Ms Flanagan several notices that the loan she had guaranteed was in default. In May 2014 Westpac commenced proceedings in the Supreme Court of New South Wales seeking vacant possession of Ms Flanagan's home.¹⁴ Ms Flanagan went to the Penrith Legal Aid office for help.

Ms Dana Beiglari, a senior solicitor from NSW Legal Aid, gave evidence to the Commission that she assisted Ms Flanagan in relation to Westpac's claim. In particular, with Ms Beiglari's help, Ms Flanagan made a complaint to the Financial Ombudsman Service (FOS).¹⁵ Ms Flanagan wanted FOS to negotiate a hardship arrangement with Westpac so that she could continue to live in her home for the duration of her life.¹⁶ Westpac rejected that request during the FOS process.¹⁷ FOS made a determination that Westpac had complied with its obligations to Ms Flanagan when it obtained the guarantee and was entitled to enforce the guarantee against Ms Flanagan

¹¹ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138].

¹² Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138].

¹³ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138].

¹⁴ Transcript, Carolyn Joy Flanagan, 21 May 2018, 2047; Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, Exhibit CJF-4 [RCD.9999.0028.0021].

¹⁵ Transcript, Dana Beiglari, 21 May 2018, 2055–6.

¹⁶ Transcript, Dana Beiglari, 21 May 2018, 2056; Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, Exhibit CJF-5 [FOS.0025.0001.0062].

¹⁷ Transcript, Dana Beiglari, 21 May 2018, 2056.

in accordance with its terms.¹⁸ In particular, FOS found that Ms Flanagan had been provided with independent legal advice in relation to the guarantee.¹⁹ Ms Flanagan sought a review of the determination but that was unsuccessful.²⁰

Following the FOS determination, NSW Legal Aid approached a senior contact at Westpac to seek a resolution that would permit Ms Flanagan to remain in her home until her death. Ms Flanagan proposed that, on her death or her selling her home, \$160,000 plus interest at 3% would be paid to Westpac.²¹ Westpac responded with a proposal to like effect but requiring that the principal amount payable be \$170,000 rather than \$160,000.²² Westpac and Ms Flanagan subsequently entered into a deed of release to that end.²³ Mr Welsh accepted that Westpac should have reached this result sooner than it did and that it had thus made an error in applying its hardship policy.²⁴

Mr Welsh told the Commission that he saw no problem with Westpac's processes governing the taking of guarantees and that, more particularly, he saw no problem with Westpac accepting a guarantee from Ms Flanagan.²⁵ In its written submission about the case study, Westpac maintained this position, submitting that it was 'appropriate in all the circumstances to accept and rely upon the guarantee from Ms Flanagan'.²⁶

¹⁸ Transcript, Dana Beiglari, 21 May 2018, 2056; Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, Exhibit CJF-8 [FOS.0025.0001.1592 at .1596].

¹⁹ Exhibit 3.6, Witness statement of Carolyn Joy Flanagan 14 May 2018, Exhibit CJF-8 [FOS.0025.0001.1592 at .1596].

²⁰ Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, 5 [29].

²¹ Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, Exhibit CJF-9 [WBC.407.001.1023].

²² Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, 6 [31]–[32].

²³ Transcript, Dana Beiglari, 21 May 2018, 2057; Exhibit 3.6, Witness statement of Carolyn Joy Flanagan, 14 May 2018, Exhibit CJF-10 [WBC.407.001.0841].

²⁴ Transcript, Alastair Derek Dawson Welsh, 22 May 2018, 2139; Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, 22 [109].

²⁵ Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2061–2.

²⁶ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 2 [5].

1.3 Categories of guarantors

When Westpac took the guarantee from Ms Flanagan, its policies provided (and still provide) that one ‘acceptable third party relationship’ for taking a guarantee is ‘Parents guaranteeing a consumer loan for one or more of their children’.²⁷ As it was written, the policy suggested that all other guarantee proposals were generally not acceptable ‘unless a direct benefit [to the guarantor] can be established.’ But, read as a whole, the policy contemplated that parents might provide voluntary guarantees of the business borrowings of children. In particular, the policy provided (and still provides):

Exercise extreme caution where parents are offering to guarantee the business borrowings of their children. Before accepting these types of guarantees make sure that the guarantor demonstrates that they are making a fully informed decision and that they are fully aware of their potential liability. The account manager and credit officer are to be satisfied that the guarantor has the means (realisable assets/cash flow) upon which they could rely if called upon to clear the borrower’s liabilities to Westpac.²⁸ (emphasis added).

The policy divided (and divides) guarantors into two categories. For present purposes, it is enough to note that the first category included individuals who are both a director and a shareholder of the borrowing entity and who meet three requirements (active participation in management, obtaining ‘a direct financial benefit from the transaction/facility provided’ and not being shown to be under the influence of other parties to the transaction). If a guarantor did not (or now does not) meet these criteria the guarantor falls into the second category. If the guarantor was (or is) in this second category, the policy provided (and provides) that the borrower must be told three things: that Westpac ‘[r]equires guarantors to obtain independent legal

²⁷ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-5 [WBC.410.001.0215]; Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-6 [WBC.107.005.0400]; cf Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-7 [WBC.400.043.6682].

²⁸ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh 15 May 2018, Exhibit AW4-5 [WBC.410.001.0215]; Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-6 [WBC.107.005.0400]; cf Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-7 [WBC.400.043.6682].

advice to ensure that they understand the nature and effect of the guarantee', that Westpac will require a solicitor's certificate to that effect, and that Westpac will need to interview the guarantor personally to provide a copy of the security documents, a copy of the facility letter, and if the Code of Banking Practice applies, other information concerning the borrower's accounts.²⁹

There was some debate, in the course of Mr Welsh's evidence, whether Ms Flanagan could have been regarded as obtaining a direct financial benefit from the loan made to the company and whether she was in the first or second category of guarantors. Mr Welsh observed that Ms Flanagan was recorded as a shareholder.³⁰ And Westpac submitted that 'Ms Flanagan had a clear and tangible interest in the business which was the subject of the loan'.³¹ Contrary to this submission, I consider it much more probable than not that Ms Flanagan obtained no financial benefit of any kind from the transactions in question. Her holding one of two issued shares in the company falls far short of demonstrating her receiving or being likely to receive any benefit from the company. Her references in earlier statements she had made to being 'a silent partner' in the business revealed no understanding of what that might mean. And, so far as the evidence went, there was no suggestion that she ever received anything from the business. Although I do not think anything turns on it, even if Ms Flanagan did stand to gain some benefit from the business, not being a director of the borrower, she would still not have met the criteria to fall within the first category of guarantors identified in Westpac's policy. Hence, even if she was not a volunteer, Westpac's policy would still have required that she obtain independent legal advice.

²⁹ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-5 [WBC.410.001.0215]; Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-6 [WBC.107.005.0400]; cf Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-7 [WBC.400.043.6682].

³⁰ Transcript, Alastair Derek Dawson Welsh, 22 July 2018, 2091; Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-12 [WBC.107.005.0241].

³¹ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 3 [15].

1.4 A fully informed decision?

As has been noted, Westpac's policy required that the banker be sure that the guarantor demonstrates that they are making a fully informed decision and that they are fully aware of their potential liability. Mr Welsh agreed that there were warning signs that the banker ought to have observed in interviewing Ms Flanagan 'and assessing whether or not Ms Flanagan demonstrated making a fully informed decision and that she was fully aware of her potential liability'.³² Those warning signs included Ms Flanagan obviously suffering debilitating health conditions, her difficulty speaking, her apparent inability to read or write, the presence of her daughter during her attendance at the branch, and the fact that she would be rendered homeless if Westpac was to call on the guarantee.³³ Mr Welsh said that he would have expected the banker to observe these matters and record them on the file.³⁴ None of these issues were documented on Westpac's file.³⁵ More particularly, Mr Welsh said that he would have expected the banker to be 'really clear' that Ms Flanagan 'had to get both independent legal and ... financial advice'.³⁶ There was no record of the banker telling Ms Flanagan anything about getting legal or financial advice.³⁷ But there was Ms Flanagan's statutory declaration dated 10 December 2010, made before a solicitor that she had 'received independent legal advice regarding the loan and security documents' between the borrower and Westpac and that '[a]fter receiving that advice' she had 'freely and voluntarily signed' the mortgage and guarantee and indemnity produced for signature before the solicitor.³⁸

As Westpac pointed out in its submissions, the then applicable solicitors' professional conduct rules 'made clear what advice a solicitor should provide' when asked to provide independent advice to an intending

³² Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2076–7.

³³ Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2076–7.

³⁴ Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2077.

³⁵ Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2077.

³⁶ Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2077.

³⁷ Transcript, Alastair Derek Dawson Welsh, 21 May 2018, 2077–8.

³⁸ Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-26 [WBC.104.001.9326].

guarantor.³⁹ Among other things, the rules required the solicitor to tell the intending guarantor, where necessary, that, if the guarantor did not remedy a failure by the borrower to comply with the terms and conditions of the loan, the lender could sue the guarantor, take possession of the property the guarantor gave as security and sell that property.⁴⁰ The rules required the solicitor to advise the intending guarantor that the solicitor did not profess any qualification to give any financial advice and that questions about any financial aspect of the transaction should be directed to an accountant or financial counsellor.⁴¹ Nothing in the rules required the solicitor to ask the intending guarantor whether he or she had considered whether it was wise to give the guarantee. By contrast, Westpac's form of acknowledgment expressly asked: 'Have you thought hard about whether to sign the Guarantee? Have you made your own decision to sign (not just because someone asked you to)?'⁴²

1.5 Characteristics of parental guarantors

Ms Beiglari gave evidence about her experience at NSW Legal Aid and the clients she had encountered who had provided guarantees such as that provided by Ms Flanagan. She observed that her clients, generally, had a limited recollection of the circumstances of signing up to the guarantee.⁴³ Her experience was that in nearly all of the cases she had seen at Legal Aid, 'the client did not understand the detail of the financial arrangement that they were signing up to'⁴⁴ even if they had been given independent legal advice. As she said, this may be because of their limited literacy skills, or other difficulties communicating, or they may have a disability or not speak English as a first language.⁴⁵ But in her view, very often the root cause was that the child had made all of the arrangements with the bank.⁴⁶

³⁹ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 3 [9].

⁴⁰ *Revised Professional Conduct and Practice Rules 1995* (NSW) r 45.6.3.

⁴¹ *Revised Professional Conduct and Practice Rules 1995* (NSW) r 45.6.4.

⁴² Exhibit 3.10, Witness statement of Alastair Derek Dawson Welsh, 15 May 2018, Exhibit AW4-27 [WBC.104.001.9133 at .9138].

⁴³ Transcript, Dana Beiglari, 21 May 2018, 2053.44–7.

⁴⁴ Transcript, Dana Beiglari, 21 May 2018, 2054.26–8.

⁴⁵ Transcript, Dana Beiglari, 21 May 2018, 2053–4.

⁴⁶ Transcript, Dana Beiglari, 21 May 2018, 2053–4.

That is, the parental guarantor came to whatever dealings he or she may have with the bank (and any provision of advice) having already decided that he or she wanted to assist the child who was arranging the loan. The dealings with the bank, and the provision of advice were no more than steps along the way to implementing a decision that had already been made. The decision to assist may have been made with little or no information or understanding about what the proposed transaction was or what it might entail. For the parent with little or no understanding of the transactions being made, it would be too easy to treat what was thereafter said or done as a matter of concern only to the borrower or as forms and solemnities to be endured rather than understood and applied. If made in those circumstances, neither the dealings with the bank nor the provision of independent advice appeared, in Ms Beiglari's experience, to fill in any gap in the guarantor's knowledge or understanding of the transaction. And that would be consistent with Ms Beiglari's general observation that nearly all of those whom she saw at Legal Aid did not understand the detail of the financial arrangements they were signing up to and her more particular explanation that:

they might not have understood the amount of the loan or the type of the loan, say, a consumer loan versus an investment or business loan, or they may not have been able to describe what it means to be a guarantor or have a mortgage. So in the cases where there has been independent legal and financial advice, I don't think that it has assisted people to understand what they're doing.⁴⁷

As Ms Beiglari said, 'people often want to put family first, they consider that family is paramount, or they might feel some pressure to do what their child asks them to do in order to preserve the relationship'.⁴⁸ That being so, as Ms Beiglari also said, parents may find it hard to say no to their child; they may be less inclined to receive and act upon legal or financial advice about the consequences of giving a guarantee. She said that:

It's very rare for clients to understand that their Centrelink pension payments may be reduced or cut off completely if the guarantee is called upon, due to the effect of the gifting rules that Centrelink has, and – and finally, a significant implication is ... the emotional toll ... and stress that this may have on the family unit. It could cause a relationship breakdown

⁴⁷ Transcript, Dana Beiglari, 21 May 2018, 2054.

⁴⁸ Transcript, Dana Beiglari, 21 May 2018, 2053.

between the parent and the child which can be devastating for a parent, particularly in their old age.⁴⁹

Ms Beiglari's observations were consistent with Ms Flanagan's insight into her own circumstances when asked about the importance of legal advice to her decision to give the guarantee she had signed:

At the moment – and doing the best you can, given the way you felt about your daughter at the time, do you think that it was likely that you would have signed the guarantees in any event? -- *I would have signed anything, love, for her, in hindsight.* I have to be honest about that.

All right? --- *If you can't help your children, who can you help?*⁵⁰

1.6 What the case study showed

Nothing in the material examined in the course of the case study pointed away from the observation that, for many seeking to start a new business, lenders will lend only if the borrower can provide some tangible security for the loan. And if the borrower cannot provide the security, the lender may seek a secured guarantee from a third party.

Often, the **third party guarantor** is a voluntary guarantor: the guarantor stands to gain no benefit from the transaction. And, as Westpac's policy documents recognised, the guarantor may be the parent of one of the principals in the new business.

The procedures prescribed by Westpac were evidently intended to ensure that 'the guarantor demonstrates that they are making a fully informed decision and that they are fully aware of their potential liability.' They were procedures evidently intended to give effect to the injunction that the Westpac banker '[e]xercise extreme caution where parents are offering to guarantee the business borrowings of their children.' But the exercise of caution demands careful attention to the substance of matters, not just ritual adherence to forms. Hence, for the banker to have 'pre-filled' the answers to questions in the acknowledgment form that would allow the lawyer to provide independent advice to Ms Flanagan was to take a step that, as

⁴⁹ Transcript, Dana Beiglari, 21 May 2018, 2053.

⁵⁰ Transcript, Carolyn Joy Flanagan, 21 May 2018, 2046 (emphasis added).

Westpac accepted⁵¹ ‘would have been inappropriate’. As I have explained, the answers in that form were evidently written by the banker and that must have been done before Ms Flanagan saw the solicitor. It was inappropriate to take that step because, contrary to Westpac’s submissions,⁵² doing so compromised the process for the provision of independent advice. It compromised that process because providing the bank’s version of the relevant answers at least affected, and in all probability it fixed an important part of, the basis on which the lawyer decided what advice he needed to give to meet the obligations prescribed by the professional conduct rules. (It will be recalled that those rules required the solicitor, ‘where necessary’, to advise the borrower of certain matters.)

By having Ms Flanagan sign the acknowledgment (as she appears to have done two days before she saw the solicitor) the banker had Ms Flanagan adopt answers that were not then true. Ms Flanagan had not had any of the advice asked about in question 3 when she signed the form. By ‘pre-filling’ answers in the acknowledgment, the bank presented the lawyer with the answers that the banker understood Ms Flanagan either had given or would later be in a position to give. But the answers to the questions were the banker’s answers and it was these answers that the bank had Ms Flanagan give to the lawyer. The answers all concerned what Ms Flanagan knew and understood about the guarantee. The professional conduct rules obliged the lawyer to decide whether it was necessary for him to advise her of the matters prescribed by those rules. The rules therefore obliged the lawyer, if he thought it necessary or desirable to advise her of the relevant matters, to decide whether what he said had been heard and had been understood sufficiently for the lawyer to take the prescribed form of statutory declaration. Pre-filling the form compromised that process. And at this moment in time (with Ms Flanagan having a very imperfect memory of events) it is simply not possible to say whether, despite the process being compromised, the substantial purposes of undertaking the process were achieved.

‘Pre-filling’ the acknowledgment with answers that depended upon the occurrence of future events (the giving of advice) is consistent with treating

⁵¹ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 2 [9].

⁵² Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 2 [9].

the document as just another form to be filled out, rather than as an important document recording what the guarantor knew and understood before she signed the guarantee. The record of what the guarantor knew and understood is important for the bank and for the guarantor. It may also be important for third parties (such as the executor of Ms Flanagan's estate) considering whether the guarantee given by Ms Flanagan was enforceable. On the face of the documents, proper procedures appeared to have been followed and if that was right, the instrument would very probably be treated as enforceable according to its terms. But in fact, the process of obtaining Ms Flanagan's acknowledgment miscarried.

I cannot say from the material presented in evidence whether the guarantee may have been unenforceable.

In particular, no matter whether Ms Flanagan was a volunteer (as I consider she probably was) or received some real benefit from entering the transaction (as Westpac submitted),⁵³ I do not think it possible to form any view about whether Westpac might have acted unconscionably in taking the guarantee.⁵⁴ If, as I consider to be the better view, Ms Flanagan was a volunteer, she stood to lose her home (her only asset) if the venture failed and she stood to gain nothing from giving the guarantee. She was obviously seriously disabled. Her only income was a disability support payment. What her daughter had told her about the venture was not explored in evidence. What her daughter and her partner had told the bank was not explored. To decide whether Westpac acted unconscionably in taking the guarantee, it would be necessary to pay close attention to what the banker concerned knew or understood about Ms Flanagan's appreciation of what she was doing. The banker did not give evidence to the Commission. It would also be important to recall not only that Ms Flanagan had given a statutory declaration to FOS in connection with her complaint in which she spoke of her having said 'yes' when the banker asked if she knew that she was putting her house up as security by signing the guarantee⁵⁵ but also that, as Ms Flanagan said in her evidence to the Commission, she would have

⁵³ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 17 [77.i].

⁵⁴ cf *Australian Securities and Investments Commission Act 2001* (Cth) s 12CC (as the Act stood in 2010).

⁵⁵ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 14 [65].

signed anything for her daughter. 'If you can't help your children, who can you help?'⁵⁶

Assuming that Westpac's taking the guarantee was not unconscionable, it would follow that its *taking* the guarantee should not be found to be conduct falling short of community standards and expectations. But whether *enforcing* the guarantee fell below those standards and expectations is a separate question.

Once Ms Flanagan made her hardship application, I consider that the community would not think it right for Westpac to deprive Ms Flanagan of the use of her home during her life. And yet, despite her application to FOS, and her expressed desire to negotiate what would be, in effect, a life tenancy in the property, Westpac rebuffed the approach and insisted upon exercising its rights under the guarantee. That was conduct that fell short of what the community would expect. As Westpac said in its submissions:

Westpac should have progressed [the request Ms Flanagan made in her complaint to FOS] with greater urgency than it did, and with more understanding of, and compassion for, Ms Flanagan's situation. The outcome ultimately reached with Ms Flanagan could and should have been reached earlier.⁵⁷

1.7 What issues arise?

The first and most critical question can be put thus. If established principles of judge-made law and statutory provisions about unconscionability would not relieve a guarantor of responsibility under a guarantee, and if, further, a bank's voluntary undertaking to a potential guarantor to exercise the care and skill of a diligent and prudent banker has not been breached, are there circumstances in which the law should nevertheless hold that the guarantee may not be enforced?

What would those circumstances be? Would they be defined by reference to what the lender did or did not do, by reference to what the guarantor was or was not told or by reference to some combination of factors of those kinds?

⁵⁶ Transcript, Carolyn Joy Flanagan, 21 May 2018, 2046.

⁵⁷ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-12 Case Study*, 8 June 2018, 11 [49].

Why shift the boundaries of established principles, existing law and the industry code of conduct?

If the guarantor is a volunteer, and if further, the guarantor is aware of the nature and extent of the obligations undertaken by executing the guarantee, is there some additional requirement that must be shown to have been met before the guarantee was given if it is to be an enforceable obligation?

How is the law to deal with the undoubted fact that a parent may guarantee a loan to an adult child because the parent wishes to support and encourage the child's ambitions? Often, perhaps very often, the parent will make that decision regardless of whether the parent has made, or has been able to make, any independent assessment of the commercial prospects of the venture that the adult child seeks to undertake.

Legal Aid NSW proposed that a lender should be required to make an assessment about whether the contract of guarantee would be unsuitable for the guarantor because it is likely that, at the time the guarantee would be given, the guarantor could meet a call on the guarantee only with substantial hardship.⁵⁸ Would that be a rule to be applied to all guarantors (and thus the principals of a corporate borrower)? If a contract of guarantee were to be assessed as unsuitable for the guarantor, what would follow: a warning to the potential guarantor or prohibition of the transaction? Would adopting provisions of this kind mean, in practice, that a guarantor could never provide his or her place of residence as security for the guarantee?

Would the provision of advice (legal, financial or both) permit giving a guarantee otherwise judged to be 'unsuitable'?

If the concern is protection of the vulnerable, how could the relevant class be defined in a way that was neither over-inclusive, nor under-inclusive? Legal Aid NSW pointed out, in its submissions⁵⁹ that '[a]llowing a Centrelink recipient (usually an older person or a person with a disability) to act as a guarantor means that an already vulnerable person will likely become homeless, or dependent on social housing funded by the State, if the debtor defaults on the credit contract'. Is being a Centrelink recipient to be treated as a disqualifying characteristic?

⁵⁸ Legal Aid NSW, *Written Submissions – Round 3 Hearing*, 3; cf NCCP Act s 131.

⁵⁹ Legal Aid NSW, *Written Submissions – Round 3 Hearing*, 3.

Is protection of the vulnerable achieved, or advanced, by providing potential guarantors with more information? Should lenders tell some potential guarantors that giving a guarantee may affect what choices they can make about health or aged care?

Should there be some recommended, or prescribed, cooling off period? Legal Aid NSW proposed⁶⁰ seven days rather than the three-day period given in the 2019 Code.

Should lenders give potential guarantors more information about the borrower or the proposed loan? What information could be given with respect to a new business?

2 Responsible lending: The Banking Code's diligent and prudent banker

2.1 Background

As noted earlier, the chief protection for small business borrowers has been, and remains, the Code of Banking Practice. The 2013 Code, and the 2019 Code both provide, in effect, that a bank considering a new loan, or an increase in a loan limit, will exercise the care and skill of a diligent and prudent banker.⁶¹ If a borrower defaults, and the bank seeks to enforce repayment of a loan, the borrower may say that a diligent and prudent banker would not have made the loan, or allowed the increased limit and make a complaint to the relevant **external dispute resolution** body (FOS, or now, AFCA).

The Commission looked at three case studies of this kind. All three concerned loans made to assist the borrower to buy a franchise: an ANZ loan to buy a gelato franchise, a Westpac loan to buy a Pie Face franchise, and a Bank of Queensland (BOQ) loan to buy two Wendy's franchises. All three ventures failed. In each case, the borrower complained that the bank

⁶⁰ Legal Aid NSW, *Written Submissions – Round 3 Hearing*, 5–6.

⁶¹ 2013 Code cl 27; 2018 Code cl 49.

had not exercised the care and skill of a diligent and prudent banker. In each case, FOS upheld the borrower's complaint.

2.2 ANZ and the gelato franchise

In October 2014, a company obtained facilities from ANZ of about \$220,000 to purchase and set up a new gelato shop.⁶² The company was controlled by a married couple. The facilities were secured by a general security agreement over all present and future acquired property of the company, personal guarantees and indemnities from each of the two directors of the company, and a second registered mortgage over an investment property owned by one of the directors of the company.⁶³

The gelato shop was a new franchise business within a franchise system originating in New Zealand. When ANZ assessed and approved the proposal, ANZ was aware that the franchise system had not yet commenced operations in Australia.⁶⁴ Although there was some evidence that one of the directors of the company may have previously worked in a different food retail business,⁶⁵ neither of the directors had any prior experience working in or operating a frozen yoghurt or gelato business.⁶⁶

The company's business lending application submitted to ANZ was accompanied by a business plan⁶⁷ containing cash flow forecasts for the new gelato shop.⁶⁸ Ms Kate Gibson, the ANZ executive who gave evidence to the Commission about the matter, accepted that the information contained in sections of the business plan was 'pretty generic'.⁶⁹ The business plan was filled with what appeared to be 'clip art' images, and mostly used general marketing language to explain exactly what the

⁶² Transcript, Kate Griffiths Gibson, 22 May 2018, 2153–4.

⁶³ Transcript, Kate Griffiths Gibson, 22 May 2018, 2154.

⁶⁴ Transcript, Kate Griffiths Gibson, 22 May 2018, 2162, 2165.

⁶⁵ Transcript, Kate Griffiths Gibson, 22 May 2018, 2165.

⁶⁶ Transcript, Kate Griffiths Gibson, 22 May 2018, 2162.

⁶⁷ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-30 [ANZ.800.534.0008].

⁶⁸ Transcript, Kate Griffiths Gibson, 22 May 2018, 2164.

⁶⁹ Transcript, Kate Griffiths Gibson, 22 May 2018, 2164.

business was and how it was intended to operate.⁷⁰ These parts of the business plan could have been used in a business plan for any food franchise business.⁷¹ There were, however, some aspects of the business plan that appeared to be quite specific to the gelato shop.⁷² So, for example, the business plan took into account the effect that seasonality would have upon gelato sales.⁷³

The business plan contained several cash flow forecasts⁷⁴ but there were some inconsistencies between them.⁷⁵ In addition, the way in which GST had been treated in one set of cash flow forecasts found in the business plan was, on its face, incorrect.⁷⁶ Further, the assumptions underpinning the various cash flow forecasts were not fully articulated in the business plan.⁷⁷ For example, the business plan said that the cash flow forecasts were based on existing store sales. But because there were then no existing Australian stores in the franchise system, the sales figures must have been from overseas stores. The business plan did not identify the location of the stores whose sales were relied on, or whether their sales had been sensitised to meet Australian market conditions.⁷⁸

In approving the application for business lending, an ANZ assessor undertook two serviceability calculations. In the first calculation, the assessor took the cash flow forecast in the business plan at face-value,⁷⁹ and added the full salary earned by one of the director-guarantors outside of the business. The business loan repayments and personal living and

⁷⁰ Transcript, Kate Griffiths Gibson, 23 May 2018, 2206.

⁷¹ Transcript, Kate Griffiths Gibson, 22 May 2018, 2166.

⁷² Transcript, Kate Griffiths Gibson, 22 May 2018, 2164.

⁷³ Transcript, Kate Griffiths Gibson, 22 May 2018, 2164.

⁷⁴ Transcript, Kate Griffiths Gibson, 22 May 2018, 2157; Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-29 [ANZ.800.534.0008].

⁷⁵ Transcript, Kate Griffiths Gibson, 22 May 2018, 2172.16–24; Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-29 [ANZ.800.534.0008 at .0034–.0038].

⁷⁶ Transcript, Kate Griffiths Gibson, 22 May 2018, 2172.

⁷⁷ Transcript, Kate Griffiths Gibson, 22 May 2018, 2164.

⁷⁸ Transcript, Kate Griffiths Gibson, 22 May 2018, 2169.

⁷⁹ Transcript, Kate Griffiths Gibson, 22 May 2018, 2161.

finance expenses of both director-guarantors were then deducted to arrive at a positive 'uncommitted monthly income' amount.⁸⁰

The ANZ assessor completed a second 'stressed'⁸¹ serviceability calculation. For this second calculation, the assessor reduced the forecast net profit recorded in the cash flow forecast to zero and halved the forecast annual salary amount for the director who was to work in the business. On this second serviceability calculation, a marginally positive 'uncommitted monthly income' amount was shown. The assessor determined that the business facilities were serviceable and approved the loans.⁸²

The business did not prosper. In 2016, the borrowers said that they could not afford to repay the loan.⁸³ They made a complaint to FOS. FOS made a recommendation in their favour, concluding that ANZ did not act responsibly when it approved the loan.⁸⁴ FOS said, in its recommendation, that it considered that the cash flow forecasts in the business plan were 'overly optimistic' when compared to industry benchmarks. The industry benchmarks to which FOS referred were ATO benchmarks relating cost of goods sold, expenses, labour costs and rent to turnover.⁸⁵ The relationship between cost of goods sold and turnover for gelato businesses having a turnover of more than \$475,000 was said to average 30%.⁸⁶ FOS recorded the business plan as indicating a relationship of 20%.⁸⁷ On this basis, FOS concluded that, by relying on the cash flow forecast to assess serviceability,

⁸⁰ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-41 [ANZ.800.539.0217].

⁸¹ Transcript, Kate Griffiths Gibson, 22 May 2018, 2161.

⁸² Transcript, Kate Griffiths Gibson, 22 May 2018, 2161; Transcript, Kate Griffiths, 23 May 2018, 2210; Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-41 [ANZ.800.539.0217 at .0263].

⁸³ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-60 [ANZ.800.470.1637].

⁸⁴ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-62 [ANZ.800.470.1644].

⁸⁵ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, Exhibit KGG-62 [ANZ.800470.1644 at .1652].

⁸⁶ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-62 [ANZ.800470.1644 at .1652].

⁸⁷ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-62 [ANZ.800470.1644 at .1652].

ANZ had failed to exercise the care and skill of a prudent and diligent banker.⁸⁸

ANZ disagreed with the conclusions FOS reached.⁸⁹ But FOS subsequently affirmed its recommendation and issued a determination⁹⁰ in favour of the company and its principals. ANZ complied with the FOS determination.

At the time she gave evidence to the Commission, Ms Gibson was the General Manager, Home Lending at ANZ.⁹¹ Between March 2014 and May 2017, she was General Manager, Small Business Banking at ANZ.⁹²

Ms Gibson said that, when an ANZ banker submits a loan for a new 'start-up' business, the ANZ banker is required to form an opinion about the reasonableness of the business plan and cash flow forecast.⁹³ When asked what further enquiries she would expect the putative diligent and prudent banker to undertake in forming this opinion, Ms Gibson said:

[W]hat is being done by the credit officer is an exercise in judgement. They need to form an opinion. We provide guidance on the sorts of things we think they should take into account, but we're not prescriptive about exactly what has to be sourced beyond saying that they do need to provide a business plan, they do need to provide cash flow forecasts, and the bank officer and credit officer need to have formed an opinion that they're reasonable.⁹⁴

Asked to consider this particular business plan, Ms Gibson said that she would have expected the banker or assessor to have a conversation with the borrowers to make sure that they understood the business,⁹⁵ and to ask further questions about the business plan and the assumptions

⁸⁸ Transcript, Kate Griffiths Gibson, 22 May 2018, 2156; Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-62 [ANZ.800470.1644].

⁸⁹ Transcript, Kate Griffiths Gibson, 22 May 2018, 2156.

⁹⁰ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-64 [ANZ.800.470.2019].

⁹¹ Transcript, Kate Griffiths Gibson, 22 May 2018, 2147.

⁹² Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, 6 [10].

⁹³ Transcript, Kate Griffiths Gibson, 22 May 2018, 2164.

⁹⁴ Transcript, Kate Griffiths Gibson, 23 May 2018, 2194.

⁹⁵ Transcript, Kate Griffiths Gibson, 22 May 2018, 2168.

underpinning the cash flow forecast.⁹⁶ She said that there was no evidence on the file that these conversations took place; but that it is possible that they may have.⁹⁷

When asked whether the banker or assessor ought to have had regard to industry benchmarks published by the ATO in forming an opinion as to the reasonableness of the cash flow forecast, Ms Gibson said:

... there are other ways of forming an opinion, and with a start-up business, that's what you need to do because you don't have historical operating figures to project from.⁹⁸

I don't believe it's a requirement that you have to reset the cash flows to the industry benchmark in order for that to be reasonable. I think if ... somebody presents to us with a business plan where they're outside the industry benchmarks, you should expect that you have an understanding of why they believe that they can run the business that way. And I also think that in the context of ... looking at the serviceability, that's one of the reasons that we do stress testing on the ...serviceability.⁹⁹

There were, however, three errors in the loan assessment process that affected both sets of serviceability calculations, and the overall loan assessment. First, the banker did not properly enter two personal liabilities of the director-guarantors into ANZ's small business loan origination system.¹⁰⁰ This error was not identified by the assessor; and the assessor completed both serviceability calculations without having regard to these additional liabilities.¹⁰¹ Their inclusion in the second 'stress-tested' serviceability calculation would have resulted in a negative 'uncommitted monthly income' amount.¹⁰²

Second, before submitting the gelato shop finance application, the directors had submitted a separate application to ANZ to finance the purchase of a

⁹⁶ Transcript, Kate Griffiths Gibson, 23 May 2018, 2195.

⁹⁷ Transcript, Kate Griffiths Gibson, 22 May 2018, 2196.

⁹⁸ Transcript, Kate Griffiths Gibson, 23 May 2018, 2196.

⁹⁹ Transcript, Kate Griffiths Gibson, 23 May 2018, 2197–8.

¹⁰⁰ Transcript, Kate Griffiths Gibson, 22 May 2018, 2160–1.

¹⁰¹ Transcript, Kate Griffiths Gibson, 23 May 2018, 2210;
Transcript, Kate Griffiths Gibson, 22 May 2018, 2161.

¹⁰² Transcript, Kate Griffiths Gibson, 23 May 2018, 2210.

different business. Both applications bore the same date; but the amounts recorded in the directors' statements of position in each application were different.¹⁰³ In assessing and approving the gelato shop facilities, the banker and assessor do not appear to have been aware of the earlier application and of the discrepancies between the two statements of position.¹⁰⁴

Ms Gibson said that this error was caused by a limitation in ANZ's small business loan assessment program that did not automatically permit the banker or assessor to see earlier applications submitted by the same borrowers. ANZ has since introduced a new small business loan origination system that allows bankers and assessors to see all prior applications submitted by a borrower and requires assessors to have regard to any other recent applications received from a borrower when assessing and approving a new business lending application.¹⁰⁵

Third, the statements of position submitted with the business loan application lacked detail and did not include all of the information entered by the banker into ANZ's loan assessment system and used by the assessor in approving the business loan. There were no contemporaneous notes recorded in ANZ's lending file that reflected the additional information entered by the banker.¹⁰⁶ The provenance of this additional information was therefore unclear.

In Ms Gibson's opinion, the way in which the banker and assessor used the business plan and cash flow forecasts in approving the facilities was acceptable.¹⁰⁷ When she looked at the assessment process as a whole, however, she was 'not comfortable' with the cumulative number of errors that had been made.¹⁰⁸ On this basis, Ms Gibson did not consider that ANZ had demonstrated the care and skill of a prudent and diligent banker in assessing and approving these business facilities.¹⁰⁹

¹⁰³ Transcript, Kate Griffiths Gibson, 22 May 2018, 2160.

¹⁰⁴ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, 40 [148].

¹⁰⁵ Transcript, Kate Griffiths Gibson, 22 May 2018, 2160.

¹⁰⁶ Transcript, Kate Griffiths Gibson, 22 May 2018, 2161.

¹⁰⁷ Transcript, Kate Griffiths Gibson, 22 May 2018, 2157.40–5;
Transcript, Kate Griffiths Gibson, 23 May 2018, 2222.

¹⁰⁸ Transcript, Kate Griffiths Gibson, 23 May 2018, 2222.

¹⁰⁹ Transcript, Kate Griffiths Gibson, 23 May 2018, 2223.

When these facilities were approved, three of the four key performance indicators (KPIs) used in ANZ's incentive scheme for business bankers focused on financial targets.¹¹⁰ For the second half of 2014, when these facilities were provided, ANZ's Performance Objectives, Targets and Incentive Plan Guide set out 'Key Messages for 2H14'.¹¹¹ The first of those key messages was that:

To achieve our aspiration in becoming the leading Corporate and Commercial bank in Australia, we need to constantly review and change the way we *relentlessly acquire new-to-bank* customers, attract larger customers and *enhance their share of wallet with ANZ* by working closely with Retail and Wealth.¹¹²

The third paragraph of the key messages told business bankers that:

Given the importance of new to bank acquisition we have increased NTB lending targets for [Business Bank Managers], while leaving the overall lending target unchanged.¹¹³

In the period immediately before these facilities were approved, the banker involved had not met the new-to-bank lending targets for his role.¹¹⁴ This banker was later subject to performance management for unrelated loans. During the performance management process, the banker said that his conduct was due in part to 'the excitement of closing new deals [and] a culture of sales pressure that you felt weighed heavily at the time'.¹¹⁵

Ms Gibson accepted that at the time these facilities were made available, 'the culture in [the small business section of ANZ] was one of wanting to

¹¹⁰ Transcript, Kate Griffiths Gibson, 23 May 2018, 2211–2; Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-23 [ANZ.800.528.0001].

¹¹¹ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-24 [ANZ.800.528.0345 at .0346].

¹¹² Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-24 [ANZ.800.528.0345 at .0346] (emphasis added).

¹¹³ Exhibit 3.15, Witness statement of Kate Griffiths Gibson, 17 May 2018, Exhibit KGG-24 [ANZ.800.528.0345 at .0346].

¹¹⁴ Transcript, Kate Griffiths Gibson, 23 May 2018, 2213; Exhibit 3.18, 30 May 2014, Performance Management Plan and Review, First Half 2014.

¹¹⁵ Transcript, Kate Griffiths Gibson, 23 May 2018, 2215; Exhibit 3.20, undated, Bundle of Disciplinary Documents 2017, 23.

perform'.¹¹⁶ Although she did not accept the characterisation of 'being under sales pressure' she did accept that the banker concerned had said that this was what he felt.¹¹⁷ Importantly, Ms Gibson said of the sales targets of that time, 'there were sales targets that were against customer and process and *that was something I personally didn't feel made a lot of sense*'.¹¹⁸

As Ms Gibson said, the incentives for business bankers have since 'evolved'.¹¹⁹ What she described as an evolution started with the first half of 2015 incentive plan and, when she gave her evidence, had reached the point where ANZ had rebalanced its KPIs to have less of a financial focus.¹²⁰ Thirty per cent of a banker's measures were financial measures.

2.3 Westpac and the Pie Face franchise

In 2012, Marjo Pty Ltd borrowed from Westpac to buy an existing Pie Face franchise business. Marjo had three directors and shareholders: Ms Marion Messih, her brother and his then wife. The Commission heard evidence from Ms Messih and Mr Alastair Welsh, General Manager, Commercial Banking, Westpac Group.

In 2012, Ms Messih, her brother and her then sister-in-law began looking to purchase their own business to run.¹²¹ At the time, both Ms Messih and her sister-in-law were employed in office management roles.¹²² Ms Messih's brother was a self-employed mechanic.¹²³ None of them had any experience in running a café business.¹²⁴ Despite this, they were particularly interested in buying a food service business.¹²⁵ When asked about this change in direction, Ms Messih explained that, after years of working in office

¹¹⁶ Transcript, Kate Griffiths Gibson, 23 May 2018, 2215.

¹¹⁷ Transcript, Kate Griffiths Gibson, 23 May 2018, 2215.

¹¹⁸ Transcript, Kate Griffiths Gibson, 23 May 2018, 2215 (emphasis added).

¹¹⁹ Transcript, Kate Griffiths Gibson, 23 May 2018, 2215.

¹²⁰ Transcript, Kate Griffiths Gibson, 23 May 2018, 2215.

¹²¹ Transcript, Marion Angelika Messih, 22 May 2018, 2175.

¹²² Transcript, Marion Angelika Messih, 22 May 2018, 2174–5.

¹²³ Transcript, Marion Angelika Messih, 22 May 2018, 2175.

¹²⁴ Transcript, Marion Angelika Messih, 22 May 2018, 2176.

¹²⁵ Transcript, Marion Angelika Messih, 22 May 2018, 2175.

management and bookkeeping roles, she was looking for a ‘change in life’, and wanted to ‘run a business, earn some money, retire early.’¹²⁶

After looking into several different options, Ms Messih, her brother and sister-in-law discovered an existing Pie Face franchise store located at a local shopping centre that was for sale.¹²⁷ They negotiated with the franchisor to purchase the store for \$330,000, and incorporated the company, Marjo, to be the entity to purchase and run the business.¹²⁸

Ms Messih and her business partners received assistance from an accountant to incorporate Marjo.¹²⁹ The accountant also obtained historical profit-and-loss trading figures for the business,¹³⁰ and provided Ms Messih and her business partners with advice on the profitability of the business. In her evidence, Ms Messih summarised this advice in the following terms:

[The accountant] said the business, looking at the figures, was not – were not very profitable at the moment, but with hard work, if you can increase sales, it could make a profit ... Within a projected time of maybe up to three years, depending on how you increase the sales.¹³¹

Having received this advice, Ms Messih, her brother and sister-in-law chose to press ahead and purchase the Pie Face franchise store.¹³² Ms Messih and her business partners required a loan to buy the business and Marjo applied to Westpac for a business loan to cover the whole purchase price plus some other costs.¹³³

Pie Face was then a franchise system ‘accredited’ by Westpac. As an accredited franchise system Westpac would lend a percentage (in the case of Pie Face, 50%) of the purchase price without security. But, because

¹²⁶ Transcript, Marion Angelika Messih, 22 May 2018, 2175.

¹²⁷ Transcript, Marion Angelika Messih, 22 May 2018, 2176.

¹²⁸ Transcript, Marion Angelika Messih, 22 May 2018, 2177.

¹²⁹ Transcript, Marion Angelika Messih, 22 May 2018, 2180.

¹³⁰ Transcript, Marion Angelika Messih, 22 May 2018, 2187; Exhibit 3.17, Witness statement of Marion Angelika Messih, 16 May 2019, 3 [19].

¹³¹ Transcript, Marion Angelika Messih, 22 May 2018, 2180.

¹³² Transcript, Marion Angelika Messih, 22 May 2018, 2180.

¹³³ Transcript, Marion Angelika Messih, 22 May 2018, 2177; Exhibit 3.17, Witness statement of Marion Angelika Messih, 16 May 2018, 3 [13].

Marjo sought to borrow more than 50% of the purchase price, its loan application was assessed under Westpac's business credit lending policy, not the Franchise Policy.¹³⁴

In July 2012, Westpac approved a business loan of \$350,000, as well as a business overdraft facility, and a banker's undertaking to be given as a rental bond in favour of the owner of the shop premises.¹³⁵ The facilities were secured by a general security agreement over all present and future assets and undertakings of Marjo and by guarantees and indemnities given by Ms Messih, her brother and her sister-in-law. The guarantees and indemnities were secured by a mortgage over a residential investment property owned by Ms Messih, and a mortgage over the home of Ms Messih's brother and sister-in-law.¹³⁶

Marjo took over the business in August 2012.¹³⁷ Ms Messih and her sister-in-law both resigned from their existing employment and began working full-time in the business.¹³⁸ The business struggled. Ms Messih described its performance during the first few months as 'woeful'.¹³⁹ Ms Messih and her business partners worked hard in the business and, by the end of the first 12 months, they had doubled their weekly sales.¹⁴⁰ Despite this improvement in sales, the business never achieved the level of profitability that they hoped it would.¹⁴¹ In late 2013, major renovation works commenced at the shopping centre¹⁴² and sales in the business declined.¹⁴³

¹³⁴ Westpac, *Westpac Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 7 [23].

¹³⁵ Exhibit 3.22, Witness statement of Alastair Derek Dawson Welsh, 19 May 2018, Exhibit AW3-40 [WBC.404.003.0138].

¹³⁶ Transcript, Marion Angelika Messih, 22 May 2018, 2179, 2180; Exhibit 3.22, Witness statement of Alastair Derek Dawson Welsh, 19 May 2018, Exhibit AW3-40 [WBC.404.003.0138].

¹³⁷ Transcript, Marion Angelika Messih, 22 May 2018, 2180.

¹³⁸ Transcript, Marion Angelika Messih, 22 May 2018, 2180.

¹³⁹ Transcript, Marion Angelika Messih, 22 May 2018, 2181.

¹⁴⁰ Transcript, Marion Angelika Messih, 22 May 2018, 2181.

¹⁴¹ Transcript, Marion Angelika Messih, 22 May 2018, 2182.

¹⁴² Transcript, Marion Angelika Messih, 22 May 2018, 2181.

¹⁴³ Transcript, Marion Angelika Messih, 22 May 2018, 2182, 2188.

By early 2014, Marjo could not make all repayments to Westpac when they were due. Marjo sought a payment plan from Westpac, and in about May 2014 this was approved.¹⁴⁴

At more or less the same time, in early 2014, Ms Messih's brother and sister-in-law were separating. The brother was released from his obligations as guarantor.¹⁴⁵ Ms Messih and the sister-in-law sought release of the land that the brother and sister-in-law had provided as security for their guarantees and Westpac agreed to do that.¹⁴⁶ The sister-in-law provided a term deposit of \$40,000 as substitute security.¹⁴⁷

Marjo fell behind in its obligations under the payment plan.¹⁴⁸ In November 2014, the Pie Face franchisor went into voluntary administration, and this led Marjo to shut its shop.¹⁴⁹

After the shop closed, Ms Messih submitted a further hardship application to Westpac. The application was approved and Marjo's repayments were suspended for a period of time.¹⁵⁰ After the suspension ended, Ms Messih was unable to make repayments under the business loan alongside meeting her personal commitments. As she explained in her evidence:

I wasn't working – or was I – I can't remember. If I had a job it was only part-time anyway. And, because I had the business loan, I had a credit card with Commonwealth Bank that I was paying off, and also another Westpac credit card that I was paying off, expenses that were put on there from the business when we went training in Sydney. So it was just too much. I wasn't – I had the income from my rental property, but that didn't cover all the expenses that I had.¹⁵¹

¹⁴⁴ Transcript, Marion Angelika Messih, 22 May 2018, 2182.

¹⁴⁵ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 7 [29].

¹⁴⁶ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 7 [29].

¹⁴⁷ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 7 [30].

¹⁴⁸ Transcript, Marion Angelika Messih, 22 May 2018, 2183.

¹⁴⁹ Transcript, Marion Angelika Messih, 22 May 2018, 2183.

¹⁵⁰ Transcript, Marion Angelika Messih, 22 May 2018, 2183.

¹⁵¹ Transcript, Marion Angelika Messih, 22 May 2018, 2184.

Ms Messih submitted a complaint to FOS on behalf of Marjo, claiming that Westpac should not have approved the business facilities because Marjo could not afford to service them.¹⁵² FOS agreed with this complaint, and issued a recommendation¹⁵³ and subsequent determination in favour of Marjo, requiring Westpac to refund all interest and bank charges from the facilities.¹⁵⁴

Although Westpac disagreed with FOS' decision, Westpac complied with the determination,¹⁵⁵ and refunded the interest and bank fees charged to the business loan.¹⁵⁶ However, the principal remained to be paid. By this time, Ms Messih was once again struggling to meet her personal financial commitments as well as repay the business loan. She sold her investment property to pay down the business loan and other personal debts. Ms Messih's evidence was that, in selling the investment property, her intention was to use the proceeds from that sale to repay only half of the outstanding principal owed under the business loan. This appears to have been on the basis that Ms Messih believed (wrongly) that she was only responsible for half of the business loan, and that her business partners were responsible for the other half.¹⁵⁷

After she had sold her investment property, Ms Messih made a second complaint to FOS about Westpac applying the sale proceeds to pay down the entire amount of the business loan, rather than agreeing to ongoing repayments being made by her sister-in-law for half of the principal amount.¹⁵⁸ The second complaint was determined in Westpac's favour.

¹⁵² Transcript, Marion Angelika Messih, 22 May 2018, 2184; Exhibit 3.22, Witness statement of Alastair Derek Dawson Welsh, 19 May 2018, Exhibit AW3-58 [WBC.404.012.0507].

¹⁵³ Exhibit 3.22, Witness statement of Alastair Derek Dawson Welsh, 19 May 2018, Exhibit AW3-56 [WBC.404.003.0110 at .0510].

¹⁵⁴ Transcript, Marion Angelika Messih, 22 May 2018, 2184; Exhibit 3.22, Witness statement of Alastair Derek Dawson Welsh, Exhibit AW3-58 [WBC.404.012.0507].

¹⁵⁵ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2240.

¹⁵⁶ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2240; Exhibit 3.22, Witness statement of Alastair Derek Dawson Welsh, 19 May 2018, 36 [154].

¹⁵⁷ Transcript, Marion Angelika Messih, 22 May 2018, 2185.

¹⁵⁸ Transcript, Marion Angelika Messih, 22 May 2018, 2185.

Contrary to Westpac's submissions,¹⁵⁹ I consider the better view to be that Ms Messih's intentions with respect to the proceeds of sale of her investment property and her complaint to FOS are consistent only with her not having understood, either when she gave the guarantee or later, that it was a joint and several obligation. That is, that the liability of each guarantor extended to the whole of the amount borrowed. The Commission heard no evidence suggesting that Ms Messih's lack of understanding was caused by any statement or by any inappropriate conduct on the part of Westpac. But I fear that there would be many who may have shared a similar misunderstanding of the effect of the arrangements that were made unless the bank or an adviser told the guarantor that the liability that each guarantor assumed extended to the whole of the amount borrowed.

After Ms Messih made the second complaint to FOS – but before it was determined – Westpac continued to send collection notices to Ms Messih. Between 17 November 2016 and 3 December 2016, Westpac sent Ms Messih 13 text messages in relation to arrears on one of her Westpac accounts.¹⁶⁰ The text messages caused Ms Messih to feel overwhelmed and stressed.¹⁶¹ As Ms Messih explained:

... I don't want to ever go through that again. It's not a nice feeling when I've always paid all my debts upfront. Bills were always paid. And to continually get phone calls from institutions about where's your payment – when are you going to make the payment is just something that I'm not used to. And it was really hard.¹⁶²

Mr Welsh reviewed the lending file relating to the transactions. He did not agree with the conclusion that FOS reached in its first determination. In his view, the loan should have been made.¹⁶³ Mr Welsh disagreed with two particular aspects of FOS' determination. First, FOS had applied an interest rate buffer of 3% when assessing serviceability of the facilities. Mr Welsh considered that figure to be 'very high'¹⁶⁴ and, if adopted, a figure that

¹⁵⁹ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 9 [39].

¹⁶⁰ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2260.

¹⁶¹ Transcript, Marion Angelika Messih, 22 May 2018, 2186.

¹⁶² Transcript, Marion Angelika Messih, 22 May 2018, 2187.

¹⁶³ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2240.

¹⁶⁴ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2240.

‘would prohibit a lot of business lending.’¹⁶⁵ Second, Mr Welsh disagreed with FOS’ approach of amortising the business overdraft and rental guarantee when calculating serviceability.¹⁶⁶ As already noted, however, Westpac complied with the determination.

Mr Welsh agreed that the sending of collection notices to Ms Messih while her second FOS dispute was on foot breached FOS’s Terms of Reference.¹⁶⁷ Mr Welsh also agreed that, regardless of the existence of the FOS complaint, it was inappropriate for so many automated collections messages to be sent to a customer in such a short time period.¹⁶⁸ (A notice was sent to Ms Messih every business day during the period.) Mr Welsh said that he had looked into why the text messages had been sent and concluded that they had been sent because the relevant loan had not been flagged as being subject to a FOS dispute.¹⁶⁹ This suggested that, but for a FOS dispute, text messages would have been sent as frequently as they were.

In its written submissions, Westpac accepted that by continuing to undertake collection activities after Ms Messih had made a complaint to FOS, it did not meet the requirement of Clause 3.2 of the then applicable Code of Banking Practice that it ‘act fairly and reasonably’.¹⁷⁰ In its written submissions, Westpac sought to further explain what had happened was ‘compounded’ by a ‘computer error’ causing ‘more text messages to be sent to Ms Messih on consecutive days than would ordinarily occur’.¹⁷¹ The submissions asserted that ‘Westpac’s usual practice where accounts are in arrears is to send, at most, one text message every three days’. Westpac had said nothing about what was said to be the compounding factor or about its ‘usual practice’ when Mr Welsh gave his evidence. What Westpac said about these matters in its written submissions was wholly new. What

¹⁶⁵ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2241.

¹⁶⁶ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2242.

¹⁶⁷ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2260.

¹⁶⁸ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2261.

¹⁶⁹ Transcript, Alastair Derek Dawson Welsh, 23 May 2018, 2261.

¹⁷⁰ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 3 [6].

¹⁷¹ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 3 [8].

was said could not be tested or examined. In the circumstances, all that I can say is that, whatever Westpac may have intended to be its 'usual practice' at the time, Ms Messih was subjected to a barrage of texts that, as Westpac itself accepted, was not to act fairly and reasonably towards its customer, and thus in breach of its obligations under both the Code¹⁷² and to act in breach of its obligation under Clause 13.1 of the FOS Terms of Reference not to take any action to recover a debt the subject of a FOS dispute.¹⁷³

2.4 BOQ and Wendy's franchises

In 2012, BOQ made a business loan to Suerich Pty Ltd to allow the company to buy two Wendy's outlets in the southern suburbs of Adelaide. Ms Suzanne Riches was the sole director of Suerich.

Ms Riches is a primary school teacher and has worked as a teacher for over 30 years. She is married with two adult children.¹⁷⁴

In early 2012, Ms Riches' husband received a small inheritance from his mother's estate. Ms Riches and her husband decided to use this money to buy their own business, as they thought that running their own business would help to secure their financial future into retirement.¹⁷⁵ After looking at a few different options, Ms Riches and her husband settled on two existing Wendy's outlets at a Westfield shopping centre.¹⁷⁶

Before signing a contract to purchase the businesses, Ms Riches consulted with an accountant and a lawyer.¹⁷⁷ The accountant told her that the bottom line profits looked 'skinny'¹⁷⁸ and that there was a 'small margin' in the

¹⁷² Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 3 [6].

¹⁷³ Westpac, *Westpac, Banking Corporation – Submissions on Rubric 3-11 Case Study*, 8 June 2018, 4 [12].

¹⁷⁴ Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, 1 [2].

¹⁷⁵ Transcript, Suzanne Gail Riches, 23 May 2018, 2276.21–23; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, 1 [3].

¹⁷⁶ Transcript, Suzanne Gail Riches, 23 May 2018, 2276.

¹⁷⁷ Transcript, Suzanne Gail Riches, 23 May 2018, 2276, 2278–9.

¹⁷⁸ Transcript, Suzanne Gail Riches, 23 May 2018, 2280; Exhibit 3.31, 15 June 2012, Email between Riches and Vlassis; Transcript, Suzanne Gail Riches, 23 May 2018, 2280.

businesses.¹⁷⁹ When asked about her reaction to this advice, Ms Riches gave the following evidence:

[I]n discussions with the Wendy's franchise manager and other franchisees that we visited in the Wendy's franchise in other shopping centres, we were aware that Wendy's had a training program and protocols and strategies in place to be able to improve the profits by 10 per cent, and they were tried and true strategies that had worked for the company before. With my husband's expertise in the hospitality industry ... as a chef and caterer, he was very confident that he had the means to be able to improve ... the percentages.¹⁸⁰

Ms Riches applied to BOQ for a business loan to purchase the businesses.¹⁸¹ During the application process, Ms Riches dealt with the branch manager¹⁸² who was the 'owner-manager' of the branch under BOQ's franchise model.¹⁸³ The branch manager's relationship with BOQ was terminated in 2013 following an investigation into misappropriation of customer funds (unrelated to Suerich) and he could not be contacted by BOQ in relation to the case study.¹⁸⁴

Ms Riches said that before her loan application was approved, she attended a meeting with the BOQ branch manager at which he told her that BOQ would be able to give her the loan, and that she could therefore make an offer to purchase the businesses that was not subject to financial approval.¹⁸⁵ In early July 2012, Ms Riches signed a contract of sale

¹⁷⁹ Transcript, Suzanne Gail Riches, 23 May 2018, 2280.

¹⁸⁰ Transcript, Suzanne Gail Riches, 23 May 2018, 2280.

¹⁸¹ Transcript, Suzanne Gail Riches, 23 May 2018, 2277 Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018,; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, 2–3 [9]–[11].

¹⁸² Transcript, Suzanne Gail Riches, 23 May 2018, 2277.

¹⁸³ Exhibit 3.34, Witness statement of Douglas Robert Snell, 15 May 2018, 46 [144].
The branch manager's name was subject to a non-publication direction.

¹⁸⁴ Exhibit 3.34, Witness statement of Douglas Robert Snell, 15 May 2018, 46 [144]–[145].

¹⁸⁵ Transcript, Suzanne Gail Riches, 23 May 2018, 2281.

on behalf of Suerich to purchase the businesses and provided a copy to BOQ.¹⁸⁶

In August 2012, Ms Riches received a conditional letter of offer from BOQ, in relation to the business loan. The conditional letter of offer was signed by the BOQ branch manager and stated that the indicative monthly repayments required under the business loan would be \$4,420 over 84 months.¹⁸⁷

Having received this conditional letter of offer, Ms Riches signed a Wendy's franchise agreement for the businesses after commencing training with Wendy's.¹⁸⁸

As the date for settling the purchase came closer, Ms Riches went to the BOQ branch to ask about the settlement arrangements. The manager said that 'there was a difficulty' and that 'the person who organised or oversaw the credit facility was away and he was waiting for him to come back'.¹⁸⁹ Ms Riches made several further inquiries about progress but appeared to be told little more than that the leases were short term and that 'they hadn't exhausted all the possibilities', leaving her with the impression that 'they were trying to find out a way to be able to service the loan'.¹⁹⁰

On 15 October 2012 (a week after the due date for settlement of the purchase) Ms Riches was told that the loan documents were ready to be signed.¹⁹¹ By that time the vendor had given a notice of default and interest was being charged on the outstanding purchase price.¹⁹²

The letter of offer by BOQ to Suerich provided for a loan term of three years and repayments of \$8,696.86 per month.¹⁹³ Ms Riches gave evidence that

¹⁸⁶ Transcript, Suzanne Gail Riches, 23 May 2018, 2281; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, Exhibit SGR-5 [BOQ.0001.0030.0499].

¹⁸⁷ Transcript, Suzanne Gail Riches, 23 May 2018, 2281.33–8; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, Exhibit SGR-7 [BOQ.0001.0023.1417].

¹⁸⁸ Transcript, Suzanne Gail Riches, 23 May 2018, 2282; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, Exhibit SGR-8 [BOQ.0001.0048.0240].

¹⁸⁹ Transcript, Suzanne Gail Riches, 23 May 2018, 2282.

¹⁹⁰ Transcript, Suzanne Gail Riches, 23 May 2018, 2283.

¹⁹¹ Transcript, Suzanne Gail Riches, 23 May 2018, 2283.

¹⁹² Transcript, Suzanne Gail Riches, 23 May 2018, 2283.

¹⁹³ Transcript, Suzanne Gail Riches, 23 May 2018, 2283; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, Exhibit SGR-12 [BOQ.0001.0023.1114].

when she received the final offer, she had been ‘alarmed’ that the monthly repayments had almost doubled from the amount set out in the conditional letter of offer.¹⁹⁴ She said that she felt, however, that she was ‘between a rock and a hard place’, with no way to get out of the contract to purchase the businesses, and so she accepted BOQ’s offer.¹⁹⁵ The business loan was secured by mortgages taken over a block of land owned by Ms Riches and over her family home, as well as a guarantee and indemnity provided by Ms Riches, and a general security agreement over all present and after acquired property of Suerich.¹⁹⁶

Suerich found it very difficult to make the monthly repayments due to BOQ and soon defaulted under the business loan.¹⁹⁷ The company kept operating the two outlets until the lease on one ran out. Having taken advice from their accountant, Ms Riches and her husband decided not to seek an extension of that lease but to continue with the other, larger and busier outlet.¹⁹⁸ Suerich continued to operate this outlet until mid-2015.¹⁹⁹

In the meantime, in July 2014, Ms Riches lodged a complaint with FOS about BOQ’s conduct in approving the business loan.²⁰⁰ After BOQ was notified of the complaint, it conducted its own internal investigation.²⁰¹ By at least 2 September 2014, as a result of its own investigation, BOQ had identified a number of errors in the serviceability calculation that had been undertaken in approving the business loan.²⁰² These errors were made by the branch manager or by the credit officer who worked for the branch manager, and were not picked up by BOQ’s central credit department that

¹⁹⁴ Transcript, Suzanne Gail Riches, 23 May 2018, 2283.

¹⁹⁵ Transcript, Suzanne Gail Riches, 23 May 2018, 2284.

¹⁹⁶ Transcript, Suzanne Gail Riches, 23 May 2018, 2278; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, Exhibit SGR-12 [BOQ.0001.0023.1114].

¹⁹⁷ Transcript, Suzanne Gail Riches, 23 May 2018, 2284; Transcript, Douglas Robert Snell, 24 May 2018, 2327.

¹⁹⁸ Transcript, Suzanne Gail Riches, 23 May 2018, 2284.

¹⁹⁹ Transcript, Suzanne Gail Riches, 23 May 2018, 2284.

²⁰⁰ Transcript, Suzanne Gail Riches, 23 May 2018, 2284; Exhibit 3.30, Witness statement of Suzanne Gail Riches, 18 May 2018, Exhibit SGR-16 [FOS.0012.0001.0003].

²⁰¹ Transcript, Douglas Robert Snell, 24 May 2018, 2328.

²⁰² Transcript, Douglas Robert Snell, 24 May 2018, 2328–9.

ultimately approved the loan.²⁰³ By at least the end of September 2014, there was no doubt within BOQ that the loan to Suerich should not have been approved as it was not serviceable.²⁰⁴ Recommendations were made internally at BOQ to settle the dispute by offering to reduce the business loan principal and to remove the interest and fees payable on the business loan.²⁰⁵ However, BOQ made no offer to Suerich, whether along the lines proposed or at all.²⁰⁶

In December 2014, BOQ received requests from FOS for further information in relation to the matters raised by Ms Riches in her complaint. One of these requests was for BOQ to '[d]etail [the] basis on which lending was approved with reference to lending guidelines and/or policy and information provided by [Ms Riches]'.²⁰⁷ BOQ responded to this request by telling FOS that '[t]he applications for finance were assessed in line with the policies applicable at the time of the application.'²⁰⁸ In his evidence, Mr Douglas Snell, General Manager of Performance, Product and Governance at BOQ, agreed that although it may not have been strictly untrue to say that the Suerich loan was assessed in accordance with BOQ's policies, in sending this response to FOS, BOQ had omitted an important fact: namely, that BOQ was aware that there had been errors made in the serviceability calculation.²⁰⁹ Mr Snell accepted that BOQ's response to FOS was inappropriate.²¹⁰

In a submission to FOS, BOQ said:

Bank of Queensland is of the understanding that the applicant has previously provided information to FOS that suggests that independent professional advice was obtained prior to the purchase of the business

²⁰³ Transcript, Douglas Robert Snell, 24 May 2018, 2324.

²⁰⁴ Transcript, Douglas Robert Snell, 24 May 2018, 2330.

²⁰⁵ Transcript, Douglas Robert Snell, 24 May 2018, 2329; Exhibit 3.34, Witness statement of Douglas Robert Snell, 15 May 2018, Exhibit DRS-2-112 [BOQ.0001.0023.0926].

²⁰⁶ Transcript, Douglas Robert Snell, 24 May 2018, 2329–30.

²⁰⁷ Transcript, Douglas Robert Snell, 24 May 2018, 2322; Exhibit 3.38, 9 December 2014, Letter FOS to BOQ, 4.

²⁰⁸ Transcript, Douglas Robert Snell, 24 May 2018, 2334; Exhibit 3.34, Witness statement of Douglas Robert Snell, 15 May 2018, Exhibit DRS-2-121 [BOQ.0001.0036.0244].

²⁰⁹ Transcript, Douglas Robert Snell, 24 May 2018, 2334.

²¹⁰ Transcript, Douglas Robert Snell, 24 May 2018, 2335.

being completed. If the independent professional advice obtained suggested the applicant not purchase the business yet still opted to, then Bank of Queensland is of the view that, should FOS find that there was maladministration in lending, then the outcome should be proportioned given this information.²¹¹

This submission was consistent with BOQ's general approach to the determination of the dispute. As a BOQ employee was later to say, in an internal email:

Throughout the investigation of the dispute by FOS, as we have known that there was maladministration in lending, I have endeavoured to minimise the restitution payable.²¹²

Mr Snell accepted that BOQ's strategy in the FOS process, of not acknowledging its maladministration, but instead working to try to limit the extent of liability was neither fair nor reasonable towards Ms Riches.²¹³

After FOS made its recommendation about the dispute, but before it determined it, Suerich was wound up. FOS determined that BOQ did not lend responsibly when it provided the business loan because it did not act as a diligent and prudent banker when assessing Suerich's ability to service the loan.²¹⁴ The FOS determination (accepted by the liquidator of Suerich) provided that BOQ should compensate Suerich by reducing the balance of the business loan by \$35,775 and reducing any interest and fees by 60% from a certain date.²¹⁵

In its written submissions, BOQ did not dispute that it did not exercise the care and skill of a diligent and prudent banker in assessing and approving the loan to Suerich and did not dispute that this was a breach of the then applicable version of the Code of Banking Practice (the 2003 Code as

²¹¹ Transcript, Douglas Robert Snell, 24 May 2018, 2334; Exhibit 3.34, Witness statement of Douglas Robert Snell, 15 May 2018, Exhibit DRS-2-121 [BOQ.0001.0036.0244 at .0245].

²¹² Transcript, Douglas Robert Snell, 24 May 2018, 2340; Exhibit 3.40, Witness statement of Douglas Robert Snell, 15 May 2018, Exhibit DRS-2-123 [BOQ.0001.0033.6267].

²¹³ Transcript, Douglas Robert Snell, 24 May 2018, 2343.

²¹⁴ Exhibit 3.34, Witness statement of Douglas Robert Snell, 15 May 2018, Exhibit DRS-2-130 [BOQ.0001.0023.0531].

²¹⁵ Transcript, Suzanne Gail Riches, 23 May 2018, 2286.

amended in 2004).²¹⁶ Nor did BOQ dispute that it fell short of the standard to be expected under Clause 2.1(b) of that Code by not communicating the final terms of the proposed loan to Ms Riches until she was asked to come into the branch to sign the loan documents.²¹⁷ BOQ denied that the breaches amounted to serious or systemic non-compliance with the Code and submitted that BOQ has taken steps to prevent recurrence of similar breaches.²¹⁸ Whether what happened with Suerich revealed serious and systemic non-compliance was not explored during the hearings. And it is clear that, by severing its connection with the particular owner manager with whom Ms Riches dealt, BOQ sought to remove the most immediate cause of the events in issue. But there remains for consideration whether BOQ acted properly in dealing with the FOS complaint as it did.

BOQ emphasised that next to no evidence was given about (and BOQ could not explore) what legal or financial advice Ms Riches and her husband took before deciding to proceed with the purchase of the businesses or what advice either received during the life of the business. (I say 'next to no evidence' because, as recorded earlier, Ms Riches did say that she had consulted her accountant and that the accountant spoke of the 'bottom line profits' being 'skinny'.) But relevant as those issues may be to deciding some claim by the Riches for damages against BOQ, they are not issues that bear upon whether BOQ complied with the Code or engaged in conduct otherwise falling short of community standards and expectations when it told FOS that a matter for FOS to investigate in relation to Ms Riches' complaint was whether BOQ had lent irresponsibly.

When BOQ was dealing with FOS about this claim, the 2013 Code required it to 'act fairly and reasonably towards customers'. BOQ concluded that it had not exercised the care and skill of a diligent and prudent banker when it approved and made the loan to Suerich. I do not consider that it was fair or reasonable for BOQ to say to FOS, as BOQ did in its response to the FOS letter of 9 December 2014, that one matter to be investigated was whether BOQ had engaged in irresponsible lending when it approved the business

²¹⁶ BOQ, *Submissions of Bank of Queensland Limited – Case Study*, 8 June 2018, 3–4 [15]–[21].

²¹⁷ BOQ, *Submissions of Bank of Queensland Limited – Case Study*, 8 June 2018, 4–5 [22]–[25].

²¹⁸ BOQ, *Submissions of Bank of Queensland Limited – Case Study*, 8 June 2018, 4 [21], 5 [26].

loan to Suerich.²¹⁹ It was not fair or reasonable to do other than tell FOS what BOQ had concluded from its internal review. That would have left BOQ free to say (if it thought it right or wise to do so) that Suerich had made an informed choice about accepting the offer and should not now be relieved of its obligations. But that was not the course that BOQ followed.

BOQ's conduct was not fair or reasonable and thus fell short of what the community would have expected of it.

As already noted, the most immediate cause of the events that happened and issues that arose in connection with Suerich would appear to have been the conduct of the owner manager concerned. It was he who gave Ms Riches the conditional letter of offer. It seems very likely that he learned, sooner than he told Ms Riches, that BOQ would not lend on the terms described in that letter and, if that is right, his delay in telling her left her, she thought, between a rock and a hard place.

Together, these matters invite attention to what connection, if any, the events had to BOQ's franchise arrangements, in which about 60% of branches are owned by the manager of the branch. Mr Snell said that he believed that in 2012, there was 'quite a low adherence to compliance' by owner-manager branches.²²⁰ Since then, BOQ has done a lot to try to improve compliance and Mr Snell said that the trend over the last five years 'has moved in the right direction' with the number of audit scores of fail or needs improvement falling and the number of satisfactory scores increasing.²²¹ It is not possible to say whether the events relating to Suerich are to be understood as arising out of, or being connected with BOQ adopting the franchise model that has been mentioned. It will be important, however, to return to the issue when considering what are the effects of sales-based remuneration. And in that connection it will be necessary to look at the changes BOQ has made to its particular remuneration arrangements and to the deeper issue of how it could implement the recommendations made by the Sedgwick Review.

²¹⁹ Exhibit 3.38, 9 December 2014, Letter FOS to BOQ; Exhibit 3.34, Witness statement Douglas Robert Snell, 15 May 2018, Exhibit DRS-121 [BOQ.0001.0036.0244].

²²⁰ Transcript, Douglas Robert Snell, 24 May 2018, 2344.

²²¹ Transcript, Douglas Robert Snell, 24 May 2018, 2344–5.

3 Responsible lending: Unsolicited offers of credit

3.1 Background

During the first round of hearings the Commission examined a number of cases where banks had made unsolicited offers to consumers of increased credit card limits or overdraft facilities. Those cases were viewed, as they must be, through the lens of the responsible lending provisions of the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act). But, as has been noted above, those provisions apply only to lending provided, or intended to be provided, wholly or predominantly for certain purposes (essentially, 'personal, domestic or household purposes' or 'to purchase, renovate or improve residential property for investment purposes').²²²

Between March and December 2012, CBA ran a pilot program of offering 'Simple Business Overdrafts' (or SBOs) to some existing business customers of CBA. The customers were chosen using a method that assessed them as presenting a low risk of default by considering various criteria, including their recent banking with CBA. By a mass mail out in 2012, CBA offered more than 10,000 customers a pre-approved SBO.²²³ Before March 2012, CBA had not used an automated process for business lending.²²⁴ The SBO offered was an unsecured loan, with a 16% interest rate and a 1.75% line fee per annum. The facility limit could not exceed \$50,000, except in very limited circumstances.²²⁵ CBA judged the pilot program to be a success and has continued to make unsolicited offers for

²²² National Credit Code s 5(1)(b) when read with National Credit Code s 4 and NCCP Act s 5. See more particularly, Jeannie Marie Paterson and Nicola Howell, *FSRC Background Paper No. 4: Everyday Consumer Credit – Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans*, 12 March 2018, 31–2; Andrew Godwin, Jeannie Marie Paterson and Nicola Howell, *FSRC Background Paper No. 10: Credit for Small Business – An Overview of Australian Law Regulating Small Business Loans*, 7 May 2018, 10–15.

²²³ Transcript, Clive Richard van Horen, 24 May 2018, 2363.

²²⁴ Exhibit 3.43, Witness statement of Clive Richard van Horen, 14 May 2018, 2 [12].

²²⁵ Transcript, Clive Richard van Horen, 24 May 2018, 2359.

SBOs. From time to time since March 2012, CBA has refined the criteria it uses to offer SBOs.

CBA made the relevant offers during 2012 (and since) without any application from the customer. It sent offers to customers who met CBA's criteria unless the customer had previously chosen not to receive marketing information from CBA.²²⁶ CBA made no inquiries of the customers to whom offers were sent about whether or how the customer would be able to service the loan if the customer accepted the offer and drew on the facility. Instead, CBA formed an opinion about the customer's ability to repay based upon a combination of financial and non-financial criteria.

As already noted, the criteria for offering SBOs changed over time. The non-financial criteria included such matters as: age; being a citizen or permanent resident of Australia or New Zealand; and having been a CBA customer for a minimum period. The financial criteria included: not being recorded as in receipt of Centrelink benefits; not being in collections or arrears with any CBA product; not having been declined for another CBA product in the preceding six months; having a CBA deposit account with a positive balance; having a history of credits to the customer's business transaction accounts of at least a specified level over the preceding three (later six) months; and, in particular, having a particular level of 'CBA Credit Risk Score'.²²⁷ From late 2015 or early 2016, the deposit account balance check was replaced by determining whether 'business surplus' (declared business revenue less declared business expenses) exceeded a specified percentage of the SBO limit and, from mid-2016, was supplemented by requiring the customer to have a minimum level of turnover in the customer's business transaction account.²²⁸

3.2 What the case study showed

Three points should be made about CBA's unsolicited offers of SBOs.

First, making the offers was not misconduct and was not conduct falling short of community standards and expectations.

²²⁶ Transcript, Clive Richard van Horen, 24 May 2018, 2365.

²²⁷ Exhibit 3.43, Witness statement of Clive Richard van Horen, 14 May 2018, 9–10 [34]–[35].

²²⁸ Exhibit 3.43, Witness statement of Clive Richard van Horen, 14 May 2018, 11 [40].

The second point has already been made in connection with dealings with consumers. It is a point that may seem to be only a point about language but it is deeper and more important than that.

Mr van Horen, CBA's Executive General Manager, Retail Products, said that the 'SBO product was developed to *better meet the needs* of small business customers'.²²⁹ This description provides a useful further example of what exactly is meant by the expression 'meeting the customer's needs' so often used by senior bank officers when giving evidence to the Commission and so often to be found in one form or another in bank documents describing bonus (or 'short term remuneration incentive') programs for bank staff. The 'needs' that are being met are not what the customer has identified as a service that is necessary (or even wanted). The 'needs' are whatever services the bank can sell.

CBA sought to simplify business lending for under \$50,000 as 'a key strategic initiative ... to improve CBA's underweight position in micro and small business lending'.²³⁰ The SBO product that was developed was priced 'for increased risk from not verifying income'.²³¹ After the initial offers were made to more than 10,000 customers in March 2012, CBA's Executive Risk Committee was told that '[a]n increased level of impairment [of loans] is expected but is more than compensated by product profitability which is driven by volume and an attractive pricing margin'. And, knowing that to be the expectation, CBA went ahead to sell the product more widely.

The language of 'meeting customers' needs' should not obscure the truth. CBA introduced the SBO to increase its profit by increasing its lending to micro and small businesses. Seeking to increase profit is not a form of misconduct; it is not conduct that falls short of what the community expects of a publicly listed company like CBA. The question for me, in this case study, was whether the means that CBA followed to 'address [its]

²²⁹ Exhibit 3.43, Witness statement of Clive Richard van Horen, 14 May 2018, 2 [9] (emphasis added).

²³⁰ Exhibit 3.43, Witness statement of Clive Richard van Horen, 14 May 2018, Exhibit CVH-10 [CBA.0517.0092.0007 at .0007]; Transcript, Clive Richard van Horen, 24 May 2018, 2366–8.

²³¹ Exhibit 3.43, Witness statement of Clive van Horen, 14 May 2018, Exhibit CVH-10 [CBA.0517.0092.0007 at .0009]; see also Transcript, Clive Richard van Horen, 24 May 2018, 2368.

underweight position in micro and small business lending' was misconduct or conduct falling short. As I have said, I consider it was neither.

The third point to make is in amplification of this conclusion. The conclusion depends upon some intermediate steps that should be exposed. It depends upon concluding that the ways in which CBA applied its credit assessment methods and formed an opinion about whether a client could repay the SBO did not amount to a failure to exercise the care and skill of a diligent and prudent banker.²³² Further, it is a conclusion that is reached recognising that CBA embarked upon this program expecting that there would be an increased level of impairment of loans. Not only that, it is a conclusion that is reached recognising that CBA changed and refined its methods of assessment of SBOs several times after its 2012 pilot program. But I consider that there is no basis for me to decide that CBA's conduct amounted to a want of reasonable care and skill.

The standard fixed by successive editions of the Code of Banking Practice focuses upon whether the diligent and prudent banker would have undertaken the risk of making the particular loan in issue. There was no evidence that would permit me to say that, at any of the different times at which CBA has offered this product, CBA did not act with the reasonable care and skill of a diligent and prudent banker. Mr van Horen said, and I accept that

the overall credit performance of the SBO product, whether it's the early days of the pilot through to today, with the iterations of our changes to the process, has been very sound. And there's nothing in what we've seen in terms of the defaults or the delinquency or the customers experiencing difficulty making their payments that suggest to us any major gap in the way that we originally offered, or the customers took up, the overdrafts.²³³

²³² cf 2004 Code cl 25; 2013 Code cl 27.

²³³ Transcript, Clive Richard van Horen, 24 May 2018, 2373.

4 Responsible lending: Suncorp and Low

4.1 Background

In November 2015 Rien Low's father died in an accident at work, leaving his mother with about \$1 million in outstanding loans, including business loans, with Suncorp.²³⁴ The loans had been made to the couple in 2013 and 2014. Mr Low's father had been the sole breadwinner and his mother had limited income with which to service the loans after his death.²³⁵

In May 2016, Rien Low and his mother made a complaint to FOS about Suncorp's conduct in approving the loans. In December 2016, FOS made its recommendation to the Lows and Suncorp about the complaint.²³⁶ The recommendation was that Suncorp's approval of the last of the five loans (a business loan of \$240,000 made in 2014) was not responsible.²³⁷ FOS said that Suncorp had not made adequate inquiries about the purpose for which the loan was sought and that, if proper inquiries had been made, the loan would not have been made.²³⁸

Because Mr Low did not agree with and accept the recommendation that FOS made about the other four loans, the matter went for formal determination by an Ombudsman.²³⁹ But, before the Lows received the FOS determination, they took steps to sell the family home. Their intention was to use the proceeds of sale to repay the amounts owed in respect of the first four loans (the loans that FOS decided were not affected by maladministration).

They received a conditional offer to buy the home. Mr Low rang Suncorp and told the customer relations banker who was handling the complaint to

²³⁴ Transcript, Rien Peter Low, 25 May 2018, 2470–1.

²³⁵ Transcript, Rien Peter Low, 25 May 2018, 2471.

²³⁶ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-4 [FOS.0028.0001.2950].

²³⁷ Transcript, Rien Peter Low, 25 May 2018, 2477.

²³⁸ Transcript, Rien Peter Low, 25 May 2018, 2478.

²³⁹ Transcript, Rien Peter Low, 25 May 2018, 2478.

FOS that a conditional offer had been received. The banker ‘straight away told [Mr Low] of their dissatisfaction [with] the fact that [he] had decided to sell the family home’ and ‘reiterated to [him] on numerous occasions that they had the power to cancel the sale, to evict [his] mum from the house, and to sell it according to ... what they’re happy with.’²⁴⁰ The purchaser did not proceed with the sale.

In February 2017, FOS determined that although four of the loans were not affected by maladministration, the debt in respect of the 2014 business loan should be reduced by the amount of interest paid and Suncorp should not be permitted to charge further interest.²⁴¹ The determination said that, if the parties were unable to reach an agreement for repayment of the debt within 30 days of a proposal being made by Mr Low, Suncorp could be entitled to commence recovery action.²⁴² In March 2017, the Lows accepted the determination.²⁴³ In April, they made a contract to sell the family home for \$815,000.²⁴⁴

After FOS made its determination and the Lows accepted it, the Lows and Suncorp made a series of offers and counter-offers about the 2014 business loan. Taking account of the reductions allowed by the FOS determination, the loan then had a remaining balance of about \$222,000.²⁴⁵ The Lows proposed that the proceeds of the sale of the family home should go to pay the balance of the four loans that FOS had left unaffected and that Mrs Low would retain the balance of those proceeds. Although Mr Low had a conversation with a Suncorp employee that Mr Low understood as agreeing to this proposal,²⁴⁶ subsequent conversations with another employee caused him to understand that Suncorp would agree to his mother keeping the surplus proceeds only if the Lows agreed to pay back the whole of the

²⁴⁰ Transcript, Rien Peter Low, 25 May 2018, 2481.

²⁴¹ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-7 [FOS.0028.0001.3071 at .3076–7].

²⁴² Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-7 [FOS.0028.0001.3071 at .3077]; Transcript, Rien Peter Low, 25 May 2018, 2481.

²⁴³ Transcript, Rien Peter Low, 25 May 2018, 2481.

²⁴⁴ Transcript, Rien Peter Low, 25 May 2018, 2481.

²⁴⁵ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-7 [FOS.0028.0001.3071 at .3076].

²⁴⁶ Transcript, Rien Peter Low, 25 May 2018, 2483–4.

fifth loan by November 2017.²⁴⁷ Mr Low asked for the proposal to be put in writing.²⁴⁸

On about 23 June 2017, Mr Low received a letter from Suncorp, dated 12 June 2017, proposing an arrangement of the kind just described, requiring Mrs Low to pay the balance of the fifth loan by 30 November that year.²⁴⁹ The offer was said to be open until 19 June 2017.

On behalf of his mother, and with the assistance of the Consumer Action Law Centre, Mr Low responded with an offer to repay the fifth loan by the instalments that had been agreed when the loan was made.²⁵⁰ Suncorp rejected the offer saying that 'what [was] requested is essentially an interest free loan spanning 17 years'.²⁵¹ (The fifth loan had originally had a thirty year term.) Suncorp offered 'to grant further time of up to 12 months to refinance' the fifth loan.²⁵²

Mr Low then contacted FOS again, asking FOS to help resolve the impasse that had been reached. FOS said the case was closed and that it could not assist him.²⁵³

The sale of the family home was settled. Suncorp, as mortgagee, took the whole of the proceeds of sale, applied enough to satisfy the four undisputed loans and offered to release the balance of the proceeds to Mrs Low if she agreed to pay the outstanding amount of the disputed loan within 12 months.²⁵⁴ Mr Low responded by offering to make weekly repayments

²⁴⁷ Transcript, Rien Peter Low, 25 May 2018, 2484.

²⁴⁸ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-9 [SUN.0603.0002.0016].

²⁴⁹ Transcript, Rien Peter Low, 25 May 2018, 2485; Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-18 [SUN.0603.0002.0267].

²⁵⁰ Transcript, Rien Peter Low, 25 May 2018, 2486.

²⁵¹ Transcript, Rien Peter Low, 25 May 2018, 2486; Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-14 [SUN.0603.0002.0375].

²⁵² Transcript, Rien Peter Low, 25 May 2018, 2486.

²⁵³ Transcript, Rien Peter Low, 25 May 2018, 2487; Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-16 [FOS.0028.0001.3404].

²⁵⁴ Transcript, Rien Peter Low, 25 May 2018, 2488.

at a rate that was slightly higher than the rate of repayment fixed when the loan was made.²⁵⁵

Some days later, Mrs Low received a letter dated 19 July 2017, signed by the Chief Executive Officer, Banking & Wealth at Suncorp, Mr David Carter, and addressed to Rien Low's father and mother. The letter said, 'We're writing to let you know the minimum repayment for your loan has decreased' and the 'minimum repayment amounts will now be \$792.53'.²⁵⁶

The letter was a form letter that had been sent automatically because there had been a change in interest rates. The Lows did not read the letter in this way. They thought it was a response to their last offer. But it was not and that was soon made apparent to them.²⁵⁷

In August 2017, Suncorp made a fresh offer.²⁵⁸ There were two options: one to give Mrs Low five years to repay the fifth loan if security was given over a property owned by the Lows in Queensland; the other to give Mrs Low two years to repay if the loan was secured over a block of land they owned in Victoria.²⁵⁹

Mr Low asked FOS to consider whether the letter signed by Mr Carter was misleading. FOS organised a conciliation telephone conference. In the course of that conference, the customer relations banker with whom Mr Low had dealt earlier, told him that Suncorp's latest offer would be withdrawn if Mr Low took his latest request to FOS to a determination.²⁶⁰ FOS gave the Lows its preliminary view of the matter:²⁶¹ that Suncorp had not misled the Lows and that it was entitled to apply the balance of the proceeds of the sale of the family home to the disputed loan. The Lows withdrew the

²⁵⁵ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-19 [SUN.0603.0011.0075].

²⁵⁶ Transcript, Rien Peter Low, 25 May 2018, 2489; Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-20 [RCD.0014.0006.0001].

²⁵⁷ Transcript, Rien Peter Low, 25 May 2018, 2490.

²⁵⁸ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-22 [SUN.0603.0011.2653].

²⁵⁹ Transcript, Rien Peter Low, 25 May 2018, 2490.

²⁶⁰ Transcript, Rien Peter Low, 25 May 2018, 2491.

²⁶¹ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-23 [FOS.0028.0001.3999].

complaint and agreed that Mrs Low would repay the disputed loan within five years.²⁶²

4.2 What the case study showed

The premise for the case study was that, contrary to the Code, Suncorp had not acted as a prudent and diligent banker when making the last of the five loans it made to the Lows. The focus of the case study was to explore what then followed.

Two points emerged.

First, it is important to recognise the effect of a dispute like this on those concerned. Mr Low described the effect on him and his family as follows:

... it's extremely stressful. I mean, the impact it has had on mum – she's not here today, because the – the pressure and the expectation – it just – everything the bank and obviously what has happened to my father, it has just – it's taken its toll on her, unfortunately. It has taken its toll on all of us. It's just very, very stressful and a lot of pressure, you know, just – and trying to live a normal life and work full-time. It has – it has just been very, very difficult.²⁶³

Second, the case revealed that neither borrower nor lender understood the bases on which a dispute of this kind was to be finally resolved after the FOS determination. This was that the loan had not been made responsibly, that the lender should not charge interest on the loan, and that, if the parties could not agree about repayment, the lender could commence recovery action.

After FOS made its determination, Mrs Low offered to repay the loan over its original term on an interest-free basis. Mr Carter gave evidence about Suncorp's decision to refuse this offer and to make different proposals. In its correspondence with the Lows, Suncorp characterised Mrs Low's proposal as 'an interest free loan spanning 17 years'.²⁶⁴ Mr Carter said to the Commission, that he accepted that the loan might be interest-free for

²⁶² Transcript, Rien Peter Low, 25 May 2018, 2492.

²⁶³ Transcript, Rien Peter Low, 25 May 2018, 2492.

²⁶⁴ Exhibit 3.73, Witness statement of Rien Peter Low, 23 May 2018, Exhibit RL-14 [SUN.0603.0002.0375]; Transcript Rien Peter Low, 25 May 2018, 2486.

a reasonable period of time, but he also said that, after whatever was a reasonable period, the loan should no longer be interest-free²⁶⁵.

The foundation for Mr Carter's view seemed to be that, once there was a FOS determination, there was a 'residual debt' rather than a loan contract and that a continuation of interest-free lending would be contrary to 'industry practice'.²⁶⁶ Exactly what was meant by the distinction between 'residual debt' and 'loan contract' proved elusive but turned on the notion that the determination brought the loan to an end.²⁶⁷ Yet Mr Carter agreed that the FOS determination did not say this. Even so, he maintained that the loan had been brought to an end by the determination.²⁶⁸ And it was a view of this kind that can be seen expressed in a letter Suncorp sent to the Lows saying that the loan contract was 'void ab initio'.²⁶⁹ It followed that, in Mr Carter's view, the business loan that had been found not to have been responsibly made was to be repaid before the other loans, which remained interest-bearing.²⁷⁰

Mr Field, Lead Ombudsman, Banking and Finance, of FOS, made the determination provided by FOS in respect of the Lows' complaint. He said that FOS does not take the view that a loan found by FOS to have been 'affected by maladministration' (which is to say made when a prudent and diligent banker would not have made the loan) comes to an end.²⁷¹ And he had not made a determination declaring a loan contract void in cases of maladministration.²⁷² He did not accept that there was any industry practice, of the kind to which Mr Carter had referred, by which a loan

²⁶⁵ Transcript, David Antony Carter, 25 May 2018, 2510.

²⁶⁶ Transcript, David Antony Carter, 25 May 2018, 2511–12

²⁶⁷ Transcript, David Antony Carter, 25 May 2018, 2511–12

²⁶⁸ Transcript, David Antony Carter, 25 May 2018, 2511–12

²⁶⁹ Exhibit 3.75, Witness statement of David Antony Carter, 25 May 2018, Exhibit 40 [SUN.0602.0001.0049].

²⁷⁰ Transcript, David Antony Carter, 25 May 2018, 2516; Exhibit 3.79, Suncorp emails of May 2017 to Jackson and others.

²⁷¹ Transcript, Philip Andrew Field, 28 May 2018, 2547.

²⁷² Transcript, Philip Andrew Field, 28 May 2018, 2543.

affected by maladministration was treated as brought to an end by a FOS determination.²⁷³

Mr Field said that a business loan affected by maladministration would have to be repaid but that the time for repayment was a matter to be agreed between lender and borrower having regard to the borrower's ability to repay.²⁷⁴ Hence, there may be cases where, as the Lows had offered, it might be reasonable to allow the borrower to repay the principal, without interest, over the original life of the loan.²⁷⁵ And he also said that where there were two loans, of which only one had been made when it should not, FOS considered that payments made by the borrower should be applied first to the interest bearing loan. FOS did not require interest bearing loans to be paid in priority to loans which were not affected by maladministration.²⁷⁶ In his view, the contrary would be appropriate.²⁷⁷

Absent more precise guidance from FOS about how effect was to be given to the determination made of the Lows complaint, it cannot be said that Suncorp might have engaged in misconduct. Whether its conduct fell short of what the community expected is more difficult. There were certainly aspects of its communications with the Lows that could have been handled better than they were. But on balance, I prefer the view that the chief difficulties that emerged between the parties stemmed from the inconclusive nature of the FOS determination: requiring the parties to decide between themselves how the loan was to be repaid.

5 CBA and double debiting interest

5.1 Background

Between December 2011 and March 2017, CBA overcharged interest to some of its business customers with Business Overdraft and Simple Business Overdraft products. CBA charged more than twice the amount

²⁷³ Transcript, Philip Andrew Field, 28 May 2018, 2548.

²⁷⁴ Transcript, Philip Andrew Field, 28 May 2018, 2549.

²⁷⁵ Transcript, Philip Andrew Field, 28 May 2018, 2549.

²⁷⁶ Transcript, Philip Andrew Field, 28 May 2018, 2550.

²⁷⁷ Transcript, Philip Andrew Field, 28 May 2018, 2550.

of interest that was supposed to be charged in respect of outstanding balances. Each month, the affected customers were charged interest at a rate of nearly 34% per annum rather than at the agreed rate of 16% per annum.

The amount of interest charged to the account, but not the rate at which it was charged, was recorded in the statements of account the bank issued to the customer. One readily available understanding of a statement in that form would be that it represented to the customer that the amount charged had been calculated in the manner provided by the contract between banker and customer. And where interest was charged at the wrong rate, the amount recorded on the statements was not calculated in that way.

The issue was first discovered in 2013 when a customer complained.²⁷⁸ Corrections were made manually until a 'system-based fix' was made in May 2015 but that 'was not comprehensive and it missed a very substantial part of the cases that [CBA] subsequently found'.²⁷⁹

In about June 2015, 'about six or seven' customers complained to CBA that interest was being charged on business overdraft accounts at too high a rate.²⁸⁰ One, not being satisfied with CBA's response, made a written complaint to CBA in November that year.²⁸¹ And in 2016, a complaint was made to FOS.²⁸² In accordance with the standard processes of CBA, when the complaint had not been resolved within 90 days, it was referred to Mr van Horen, as Executive General Manager, Retail Products.²⁸³

CBA sought to resolve the complaint. One internal email within CBA suggested resolution lest the matter 'escalate' and be treated (presumably by FOS) as a systemic issue.²⁸⁴ And when the complainant threatened

²⁷⁸ Transcript, Clive Richard van Horen, 24 May 2018, 2376.

²⁷⁹ Transcript, Clive Richard van Horen, 24 May 2018, 2378–9.

²⁸⁰ Transcript, Clive Richard van Horen, 24 May 2018, 2381.

²⁸¹ Exhibit 3.46, 5 November 2015, Letter to whom it may concern concerning interest overcharging; Transcript, Clive Richard van Horen, 24 May 2018, 2379–81.

²⁸² Transcript, Clive Richard van Horen, 24 May 2018, 2381.

²⁸³ Transcript, Clive Richard van Horen, 24 May 2018, 2381.

²⁸⁴ Exhibit 3.47, 14 July 2015, Email to C & CS Escalations.

taking the matter to the media, CBA increased the offer it had made to settle the dispute.²⁸⁵

By September 2016, CBA recognised that the overcharging of interest raised in the FOS complaint was not isolated.²⁸⁶ At that time it was thought that 'up to 4000' Simple Business Overdraft accounts had been overcharged interest since 2013 and that 'up to 1000 customers' were still being overcharged.²⁸⁷

In November 2016, CBA began a remediation program. It wrote to affected customers with Simple Business Overdrafts in March 2017 and to Business Overdraft customers in May and June 2017.²⁸⁸ The letters it sent in March were delayed for 10 days and were sent after a federal Parliamentary hearing, at which the matter might be brought up, had been held.²⁸⁹

More than 2,500 customers were compensated: 337 customers with a Business Overdraft and 2,354 customers with a Simple Business Overdraft.²⁹⁰ The total amount paid was about \$3 million. The compensation was paid about two and a half years after the first overcharging occurred; it was paid about 240 days after CBA first identified the issue.²⁹¹

In his evidence to the Commission, Mr van Horen accepted that during 2015 CBA had not had proper systems in place to ensure that the issue was dealt with properly.²⁹² As he put it (I think rightly): 'having looked at a number of the emails and various correspondence that occurred in the 2015 to '16 period ... [CBA] didn't do what – what we expect to have – should be

²⁸⁵ Transcript, Clive Richard van Horen, 24 May 2018, 2385.

²⁸⁶ Exhibit 3.42, Witness statement of Clive Richard van Horen, 15 May 2018, Exhibit CVH-1 [CBA.0001.0283.1924].

²⁸⁷ Exhibit 3.42, Witness statement of Clive Richard van Horen, 15 May 2018, Exhibit CVH-1 [CBA.0001.0283.1924].

²⁸⁸ Exhibit 3.42, Witness statement of Clive Richard van Horen, 15 May 2018, 8 [53]; Transcript, Clive Richard van Horen, 24 May 2018, 2386.

²⁸⁹ Transcript, Clive Richard van Horen, 24 May 2018, 2387; Exhibit 3.50, 17 February 2017, Emails between Leo and van Horen.

²⁹⁰ Exhibit 3.42, Witness statement of Clive Richard van Horen, 15 May 2018, Exhibit CVH-12 [CBA.0517.0090.0001].

²⁹¹ Transcript, Clive Richard van Horen, 24 May 2018, 2386.

²⁹² Transcript, Clive Richard van Horen, 24 May 2018, 2381–2.

expected to have done'.²⁹³ By this I understood him to accept that CBA had taken too long to identify that there was a substantial issue. By contrast, Mr van Horen did not accept that the remediation of affected customers had been too slow.²⁹⁴

CBA did not report any of these matters to ASIC until, on 15 May 2018, CBA notified ASIC that, having 'recently reviewed the overcharging issue in detail', CBA had identified 'that it has breached section 12DA of the ASIC Act when it issued periodic statements' to the relevant customers.²⁹⁵ As CBA said in that notification, and I accept, the account statements it issued to affected customers 'will have misled, or are likely to have misled, the account holder'.²⁹⁶

5.2 What the case study showed

CBA did not detect what turned out to be an issue affecting nearly 3,000 customers until well after the event. When it did detect the problem, it took some time to remedy the consequences. And on any view, what had happened was that the bank had charged customers interest to which the bank was not entitled. An event of that kind demands swift action.

At the time, it seems that CBA did not understand that it had issued statements of account that were misleading or were likely to mislead. Only when the Commission was about to inquire into the matter did CBA report the matter to ASIC. And in that notification, CBA accepted, rightly in my opinion, that it had breached Section 12DA of the ASIC Act. It follows that CBA might also have contravened Section 12DB of that Act prohibiting false or misleading representations. The matter now having been reported to ASIC, it is for ASIC to determine what further action it should take in respect of these matters.

CBA's report to ASIC was made well after the events that are referred to in the report. That being so, it may be that CBA did not report the matter within

²⁹³ Transcript, Clive Richard van Horen, 24 May 2018, 2382.

²⁹⁴ Transcript, Clive Richard van Horen, 24 May 2018, 2386–7.

²⁹⁵ Exhibit 3.42, Witness statement of Clive Richard van Horen, 15 May 2018, Exhibit CVH-6A [CBA.0517.0096.6000 at .6002].

²⁹⁶ Exhibit 3.42, Witness statement of Clive Richard van Horen, 15 May 2018, Exhibit CVH-6A [CBA.0517.0096.6000 at .6002].

the time prescribed by Section 912D of the Corporations Act. It is for ASIC to determine what further action it should take in respect of this aspect of these matters.

6 Power and communication

6.1 Background

Two of the case studies examined raised issues about the ways in which a lender exercises its powers during the currency of a loan or when seeking to have the loan repaid. In both cases the bank told the borrower that the borrower could not have access to the proceeds of the sale of a property unless the borrower agreed to restructure existing loan arrangements. In one case the bank's witness said, in evidence to the Commission, that the bank had acted inappropriately and unfairly;²⁹⁷ in the other, the bank's witness accepted in evidence that the bank did not have a right to hold the customer out of the money.²⁹⁸

The first of these cases concerned two loans made by Bank of Melbourne (a brand name of Westpac) to Thir Pty Ltd, a company controlled by Mr Bradley Wallis and his wife, Ms Tara Wallis.

6.2 Westpac – Bank of Melbourne: Mr and Mrs Wallis

In late 2015, Mr Bradley Wallis and his wife began looking for opportunities to run their own business.²⁹⁹ When asked why they were interested in running their own business, Mr Wallis explained:³⁰⁰

Well, we'd thought about owning our own business for a while. We thought it would give us a bit of freedom and allow something for us to both work on together. And so we started to look at various opportunities.

²⁹⁷ Transcript, Alastair Derek Dawson Walsh, 25 May 2018, 2458–9.

²⁹⁸ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, 51 [194]; Transcript, Ross Hugh McNaughton, 31 May 2018, 2890–1.

²⁹⁹ Transcript, Bradley Paul Wallis, 24 May 2018, 2400; Exhibit 3.54, Witness statement of Bradley Paul Wallis, 22 May 2018, 2 [6].

³⁰⁰ Transcript, Bradley Paul Wallis, 24 May 2018, 2400.

We felt we were reasonably experienced and qualified to – to have a crack at small business ...

In April 2016, Mr Wallis and his wife came across a café and bed-and-breakfast business situated on 20 acres of land in Byabarra in New South Wales that was for sale.³⁰¹ Mr Wallis and his wife applied to the Bank of Melbourne for a loan to assist with the purchase of the Byabarra property through their company, Thir.³⁰² Mr and Mrs Wallis signed and submitted a 'Commercial Finance Application Form',³⁰³ and provided the Bank of Melbourne with a projected profit and loss statement for the year ending 31 December 2017 for the business.³⁰⁴ In the commercial finance application form, Mr and Mrs Wallis indicated that the loan was for the purpose of purchasing a property with a house and a business located on it.³⁰⁵ The loan was to be secured by a mortgage over the Byabarra property.³⁰⁶

Before the loan was approved, the Bank of Melbourne business banker assigned to Mr and Mrs Wallis' application told his regional manager that there was a 'small shop' operating on the Byabarra property; and that the bank's panel valuers considered that the property ought to be valued on a 'commercial' basis for loan security purposes.³⁰⁷ Internal notes made in relation to the Wallis' application show that prior to approving the loan, the Bank of Melbourne's credit team was also aware that there was a commercial enterprise operating on the Byabarra property.³⁰⁸

Classifying a security property as either 'residential' or 'commercial' had a significant effect on the assessment and approval of a loan.

³⁰¹ Transcript, Bradley Paul Wallis, 24 May 2018, 2400.

³⁰² Transcript, Bradley Paul Wallis, 24 May 2018, 2401–2.

³⁰³ Transcript, Bradley Paul Wallis, 24 May 2018, 2402.

³⁰⁴ Transcript, Bradley Paul Wallis, 24 May 2018, 2403, 2404, 2415; Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2425; Exhibit 3.56, undated, Excel Spreadsheet Profit and Loss; Exhibit 3.57, 6 June 2016, Home Loan Application.

³⁰⁵ Transcript, Bradley Paul Wallis, 24 May 2018, 2402, 2403; Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2425; Exhibit 3.54, Witness statement of Bradley Paul Wallis, 22 May 2018, Exhibit BPW-1 [WBC.403.001.0989].

³⁰⁶ Exhibit 3.59, Witness statement of Alastair Derek Dawson Welsh, 17 May 2018, 19 [82].

³⁰⁷ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2436.

³⁰⁸ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2446.

Westpac's witness (Mr Alastair Welsh, General Manager, Commercial Banking, Westpac Business Banking) said that, where a loan was to be secured against commercial property, the Bank of Melbourne's internal lending policies only permitted the bank to lend up to 65% of the value of the property. Where a loan was to be secured by residential property, the bank's lending policy permitted lending up to 80% of the value of the property.³⁰⁹

Despite the borrower making a Commercial Lending Application, and despite Mr and Mrs Wallis telling the bank that they intended to run a bed-and-breakfast business on the property, the bank assessed and approved the loan, in June 2016, as a residential loan, and offered to lend Thir an amount equal to approximately 80% of the purchase price for the Byabarra property.³¹⁰ Mr and Mrs Wallis accepted the offer and finalised Thir's purchase of the Byabarra property. Mr and Mrs Wallis moved their family of six from Melbourne to Byabarra to live and work at the Byabarra property.³¹¹ In June 2016, Mr and Mrs Wallis also agreed to refinance an existing mortgage over a residential investment property owned by Thir with the Bank of Melbourne.³¹²

When the Byabarra loan was assessed and approved, the internal performance targets for the business banker assigned to Mr and Mrs Wallis' application were heavily weighted towards financial performance.³¹³ The Commission heard evidence that, during the loan assessment process, the Bank of Melbourne business banker became aware that another bank had provided the Wallis' with conditional approval for a loan. The Bank of Melbourne business banker was keen to get the Wallis' loan application approved as soon as possible to avoid them accepting this competing offer.³¹⁴

³⁰⁹ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2430.

³¹⁰ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2442.

³¹¹ Transcript, Bradley Paul Wallis, 24 May 2018, 2406; Exhibit 3.54, Witness statement of Bradley Paul Wallis, 22 May 2018, 4 [21].

³¹² Transcript, Bradley Paul Wallis, 24 May 2018, 2402; Exhibit 3.54, Witness statement of Bradley Paul Wallis, 22 May 2018, 3 [17].

³¹³ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2439; Exhibit 3.27, Witness statement of Carol Separovich, 21 May 2018, Exhibit CS3-2 [WBC.107.003.1089].

³¹⁴ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2436, 2437, 2440.

The Byabarra business began to struggle within five to six weeks after it was re-opened under the management of Mr and Mrs Wallis. By early 2017, Mr and Mrs Wallis had decided that it was no longer viable for them to operate the business. They leased out the Byabarra business and property and relocated their family to the Gold Coast where Mr Wallis had found new employment.³¹⁵

In June 2017, Mr Wallis asked the Bank of Melbourne to revalue Thir's investment property and the Byabarra property.³¹⁶ Mr Wallis hoped to borrow against any equity that had accrued in either property to purchase a new family home on the Gold Coast.³¹⁷ After receiving this request, the Bank of Melbourne's credit team told Mr Wallis that the Byabarra property had been improperly classified as a residential loan, rather than as a commercial loan secured by commercial property.³¹⁸ As a consequence, the Bank of Melbourne considered that it had a security shortfall under the Byabarra loan of just under \$100,000.³¹⁹ This was on the basis that, had the Byabarra loan been assessed as a loan secured by commercial property, the bank would only have been prepared to lend 65% of the purchase price for the Byabarra property, rather than the 80% that it had in fact lent under the residential loan.³²⁰

Mr Wallis did not proceed with the revaluation request, but instead sold Thir's investment property 'to free up some capital'.³²¹ Upon selling the investment property, Mr Wallis sent a request to the Bank of Melbourne to discharge its mortgage held over that property.³²² In response, the Bank of Melbourne told Mr Wallis that it would not agree to discharge its mortgage unless \$100,000 from the proceeds of sale of the investment property was deposited and held in a Bank of Melbourne term deposit account.³²³

³¹⁵ Transcript, Bradley Paul Wallis, 24 May 2018, 2408.

³¹⁶ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2443.

³¹⁷ Transcript, Bradley Paul Wallis, 24 May 2018, 2408, 2409.

³¹⁸ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2443.

³¹⁹ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2448.

³²⁰ Transcript, Alastair Derek Dawson Welsh, 25 May 2018, 2448.

³²¹ Transcript, Bradley Paul Wallis, 24 May 2018, 2409.

³²² Transcript, Bradley Paul Wallis, 24 May 2018, 2409.

³²³ Transcript, Bradley Paul Wallis, 24 May 2018, 2409, 2410.

The Bank of Melbourne intended to hold the \$100,000 as collateral for the potential security shortfall, and only release it after the Byabarra loan had been restructured to a commercial loan facility with a lower loan-to-value ratio.³²⁴

In the end the loan was not restructured. Instead, Thir sold the Byabarra property and repaid the amount secured. Bank of Melbourne released the \$100,000 that it had placed on term deposit.³²⁵

Mr Wallis said that he felt ‘held for ransom’ by the Bank of Melbourne,³²⁶ and that he had questioned the bank’s entitlement to withhold these funds.³²⁷ In response, the bank’s regional manager told Mr Wallis that ‘sections 22.2, 22.3, 23a, 23b along with section 27.1’ of the Bank of Melbourne Memorandum of Provisions entitled the bank to withhold the funds.³²⁸ FOS concluded that these provisions, together, had authorised the bank to retain the moneys, presumably as moneys received under the investment property mortgage being held in respect of the ‘all moneys’ obligation secured by that mortgage (where ‘all moneys’ extended to ‘all money which one or more of you owe us *or will or may owe in the future*’).³²⁹

Westpac submitted that the provisions relied on by the regional manager had the effect asserted.³³⁰ Alternatively, Westpac submitted that the regional manager had genuinely held the view that the bank was entitled to act as it was and that there were reasonable grounds for holding the opinion.³³¹

³²⁴ Transcript, Alastair Derek Dawson Walsh, 25 May 2018, 2448, 2449, 2450.

³²⁵ Transcript, Alastair Derek Dawson Walsh, 25 May 2018, 2459; Exhibit 3.59, Witness statement of Alastair Derek Dawson Welsh, 17 May 2018, 23 [114]–[116].

³²⁶ Transcript, Bradley Paul Wallis, 24 May 2018, 2410.

³²⁷ Transcript, Bradley Paul Wallis, 24 May 2018, 2411; Exhibit 3.54, Witness statement of Bradley Paul Wallis, 22 May 2018, Exhibit BPW-9 [WBC.403.006.4064].

³²⁸ Exhibit 3.54, Witness statement of Bradley Paul Wallis, 22 May 2018, Exhibit BPW-9 [WBC.403.006.4064]; Exhibit 3.59, Witness statement of Alastair Derek Dawson Welsh, 17 May 2018, Exhibit AW2-31 [WBC.403.006.4386].

³²⁹ Transcript, Alastair Derek Dawson Walsh, 25 May 2018, 2457–8.

³³⁰ Westpac, *Submissions on Rubric 3-10 Case Study*, 8 June 2018, 4 [17]–[19].

³³¹ Westpac, *Submissions on Rubric 3-10 Case Study*, 8 June 2018, 4–5 [20].

If the relevant provisions did apply, they provided that money received be ‘used towards paying the amount owing’ (unless someone else had a prior claim). If the amount owing was not due for payment, the provisions required that the money received was to be held in an interest bearing account and then applied to pay the ‘amount owing when it becomes due for payment’. But, so far as the evidence went, Bank of Melbourne did not ever seek to use the money received ‘towards paying the amount owing’. Instead, it sought to use the retention of the money as a bargaining chip to persuade the borrower to agree to restructure the loan that had been made in respect of Byabarra in a way that would accord with the bank’s policies. But the departure from policies had been the bank’s doing, not the borrower’s.

At the least then, Mr Walsh was right to accept that the bank’s conduct was unfair.³³² The borrower had made plain the nature of the transaction and how they intended to use the security property. If there had been a mistake, it was the bank’s, not the borrower’s. To apply commercial pressure to the borrower in those circumstances was at least unfair.

I express no concluded view about whether the bank’s common provisions might have authorised retention of the surplus proceeds of sale of the investment property. I observe, however, that the money was not retained for the contractually stipulated purpose (of being held to pay what was owing in respect of the Byabarra loan). That may suggest that the relevant provisions were not engaged. Tellingly, Mr Walsh did not seek in his evidence to support the proposition that the bank had been entitled to act as it did. Rightly, he agreed that the common provision clauses relied on by the bank to justify withholding the \$100,000 from Mr and Mrs Wallis were too complex for a customer to understand.³³³

6.3 NAB: Mr Ross Dillon and National Music Pty Ltd

The second of the cases about power and communication concerned NAB and National Music Pty Ltd. In this case, Mr Ross Dillon, a director of National Music, guaranteed the company’s debts to NAB. The guarantee was supported by a mortgage over a rural property that Mr and Mrs Dillon

³³² Transcript, Alastair Derek Dawson Walsh, 25 May 2018, 2458–9.

³³³ Transcript, Alastair Derek Dawson Walsh, 25 May 2018, 2456.

owned and on which they lived. The property was called 'Goanna Downs'. The mortgage of Goanna Downs was given as security for the personal debts of Mr and Mrs Dillon, not the company's. If the guarantee that Mr Dillon had given in respect of the company's debts was called, the mortgage would secure that obligation of Mr Dillon. Mr Dillon told NAB he wanted to sell the property and did so. Mr Dillon proposed to use part of the proceeds of sale to reduce National Music's debts and to use part of the proceeds to buy another house. Although the bank had not called on the guarantee, it required Mr Dillon to apply substantially the whole of the proceeds of sale to reducing National Music's debts and to agree to reduce the limits of National Music's facilities with NAB. Mr Dillon agreed but thought that he had no choice.

Mr Dillon made a public submission to the Commission complaining of what NAB had done.

From about 2010, Mr Dillon had discussed with NAB his intention to sell Goanna Downs.³³⁴ Internal NAB documents referred to the Dillons' intention to use the proceeds of sale remaining after discharge of the relevant home loan facility debt for two purposes: to inject funds into National Music and to purchase another property as their primary place of residence.³³⁵ (The Dillons intended to relocate to Melbourne to be closer to their adult children and expected grandchildren.)³³⁶ At the time, National Music had a number of facilities with NAB including a trade facility, overdraft, market rate facility, debtor finance facility and asset finance facility.³³⁷

In the years before the sale of Goanna Downs, National Music had been seen by NAB as struggling to achieve profitability and as experiencing cash flow problems which, if not rectified, would lead to failure. In 2010, National Music was referred to NAB's 'Portfolio Review Group' for review and that group made several recommendations about the future conduct of the

³³⁴ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RHM-1 (Tab 81) [NAB.005.342.0032 at .0034].

³³⁵ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 68) [NAB.005.342.0021]; Exhibit 3.141, 25 March 2013, Business Memorandum of Increase.

³³⁶ Transcript, Ross Alan Dillon, 30 May 2018, 2831.

³³⁷ Exhibit 3.136, Witness statement of Ross Alan Dillon, 28 May 2018, 1 [3].

business.³³⁸ The review noted that the ‘file demonstrates characteristics for SBS involvement’, that is the involvement of Strategic Business Services, the department of the bank responsible for managing accounts showing signs of distress.³³⁹ National Music agreed to have an external review of its business. One of the recommendations of the review was that funds be injected into the business to reduce the expenses associated with bank debt.³⁴⁰

Mr Dillon put Goanna Downs on the market in 2010. He told National Music’s NAB relationship manager that if the property sold, he would use about \$800,000 or \$1 million to buy another property and apply the balance to reduce bank debt.³⁴¹ The property did not sell. National Music asked NAB to waive three months of payments on one of its facilities. The then relationship banker recorded that Mr Dillon said that he would apply all but about \$100,000 of the proceeds of Goanna Downs to reduction of debt.³⁴²

National Music was referred to Strategic Business Services in 2010 but repatriated to the relationship banker in 2011.³⁴³

Mr Dillon continued to market Goanna Downs in 2012, 2013 and again in 2015. As NAB’s internal records showed, in 2013 Mr Dillon told his relationship manager that when Goanna Downs sold he would look to pay out two facilities (the Portfolio facility and the asset finance facility), put \$200,000 into the business and use the balance to buy another property.³⁴⁴

³³⁸ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 57) [NAB.005.418.0039].

³³⁹ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 57) [NAB.005.418.0039].

³⁴⁰ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 62) [NAB.005.379.0027].

³⁴¹ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 68) [NAB.005.342.0021].

³⁴² Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 81) [NAB.005.342.0032].

³⁴³ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 84) [NAB.005.370.0001].

³⁴⁴ Exhibit 3.141, 25 March 2013, Business Memorandum of Increase.

In early March 2015, Mr Dillon met with the new business banking manager for National Music, Shaun Bassett. Mr Dillon's evidence was that he informed Mr Bassett of his intention to sell Goanna Downs and use the proceeds to inject around \$200,000 to \$300,000 into National Music and to purchase a new home in Melbourne.³⁴⁵ While Mr Bassett recalled meeting Mr Dillon on this date, he did not recall the details of the discussion.³⁴⁶ He did not deny the content of the discussion as put forward by Mr Dillon³⁴⁷ and that account is also consistent with an email from Mr Bassett sent shortly thereafter.³⁴⁸ It is also clear from the documents, and from Mr Bassett's evidence, that he did not discuss with Mr Dillon what NAB's expectations were in respect of the sale proceeds,³⁴⁹ and that he did not tell Mr Dillon that NAB would require further security if Goanna Downs was sold.³⁵⁰

On 30 April 2015, Mr Dillon signed a contract of sale for Goanna Downs for \$2.22 million.³⁵¹ According to NAB's records, on the same day Mr Dillon told Mr Bassett that his 'initial plans with the funds were that, after paying off the loan secured against Goanna Downs, paying \$200,000 into National Music, and paying out credit card debts, he intended to invest the balance in "annuity type investments"'.³⁵² In the following days, Mr Dillon was told by Mr Bassett that NAB would be retaining the entire sale proceeds from Goanna Downs, with the funds remaining after the repayment of the mortgage to be put towards reducing the overall debt position of National

³⁴⁵ Transcript, Ross Alan Dillon, 30 May 2018, 2832; see also Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 105) [NAB.134.007.9166].

³⁴⁶ Exhibit 3.137, 18 May 2018, Statutory Declaration of Shaun Bassett; Transcript, Shaun Bassett, 31 May 2018, 2880.

³⁴⁷ Transcript, Shaun Bassett, 31 May 2018, 2880.

³⁴⁸ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 109) [NAB.134.007.9186]; see also Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 91) [NAB.005.376.1199]; Transcript, Ross Hugh McNaughton, 31 May 2018, 2901.

³⁴⁹ Transcript, Shaun Bassett, 31 May 2018, 2881–2.

³⁵⁰ Transcript, Ross Hugh McNaughton, 31 May 2018, 2906.

³⁵¹ Exhibit 3.136, Witness statement of Ross Alan Dillon, 28 May 2018, 5 [25].

³⁵² Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, Exhibit RMH-1 (Tab 104) [NAB.134.007.9169].

Music.³⁵³ National Music was not then in default of its monetary obligations in respect of the facilities with NAB.³⁵⁴

After the sale of Goanna Downs, NAB reduced National Music's facility limits. Mr Dillon said that the reduction in the trade facility by half had a particularly detrimental effect on the business, because the company relied on having a substantial trade facility to conduct its import business.³⁵⁵ He said that the business would not have survived without an injection of funds from his brother.³⁵⁶

It is clear that, before Mr Dillon had agreed to sell Goanna Downs, NAB did not tell him that it intended to take all of the proceeds of sale. Within NAB, the proposal to take all the proceeds of sale appears to have been made first by Ms Moynahan, a manager in Strategic Business Services, in response to Mr Bassett sending her a copy of the contract of sale of Goanna Downs.³⁵⁷

Mr Dillon's evidence was that if he had been told before the sale of Goanna Downs that he would not receive any of the sale proceeds he would have waited for a better offer. He said:

I wouldn't have sold, because I understand how hard it is to move somebody on who is up to date with their payments. We had an offer on the table from another gentleman who owns one of the most successful stallions in Australia, that was two and a half [\$2.5 million], but he couldn't fulfil that offer for probably up to a year because he had to wait until his stallion cheque came from the stud. And at that time we accepted because we felt under pressure from the NAB, but we wouldn't have even accepted, if we had known we weren't going to get a penny, no way. We would have waited.³⁵⁸

There can be no doubt that Mr Dillon acquiesced in NAB's taking the whole of the proceeds of sale of Goanna Downs and in the new limits that NAB fixed for National Music's facilities. But the point of present importance is

³⁵³ Exhibit 3.136, Witness statement of Ross Alan Dillon, 28 May 2018, 5 [27].

³⁵⁴ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, 53 [207].

³⁵⁵ Transcript, Ross Alan Dillon, 30 May 2018, 2838–9.

³⁵⁶ Transcript, Ross Alan Dillon, 30 May 2018, 2839.

³⁵⁷ Transcript, Shaun Bassett, 31 May 2018, 2880–1.

³⁵⁸ Transcript, Ross Alan Dillon, 30 May 2018, 2838.

that there can also be no doubt that Mr Dillon acted because NAB said that it required him to apply the whole of the proceeds in reduction of debt. Whether he accepted this requirement with grace and fortitude (as he did) is neither here nor there. He considered that he had no choice. Hence NAB's references to expressions of gratitude by Mr Dillon for NAB's provision of reduced facilities show no more than a customer seeking to preserve a workable relationship with his bank.

Mr Ross McNaughton, now General Manager of Strategic Business Services at NAB, and the principal NAB witness called with respect to this case study, agreed that NAB did not have a right to apply the whole of the proceeds of sale from Goanna Downs to National Music's facilities.³⁵⁹ Rightly, he agreed that NAB held no security over Goanna Downs with respect to National Music's obligations; the security supported Mr and Mrs Dillon's obligations, not the company's. He also accepted that, under the terms of the guarantee and indemnity that Mr Dillon had given with respect to National Music, NAB had no right to prevent the sale of Goanna Downs.³⁶⁰

In its written submissions, NAB said that it did not, in 2015 or in its submissions 'assert or imply that it had a *legal* entitlement to payment of the proceeds in reduction of debt' (original emphasis).³⁶¹

This submission must be judged in light of the fact that Mr McNaughton accepted that, when he started preparing to give evidence, he had believed that NAB did have the legal entitlement to payment of the proceeds of sale in reduction of National Music's debt.³⁶² Indeed, the draft of Mr McNaughton's statement, supplied to the Commission, said as much. But before Mr McNaughton's statement was finalised, Mr McNaughton came to understand that this was not right, and the assertion of legal entitlement was deleted. But Mr McNaughton did not acknowledge, in that final version of his statement, that he had changed his mind about the

³⁵⁹ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, 51 [194]; Transcript, Ross Hugh McNaughton, 31 May 2018, 2890–1.

³⁶⁰ Transcript, Ross Hugh McNaughton, 31 May 2018, 2905.

³⁶¹ NAB, *Third Round of Public Hearings: Lending to Small and Medium Enterprises, Submissions of National Australia Bank Limited (NAB) – National Music Case Study*, 8 June 2018, 15 [53].

³⁶² Transcript, Ross Hugh McNaughton, 31 May 2018, 2890.

matter. All that was done was to delete the positive assertion of entitlement. Even so, Mr McNaughton persisted in asserting, in his statement, that:

The rural property known as Goanna Downs was a specialised broodmare property provided by Mr Dillon and his wife as security for a number of facilities *held in their own names and by National Music*.³⁶³

But, as Mr McNaughton accepted in cross-examination, Goanna Downs was *not* direct security for any obligation of National Music; it secured only the personal obligations of Mr and Mrs Dillon which, in Mr Dillon's case, included his obligations under the guarantee and indemnity he had given.³⁶⁴ His statement that Goanna Downs was 'security for a number of facilities held ... by National Music' was not right and should not have been made.

NAB sought to argue that 'as a matter of practicality and NAB's contractual rights under its security arrangements with the Dillons, NAB would not (and could not) have agreed to discharge the mortgage over Goanna Downs unless Mr Dillon provided alternative security for the guarantee and indemnity or he agreed to an appropriate reduction of the exposures formerly collateralised by the mortgage'.³⁶⁵ Even if this proposition were to be accepted (and the references to what NAB *could* have done cannot be accepted) it obscures the important point. Alternative security or reduction of limits were matters to take up with the Dillons *before* the property was put on the market. They were not matters to raise, let alone attempt to resolve, after a sale had been made. And NAB did not raise them before sale.

Having not raised any question of adjusting securities before sale, the central question after sale was whether NAB had any *right* to the proceeds of the sale. It accepts that it did not.

Counsel Assisting (and counsel for Mr Dillon) submitted that NAB may have engaged in misleading or deceptive conduct either by failing to tell Mr Dillon, before the contract of sale was made, that he would not be able to have access to a significant part of the proceeds, or by representing to him that

³⁶³ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, 19 [65] (emphasis added).

³⁶⁴ Transcript, Ross Hugh McNaughton, 31 May 2018, 2890–1.

³⁶⁵ NAB, *Third Round of Public Hearings: Lending to Small and Medium Enterprises, Submissions of National Australia Bank Limited (NAB) – National Music Case Study*, 8 June 2018, 16 [54].

it had the legal right to require him to apply the whole of the proceeds in reduction of National Music's debts.³⁶⁶ NAB denies that it made any such representation.³⁶⁷

In its written submissions relating to this case study, NAB placed much emphasis on what it sought to portray as differences between the account of events given by Mr Dillon and the account of those events revealed by contemporaneous diary notes and other records held by NAB.³⁶⁸ There are some differences that can be identified between the two accounts. It would be surprising if there were not. But to the extent that there are differences, I do not consider that any of them are important.

The constant refrain of NAB's submissions in relation to this matter was, in effect, that what it required about application of funds and restructuring of facilities was 'obviously' the only 'practical' and 'commercial' outcome possible. NAB took what Mr Dillon was recorded as saying to the bank as his recognising this to be so. Its submissions took his replies to correspondence sent to him by the bank as further recognition of what it sought to say was both inevitable and obvious.

But these submissions saw events through only the eyes of the bank. And they took no account of the uncontroverted fact that, after the contract to sell Goanna Downs had been made, Mr Dillon initially proceeded on the footing that he could use the proceeds of sale as he intended and that he need not see the proceeds go wholly in reduction of National Music's debts. When the bank told him that it would take all the proceeds, the news came to him as a great surprise.

Not only did NAB's submissions look at matters only through the eyes of the bank, the submissions took no account of the fact that, as NAB itself emphasised, 'the first evidence of any 'decision' being taken by NAB that the sale proceeds should be applied to reduction of debt' was

³⁶⁶ Transcript, Senior Counsel Assisting, 1 June 2018, 3056; Ross Alan Dillon, *Submission on Behalf of Ross Dillon*, 8 June 2018, 6 [22]–[24].

³⁶⁷ NAB, *Third Round of Public Hearings: Lending to Small and Medium Enterprises, Submissions of National Australia Bank Limited (NAB) – National Music Case Study*, 8 June 2018, 18–19 [65]–[66].

³⁶⁸ NAB, *Third Round of Public Hearings: Lending to Small and Medium Enterprises, Submissions of National Australia Bank Limited (NAB) – National Music Case Study*, 8 June 2018, 2–3 [9].

Ms Moynahan's response on 30 April 2015 to Mr Bassett's email telling her of the sale of Goanna Downs.³⁶⁹ NAB's written submissions were that there was 'no evidence that such a decision was taken – and therefore could or should have been communicated to Mr Dillon – prior to him entering the contract of sale'.³⁷⁰ That is, NAB was at pains to point out that it did *not* decide, until after the property had been sold, to demand application of the full proceeds of sale to reduction of debt. Yet the central thrust of its submissions was that this was the obvious and only possible outcome.

What was said and done by NAB, after Mr Dillon told Mr Bassett that a contract of sale had been signed, was sharply at odds with the basis of the case it sought to make in answer to the submission that I should decide that NAB might have misled or deceived Mr Dillon. The central plank of NAB's submissions was that, at all relevant times, both the bank and Mr Dillon knew full well that no other course than applying the full proceeds to debt reduction was realistically available. If that was the case, why not tell Mr Dillon before he made the sale? Why not remind him as soon as the property was sold? Why, once the sale had been made, did Mr Bassett propose a different course? Why wait for a decision from Ms Moynahan before responding to the proposal?

Further, all that was said and done by NAB, after the contract of sale was signed, was consistent with the bank asserting a legal entitlement to apply the funds as it proposed. That Mr McNaughton came to a different view only after his draft statement had been given to the Commission was consistent with the bank having acted, until that time, on the basis that it had a legal entitlement to apply the funds in reduction of debt. And Mr McNaughton's description of the bank's interest in Goanna Downs, in his final statement, as a security the Dillons had given 'for a number of facilities held in their own names and by National Music'³⁷¹ was consistent only with the bank acting, as it did, on the footing that Goanna Downs directly secured National Music's obligations.

³⁶⁹ NAB, *Third Round of Public Hearings: Lending to Small and Medium Enterprises, Submissions of National Australia Bank Limited (NAB) – National Music Case Study*, 8 June 2018, 14 [45].

³⁷⁰ NAB, *Third Round of Public Hearings: Lending to Small and Medium Enterprises, Submissions of National Australia Bank Limited (NAB) – National Music Case Study*, 8 June 2018, 14 [45].

³⁷¹ Exhibit 3.140, Witness statement of Ross Hugh McNaughton, 22 May 2018, 19 [65].

Yet NAB, in its submissions, sought to say that this was all wrong and that what happened was to be seen as no more than the inevitable playing out of what Mr Dillon and NAB always knew to be the only commercially available course.

As I have explained elsewhere in this report, it is no part of my function to determine whether NAB did mislead or deceive Mr Dillon. My task is to determine whether the conduct of NAB might have amounted to misconduct. I consider that, by not telling Mr Dillon, until after the making of the contract, that he could not dispose of the proceeds of sale of Goanna Downs as *he* chose, NAB might have engaged in conduct that was misleading, deceptive, or both. Further, I consider that, in its dealings with Mr Dillon after the making of the contract, NAB might have represented to Mr Dillon that it had a legal entitlement to apply the proceeds of sale as it proposed. If a representation of that kind was made, its making might have amounted to conduct that was misleading or deceptive or both. And if NAB's conduct was misleading or deceptive, it may well have contravened its 'key commitment' under Clause 3.2 of the 2013 Code to act in a consistent and ethical manner.

6.4 What the case studies showed

Both case studies concerned banks asserting a power to direct disposition of funds that the customer believed were the customer's. Customers are not well placed to challenge an assertion of that kind. And even if the bank has the power to control disposition of the funds, there remains, as Mr Walsh of Westpac accepted, the overarching question of whether it is fair to exercise that right. As Mr Walsh further accepted, it is not fair to use a power of that kind as a bargaining chip to enable the bank to rectify some mistake that the bank may later think it has made in classifying a loan as commercial or residential. And in a case, like NAB and Mr Dillon, where the bank does not have the legal right to direct a particular disposition of funds, it would obviously be wrong for the bank to assert, expressly or impliedly, that it has that right.

If a bank is to give effect to its key commitment under the Code, to act fairly and reasonably, in a consistent and ethical manner, it can easily avoid circumstances of the kind examined in these case studies. The easiest and best means of avoidance is to identify clearly what power it is sought to exercise and how and why the power is engaged. Much more often than not, telling the customer what power is being exercised, and why, will

expose to both bank and customer whether it would be fair, reasonable, consistent and ethical to use the power. And, even if the exercise of power is defensible, if the customer is not told what power is being exercised and why, it will be all too easy for the customer to see what happens as a naked exercise of commercial strength.

These are not matters to resolve by additional regulation. Banks have made the commitments they have under the Code and those commitments, if met, are sufficient to avoid misuse of power. Much more often than not, the commitments to act fairly and reasonably will call for proper communication with customers about what is being done and why.

Proper communication of that kind was absent in both these case studies. Had Bank of Melbourne thought that it had to explain to Mr and Mrs Wallis why the bank was retaining the surplus proceeds of sale of the investment property, it is greatly to be doubted that the bank would have acted as it did. But the bank did not, and the customers thought that they were treated unfairly. In the case of NAB and Mr Dillon, at the very least, NAB could and should have told Mr Dillon, much sooner than it did, what the bank would ask if he were to sell Goanna Downs. But it did not and, again, the customer rightly felt that he was treated unfairly.

The need to act fairly and reasonably directly affects how individual bankers are managed. The need to act in that way with respect to distressed loans will always call for close and constant attention. Hence, management of those parts of a bank that have particular responsibility for distressed loans calls for special attention to these considerations. As is explained in connection with some of the case studies about loans to farming enterprises, rewarding bankers responsible for distressed loans for bringing files to the point where the loan is either back in order or is brought to an end within a fixed period can lead to borrowers not being treated fairly.

Case studies: Bankwest and CBA

1 Background

The Commission heard evidence about the dealings four Bankwest business banking customers had with CBA after CBA acquired Bankwest: Mr Michael Kelly;¹ Mr Stephen Weller;² Mr Michael Doherty;³ and Mr Brendan Stanford.⁴ Each had made a submission to the Commission.

In each case, the loans were reviewed as part of Project Magellan. Project Magellan was explained in Chapter 5. The loans about which these four customers gave evidence spanned the spectrum of classification from 'green' to 'double red'. The businesses were in industries where CBA had identified risks in the Bankwest business loan book, either in relation to the trends within the industry or the size of the Bankwest exposure: property development, land-banking and 'pubs and clubs'. The loans ranged from about \$1 million to Mr Stanford's company, to more than \$50 million to Doherty Hotels.

Together, the four cases showed how CBA had dealt with Bankwest loans that it identified as troublesome or impaired and how CBA's actions played out in the experience of individual customers. Separately, each case raised distinct issues. Mr Kelly's case raised issues about what is to happen when the loan term has ended but the borrower continues to need finance. Mr Weller's case raised issues about how the lender is to deal with what it sees as deterioration in the business. Mr Doherty's case raised issues about security valuations. Mr Stanford's case raised issues about the lender's use of investigating accountants. As the more detailed treatment of those cases will show, each raised other issues as well.

¹ Exhibit 3.88, Witness statement of Michael Lawrence Kelly, 24 May 2018.

² Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018.

³ Exhibit 3.99, Witness statement of Michael Edwin Doherty, 24 May 2018.

⁴ Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018.

2 Mr Michael Kelly

2.1 Evidence

Mr Michael Kelly⁵ gave evidence to the Commission about business facilities Bankwest had granted to two entities, Wildlines Pty Ltd and Silversun Corporation Pty Ltd. Mr Kelly was a director and one of a number of shareholders of each company.⁶ One company had 15 shareholders, the other, eight shareholders.⁷ Each facility was for the purpose of, and secured by, land acquired for development projects in Western Australia.⁸ The original facilities were entered into in 2007,⁹ and the companies were customers of Bankwest until 2012.¹⁰ Silversun intended to have its land rezoned and then resell it.¹¹ Wildlines intended to have its land rezoned and then develop the land.¹²

Wildlines' initial facility was used to buy the land. The interest rate was fixed as the **Bank Bill Swap Rate (BBSY)** plus 1.75% per annum.¹³ The loan-to-value ratio (LVR) was to be 60% or less.¹⁴ Interest and fees could be capitalised within the LVR limit. In June 2007 Wildlines' land was valued 'as is' at \$11 million.¹⁵

⁵ Mr Kelly had been an employee of Bankwest between January 1985 and September 2007 but he had no dealings at Bankwest with any of the matters that were the subject of his witness statement. See Exhibit 3.88, Witness statement of Michael Lawrence Kelly, 24 May 2018, 1 [3], 2 [10].

⁶ Exhibit 3.88, Witness statement of Michael Lawrence Kelly, 24 May 2018, 3 [15]; Transcript, Michael Lawrence Kelly, 28 May 2018, 2558.

⁷ Transcript, Michael Lawrence Kelly, 28 May 2018, 2557.

⁸ Transcript, Michael Lawrence Kelly, 28 May 2018, 2557.

⁹ Transcript, Michael Lawrence Kelly, 28 May 2018, 2558.

¹⁰ Transcript, Michael Lawrence Kelly, 28 May 2018, 2580.

¹¹ Transcript, Michael Lawrence Kelly, 28 May 2018, 2557.

¹² Transcript, Michael Lawrence Kelly, 28 May 2018, 2557.

¹³ Transcript, Michael Lawrence Kelly, 28 May 2018, 2558.

¹⁴ Transcript, Michael Lawrence Kelly, 28 May 2018, 2558.

¹⁵ Transcript, Michael Lawrence Kelly, 28 May 2018, 2560.

Silversun borrowed from Bankwest in August 2007.¹⁶ It paid \$10.3 million for the land and borrowed half the purchase price.¹⁷ (The investors in Silversun provided the balance of the purchase price.) The terms of Silversun's loan were generally the same as the terms on which Bankwest lent to Wildlines. The two chief differences were that the term of the Silversun loan was three years, not two, and the LVR was 50%, not 60%.¹⁸

In 2008, the bank reviewed both loans. Silversun's loan (which was reviewed first) continued unchanged; Wildlines' interest rate was increased by 0.5%.¹⁹

In 2009, Wildlines' loan was to expire.²⁰ Mr Kelly went to a meeting with the company's relationship manager to ask for the loan to be rolled over. The manager opened the meeting by telling Mr Kelly that the bank wanted the companies to refinance the facilities at expiry or, as Mr Kelly put it, 'take our facilities and go'.²¹ Some days later, however, Bankwest offered to extend the facility but on terms that the LVR would drop from 60% to 45% and the interest rate would increase.²² After some negotiation, it was agreed that the LVR would be reduced from 60% to 50% within two months but the interest rate would be higher than the rate that had been offered.²³ If the LVR was reduced in that way, the borrower sought an extension of 16 months.²⁴ Wildlines reduced the LVR as required by raising money from its shareholders and the loan was extended, albeit only for 14 months.²⁵

¹⁶ Transcript, Michael Lawrence Kelly, 28 May 2018, 2558; Exhibit 3.88, Witness statement of Michael Lawrence Kelly, 24 May 2018, Exhibit MLK-42 [CBA.0517.0096.3061].

¹⁷ Transcript, Michael Lawrence Kelly, 28 May 2018, 2561.

¹⁸ Transcript, Michael Lawrence Kelly, 28 May 2018, 2561.

¹⁹ Transcript, Michael Lawrence Kelly, 28 May 2018, 2561.

²⁰ Transcript, Michael Lawrence Kelly, 28 May 2018, 2562.

²¹ Transcript, Michael Lawrence Kelly, 28 May 2018, 2562.

²² Transcript, Michael Lawrence Kelly, 28 May 2018, 2563.

²³ Transcript, Michael Lawrence Kelly, 28 May 2018, 2564–5.

²⁴ Transcript, Michael Lawrence Kelly, 28 May 2018, 2565.

²⁵ Transcript, Michael Lawrence Kelly, 28 May 2018, 2564–5.

Although Silversun's loan was not repriced in 2008, it was in 2009.²⁶ The margin above BBSY was increased by 0.9%.²⁷

In May 2010, the Wildlines and Silversun files were reviewed in Project Magellan.²⁸ The Bankwest Review Panel said that there should be an urgent valuation of Silversun's property.²⁹ The panel classified both files as 'red' and revised the risk grade on each account to reflect increased risk.³⁰ The panel recommended that the files should be moved into the Credit Access Management division (CAM), which was then the asset management unit of Bankwest, the LVR covenant in the facilities should be reduced and the collective provisioning should be recalculated.³¹

In about September 2010, both the Wildlines loan and the Silversun loan were moved into CAM.³² Neither borrower had then missed a payment or committed any other breach of the funding agreements.³³

At about the time the loans were moved into CAM, Silversun's interest rate was increased from a margin of 2.65% to 3.95% and its land was revalued.³⁴ The value had increased and Silversun's LVR dropped from 50% to 37.2%.³⁵ The concern raised in the Magellan Review about the valuation of the Silversun property (and therefore potential LVR breach) was shown not to be well-founded.

In November 2010, both borrowers asked for an extension of their facilities, which were due to expire on 31 December 2010.³⁶ At the very end of

²⁶ Transcript, Michael Lawrence Kelly, 28 May 2018, 2566.

²⁷ Transcript, Michael Lawrence Kelly, 28 May 2018, 2566.

²⁸ Transcript, Brett Robert Perry, 28 May 2018, 2597–8.

²⁹ Transcript, Brett Robert Perry, 28 May 2018, 2598.

³⁰ Transcript, Brett Robert Perry, 28 May 2018, 2598.

³¹ Transcript, Brett Robert Perry, 28 May 2018, 2598–9.

³² Transcript, Michael Lawrence Kelly, 28 May 2018, 2567.

³³ Transcript, Michael Lawrence Kelly, 28 May 2018, 2567.

³⁴ Transcript, Michael Lawrence Kelly, 28 May 2018, 2568–9.

³⁵ Transcript, Michael Lawrence Kelly, 28 May 2018, 2568.

³⁶ Transcript, Michael Lawrence Kelly, 28 May 2018, 2569.

December they were offered extensions until 28 February 2011.³⁷ On 13 January 2011, Bankwest gave notice of default to both borrowers.³⁸ The breaches were said to be not having accepted the variation of facilities that had been offered and not having repaid the facilities on 31 December 2010.³⁹ CBA proposed to charge default interest but later agreed not to do so while negotiations continued.

During February and March 2011, the borrowers negotiated with Bankwest about extending the facilities until eventually offers were made to extend the facilities for short periods. In January 2012, the borrowers sought further extensions but, no approval having been given by June, Wildlines refinanced its facility with another lender and paid out its facility with Bankwest.⁴⁰ A few months later, Silversun refinanced its facility and paid out the facility with Bankwest.⁴¹

Mr Brett Perry, General Manager of Group Credit Structuring of CBA gave evidence about the transactions. The central point Mr Perry made was that when a borrower enters into a facility they 'understand, or ought to understand'⁴² that the facility has a particular term and at the expiry of that term the bank may or may not be willing to refinance the facility and that if the bank is willing to refinance it may be on different terms.⁴³ That is, his evidence was that the borrower takes the risk that at the expiry date of a facility the bank may not be willing to refinance or refinance on the same terms.⁴⁴ As he rightly pointed out, when loans are extended, or 'rolled over' these are new contractual arrangements that are negotiated at arm's length with the borrower.⁴⁵

³⁷ Transcript, Michael Lawrence Kelly, 28 May 2018, 2570.

³⁸ Transcript, Michael Lawrence Kelly, 28 May 2018, 2571.

³⁹ Transcript, Michael Lawrence Kelly, 28 May 2018, 2572.

⁴⁰ Transcript, Michael Lawrence Kelly, 28 May 2018, 2580.

⁴¹ Transcript, Michael Lawrence Kelly, 28 May 2018, 2580.

⁴² Transcript, Brett Robert Perry, 28 May 2018, 2593.

⁴³ Transcript, Brett Robert Perry, 28 May 2018, 2593.

⁴⁴ Transcript, Brett Robert Perry, 28 May 2018, 2593–4.

⁴⁵ Transcript, Brett Robert Perry, 28 May 2018, 2596–7.

Mr Perry accepted that Bankwest wanted to exit from the Wildlines and Silversun facilities as soon as it was practically possible to do so and that it wanted to do this by having the companies refinance their loans with another bank.⁴⁶ This reflected the general view at the time that Bankwest was over-exposed to commercial property.⁴⁷ Mr Perry accepted that once Bankwest had identified the level of risk associated with commercial property and put in place policies to address this risk such as caps on levels of exposure in the loan book, these policies affected Bankwest's willingness to extend or refinance a facility.⁴⁸ But he said that, at the relevant time, Bankwest's policy was not to end facilities early, but rather to exit them at the end of the term.⁴⁹ Mr Perry's view was that in these cases there had been no early withdrawal as Bankwest had always let the facilities run their respective terms.⁵⁰

In relation to the process of negotiation of renewed facilities, particularly in late 2010 and early 2011, Mr Perry accepted that there were inconsistencies in the information that was given to Mr Kelly about whether and how default interest would be charged once the existing facilities had expired.⁵¹

Mr Perry said, unsurprisingly, that the risk grade given to a file affected the interest rate charged on the facility⁵² but he could not identify contemporaneous guidelines or models that would explain the various interest rates changes that were being applied to the Wildlines and Silversun accounts over the period in question.⁵³ He did accept that the fact that the Project Magellan review had increased the risk grade on the account would logically have affected the interest rate margin.⁵⁴

⁴⁶ Transcript, Brett Robert Perry, 28 May 2018, 2596.

⁴⁷ Transcript, Brett Robert Perry, 28 May 2018, 2594, 2596.

⁴⁸ Transcript, Brett Robert Perry, 28 May 2018, 2594.

⁴⁹ Transcript, Brett Robert Perry, 28 May 2018, 2593–4.

⁵⁰ Transcript, Brett Robert Perry, 28 May 2018, 2594.

⁵¹ Transcript, Brett Robert Perry, 28 May 2018, 2615.

⁵² Transcript, Brett Robert Perry, 28 May 2018, 2614.

⁵³ Transcript, Brett Robert Perry, 28 May 2018, 2614.

⁵⁴ Transcript, Brett Robert Perry, 28 May 2018, 2614.

2.2 What the case study showed

The central point to emerge from the case study is that it is for the lender to decide whether, and on what terms, it will renew a loan when it expires. The lender may offer terms that the borrower thinks harsh. But the lender is not bound to renew the loan. The 2019 Code will oblige banks to give small businesses three months' notice of intention not to extend a term loan before requiring repayment in full. But the Code also makes plain that the lender is not required to extend or refinance the loan on the same terms. It follows that, under the 2019 Code, a small business borrower may confront circumstances of the kind revealed in this case study.

I am not persuaded that the bank's conduct of this matter was shown to have fallen short of community standards and expectations.

3 Mr Stephen Weller

3.1 Evidence

This case study looked at Bankwest's reliance on non-monetary defaults as indicating that the financial health of the borrower's business was declining. In this case the terms of the loan were varied by shortening the term and, as the LVR deteriorated, Bankwest entered into a deed of forbearance with the borrower requiring the borrower to sell the business. These issues arose in a context where (until at least the very end of the relationship) there had been no monetary defaults. The case study also directed attention to the lender's reliance on a valuation of the security property that it would not give to the borrower.

The Commission heard evidence from Mr Stephen Weller and Mr Peter Clark, Chief Credit Officer of CBA.

Bankwest granted business facilities to Bainbridge Enterprises No 1 Pty Ltd, a company of which Mr Weller was a director.⁵⁵ The facilities were used to buy the Nambucca Hotel in Macksville NSW in 2005 and, in 2008, to allow Mr Weller to buy out his business partner.⁵⁶

⁵⁵ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 2 [8].

⁵⁶ Transcript, Stephen Francis Weller, 28 May 2018, 2618–9.

The 2008 facilities were for a term of 15 years.⁵⁷ The total borrowings under those facilities was \$3.725 million, of which \$3.71 million was interest-only until June 2010.⁵⁸ Those facilities included two non-monetary covenants: a debt service ratio (or 'DSR') covenant and an interest cover ratio (or 'ICR') covenant. The facilities did not include an LVR covenant.⁵⁹ The loan agreement provided for periodic reviews of the facilities.⁶⁰ Mr Weller and his wife gave personal guarantees for the facilities.⁶¹

In 2009, the hotel was valued at \$4.53 million.⁶²

In 2010, the hotel's revenue declined.⁶³ Mr Weller, and the bank, attributed this to the Global Financial Crisis (GFC) having led to a general reduction in discretionary spending.⁶⁴ Bainbridge continued to make all necessary payments to the bank, but the bank issued notices that the company was in breach of the DSR and ICR covenants.⁶⁵ In June 2010, the interest free period ended. Bankwest and Bainbridge negotiated a variation to the facilities.⁶⁶ In August 2010, Bankwest offered to vary the loan so that the facilities would expire in two years, the margin on the interest rate would increase by 0.45% to 3.19% and the principal payments would be \$15,000 per month.⁶⁷ In response, Mr Weller proposed that the expiry date continue to be June 2023, the interest rate margin be only 3.00% and the principal

⁵⁷ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 2 [8].

⁵⁸ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 3 [15], 5 [28]; Exhibit 3.101, Witness statement of Peter Nathaniel Clark, 27 May 2018, Exhibit PNC-20 [CBA.4000.0075.1436].

⁵⁹ Transcript, Stephen Francis Weller, 28 May 2018, 2619.

⁶⁰ Transcript, Stephen Francis Weller, 28 May 2018, 2620.

⁶¹ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 4 [23].

⁶² Transcript, Stephen Francis Weller, 28 May 2018, 2620.

⁶³ Transcript, Stephen Francis Weller, 28 May 2018, 2621.

⁶⁴ Transcript, Peter Nathaniel Clark, 29 May 2018, 2679.

⁶⁵ Transcript, Stephen Francis Weller, 28 May 2018, 2621.

⁶⁶ Transcript, Stephen Francis Weller, 28 May 2018, 2621.

⁶⁷ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-06 [CBA.0001.0318.1880]; Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-07 [CBA.4000.0075.1182].

repayments be in the range of \$5,000 to \$7,500 per month.⁶⁸ A bank employee explained in an email to Mr Weller that ‘a reduced term assists with pricing so as to alleviate issues with long term funding premiums’.⁶⁹ Nevertheless, in response to Mr Weller’s request, the bank provided a revised offer of variation with an expiry date of June 2023, an interest rate margin of 3.95%, a 12-month interest-only period for half of the borrowings and principal repayments of \$8,000 per month for the other half.⁷⁰ Mr Weller did not accept this revised offer⁷¹ and, instead, requested a reduced term with a lower interest rate.⁷² In November 2010, the bank made a further revised offer at an interest rate margin of 2.81% over the BBSY, interest-only payments for half of the borrowings and principal repayments of \$8,000 per month towards the other half of the borrowings.⁷³ Bainbridge accepted this further revised offer.⁷⁴

During 2011, Bainbridge made the payments required under the loan agreement but breached the non-monetary covenants.⁷⁵ The loan was extended for a further 12 months to January 2013.⁷⁶

In the latter part of 2012, employees of Bankwest met with Mr Weller and his wife to inform them of the need for an updated valuation of the hotel, and the need to reduce the principal of any new facility.⁷⁷ Bankwest arranged for

⁶⁸ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 6–8 [32], [34], [36]; Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-06 [CBA.0001.0318.1880]; Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-07 [CBA.4000.0075.1182].

⁶⁹ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-07 [CBA.4000.0075.1182].

⁷⁰ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-08 [CBA.4000.0074.8041].

⁷¹ Transcript, Stephen Francis Weller, 28 May 2018, 2623–4.

⁷² Exhibit 3.101, Witness statement of Peter Nathaniel Clark, 27 May 2018, Exhibit PNC-59A [CBA.0002.1959.7331].

⁷³ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, Exhibit SFW-09 [CBA.4000.0074.8062].

⁷⁴ Transcript, Stephen Francis Weller, 28 May 2018, 2624.

⁷⁵ Transcript, Stephen Francis Weller, 28 May 2018, 2625.

⁷⁶ Transcript, Stephen Francis Weller, 28 May 2018, 2625–6.

⁷⁷ Transcript, Stephen Francis Weller, 28 May 2018, 2626.

a valuation of the hotel (at the borrower's expense). Mr Weller engaged an agent to sell some of the hotel's poker machines and he and his wife put their home on the market.⁷⁸ (Their home had never been security for the facility.⁷⁹) Mr Weller and his wife met again with Bankwest in December 2012. Bankwest then had a draft of the valuation but would not provide him with a copy, although it was indicated to him that the revised valuation meant the LVR would be close to 100%.⁸⁰

The bank told Mr Weller it was not prepared to rollover the facility.⁸¹ Because the term of the existing loan was about to expire, the bank said that Bainbridge would need to make a deed of forbearance with the bank.⁸² Mr Weller received the first draft of this deed of forbearance two days before the facility was due to expire.⁸³

The deed of forbearance was made two weeks later, but almost immediately, the bank notified Mr Weller of a breach of its terms.⁸⁴

Mr Weller made a complaint to the Financial Ombudsman Service (FOS). In December 2013 that dispute was settled on terms that Mr Weller would sell the hotel by 28 February 2014.⁸⁵ He did not. The bank issued a further notice of breach and Mr Weller made another complaint to FOS.⁸⁶ FOS decided that it had no jurisdiction to consider this further complaint.⁸⁷ The bank appointed receivers, who sold the hotel.⁸⁸ The bank called on the guarantee Mr Weller had given and that claim was compromised in 2016.⁸⁹

⁷⁸ Transcript, Stephen Francis Weller, 28 May 2018, 2626.

⁷⁹ Transcript, Stephen Francis Weller, 28 May 2018, 2626.

⁸⁰ Transcript, Stephen Francis Weller, 28 May 2018, 2626–7.

⁸¹ Transcript, Stephen Francis Weller, 28 May 2018, 2627.

⁸² Transcript, Stephen Francis Weller, 28 May 2018, 2627.

⁸³ Transcript, Stephen Francis Weller, 28 May 2018, 2627.

⁸⁴ Transcript, Stephen Francis Weller, 28 May 2018, 2628.

⁸⁵ Transcript, Stephen Francis Weller, 28 May 2018, 2629.

⁸⁶ Transcript, Stephen Francis Weller, 28 May 2018, 2630.

⁸⁷ Transcript, Stephen Francis Weller, 28 May 2018, 2630.

⁸⁸ Transcript, Stephen Francis Weller, 28 May 2018, 2631.

⁸⁹ Transcript, Stephen Francis Weller, 28 May 2018, 2630–1.

The evidence of Mr Weller raised three main issues to which Mr Clark responded on behalf of CBA:

- the lack of transparency around the final valuation of the hotel;
- the shortening of the original term of the facility through a series of variations to the facility; and
- the relationship between breaches of non-monetary covenants and the entry into the deed of forbearance.

In relation to the valuation, Mr Clark agreed that if significant decisions are made in relation to a customer's facilities on the basis of a valuation that they have not been shown, there is a lack of transparency.⁹⁰ Obviously that is right and, given that the borrower will ordinarily pay for the valuation, the borrower's sense of grievance at being dealt with on the basis of information that the bank will not disclose will be all the greater. Mr Clark's evidence was that it is no longer the policy of CBA to withhold valuations from customers who have paid for the valuation.⁹¹ As he rightly said, showing customers the valuation is 'a fair thing to do'.⁹²

As to the shortening of the length of the facility from 15 years to 12 months, Mr Clark pointed out that banks prefer shorter term facilities because longer term facilities come with higher risks.⁹³ He explained that the longer the term, the longer the time for things to go wrong.⁹⁴ Mr Clark accepted that there may be conflicting views between borrowers and the banks about the preferable length of a facility.⁹⁵ As Mr Clark said, a shorter loan increases the ability of the bank to exit a facility if it does not want to lend to that customer any longer.⁹⁶ In this case, Mr Clark accepted that, if the Bainbridge facility had remained as 15 years, there would have been less flexibility for Bankwest to consider exiting in the near future. Mr Clark

⁹⁰ Transcript, Peter Nathaniel Clark, 29 May 2018, 2682.

⁹¹ Transcript, Peter Nathaniel Clark, 29 May 2018, 2683.

⁹² Transcript, Peter Nathaniel Clark, 29 May 2018, 2683.

⁹³ Transcript, Peter Nathaniel Clark, 29 May 2018, 2678.

⁹⁴ Transcript, Peter Nathaniel Clark, 29 May 2018, 2678.

⁹⁵ Transcript, Peter Nathaniel Clark, 29 May 2018, 2678.

⁹⁶ Transcript, Peter Nathaniel Clark, 29 May 2018, 2678–9.

explained in his oral evidence that the lengthier term offered by the bank to Bainbridge required the additional risk to the bank to be considered. This additional risk was reflected in a long-term funding premium.⁹⁷ Mr Clark was right to say that the shortening of the loan term was not a unilateral change to Bainbridge's facility, but, rather, had occurred as part of the re-negotiation of the facility at the end of interest free period.⁹⁸

Turning to non-monetary covenants generally, Mr Clark's evidence was that it was 'very rare, in my experience, for a bank to actually call a default and demand repayment as a result of a breach [of one of the financial ratio covenants] alone'.⁹⁹ (As discussed below, in connection with the Stanford case study, Mr Cohen gave generally similar evidence.) But Mr Clark explained that the inclusion of financial covenants, such as ICR and DSR ratios is part of prudent management of a business loan because they are ratios that allow monitoring of the business and comparison to forecasts and expectations.¹⁰⁰ Mr Clark's evidence was that in this case, the breaches of non-monetary covenants were not used as a 'termination event'.¹⁰¹ In particular, the breach of the LVR was one part of the decision process not to renew the loan, but there were other reasons as well.¹⁰² Mr Clark's evidence was that Bankwest did not want to extend Bainbridge's facility but also did not want to take enforcement action, so a deed of forbearance was of benefit to both the bank and the borrower.¹⁰³ Mr Clark did accept that if it was not for the deed of forbearance, Bankwest would have been enforcing on the basis of non-monetary default,¹⁰⁴ and that providing the draft deed to Mr Weller two days before the facilities were to expire did not seem very fair.¹⁰⁵ Mr Weller complains that he was not in monetary default,¹⁰⁶ which

⁹⁷ Transcript, Peter Nathaniel Clark, 29 May 2018, 2678–9.

⁹⁸ Transcript, Peter Nathaniel Clark, 29 May 2018, 2684.

⁹⁹ Transcript, Peter Nathaniel Clark, 29 May 2018, 2669.

¹⁰⁰ Transcript, Peter Nathaniel Clark, 29 May 2018, 2668.

¹⁰¹ Transcript, Peter Nathaniel Clark, 29 May 2018, 2681.

¹⁰² Transcript, Peter Nathaniel Clark, 29 May 2018, 2681–2.

¹⁰³ Transcript, Peter Nathaniel Clark, 29 May 2018, 2683.

¹⁰⁴ Transcript, Peter Nathaniel Clark, 29 May 2018, 2683

¹⁰⁵ Transcript, Peter Nathaniel Clark, 29 May 2018, 2683.

¹⁰⁶ Stephen Francis Weller, *Response to Round 3 and CBA Submissions*, 20 August 2018, 1.

was indeed the case until January 2013. But, at the time that the 2013 deed of forbearance was executed, the facility had expired, and the funds borrowed were owing to the bank. Though due, the loan was not repaid.

As to the general handling of Bainbridge's file Mr Clark said that the file had been reviewed as part of Project Magellan in 2010, and that the review had classified the file as 'green'.¹⁰⁷ Therefore the file had not been transferred into CAM in 2010.¹⁰⁸ But the file was transferred into CAM in May 2012 because of the declining trade of the hotel, and concern that, although Bainbridge was meeting repayments at this time, it would struggle to do so in the near future.¹⁰⁹ The Bainbridge file was in CAM when the 2012 valuation was undertaken and when the 2013 deed of forbearance was executed.

3.2 What the case study showed

The course of events revealed by this case study must be judged against one critical fact: that the bank believed that the borrower's business was deteriorating. The belief was not unreasonable. Nationally, and internationally, economic conditions had changed. Businesses, like Mr Weller's, which depended on discretionary spending, were adversely affected. Hindsight will often suggest that different decisions might reasonably have been open to a lender that wants not to renew or extend a loan. All that the borrower, or the public, can expect of the lender is that it takes account of the borrower's interests when it decides what course it will take. And there will be cases, of which this was one, where it is reasonable for the lender to insist upon repayment of the loan it has made and enforce recovery.

Often, telling the borrower why the bank has decided on a particular course of action, and telling the borrower what it believes to be the important facts on which the conclusion is based (such as the value of securities) will lessen the chance of misunderstanding. And in this case, there seems no good reason not to have provided Mr Weller with the valuation of the hotel that the bank held when it decided not to renew the loan. The public would

¹⁰⁷ Transcript, Peter Nathaniel Clark, 29 May 2018, 2672.

¹⁰⁸ Transcript, Peter Nathaniel Clark, 29 May 2018, 2673.

¹⁰⁹ Transcript, Peter Nathaniel Clark, 29 May 2018, 2680–1.

have expected the bank to do that. In this respect, the conduct of the bank fell short of community standards and expectations.

I readily accept that to change the term of the loan from several years to one was to make a radical variation to the agreement and that Mr Weller is not, and was not, pleased with the shortening of the term of the loan.¹¹⁰ But the change was not a unilateral one;¹¹¹ rather, the change was the outcome of a negotiation. Mr Weller had been offered a longer term at a higher interest rate during the negotiation and declined the offer. Mr Weller was in the unenviable position of needing to negotiate new terms with the bank that would accommodate the cash flow difficulty that Bainbridge was experiencing at the time.¹¹² However, the bank was not the cause of that difficulty.

Except to the limited extent identified, I am not persuaded that the bank's conduct of this matter was shown to have fallen short of community standards and expectations.

4 Mr Michael Doherty

4.1 Evidence

Mr Doherty owned and controlled a group of companies known as the Doherty Hotels group. In 2008, one of those companies obtained a business facility from Bankwest for approximately \$50 million. The loan was used to develop a hotel in Hobart.¹¹³ The company owned an historic hotel in Hobart called Hadley's Hotel. It had refurbished the hotel. The company also owned adjoining land and it intended to create a mixed-use development, with retail premises on the ground floor, a restaurant on the first floor, car parking on the next three floors, four floors of serviced apartments and a top floor of eight penthouses overlooking the Derwent River.¹¹⁴ The development was

¹¹⁰ Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 9 [45]

¹¹¹ cf Stephen Francis Weller, *Response to Round 3 and CBA Submissions*, 20 August 2018, 1.

¹¹² Transcript, Stephen Francis Weller, 28 May 2018, 2622; see also Exhibit 3.97, Witness statement of Stephen Francis Weller, 21 May 2018, 5 [29].

¹¹³ Transcript, Michael Edwin Doherty, 28 May 2018, 2639.

¹¹⁴ Transcript, Michael Edwin Doherty, 28 May 2018, 2634.

not completed before receivers were appointed in early 2012. Mr Peter Clark, Chief Credit Officer, CBA, said that Bankwest lost \$38 million on this account.¹¹⁵

A focus of the case study was Bankwest's use of valuations of the development in its decision making with respect to the facility, in particular when the facility was initially offered, and several years later when Bankwest was making decisions about whether to extend or renew the facilities. The development was a complex hotel and retail development and two different approaches could be taken to valuation of the property.

In 2008, when the facility was offered, the development was valued on a 'mixed-use' basis, meaning that various components of the development were assessed by reference to their different functions.¹¹⁶ This was in contrast to an approach of valuing the property 'in one line' as a hotel, which would have resulted in a lower valuation. Mr Clark accepted that the file showed that a mixed-use valuation had been used in the approval process.¹¹⁷ As will later appear, the bank's later decisions were based on a valuation 'in one line'.

Construction started in 2009.¹¹⁸ The borrower made the necessary interest payments but the bank asked for, and the borrower provided, additional security by giving a mortgage over another property.¹¹⁹

In 2010, a new manager took over the file.¹²⁰ The manager told Mr Doherty that because of what were described as 'concerns' over the June 2009 accounts of the borrower, and the 'worsening economy', it wanted an investigative accountant appointed.¹²¹ An accountant was appointed and made a report to the bank. The borrower was charged the accountant's fees

¹¹⁵ Transcript, Peter Nathaniel Clark, 29 May 2018, 2697.

¹¹⁶ Transcript, Michael Edwin Doherty, 28 May 2018, 2638.

¹¹⁷ Transcript, Peter Nathaniel Clark, 29 May 2018, 2687.

¹¹⁸ Transcript, Michael Edwin Doherty, 29 May 2018, 2645.

¹¹⁹ Transcript, Michael Edwin Doherty, 29 May 2018, 2645.

¹²⁰ Transcript, Michael Edwin Doherty, 29 May 2018, 2645.

¹²¹ Transcript, Michael Edwin Doherty, 29 May 2018, 2646.

of more than \$200,000.¹²² Mr Doherty was given a copy of some, but not all, of the report.¹²³

At about the same time, the file was reviewed as part of Project Magellan. It was classified as 'double red'.¹²⁴ The bank moved the file into CAM.¹²⁵

Towards the end of 2010, the bank proposed new conditions for the loan including an increase in the interest.¹²⁶

In an attempt to meet concerns then being expressed by the bank, Mr Doherty had commissioned, in May 2010, a valuer from the bank's panel of valuers to value the project. The valuation took account of the mixed uses to which the project would be put and valued the project at \$67.75 million.¹²⁷ Mr Doherty said that, by December 2010, there were some 'very significant presales on the building for the unit development and we were also negotiating with Mantra Group for them to come in' to manage part of the development.¹²⁸ He commissioned a further valuation of the project and the valuer valued the project, on the basis of its proposed mixed use, at \$75.317 million.¹²⁹

Mr Doherty said that, in early 2011, the building 'was coming to a close' but '[w]e were getting very short of cash due to all the additional expenses that the bank was piling on us and ... additional raised interest'.¹³⁰

In March 2011, the bank commissioned its own valuation. The valuer was instructed to value the property 'in one line'.¹³¹ Mr Doherty protested that the valuation would not take account of the actual trading performance of the project as indicated by, for example, the interest then being shown by the

¹²² Transcript, Michael Edwin Doherty, 29 May 2018, 2646

¹²³ Transcript, Michael Edwin Doherty, 29 May 2018, 2646.

¹²⁴ Transcript, Peter Nathaniel Clark, 29 May 2018, 2696.

¹²⁵ Transcript, Michael Edwin Doherty, 29 May 2018, 2646.

¹²⁶ Transcript, Michael Edwin Doherty, 29 May 2018, 2647.

¹²⁷ Transcript, Michael Edwin Doherty, 29 May 2018, 2647–8.

¹²⁸ Transcript, Michael Edwin Doherty, 29 May 2018, 2648.

¹²⁹ Transcript, Michael Edwin Doherty, 29 May 2018, 2648.

¹³⁰ Transcript, Michael Edwin Doherty, 29 May 2018, 2649.

¹³¹ Transcript, Michael Edwin Doherty, 29 May 2018, 2650.

Accor Group, in managing the hotel.¹³² The valuer completed the valuation. In accordance with usual practice, the borrower paid for the cost of the valuation. The bank refused to give Mr Doherty a copy.¹³³

The loan made by the bank to finance construction of the project was to expire at the end of July 2011. The bank said that it would not renew or extend the loan and that the borrower should move to another financier.¹³⁴ The borrower tried to make new arrangements but could not. It was then having cash flow difficulties. It owed the ATO about \$1.2 million.¹³⁵ It was negotiating with Mantra Group about management of serviced apartments in the project and there was the prospect that Mantra would make an initial payment of \$3 million if an agreement could be made.¹³⁶

In August 2011, a certificate of occupancy was granted for the accommodation. Mantra had appointed staff to run the hotel but no agreement had been made between Mantra, Mr Doherty's company and the bank. The bank refused to sign the agreement saying that if the company could not refinance its debt, the bank would probably appoint a receiver and sell the project with vacant possession.¹³⁷ Mr Clark explained the bank's refusal to make an agreement with Mantra by reference to Mantra's insistence on terms that the bank was not to disturb Mantra's possession of the property.¹³⁸ This, Mr Clark said, would have inhibited the bank's realising its security because only the party having the benefit of the non-disturbance provision would be willing to buy the property.¹³⁹

¹³² Transcript, Michael Edwin Doherty, 29 May 2018, 2650–1.

¹³³ Transcript, Michael Edwin Doherty, 29 May 2018, 2653.

¹³⁴ Transcript, Michael Edwin Doherty, 29 May 2018, 2654.

¹³⁵ Transcript, Michael Edwin Doherty, 29 May 2018, 2654.

¹³⁶ Transcript, Michael Edwin Doherty, 29 May 2018, 2653–4.

¹³⁷ Transcript, Michael Edwin Doherty, 29 May 2018, 2655–6.

¹³⁸ Transcript, Peter Nathaniel Clark, 29 May 2018, 2696.

¹³⁹ Transcript, Peter Nathaniel Clark, 29 May 2018, 2696.

Despite the bank insisting that the company refinance its debt, the bank said that it would not release its securities without first being paid \$980,000 as a 'break fee'.¹⁴⁰ As Mr Doherty said, this made refinancing impossible.¹⁴¹

By December 2011, the ATO was pressing for the company to pay its debt of \$1.2 million. In February 2012, Mr Doherty, recognising that the company would be trading while insolvent, asked the bank to recommend an insolvency practitioner to appoint as administrator.¹⁴² As he was taking steps to that end, the bank appointed a receiver.¹⁴³

As already noted, Mr Clark accepted that in earlier decision-making processes Bankwest had been prepared to rely on a mixed-use method of valuation. It is clear that Bankwest's position had changed by 2011. Mr Clark said that he did not know why the approach had changed.¹⁴⁴ Mr Clark's evidence was that ultimately the valuation method adopted in the July 2011 valuation did not have a bearing on the outcome of the Doherty account. While Mr Clark said that he had no basis on which to question Mr Doherty's evidence that he had been told by a Bankwest staff member that the valuation put the facility in breach of its LVR covenant,¹⁴⁵ his review of the file had revealed no formal notice of breach.¹⁴⁶ Moreover, his evidence was that the high LVR was not itself the reason that the facility was not renewed. His review of the file suggested that there were concerns about the amounts the borrower owed to its creditors, the time it would take to complete the project coupled with the belief that the bank did not have a 'good understanding of the borrower'.¹⁴⁷ Mr Clark did accept that it would have been a fair thing to do to show Mr Doherty the valuation in the circumstances.¹⁴⁸

¹⁴⁰ Transcript, Michael Edwin Doherty, 29 May 2018, 2656.

¹⁴¹ Transcript, Michael Edwin Doherty, 29 May 2018, 2656.

¹⁴² Transcript, Michael Edwin Doherty, 29 May 2018, 2656.

¹⁴³ Transcript, Michael Edwin Doherty, 29 May 2018, 2656.

¹⁴⁴ Transcript, Peter Nathaniel Clark, 29 May 2018, 2688.

¹⁴⁵ Transcript, Peter Nathaniel Clark, 29 May 2018, 2693–4.

¹⁴⁶ Transcript, Peter Nathaniel Clark, 29 May 2018, 2693–4.

¹⁴⁷ Transcript, Peter Nathaniel Clark, 29 May 2018, 2695.

¹⁴⁸ Transcript, Peter Nathaniel Clark, 29 May 2018, 2683.

4.2 What the case study showed

Mr Doherty has submitted that the conduct of Bankwest was unconscionable conduct within the meaning of the ASIC Act. The starting premise of that submission is that Bankwest made a continuing decision from 2010 ‘to reduce its over-exposure to east coast high-risk hospitality assets at any cost to [the Doherty Hotels group]’.¹⁴⁹ As is apparent from the actual course of events explained above, and the matters addressed in Chapter 5, the evidence does not support that premise and I do not accept that the conduct may constitute unconscionable conduct within the meaning of the ASIC Act.

Again it is necessary to consider what happened in this case recognising that the bank decided that it would not extend the loan it had made. The bank made that decision according to its assessment of whether it was better to enforce the loan or extend further credit. I have no doubt that the borrower thought that extending the loan was the better choice to be made: better for the borrower and ultimately better for the bank. The borrower would say, rightly, that the project was very close to complete and that income would soon start to flow. But the bank decided that it would not extend further credit. That is, its assessment of the prospects for the venture differed from the assessments the borrower made. And both bank and borrower suffered substantial loss.

The borrower can point to CBA adopting a more conservative valuation basis than Bankwest had adopted when the loan was made. But again, that was a choice made by the bank and I cannot say that the choice was not open.

Apart from the bank’s failure to give Mr Doherty the valuation on which it relied, I am not persuaded that the bank’s conduct fell below what the community would expect it to have done.

¹⁴⁹ Michael Doherty, *Submissions of Michael Doherty and Doherty Hotels Group (DHG) with Respect to Conduct of Bankwest in Relation to Its Funding of Hadleys Hotel in Hobart, Tasmania and an Adjacent Mixed-use Development Known as Inner Collins, in 2011 and 2012*, 19 June 2018, 17 [80].

5 Mr Brendan Stanford

The fourth and final Bankwest case study concerned two brothers, Brendan and Michael Stanford, who owned and operated the Coronation Hotel in Portland, New South Wales. Mr Brendan Stanford and Mr David Cohen, CBA's Chief Risk Office, gave evidence.

5.1 Evidence

The Stanfords bought the hotel in 2006 for \$1.6 million.¹⁵⁰ They borrowed \$1.2 million from Bankwest to assist with this purchase.¹⁵¹ The loan was a principal and interest loan amortising over a 20-year term.¹⁵² As part of the loan application process, Brendan Stanford arranged for one of Bankwest's panel valuers to prepare a valuation of the Coronation Hotel. The valuer's report valued the hotel at \$1.6 million.¹⁵³

The Stanfords bought the hotel in their own names.¹⁵⁴ They incorporated a company, Let It Rain Pty Ltd, to run the hotel business. Mr Brendan Stanford was a shareholder of Let It Rain.¹⁵⁵ Mr Michael Stanford was the sole director of Let It Rain and was the licensee for the Coronation Hotel.¹⁵⁶ For the first 15 or 16 months, both Brendan and Michael Stanford were involved in the daily management and operations at the Coronation Hotel. From about the end of 2007, Mr Michael Stanford assumed responsibility for the running of the Coronation Hotel, and Brendan Stanford returned to separate paid employment in Bathurst.¹⁵⁷ Brendan Stanford remained, however, involved in the management and operations at the Coronation

¹⁵⁰ Transcript, Brendan John Stanford, 29 May 2018, 2703.

¹⁵¹ Transcript, Brendan John Stanford, 29 May 2018, 2704.

¹⁵² Transcript, Brendan John Stanford, 29 May 2018, 2704; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 39 [156], Exhibit DC-81 [CBA.4000.0037.5116].

¹⁵³ Transcript, Brendan John Stanford, 29 May 2018, 2704.

¹⁵⁴ Transcript, Brendan John Stanford, 29 May 2018, 2704.

¹⁵⁵ Transcript, Brendan John Stanford, 29 May 2018, 2705.

¹⁵⁶ Transcript, Brendan John Stanford, 29 May 2018, 2706.

¹⁵⁷ Transcript, Brendan John Stanford, 29 May 2018, 2705.

Hotel, speaking to Michael Stanford ‘virtually daily’, and helping out with operations at the Coronation Hotel whenever he could.¹⁵⁸

In 2009, in accordance with the terms of the business loan, the Stanfords arranged for one of the bank’s panel valuers to prepare a new valuation report for the Coronation Hotel. On 30 October 2009, the valuers provided their report valuing the Coronation Hotel at \$1.55 million.¹⁵⁹

In 2010, the Coronation Hotel experienced a downturn in trade. Brendan Stanford’s evidence was that he considered this downturn to be the result of flow-on effects from the GFC, as well as certain regulatory changes that had affected the hotel industry as a whole, including, in particular, smoking legislation reform.¹⁶⁰ Despite the downturn, the Stanfords continued to make all principal and interest repayments due under the loan.¹⁶¹ Let It Rain, however, fell behind on its payment commitments to the ATO. The Stanfords negotiated a repayment plan with the ATO in relation to the Let It Rain arrears and began making repayments to the ATO in accordance with this agreement. Contemporaneous internal credit memos prepared by the Bankwest relationship manager reveal that, at all relevant times, the bank was aware of the ATO arrears, the repayment plan, and the Stanfords’ compliance with the repayment plan.¹⁶²

In April 2010, the bank offered to extend an overdraft facility to Let It Rain.¹⁶³ This offer was accepted, and the overdraft facility was in place by early July 2010.

¹⁵⁸ Transcript, Brendan John Stanford, 29 May 2018, 2705.

¹⁵⁹ Transcript, Brendan John Stanford, 29 May 2018, 2706.

¹⁶⁰ Transcript, Brendan John Stanford, 29 May 2018, 2706.

¹⁶¹ Transcript, Brendan John Stanford, 29 May 2018, 2707;
Transcript, David Antony Keith Cohen, 30 May 2018, 2770.

¹⁶² Transcript, Brendan John Stanford, 29 May 2018, 2707; Transcript, David Antony Keith Cohen, 30 May 2018, 2769, 2774; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-94 [CBA.0001.0285.0983].

¹⁶³ Transcript, David Antony Keith Cohen, 30 May 2018, 2770; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 39 [156], 40 [160]–[163]; Exhibit DC-81 [CBA.4000.0037.5116], Exhibit DC-84 [CBA.4000.0037.5126], Exhibit DC-85 [CBA.0001.0285.1082].

In April and May 2010, the business loan with the Stanfords was reviewed by the bank as part of 'Project Magellan'. This review outlined the bank's concern about the falling value of the hotel.¹⁶⁴

In late 2010, the bank started issuing breach letters for non-monetary defaults relating to reporting covenants, and DSR and ICR covenant breaches.¹⁶⁵ Internally, the bank acknowledged the Stanfords' 'first class' repayment history but, in light of the non-monetary covenant breaches, the bank's state manager of business credit began pressing for the bank to exit the banking relationship with the Stanfords and Let It Rain.¹⁶⁶ Internal bank records of the time reveal that the bank did not consider that it would be possible for the Stanfords to refinance with another lender, and that the only viable option was for the Stanfords to sell the Coronation Hotel.¹⁶⁷

Mr Cohen said, in his evidence, and I accept, that non-monetary defaults – and in particular breaches of financial ratios – are powerful indicators of trouble to come.¹⁶⁸ In this case, because there had been non-monetary defaults, the bank expected there to be financial breaches¹⁶⁹ and it sought to exit the connection. Mr Cohen said, however, that he did not consider that the bank adequately communicated to the Stanfords the bank's position in respect of non-monetary defaults and why those defaults led the bank to conclude that the only viable option was to sell the Coronation Hotel. Mr Cohen said that in failing to provide a proper explanation to the Stanfords, the bank's conduct was 'not reasonable' and 'not fair'.¹⁷⁰

In the second half of 2011, Bankwest appointed PPB Advisory as investigative accountants to produce a report on the state of the business at

¹⁶⁴ Transcript, David Antony Keith Cohen, 30 May 2018, 2771, 2773; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-103 [CBA.0001.0285.1114].

¹⁶⁵ Transcript, Brendan John Stanford, 29 May 2018, 2709–10.

¹⁶⁶ Transcript, David Antony Keith Cohen, 30 May 2018, 2780, 2781.

¹⁶⁷ Transcript, David Antony Keith Cohen, 30 May 2018, 2785; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-114 [CBA.0001.0285.1318].

¹⁶⁸ Transcript, David Antony Keith Cohen, 30 May 2018, 2800.

¹⁶⁹ Transcript, David Antony Keith Cohen, 30 May 2018, 2798.

¹⁷⁰ Transcript, David Antony Keith Cohen, 30 May 2018, 2799.

the Coronation Hotel. Mr Brendan Stanford's evidence was that he had no knowledge of PPB Advisory being appointed until he received a telephone call from his brother that PPB Advisory had shown up to the hotel.¹⁷¹

In their report, the accountants raised concerns about the management of the Coronation Hotel. The investigative accountants also expressed concern about the financial controls in place at the Coronation Hotel. They said that there was a risk that the ATO may take steps to recover its debt. But there was no evidence that the investigative accountants were aware of the repayment plan in place between the Stanfords and the ATO.¹⁷² The investigative accountants recommended that the hotel be sold either voluntarily by the Stanfords, or compulsorily by the bank.¹⁷³

In November 2011, Bankwest's lawyers sent the Stanfords a letter that referred to the investigative accountants' report and said that, having reviewed this report, the bank was concerned that a change had occurred in the Coronation Hotel's financial condition that had had a material adverse effect on the value of the bank's security. The letter required the Stanfords to respond within seven days acknowledging that there had been a material adverse change in the financial condition of the hotel or, if not, providing reasons why the Stanfords did not consider there had been such a change, along with financial records to support the Stanfords' position. The letter also required the Stanfords to pay the investigative accountants' fees of \$9,900.¹⁷⁴

In response, the Stanfords engaged lawyers, who wrote back to the bank's lawyers asking for a copy of the PPB Advisory report and the invoice for their work.¹⁷⁵ The bank never provided the Stanfords with a copy of the

¹⁷¹ Transcript, Brendan John Stanford, 29 May 2018, 2711.

¹⁷² Transcript, David Antony Keith Cohen, 30 May 2018, 2788; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-115 [CBA.4000.0037.4936].

¹⁷³ Transcript, David Antony Keith Cohen, 30 May 2018, 2787; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-115 [CBA.4000.0037.4936 at .4940].

¹⁷⁴ Transcript, Brendan John Stanford, 29 May 2018, 2712; Witness statement of David Antony Keith Cohen, 17 May 2018, Exhibit DC-118 [CBA.0517.0074.0003].

¹⁷⁵ Transcript, Brendan John Stanford, 29 May 2018, 2713; Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018, Exhibit BJS-9 [CBA.4000.0037.5293].

report or the invoice. The investigative accountants' fees were charged to Let It Rain's overdraft account.¹⁷⁶

At the time these events occurred, CBA's policy was that it was appropriate not to provide an investigative accountant report to borrowers in the position of the Stanfords, and the CBA policy was to provide borrowers with only seven days to respond to a notice of material adverse change.¹⁷⁷

In his evidence, Mr David Cohen accepted that in asking the Stanfords to respond to concerns raised in an investigative accountants' report that was not provided to them – and in only providing the Stanfords with seven days to do so – CBA acted unfairly.¹⁷⁸ Mr Cohen also accepted that it was unfair for the bank to require the Stanfords to pay for a report that they had not received, and to only give them seven days to do so.¹⁷⁹

Mr Cohen said that CBA's policy has since changed. He said that, under the CBA policy that now applies to the Bankwest brand, the bank will provide 30 days for a customer to respond to matters raised in an investigative accountant's report. The bank will also provide a copy of the report to borrowers in most, but not all, circumstances.¹⁸⁰ In particular, where an investigative accountant's report expresses concerns about the quality of the management of a business, CBA's policy permits those parts of the report to be excised and not shown to the borrower. Mr Cohen's evidence was that this approach is taken because commentary on the quality of management of the business 'can be quite emotionally confronting for the borrower'.¹⁸¹ Instead of providing this information to the borrower, CBA's policy requires that the relevant banker have a discussion with the borrower in relation to the conclusions reached in the investigative

¹⁷⁶ Transcript, Brendan John Stanford, 29 May 2018, 2713.

¹⁷⁷ Transcript, David Antony Keith Cohen, 30 May 2018, 2789; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 18–19 [88]–[90].

¹⁷⁸ Transcript, David Antony Keith Cohen, 30 May 2018, 2789.

¹⁷⁹ Transcript, David Antony Keith Cohen, 30 May 2018, 2790–1.

¹⁸⁰ Transcript, David Antony Keith Cohen, 30 May 2018, 2790.

¹⁸¹ Transcript, David Antony Keith Cohen, 30 May 2018, 2790.

accountants' report.¹⁸² As to this aspect of CBA's current policy, Mr Cohen said:¹⁸³

[T]he discussion with the borrower about the report would entail a view being expressed by the bank as to the capability of the borrower to trade their way out of a difficult situation, for example. So, although the comments, written comments in the report, would probably not be shown to the borrower, the point of the policy that requires engagement with the borrower to talk about the report is aimed at ensuring that there is a discussion about the findings, albeit not in the black and white terms of the written report.

The Stanfords made a complaint to FOS in mid-November 2011. As a consequence, recovery action by the bank ceased.¹⁸⁴ In late 2011, the bank and the Stanfords met, together with their respective legal representatives. Mr Stanford recalls that he and his brother 'were trying to ascertain what the investigative report actually showed'.¹⁸⁵ The bank pointed to the downturn in trade at the Coronation Hotel; the Stanfords said that 'all businesses go through peaks and troughs'.¹⁸⁶ At the end of the meeting, Mr Stanford had the impression that the relationship with the bank was not recoverable¹⁸⁷ and thinks that he and his brother contemplated selling the hotel.¹⁸⁸

Mr Stanford had limited involvement in the business in 2012 because he was ill and was receiving treatment.¹⁸⁹ During that year, the first FOS complaint was closed. In 2013, the Stanfords made a second FOS complaint.¹⁹⁰ FOS arranged a telephone conciliation conference in

¹⁸² Transcript, David Antony Keith Cohen, 30 May 2018, 2791.

¹⁸³ Transcript, David Antony Keith Cohen, 30 May 2018, 2790.

¹⁸⁴ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 46–7 [191]–[192].

¹⁸⁵ Transcript, Brendan John Stanford, 29 May 2018, 2714.

¹⁸⁶ Transcript, Brendan John Stanford, 29 May 2018, 2714.

¹⁸⁷ Transcript, Brendan John Stanford, 29 May 2018, 2715.

¹⁸⁸ Transcript, Brendan John Stanford, 29 May 2018, 2715; Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018, 6 [31].

¹⁸⁹ Transcript, Brendan John Stanford, 29 May 2018, 2716; Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018, 6 [32].

¹⁹⁰ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 48 [196]; Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018, 6 [34].

January 2014.¹⁹¹ By this time, there had been monetary defaults under the Stanfords' loan.¹⁹² The bank and the Stanfords entered into an agreement that gave the Stanfords until 30 June 2014 to sell the Coronation Hotel and repay the outstanding debt.¹⁹³

The Stanfords engaged a broker to attempt to sell the hotel and a marketing campaign was prepared.¹⁹⁴ However, the price that the Stanfords wanted to obtain from the sale was above the market price at the time.¹⁹⁵ The Senior Manager from CAM who was handling the Stanfords' file expressed the view, in a contemporaneous email, that the Stanfords were not genuinely interested in selling the hotel.¹⁹⁶ Mr Stanford's recollection is that they wanted to sell but then realised that they could not obtain a price sufficient to pay out the bank.¹⁹⁷

On 26 June 2014, four days before the Stanfords were required under their agreement to have sold the hotel, they made an offer to the bank. The offer was to pay down the loan by \$300,000 over the following month on the basis that they would then continue to operate the hotel for three to five years before trying to sell it. The \$300,000 was money that had been, or would be, borrowed by the partner of Mr Stanford's brother.¹⁹⁸ The bank rejected this offer. The offer carried a very substantial risk to the Stanfords and their partners because of the possibility that the performance of the business would continue to decline and the Stanfords would then not be

¹⁹¹ Transcript, Brendan John Stanford, 29 May 2018, 2716; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 48 [198]; Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018, 7 [35].

¹⁹² Transcript, David Antony Keith Cohen, 30 May 2018, 2799.

¹⁹³ Transcript, Brendan John Stanford, 29 May 2018, 2716; Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 48–9 [199]; Exhibit 3.106, Witness statement of Brendan John Stanford, 24 May 2018, 7 [35].

¹⁹⁴ Transcript, Brendan John Stanford, 29 May 2018, 2716; Transcript, David Antony Keith Cohen, 30 May 2018, 2801.

¹⁹⁵ Transcript, Brendan John Stanford, 29 May 2018, 2716–18; Transcript, David Antony Keith Cohen, 30 May 2018, 2801.

¹⁹⁶ Exhibit 3.126, 27 June 2014, Emails between Fragar and Medway; see also Transcript, David Antony Keith Cohen, 30 May 2018, 2802.

¹⁹⁷ Transcript, Brendan John Stanford, 29 May 2018, 2717–18.

¹⁹⁸ Exhibit 3.107, 26 June 2014, Email Medway to Bankwest; Transcript, Brendan John Stanford, 29 May 2018, 2718–19.

able to service the balance of the loan, still be in default, still be unable to realise a price sufficient to pay out the balance of the loan and would then also have lost an additional \$300,000.¹⁹⁹ Mr Cohen said that he had made inquiries of the relevant manager who had informed him that a reason that she had rejected the offer was because she had a serious concern that the situation would get worse for the Stanfords.²⁰⁰

The Stanfords made a further offer to pay \$400,000 and then try to refinance the balance. This offer was also rejected though by a different bank employee who suggested a counter-proposal that if the Stanfords wished to repay \$400,000 then the bank might consider allowing a further period of eight weeks for the Stanfords to seek to refinance fully.²⁰¹ The Stanfords' offer carried the same risk for them as the earlier offer. Mr Cohen's view was that the counter-proposal should not have been made because of the risk to third parties.²⁰² I agree with Mr Cohen's view though of course ultimately the counter-proposal was not accepted by the Stanfords so the danger was avoided.

The bank appointed receivers and managers on 9 July 2014.²⁰³ The hotel was sold for \$525,000 leaving Bankwest with a loss of approximately \$600,000.²⁰⁴ Bankwest decided not to pursue its rights under the guarantees given by the Stanfords having regard to Mr Stanford's illness, the co-operation of the Stanfords with the receivers and the minimal anticipated likely return of any action on the guarantees.²⁰⁵ The experience was very difficult for the Stanfords and Mr Stanford explained that his brother had struggled after the sale.²⁰⁶

¹⁹⁹ See Transcript, Brendan John Stanford, 29 May 2018, 2722; see also Transcript, David Antony Keith Cohen, 30 May 2018, 2804–5.

²⁰⁰ Transcript, David Antony Keith Cohen, 30 May 2018, 2804–5.

²⁰¹ Exhibit 3.109, 2 July 2014, Emails between Bankwest, Medway and others; Transcript, Brendan John Stanford, 29 May 2018, 2720.

²⁰² Transcript, David Antony Keith Cohen, 30 May 2018, 2807.

²⁰³ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 50 [205].

²⁰⁴ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 50–1 [208]–[209].

²⁰⁵ Exhibit 3.111, Witness statement of David Antony Keith Cohen, 17 May 2018, 51 [209].

²⁰⁶ Transcript, Brendan John Stanford, 29 May 2018, 2722.

5.2 What the case study showed

As Mr Cohen acknowledged, not all the bank's dealings with the Stanfords were fair. When the bank requires the borrower to pay for a report it is ordinarily fair that the bank give the borrower a copy. I accept that there may be reasons to excise some parts of an investigative accountants' report but, as a general rule, the customer should be given a copy of what the bank has commissioned at the customer's expense. And when the bank considers that a borrower's defaults may point to more significant trouble ahead, it will ordinarily be important that the bank tell the borrower. But the bank did not do that in this case. Mr Cohen was right to acknowledge that these actions were not fair. They fell below what the community would expect.

6 Issues

Together the four cases directed attention to the evident gap between what borrowers hoped or expected that 'their' bank would do when the loans that had been made were at the end of their term and the reality that the bank was not obliged to extend further credit. Whether to extend further credit will be a decision for the bank to make and unless it has represented or promised that it will extend more credit, the bank will make its decision by reference to *its* assessment of what is in *its* best interests.

The gap between a customer's hopes and expectations and what I have called the 'reality' of the situation is made larger when banks give such emphasis as they do in advertisements to notions of help for, even partnership with, small business. Inevitably, the business owner whose loan is enforced or not renewed will draw unfavourable comparisons between what was said and what was done.

Regardless of whether comparisons of that kind are fair or well-founded, the deeper questions remain. Those questions may best be identified by reference to the 2019 Code. Are the provisions of that Code about:

- notice of intention not to renew a loan;
- non-monetary defaults; and
- provision of valuations and reports,

sufficient? Or should more be expected of banks?

In considering the adequacy of the Code, it is also important to recognise that a breach of these requirements of the Code may not necessarily lead to compensable loss for a borrower, at least of the kind that appears to be envisaged by some who have made submissions to the Commission. For example, in the future, the failure to provide a copy of a valuation or investigative accountant's report may breach a provision of the 2019 Code. But the failure to provide the valuation or report will probably not cause any loss to the borrower even if receivers and managers are appointed and the borrower's business is sold.

Similarly, with respect to the conduct that I have identified as being below community standards and expectations, I should say that while the conduct falls below what the community would expect of a bank, the evidence does not show that the conduct caused *financial* loss to the borrowers though it contributed (and in some cases contributed substantially) to the very great emotional distress they suffered.

Case studies:

Agricultural lending

1 Landmark – ANZ

The first case study in the fourth round of hearings concerned ANZ's handling of the accounts of former customers of Landmark Financial Services (Landmark) after ANZ acquired Landmark's loan and deposit books in March 2010. The Commission heard evidence from Mr Benjamin Steinberg, ANZ's Head of Lending Services – Corporate and Commercial. Lending Services is a team within ANZ that is responsible for helping to manage ANZ's high-risk corporate and commercial accounts.¹ The Commission also heard evidence from Mr Michael Hirst.

Over the course of three days, Mr Steinberg gave evidence about 13 farmers or farming families who were former customers of Landmark Financial Services: the Cheesmans, the Courtes, the Hirsts, the Harleys, the Handleys, the Cashmores, the Phillotts, and six other farmers or farming families whose names are the subject of non-publication directions. Mr Steinberg also gave evidence about ANZ's acquisition of Landmark more generally, and about changes in the practices, policies and culture of ANZ's Lending Services team over the past eight years.

Mr Steinberg acknowledged that ANZ had engaged in conduct that fell below community standards and expectations in many of the cases examined. In some instances, Mr Steinberg acknowledged that ANZ had engaged in misconduct. In each of the cases, Mr Steinberg acknowledged that there were things that ANZ would do differently if a similar situation arose today.

¹ Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 4 [7], [9].

1.1 Background

ANZ's board decided to acquire the loan and deposit books of Landmark Financial Services on 21 October 2009.² There were two main motives for the acquisition. First, to allow ANZ to enhance its agribusiness portfolio and become the second largest agribusiness bank;³ and second, to enable ANZ to cross-sell its products to Landmark customers.⁴ ANZ also identified an opportunity to re-price the loans of former Landmark customers to earn an additional \$6 million in annual revenue.⁵ Mr Steinberg was not able to say whether ANZ took advantage of this opportunity.⁶ But in the absence of evidence to the contrary, it is improbable that ANZ did not take the opportunity it had identified.

ANZ undertook a due diligence process in connection with the acquisition. Among other things, that process identified that the Landmark loan book was of lower quality than ANZ's loan book.⁷ ANZ was aware that there were issues in relation to the Landmark loan book, including a poor control environment within Landmark and a lack of regulatory oversight of Landmark.⁸ In particular, ANZ identified that Landmark's management had underestimated the provision that would need to be made for the losses it would incur on its loan book.⁹

² Transcript, Benjamin William Steinberg, 25 June 2018, 3128.

³ Transcript, Benjamin William Steinberg, 25 June 2018, 3129; Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, Exhibit BWS-1 [ANZ.800.097.7082 at .7083 -.7084].

⁴ Transcript, Benjamin William Steinberg, 25 June 2018, 3130; Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, Exhibit BWS-1 [ANZ.800.097.7082 at .7084].

⁵ Transcript, Benjamin William Steinberg, 25 June 2018, 3143; Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, Exhibit BWS-7 [ANZ.800.616.1266 at .1268].

⁶ Transcript, Benjamin William Steinberg, 25 June 2018, 3143–4.

⁷ Transcript, Benjamin William Steinberg, 25 June 2018, 3147–8.

⁸ Transcript, Benjamin William Steinberg, 25 June 2018, 3152.

⁹ Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, Exhibit BWS-3 [ANZ.800.616.1038 at .1053]; Transcript, Benjamin William Steinberg, 25 June 2018, 3151.

ANZ acquired the Landmark loan book on 1 March 2010.¹⁰ From that time, the former customers of Landmark were customers of ANZ.¹¹ Mr Steinberg acknowledged that ANZ's communication with former Landmark customers at the time of and immediately following the acquisition was not always satisfactory,¹² and that ANZ could have done a better job in communicating with the former Landmark customers about the acquisition.¹³ He acknowledged that this conduct fell below community standards and expectations.¹⁴

Over the following year, ANZ moved the former Landmark customers onto its systems.¹⁵ Mr Steinberg acknowledged that there were issues associated with this process that affected former Landmark customers.¹⁶ He acknowledged that, after the acquisition, some former Landmark customers experienced delays in receiving responses from ANZ to information and funding requests.¹⁷ He said that there were cases where limits were incorrectly loaded onto the new system and interest rates were incorrectly charged,¹⁸ and that some customers experienced difficulties in opening accounts.¹⁹ Mr Steinberg rightly acknowledged that this conduct fell below community standards and expectations.²⁰

Mr Steinberg accepted that the quality of the Landmark loan book was worse than ANZ anticipated.²¹ In March 2010, there were 433 former Landmark accounts rated as high risk or impaired, with a total value of

¹⁰ Transcript, Benjamin William Steinberg, 25 June 2018, 3132.

¹¹ Transcript, Benjamin William Steinberg, 25 June 2018, 3132.

¹² Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 21 [51(a)].

¹³ Transcript, Benjamin William Steinberg, 25 June 2018, 3140–1.

¹⁴ Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 20 [50].

¹⁵ Transcript, Benjamin William Steinberg, 25 June 2018, 3141.

¹⁶ Transcript, Benjamin William Steinberg, 25 June 2018, 3141.

¹⁷ Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 21 [51(b)].

¹⁸ Transcript, Benjamin William Steinberg, 25 June 2018, 3141.

¹⁹ Transcript, Benjamin William Steinberg, 25 June 2018, 3141.

²⁰ Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 20 [50].

²¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3157.

\$273 million.²² (A 'high risk account' had an internal risk rating of 7+D or worse; an impaired loan had an internal risk rating of 8 -, 9 or 10.²³) By July 2013, there were 1,050 former Landmark accounts with an internal risk rating of 7+D or worse, with a total value of \$722 million.²⁴ This represented almost one third of the total value of the former Landmark loan book.²⁵

As already noted, Mr Steinberg gave evidence about 13 farmers or farming families who were former customers of Landmark.

1.2 The Cheesmans

Arthur and Rhonda Cheesman, their son Reuben, and his wife Katrina ran a farm in rural Victoria.²⁶ The farm produced hay, cereals, oil seeds and pulses.²⁷ The Cheesmans were third and fourth generation farmers who had farmed in the area all their lives.²⁸

The Cheesmans' farm was spread across a number of properties. The Cheesmans owned some of these properties and leased others.²⁹ Arthur and Rhonda Cheesman lived in a house on one of the properties, and Reuben and Katrina Cheesman lived in a house on another property.³⁰

The Cheesmans had been customers of Landmark since 2004.³¹ By March 2010, when ANZ acquired the Landmark loan book, they were already facing financial difficulties.³² A Landmark credit submission

²² Exhibit 4.10G, Witness statement of Benjamin William Steinberg (Annexure G), 18 June 2018; Transcript, Benjamin William Steinberg, 26 June 2018, 3158; Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 10–11 [34]–[35].

²³ Transcript, Benjamin William Steinberg, 26 June 2018, 3158.

²⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3158; Exhibit 4.8, Witness statement of Benjamin William Steinberg, 18 June 2018, 10–11 [34]–[35].

²⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3158.

²⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3167.

²⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3167.

²⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3167.

²⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3167.

³⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3168.

³¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3168.

³² Transcript, Benjamin William Steinberg, 26 June 2018, 3169.

prepared in May 2009 showed that the Cheesmans' farm had made a loss in each of the previous three financial years.³³ It also showed that, in the 2007 and 2008 financial years, the interest costs being paid by the Cheesmans were around 40% of their total farm income.³⁴ Part of the reason for this was that the Cheesmans' region had experienced droughts and below average rainfall.³⁵

By August 2010, ANZ was already considering transferring the Cheesmans' file to Lending Services.³⁶ In October 2010, ANZ increased the Cheesmans' facilities to allow them to trade for the rest of the season.³⁷ It did this on the basis that the Cheesmans would clear their debt through the sale of assets by March 2011.³⁸ The Cheesmans sold one of their properties and used the proceeds to pay down their debt, but they were not able to repay their debt in full.³⁹ In March 2011, their file was transferred to Lending Services.⁴⁰

After the Cheesmans' file was transferred to Lending Services, the ANZ staff member with primary responsibility for the file was Mr Ian Wormald.⁴¹ In July 2011, Mr Wormald recommended that ANZ extend the Cheesmans' facilities to 31 March 2012, on the condition that the Cheesmans enter into an Asset Management Agreement (AMA) with ANZ.⁴²

In October 2011, consistently with that recommendation, ANZ sent the Cheesmans a letter of offer and a proposed AMA. Under the letter of offer, ANZ said that it would extend the Cheesmans' facilities until March 2012,

³³ Transcript, Benjamin William Steinberg, 26 June 2018, 3169.

³⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3169.

³⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3170.

³⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3170.

³⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3171.

³⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3171–2.

³⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3172.

⁴⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3172.

⁴¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3172.

⁴² Transcript, Benjamin William Steinberg, 26 June 2018, 3173–4.

on the condition that the Cheesmans entered into the AMA.⁴³ The letter of offer recorded that the facilities would be secured by mortgages over the Cheesmans' properties, including the properties on which they lived, as well as a crop lien, a stock mortgage, and guarantees.⁴⁴ Under the proposed AMA, ANZ said that it would temporarily withhold from enforcing its securities, provided that the Cheesmans took certain steps to sell the secured property.⁴⁵ If the Cheesmans did not sell the secured property by the end of November 2011 – less than two months after ANZ provided the AMA to the Cheesmans – the AMA would require the Cheesmans to put the property up for auction.⁴⁶ If the property did not sell at auction, the AMA would require the Cheesmans to give ANZ vacant possession of the property within seven days of its demand.⁴⁷

In its submissions, ANZ did not accept that, by proposing to enter into an agreement in these terms, its conduct fell below community standards and expectations.⁴⁸ In particular, ANZ said that the time period for the sale of the properties in the AMA should be viewed in the overall context of ANZ's engagement with the Cheesmans to secure the sale of assets and a reduction in debt, which process was ongoing from early 2010.⁴⁹ ANZ also said that 'there is no suggestion that the Cheesmans viewed the period of two months as inappropriate in their overall circumstances'.⁵⁰

⁴³ Transcript, Benjamin William Steinberg, 26 June 2018, 3174–5; Exhibit 4.10G.22, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-22 [ANZ.160.004.0002 at .0006].

⁴⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3175–6.

⁴⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3175; Exhibit 4.10G.17, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-17 [ANZ.160.004.0013 at .0016].

⁴⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3176.

⁴⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3176.

⁴⁸ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 5 [20].

⁴⁹ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 5 [21]; Transcript, Benjamin William Steinberg, 26 June 2018, 3178.

⁵⁰ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 5 [21].

It appears from the evidence, however, that the Cheesmans did regard that period as inappropriate. Before they signed the AMA, the Cheesmans asked ANZ if they could delay the sale of the two properties where they lived, and delay the sale of their equipment and machinery.⁵¹ The Cheesmans wanted to see if they could clear the debt through the sale of the other properties, or refinance after they had reduced the debt.⁵² ANZ did not agree to this, but did allow the Cheesmans some additional time to sell their properties – until 15 January 2012 by private sale, and until 31 March 2012 to sell by auction.⁵³ The Cheesmans signed the AMA.

By January 2012, the Cheesmans had not been able to sell the properties, and they had organised an auction to take place on 10 February 2012.⁵⁴ The Cheesmans asked ANZ if their houses could be excluded from the auction. On 13 January 2012, through their accountant, the Cheesmans told ANZ that, if those properties were sold, they would have nowhere else to live.⁵⁵ On 27 January 2012, the Cheesmans' accountant again told ANZ that, if the properties were sold, the Cheesmans were 'concerned as to where they would reside'.⁵⁶

On 31 January 2012, Mr Wormald prepared a diary note in which he recorded his consideration of the Cheesmans' proposal to exclude the houses from the auction, and the enquiries he had made with a valuer about the proposal.⁵⁷ Mr Wormald did not mention as a consideration that the Cheesmans would have nowhere to live if the houses were sold.⁵⁸ In

⁵¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3178–9.

⁵² Transcript, Benjamin William Steinberg, 26 June 2018, 3179–80.

⁵³ Transcript Benjamin William Steinberg, 26 June 2018, 3181–2; Exhibit 4.10G.17, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-17 [ANZ.160.004.0013 at .0016–.0017].

⁵⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3182.

⁵⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3182–3; Exhibit 4.10G.27.6, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0047].

⁵⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3182–3; Exhibit 4.10G.27.7, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0046].

⁵⁷ Exhibit 4.10G.27.10, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0043 at .0044].

⁵⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3185.

the diary note, Mr Wormald said, 'We have a choice – exclude the houses from sale and realise circa \$2.5M or include the houses in the auction and realise circa \$2.5M'.⁵⁹ He said that he would be prepared to exclude one of the houses from the auction, but needed further information to assess the proposal.⁶⁰

Even though it appeared from the diary note that the exclusion of the houses from the auction might not make any substantial difference to the price obtained ANZ did not entertain the proposal.⁶¹ The following day, 1 February 2012, Mr Wormald told the Cheesmans' accountant that the houses would not be excluded from the auction.⁶²

Mr Steinberg acknowledged that, if the same situation arose today, ANZ would take a more empathetic approach to the needs of its customers, and look at options that would, if possible, result in some retention of home ownership.⁶³ He also acknowledged that the 'right thing to do' at the time of these events would have been to structure a different arrangement with the Cheesmans, which would have potentially given them an opportunity to retain some form of home ownership, and some way of earning an income.⁶⁴

Despite this, Mr Steinberg did not accept that the community would have expected ANZ to handle this situation differently at the time. He accepted only that 'certain parts of the community' would have expected ANZ to act differently.⁶⁵ In its submissions, ANZ did not accept that its conduct in refusing to delay the sale of the Cheesmans' homes fell below community

⁵⁹ Exhibit 4.10G.27.10, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0043 at .0044].

⁶⁰ Exhibit 4.10G.27.10, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0043 at .0044–.0045].

⁶¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3186–7; Exhibit 4.10G.27.9, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0042].

⁶² Exhibit 4.10G.27.11, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0041].

⁶³ Transcript, Benjamin William Steinberg, 26 June 2018, 3187.

⁶⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3188–9.

⁶⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3187–8.

standards and expectations.⁶⁶ In making this submission, ANZ relied heavily on a file note recording a conversation between a real estate agent and a member of the Lending Services team that took place on 2 February 2012, in which the real estate agent expressed the view that the properties should be sold including the house blocks.⁶⁷ Yet the view that Mr Wormald held was that the sale of the houses might not increase the amount realised.

It may have been in line with community standards and expectations if ANZ had refused the Cheesmans' proposal after it had discussed the matter with the real estate agent and obtained further and different information from the agent. But that is not what occurred. ANZ told the Cheesmans' accountant on 1 February 2012 that the house blocks would not be excluded from the auction.⁶⁸ In circumstances where the Cheesmans had told ANZ that they would have nowhere to live if the homes were sold,⁶⁹ and there was at least a reasonable prospect that the exclusion of the homes from the auction would make no difference to the sale price,⁷⁰ the community would expect ANZ to undertake appropriate inquiries before refusing to exclude the homes from the auction. ANZ's failure to do so was conduct falling below community standards and expectations.

The auction went ahead in February 2012. Arthur and Rhonda Cheesman's house sold at auction, but Reuben and Katrina Cheesman's house did not.⁷¹ The Cheesmans were left with an outstanding debt of around \$630,000.⁷²

⁶⁶ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 5–6 [22]–[24].

⁶⁷ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 5–6 [23]; Exhibit 4.10G.27.12, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0037 at .0039–.0040]

⁶⁸ Exhibit 4.10G.27.11, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0041].

⁶⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3182–3; Exhibit 4.10G.27.6, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-17 [ANZ.160.003.0047]; Exhibit 4.10G.27.7, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0046].

⁷⁰ Exhibit 4.10G.27.10, Witness statement of Benjamin William Steinberg (Annexure G), 21 June 2018, Exhibit LMG-27 [ANZ.160.003.0043 at .0044].

⁷¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3192.

⁷² Transcript, Benjamin William Steinberg, 26 June 2018, 3192.

Over the coming months, the Cheesmans made a series of offers to ANZ to settle the outstanding debt.⁷³ It is not necessary to record the terms of each of those offers here. The Cheesmans also sold off equipment and machinery to reduce the debt.⁷⁴ ANZ did not accept any of the offers made by the Cheesmans. Mr Steinberg acknowledged that, each time ANZ refused an offer, it put the Cheesmans at risk of losing Reuben and Katrina's house as well.⁷⁵ ANZ ultimately settled a \$276,000 debt for a payment of \$265,000.⁷⁶

Mr Steinberg accepted that three of the settlement offers made by the Cheesmans – in June, October and December 2012 – were reasonable.⁷⁷ He also acknowledged that, by failing to accept those offers, ANZ's conduct fell below community standards and expectations.⁷⁸ I agree that it did. Mr Steinberg accepted that the Cheesmans' relationship manager never expressly took into account that refusing those offers could have caused Reuben and Katrina Cheesman to lose their home.⁷⁹ He also acknowledged that ANZ could have tried to come up with a solution that would not involve the loss of the home.⁸⁰

Although Mr Steinberg accepted that the settlement offers referred to above were reasonable and that, by failing to accept the offers, ANZ's conduct fell below community standards and expectations, he did not accept that ANZ's failure to accept them was unreasonable,⁸¹ or that the failure breached Clause 2.2 of the Code of Banking Practice (the Code). (Clause 2.2, as it then stood, required ANZ to act fairly and reasonably towards the

⁷³ Transcript, Benjamin William Steinberg, 26 June 2018, 3192–9.

⁷⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3192.

⁷⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3201.

⁷⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3198–200.

⁷⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3202.

⁷⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3202.

⁷⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3201.

⁸⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3203.

⁸¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3202.

Cheesmans in a consistent and ethical manner.⁸²) It is not clear to me how the evident tension between these positions can be resolved.

In its submissions, ANZ did not accept that its conduct in refusing the reasonable settlement offers breached Clause 2.2 of the Code.⁸³ ANZ submitted that it had supported the Cheesmans over a long period of time.⁸⁴ It submitted that there was evidence that the Cheesmans did not apply the entirety of their crop proceeds to reduce their indebtedness to ANZ, in circumstances where the crop was subject to a crop lien in favour of ANZ.⁸⁵ But these considerations are beside the point if, as Mr Steinberg accepted, the offers were reasonable. If the offers were reasonable, refusing them was not reasonable and insisting on other and different terms was not fair. If that is right (and I think it is) it would follow that the refusal to accept the offers would be conduct that might have breached Clause 2.2 of the Code.

In 2015 and 2016, after stories about former Landmark customers appeared in the media, ANZ reviewed the Cheesmans' case, and paid Arthur Cheesman \$270,000.⁸⁶ In a document recording the decision to pay this amount, ANZ noted that '[A] more commercial and compassionate assessment would have enabled the customer a level of funds from the asset sales to enable a more positive movement forward. Rather, all principal and interest was cleared, unsecured creditors and statutory commitments paid in full and the customer (i.e. the elderly Arthur and Katrina) were left [with] nothing at all.'⁸⁷ These later events, and ANZ's analysis of them reinforce the conclusion earlier expressed that ANZ's conduct in refusing the offers was not fair and might constitute a breach of Clause 2.2 of the Code.

⁸² Transcript, Benjamin William Steinberg, 26 June 2018, 3203; Exhibit 4.13, May 2004, Code of Banking Practice, 6.

⁸³ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 6 [25].

⁸⁴ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 6 [26].

⁸⁵ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 6–7 [28]; Transcript, Benjamin William Steinberg, 26 June 2018, 3200–1.

⁸⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3203, 3206.

⁸⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3204; Exhibit 4.17, 26 April 2016, Memorandum Landmark Taskforce Consideration re Cheesmans, 3.

1.3 Annexure B customers

The names of the former Landmark customers who were the subject of Annexure B to Mr Steinberg's statement⁸⁸ are the subject of a non-publication direction. These customers operated a farming property in Queensland, where they bred and sold cattle.⁸⁹

Mr Steinberg told the Commission about an occasion in October 2011 when ANZ met with these customers to discuss their debt reduction options, but on the same day issued them with a default notice.⁹⁰ Mr Steinberg accepted that this did not represent consistent communication with the customers.⁹¹ He described the file as one that was difficult and had a long history. He accepted that this suggested that there was greater reason for ANZ to be consistent and reasonable in its dealings with these customers.⁹²

In its submissions, ANZ did not accept that this inconsistent communication breached Clause 2.2 of the Code. ANZ said that the Code 'does not impose an obligation on banks to always act "consistently", but rather, fairly and reasonably in a consistent and ethical manner, in light of the customer's conduct, the bank's conduct, and the parties' contract.'⁹³ ANZ said that, although Mr Steinberg accepted that ANZ's conduct in attending a meeting and issuing a default notice involved inconsistency, it did not follow that ANZ failed to act fairly and reasonably.⁹⁴ ANZ also did not accept that this conduct fell short of community standards and expectations.⁹⁵

The community expects that banks will act consistently in their dealings with customers. This is reflected in the requirement in Clause 2.2 of the Code for

⁸⁸ Exhibit 4.9B, Witness statement of Benjamin William Steinberg (Annexure B), 20 June 2018.

⁸⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3211.

⁹⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3212.

⁹¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3212.

⁹² Transcript, Benjamin William Steinberg, 26 June 2018, 3214.

⁹³ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 10 [46].

⁹⁴ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 10 [46].

⁹⁵ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 10 [44].

banks to act in a 'consistent and ethical manner'. It is also consistent with Mr Steinberg's evidence that the community expects ANZ to 'do the things that we say we are going to do'.⁹⁶ In this case, ANZ did not act consistently. On the same day that it met with the customers to discuss their debt reduction options, it issued them with a default notice. This fell short of what the community would expect.

Is it conduct that might contravene Clause 2.2 of the Code? As with any provision that uses several normative descriptions there may be debates about the proper construction of the provision requiring banks to act fairly, reasonably and in a consistent and ethical manner. I deal further with this provision of the Code, and related questions about community standards and expectations, at the end of my consideration of the case studies concerning ANZ and Landmark. For the moment, it is enough to say that I tend to the view that the Clause is best understood in a way that gives each element a meaning informed by the other elements but gives each element its own separate work to do. On that understanding, ANZ's not acting consistently might be conduct that breached the Code. The inconsistency between discussing what is to be done and giving notice of default might be characterised as both inconsistent and unfair conduct.

Mr Steinberg also told the Commission about an occasion in January 2012 when ANZ refused to accept an offer by the customers to settle their outstanding debt to ANZ. The offer made by the customers was equal to the fair market value of the real property held as security by ANZ.⁹⁷ ANZ refused the offer but neither explained the reasons for its refusal nor invited the customers to enter into further negotiations.⁹⁸ Mr Steinberg accepted that, with the benefit of hindsight, it might be said that the offer should have been accepted, subject to acceptable terms.⁹⁹

Whether ANZ ought to have accepted the settlement offer at the time that it was made is a matter on which reasonable minds may differ. It is not necessary for me to express a concluded view on that point. However, in circumstances where, on its face, the offer was reasonable – being equal to

⁹⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3190.

⁹⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3222.

⁹⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3220.

⁹⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3217–8.

the fair market value of the real property held as security by ANZ – I consider that the community would expect ANZ to do more than simply refuse the offer without providing any reasons.

1.4 The Hirsts

Dimity and Michael Hirst were farmers in northern Tasmania.¹⁰⁰ They bred cattle and lambs, and from 2006 they began investing in the forestry industry.¹⁰¹

Mr Steinberg acknowledged that, having regard to the cumulative effect of various aspects of ANZ's conduct towards the Hirsts between 2011 and 2013, ANZ's conduct towards them fell below community standards and expectations.¹⁰² That conduct included increasing the interest rate on the Hirsts' facilities at a time when they were known by ANZ to be under financial stress;¹⁰³ not engaging in farm debt mediation with the Hirsts;¹⁰⁴ and entering into a deed of settlement and release that involved little or no compromise from the bank.¹⁰⁵ I accept that Mr Steinberg was right to say that this conduct fell below community standards and expectations.

Mr Steinberg said that initially he had formed the view that ANZ had acted in breach of Clause 2.2 of the Code in relation to the Hirsts, by encouraging and granting increased loans to the Hirsts without either informing them that it disapproved of their property investment model, or obtaining updated valuations.¹⁰⁶ By the time he gave oral evidence before the Commission, however, Mr Steinberg had changed his mind about breach of the Code. But he did accept that this particular conduct formed part of ANZ's conduct in relation to the Hirsts that fell below community standards and

¹⁰⁰ See generally, Exhibit 4.9E, Witness statement of Benjamin William Steinberg (Annexure E), 20 June 2018, 20 [94].

¹⁰¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3223.

¹⁰² Transcript, Benjamin William Steinberg, 26 June 2018, 3223.

¹⁰³ Transcript, Benjamin William Steinberg, 26 June 2018, 3225.

¹⁰⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3223.

¹⁰⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3224–5.

¹⁰⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3226–7.

expectations.¹⁰⁷ ANZ submitted that this conduct did not constitute a breach of Clause 2.2 of the Code.¹⁰⁸

Mr Steinberg's initial view depended upon his accepting the views expressed by the Hon Susan Crennan AC QC in an evaluation she had conducted of ANZ's dealings with the Hirsts. Mr Steinberg changed his mind because he came to dispute the views expressed in the evaluation.

As I have explained at the outset of my consideration of all of the case studies, my task is not to determine whether particular conduct constituted a form of misconduct; it is to decide whether conduct might constitute misconduct or did fall short of community standards and expectations. I agree with Mr Steinberg that ANZ's conduct did fall short of community standards and expectations. The conduct might have breached Clause 2.2 of the Code and thus constitute misconduct.

1.5 The Harleys

The Harleys ran a sheep farm in Western Australia.¹⁰⁹ That farm was based on a number of parcels of land referred to collectively as the McAlinden Property.¹¹⁰ By 2013, the farm had been operating on that property for more than 100 years.¹¹¹

The Harleys had been customers of Landmark since 2004.¹¹² By March 2010, when ANZ acquired the Landmark loan book, they were already facing financial difficulties.¹¹³ They had had consecutive trading losses for about five years, and they recognised that they would need to sell some of their land in order to improve their financial position.¹¹⁴

¹⁰⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3227.

¹⁰⁸ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 9 [39]–[40].

¹⁰⁹ See generally, Exhibit 4.9D, Witness statement of Benjamin William Steinberg (Annexure D), 20 June 2018, 19 [70]; Transcript, Benjamin William Steinberg, 26 June 2018, 3228.

¹¹⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3228.

¹¹¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3228.

¹¹² Transcript, Benjamin William Steinberg, 26 June 2018, 3229.

¹¹³ Transcript, Benjamin William Steinberg, 26 June 2018, 3230.

¹¹⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3230.

In May 2011, ANZ sent the Harleys a letter of offer, by which it offered the Harleys a \$2.3 million facility expiring in March 2012 and a \$250,000 overdraft expiring in February 2012.¹¹⁵ The facilities were secured by a mortgage over the McAlinden Property and guarantees given by the Harleys.¹¹⁶ Under the letter of offer, ANZ required the Harleys to provide certain financial information to ANZ.¹¹⁷

In August 2011, after the Harleys fell into arrears in their interest payments and failed to provide the required financial information to ANZ, ANZ transferred their file to Lending Services.¹¹⁸ By around this time, ANZ had formed the view that land sales were necessary to reduce the Harleys' debt, and that it was willing to give the Harleys an opportunity to sell the land themselves.¹¹⁹

In February 2012, ANZ had the parcels of land comprising the McAlinden Property valued.¹²⁰ It charged the Harleys the cost of these valuations.¹²¹

In March 2012, ANZ sent the Harleys a further letter of offer, offering the Harleys a \$2.55 million facility expiring in March 2013.¹²² The offer was made on the basis that the Harleys would sell their land and repay the debt in full by that date.¹²³

In July 2012, the Harleys sold one of their blocks of land and used the proceeds to pay down debt.¹²⁴ But in October 2012, Mr Harley fell ill and was hospitalised.¹²⁵ In January 2013, the auction of the Harleys' sheep was

¹¹⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3232.

¹¹⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3232.

¹¹⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3232.

¹¹⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3232–3.

¹¹⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3235.

¹²⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3237.

¹²¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3238.

¹²² Transcript, Benjamin William Steinberg, 26 June 2018, 3240.

¹²³ Transcript, Benjamin William Steinberg, 26 June 2018, 3230, 3240.

¹²⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3240.

¹²⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3240.

unsuccessful.¹²⁶ In March 2013, after the Harleys had subdivided one of their blocks into four, they put all of their property up for auction but they received no bids.¹²⁷ The Harleys therefore could not, and did not, repay the debt by the March 2013 deadline.¹²⁸

In May 2013, Mr Harley suffered a heart attack. Mrs Harley told ANZ that this had occurred. Less than a month later, ANZ issued the Harleys with a notice of default under their facilities.¹²⁹

In September 2013, ANZ made a settlement deed with the Harleys.¹³⁰ Under the deed, the Harleys agreed to repay their debt by 31 March 2014.¹³¹ ANZ agreed that, if they repaid the debt before that date, it would release the Harleys from all claims.¹³² But the deed provided that, if the Harleys failed to repay the debt by 31 March 2014, they must give ANZ vacant possession of their properties by 1 April 2014, and ANZ would be entitled to obtain immediate judgment against them for all that they owed.¹³³ Mr Steinberg acknowledged that, if similar circumstances arose today, ANZ would not ask the Harleys to enter into a deed in those terms.¹³⁴

ANZ did not accept that its conduct in entering into a deed in these terms amounted to a breach of Clause 2.2 of the Code, or that that conduct fell short of community standards and expectations.¹³⁵ Again, there is evident tension between Mr Steinberg's statement that ANZ would not now make an agreement like the one it required the Harleys to make and the submission that ANZ's conduct did not fall short of what the community

¹²⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3241.

¹²⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3241.

¹²⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3241.

¹²⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3242.

¹³⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3245

¹³¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3246

¹³² Transcript, Benjamin William Steinberg, 26 June 2018, 3246

¹³³ Transcript, Benjamin William Steinberg, 26 June 2018, 3245–6; Exhibit 4.9D.19, Witness statement of Benjamin William Steinberg (Annexure D), 20 June 2018, Exhibit LMD-19 [ANZ.800.644.0421 at .0427, .0430, .0432, .0441–.0442].

¹³⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3250.

¹³⁵ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 7 [30].

would expect. That tension is made worse by ANZ's acceptance that, taken on its own, a period of one day would not be a sufficient period of time in which to vacate a property. ANZ sought to deal with that by submitting that the Harleys knew for six months that steps would need to be taken to vacate their properties if a sale of assets did not occur.¹³⁶ Likewise, Mr Steinberg noted that, under the deed, the Harleys had six months to sell their properties and said that, by the time the Harleys made the deed, the asset sale process had been going on for some years.¹³⁷

It is obvious that one day is not sufficient time to vacate a property of the kind in question. It is not to the point to say that the Harleys could have made preparations to vacate the property in the preceding six months. Preparations would have required the Harleys to incur costs (in packing their belongings and arranging alternative accommodation), which would have been unnecessary if the debt were repaid before the expiry of the deadline. Those preparations would have added to the distress faced by the Harleys and, as noted above, by the time the Harleys entered into the deed, they already were dealing with the ill health of Mr Harley, who had suffered a heart attack earlier that year. In the circumstances, I find that ANZ's conduct in proffering a deed that gave the Harleys only a day to vacate their property, and provided for immediate judgment if the Harleys did not repay their debt, fell short of what the community would expect.

Following the execution of the deed, the Harleys had some success in selling their land.¹³⁸ By 27 March 2014, they had sold five of their nine parcels of land¹³⁹ – including the parcels they thought would be most difficult to sell¹⁴⁰ – and sold livestock.¹⁴¹ They had paid about \$1.6 million of their \$2.5 million debt.¹⁴² They asked ANZ for an extension of time until

¹³⁶ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 8 [36].

¹³⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3246.

¹³⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3250.

¹³⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3251.

¹⁴⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3251–2.

¹⁴¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3251.

¹⁴² Transcript, Benjamin William Steinberg, 26 June 2018, 3251.

December 2014 to sell their remaining properties. They thought there would be more interest in these properties in the spring.¹⁴³

In late April 2014, ANZ refused this request.¹⁴⁴ Instead, it required the Harleys to give vacant possession of all their remaining properties – including the property on which they lived – and appointed agents for a mortgagee in possession to sell those properties.¹⁴⁵

Mr Steinberg accepted that, in the period leading up to this decision, the Harleys had clearly demonstrated their willingness to sell their properties and livestock, and had had some success in doing so.¹⁴⁶ He also accepted that requiring the Harleys to vacate the properties and pay the enforcement costs associated with appointing agents for a mortgagee in possession would have caused the Harleys distress.¹⁴⁷ Importantly, he said that he did not know whether there was any reason for ANZ to think that agents for a mortgagee in possession could get a better price for the sale of the remaining parcels of land than the Harleys could.¹⁴⁸ He said that ‘what the mortgagee in possession would achieve for us would be to actually get those properties sold’.¹⁴⁹ But he did not seek to justify the decision as one that would or even may lead to a better financial outcome than allowing the Harleys to continue with their evidently genuine attempts to sell the remaining land.

By the time ANZ took possession of the land and appointed its agent in possession, the Harleys’ file had been in Lending Services for more than 30 months. This was then at the outer limit of the target for turnover of agribusiness files within Lending Services.¹⁵⁰ It is impossible to resist the inference that ‘finalisation’ or ‘completion’ of the file had become an end in

¹⁴³ Transcript, Benjamin William Steinberg, 26 June 2018, 3251; Exhibit 4.9D.45.1, Witness statement of Benjamin William Steinberg (Annexure D), 20 June 2018, Exhibit LMD-45 [ANZ.800.644.0387 at .0388].

¹⁴⁴ Transcript, Benjamin William Steinberg, 26 June 2018, 3251–2.

¹⁴⁵ Transcript, Benjamin William Steinberg, 26 June 2018, 3252–6.

¹⁴⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3256.

¹⁴⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3256–7.

¹⁴⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3257.

¹⁴⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3257.

¹⁵⁰ Transcript, Benjamin William Steinberg, 27 June 2018, 3270–2.

itself. But the consequence here was that properties were sold a month or two before the time that the owners thought best with no formulated expectation that this would bring some identifiable commercial advantage to the bank.

Mr Steinberg accepted that, if the same situation arose today, he would have been more likely to give the Harleys some additional time to sell their properties.¹⁵¹ However, despite this acknowledgment, neither Mr Steinberg nor ANZ accepted that ANZ's conduct in refusing to allow the Harleys additional time to sell their properties fell short of community standards and expectations.¹⁵² ANZ also did not accept that this conduct breached Clause 2.2 of the Code.¹⁵³

Again there is a tension between saying that things would be done differently today but what was done then was not unfair. In its submissions, ANZ said in relation to this decision that it 'was entitled to appoint an agent as mortgagee in possession to facilitate a sale of the properties'.¹⁵⁴ ANZ also noted that it had provided the Harleys with forbearance in a number of ways.¹⁵⁵ ANZ denied that the decision to take enforcement action was motivated by organisational time limits.¹⁵⁶

Saying the bank was 'entitled' to take enforcement action in relation to the Harleys' properties fails to grapple with the real issue: Was it fair and reasonable for ANZ to do so in the circumstances of this case? Or, to put it another way, was it the right thing for ANZ to do? As ANZ pointed out in its submissions, it is true that, by the time ANZ refused the Harleys' request for an extension, the Harleys had been trying for four years to sell their

¹⁵¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3256.

¹⁵² Transcript, Benjamin William Steinberg, 26 June 2018, 3257; ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 8 [37].

¹⁵³ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 8 [37].

¹⁵⁴ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 8 [37].

¹⁵⁵ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 7 [32], 7–8 [34].

¹⁵⁶ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 7 [33].

properties. It is also true that ANZ granted the Harleys a number of extensions over this time. But ANZ's submissions overlooked, or at least did not give proper weight to, a number of important matters. First, the Harleys sold a number of their parcels of land in the six months between September 2013 and March 2014, demonstrating that the Harleys were both willing and able to sell their properties. Second, the parcels of land that the Harleys had sold included the parcels they thought would be most difficult to sell. Third, the requested extension of time was relatively brief, and would have enabled the Harleys to sell the properties in the spring when they thought interest would be higher. Fourth, by this time, the Harleys had paid \$1.6 million of their \$2.5 million debt.

In the circumstances I consider that ANZ's conduct fell below what the community would expect. Mr Steinberg did not point to any reason for ANZ to think that agents for a mortgagee in possession could get a better price for the sale of the remaining parcels of land than the Harleys could.¹⁵⁷ The bank acted as it did to achieve 'certainty' (which is to say finality). It gave no financial reason for acting as it did. Mr Steinberg said that, if the same situation arose today, he would have been more likely to give the Harleys some additional time to sell their properties.¹⁵⁸

In August 2014, the agents appointed by ANZ sold the remaining parcels of land, including the parcel on which the Harleys' home was located.¹⁵⁹ They sold three of the remaining parcels for a combined total of \$780,000 and the final parcel for \$250,000.¹⁶⁰ These sales took place after the properties had remained vacant for approximately three months. They took place in winter, and not in the spring, when the Harleys had told ANZ that interest in the properties would be at its highest. The prices achieved by the agents represented a discount of at least one third on valuations of those properties conducted in June 2013, when the Harleys were still on the land.¹⁶¹ The proceeds of these sales were used to pay down the remaining debt, but were not enough to clear the debt. There remained a balance of about

¹⁵⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3257.

¹⁵⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3256.

¹⁵⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3258.

¹⁶⁰ Transcript, Benjamin William Steinberg, 27 June 2018, 3275.

¹⁶¹ Exhibit 4.9, Witness statement of Benjamin Steinberg (Annexure D), 20 June 2018, 14–15 [60], 16–17 [64].

\$309,000.¹⁶² ANZ charged the Harleys about \$59,000 in enforcement costs.¹⁶³

In November 2014, ANZ's lawyers sent the Harleys a letter and told them that, if the Harleys did not pay the remaining debt by 4 December – about eight days later – then it might commence bankruptcy proceedings against them.¹⁶⁴

On 23 December 2014, the Harleys' lawyers wrote to ANZ. They said that if ANZ had sold the properties at a more reasonable discount to the June 2013 valuations, ANZ could have cleared the debt. They asked ANZ to release the Harleys from the remaining debt.¹⁶⁵ ANZ refused this request but did not take further action to recover the debt.¹⁶⁶ Mr Steinberg accepted that, if similar circumstances were to arise today, ANZ would likely have accepted the Harleys' proposal.¹⁶⁷ In February 2018, ANZ ultimately agreed to release the Harleys from their obligation to pay the remaining amount of the debt.¹⁶⁸

Despite Mr Steinberg's acceptance that ANZ would act differently if similar circumstances arose today, and despite the fact that ANZ later forgave the Harleys' debt, neither ANZ nor Mr Steinberg accepted that ANZ's conduct in refusing the Harleys' proposal fell short of community standards and expectations.¹⁶⁹ I disagree.

By December 2014, ANZ had required the Harleys to sell all of their properties, including their home, at a time when Mr Harley was recovering from serious health issues. ANZ had charged them almost \$60,000 in

¹⁶² Transcript, Benjamin William Steinberg, 27 June 2018, 3275.

¹⁶³ Transcript, Benjamin William Steinberg, 27 June 2018, 3276.

¹⁶⁴ Transcript, Benjamin William Steinberg, 27 June 2018, 3275–6.

¹⁶⁵ Transcript, Benjamin William Steinberg, 27 June 2018, 3280.

¹⁶⁶ Transcript, Benjamin William Steinberg, 27 June 2018, 3280.

¹⁶⁷ Exhibit 4.9, Witness statement of Benjamin Steinberg (Annexure D), 20 June 2018, 25 [96(b)(iii)].

¹⁶⁸ Transcript, Benjamin William Steinberg, 27 June 2018, 3283.

¹⁶⁹ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 8–9 [38]; Transcript, Benjamin William Steinberg, 27 June 2018, 3281.

enforcement costs, and left them without their farming business, which was their method of generating income. It had sold the last four of the Harleys' properties in circumstances where those properties had remained unoccupied for several months. It had also sold those properties before the spring, when the Harleys had told the bank there would be the most interest in the properties. Those last two matters were the result of ANZ's decision to refuse the Harleys an extension of time – a decision that I consider was not fair and reasonable. In these circumstances, I believe that the community would expect ANZ to have forgiven the Harleys' outstanding debt, as it ultimately did in February 2018.

One other point should be noted. In the time that the Harleys' file was being managed by Lending Services, no one from ANZ travelled to their farm to meet with them.¹⁷⁰ Mr Steinberg acknowledged that this was not acceptable.¹⁷¹ I agree that it was not.

1.6 The Handleys

The Handleys ran a cattle farm in Queensland.¹⁷² They too encountered financial difficulty. Again their dealings with ANZ were marked by conduct that Mr Steinberg agreed fell short of what the community would expect.

First, Mr Steinberg told the Commission about an occasion in November 2014 when the Handleys' lawyers asked ANZ to postpone a mediation on the basis that Mrs Handley had received adverse test results arising from a series of biopsies.¹⁷³ ANZ refused this request without seeking more information, even though Mrs Handley had in fact been diagnosed with cancer and was scheduled for surgery. Mr Steinberg accepted that this conduct fell below community standards and expectations,¹⁷⁴ and I agree that it did.

Second, Mr Steinberg told the Commission that ANZ made a series of errors in relation to the overcharging of interest and fees on the Handleys'

¹⁷⁰ Transcript, Benjamin William Steinberg, 26 June 2018, 3236.

¹⁷¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3236.

¹⁷² Transcript, Benjamin William Steinberg, 27 June 2018, 3285; Exhibit 4.9C, Witness statement of Benjamin William Steinberg (Annexure C), 20 June 2018, 6 [4].

¹⁷³ Transcript, Benjamin William Steinberg, 27 June 2018, 3285.

¹⁷⁴ Transcript, Benjamin William Steinberg, 27 June 2018, 3285.

accounts. As a result of these errors, there was a period when the Handleys did not have access to funds, and several of the cheques that they presented were dishonoured. Mr Steinberg accepted that this conduct too may have fallen below community standards and expectations.¹⁷⁵

Third, Mr Steinberg told the Commission that ANZ also failed to extend overdraft limits to the Handleys, when it had previously agreed to do so, which meant that there was a period when the Handleys were charged default interest when they should not have been.¹⁷⁶ Mr Steinberg did not accept that this conduct fell below community standards and expectations.¹⁷⁷

In its submissions, ANZ characterised all of these events as ‘honest mistakes arising from individual errors’, which were later corrected.¹⁷⁸ However, in light of the number of errors and the effect that they had on the Handleys, I find that this conduct, taken as a whole, fell short of community standards and expectations.

Finally, Mr Steinberg gave evidence about an occasion when an ANZ staff member involved with the Handleys signed documents as a witness, even though the staff member had not witnessed the Handleys signing the documents. Mr Steinberg accepted that this amounted to misconduct.¹⁷⁹ I agree that it did.

1.7 Annexure F customers

The names of the customers who were the subject of Annexure F to Mr Steinberg’s statements were the subject of a non-publication direction. These customers were also cattle farmers from Queensland.¹⁸⁰ Mr Steinberg told the Commission that, in May 2010, ANZ offered these customers a \$450,000 overdraft facility, but only made a \$350,000 overdraft

¹⁷⁵ Transcript, Benjamin William Steinberg, 27 June 2018, 3286.

¹⁷⁶ Transcript, Benjamin William Steinberg, 27 June 2018, 3286.

¹⁷⁷ Transcript, Benjamin William Steinberg, 27 June 2018, 3286.

¹⁷⁸ ANZ, *Hearing Round 4: ANZ’s Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 10 [43].

¹⁷⁹ Transcript, Benjamin William Steinberg, 27 June 2018, 3287.

¹⁸⁰ Transcript, Benjamin William Steinberg, 27 June 2018, 3288; Exhibit 4.10F, Witness statement of Benjamin William Steinberg (Annexure F), 21 June 2018.

facility available to them.¹⁸¹ It was not until September 2010 that ANZ made the full facility available. Mr Steinberg accepted that this conduct fell below community standards and expectations,¹⁸² and I agree that it did.

1.8 Other customers

In his first statement, Mr Steinberg made acknowledgments in relation to other former Landmark customers without describing ANZ's dealings with those customers in any detail. With two exceptions, the names of these customers are subject to non-publication directions.

Mr Steinberg acknowledged, and I find, that, in three instances, ANZ's conduct in relation to these customers fell below community standards and expectations.¹⁸³ Those instances are as follows:

- First, in relation to one customer ANZ engaged in poor communication and inconsistent practice in that it applied the entirety of the secured property sale proceeds to reduce principal rather than to annual principal and interest payments.
- Second, in relation to certain other customers, ANZ failed to honour cheques contrary to a previous commitment to do so.
- Third, in relation to a third customer, ANZ did not communicate properly with them about the restructure of their loans.

Mr Steinberg also acknowledged, and I accept, that ANZ breached its obligations under the Code in relation to certain other former Landmark customers,¹⁸⁴ and therefore engaged in misconduct. He identified four cases of such conduct:

- First, ANZ breached Clause 2.2 of the Code in relation to its dealings with the Phillotts.¹⁸⁵ ANZ took responsibility for some of the dealings that Landmark had with Mr Phillott Jnr in relation to the original lending to him and, after ANZ acquired the Landmark loan book, it failed to work

¹⁸¹ Transcript, Benjamin William Steinberg, 27 June 2018, 3288.

¹⁸² Transcript, Benjamin William Steinberg, 27 June 2018, 3288.

¹⁸³ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 16–17 [43].

¹⁸⁴ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 18–20 [45].

¹⁸⁵ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 18–20 [45].

constructively with Mr Phillott Jnr to overcome his financial difficulties.¹⁸⁶ Mr Steinberg conceded that the bank acted in a way that was not fair, not reasonable, and not ethical.¹⁸⁷

- Second, ANZ breached Clause 25.2 of the Code in relation to its dealings with the Phillotts.¹⁸⁸ ANZ failed to try to help Mr Phillott Jnr to overcome his financial difficulties, and instead issued a notice terminating the facilities and requesting repayment of them.¹⁸⁹
- Third, in relation to Cashmore Farms Pty Ltd, ANZ made significant variations to the Cashmores' loan (which was not in monetary default) without also communicating those changes in a clear and transparent way, and applied the sale proceeds of a residential property to a long term rather than short term loan.¹⁹⁰
- Fourth, in relation to certain other customers, ANZ took guarantees from the customer's mother and siblings without taking all reasonable steps to ascertain if they were suitable to act as guarantors.¹⁹¹

1.9 More recent changes

Mr Steinberg told the Commission about changes that ANZ had made to its Lending Services team since 2014. In August 2014, ANZ established a specialist agribusiness team within Lending Services. It established this team because it was thought that high risk agribusiness customers would benefit from being serviced by relationship managers who had specific knowledge of and experience in agriculture and restructuring.¹⁹² At around the same time, ANZ started to use farm debt mediation more frequently, and increased the frequency of face-to-face farm visits by Lending Services staff.¹⁹³

¹⁸⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3163.

¹⁸⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3164.

¹⁸⁸ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 18–20 [45].

¹⁸⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3164.

¹⁹⁰ Transcript, Benjamin William Steinberg, 27 June 2018, 3291.

¹⁹¹ Transcript, Benjamin William Steinberg, 27 June 2018, 3291–2.

¹⁹² Transcript, Benjamin William Steinberg, 27 June 2018, 3292.

¹⁹³ Transcript, Benjamin William Steinberg, 27 June 2018, 3292.

In the first half of 2015, after stories about former Landmark customers began to receive political and media attention, ANZ made further changes to the culture of Lending Services. In July 2015, after a story about Mr Phillott was broadcast on *60 Minutes*, ANZ established a taskforce to review the files of former Landmark customers.¹⁹⁴ The taskforce went on to review the files of about 200 former Landmark customers.¹⁹⁵ Mr Steinberg estimated that ANZ reached settlements with about 40 or 50 of these customers, for a total amount of around \$40 million.¹⁹⁶

ANZ continued to make changes in 2016 and 2017. Mr Steinberg told the Commission that:

- It is now a requirement for members of the Lending Services Global Leadership Team to approve any decision to commence enforcement action.¹⁹⁷
- Where enforcement action is taken, ANZ now has a panel of insolvency providers who have agreed to a consistent set of terms and conditions, and ANZ expects that, in the conduct of their duties, these providers would act consistently with ANZ's values.¹⁹⁸
- Where a valuation is obtained, ANZ will now give the customer a say about the choice of valuer, and as a matter of policy will provide a copy of the valuation to the customer.¹⁹⁹

Further, decisions in Lending Services at ANZ are now informed by the Lending Services Purpose.²⁰⁰ Among other things, the Lending Services Purpose emphasises that ANZ should take into account the emotional and personal impacts of recovery and enforcement action on customers in its

¹⁹⁴ Transcript, Benjamin William Steinberg, 27 June 2018, 3295–7.

¹⁹⁵ Transcript, Benjamin William Steinberg, 27 June 2018, 3298.

¹⁹⁶ Transcript, Benjamin William Steinberg, 27 June 2018, 3302–3.

¹⁹⁷ Transcript, Benjamin William Steinberg, 27 June 2018, 3298.

¹⁹⁸ Transcript, Benjamin William Steinberg, 26 June 2018, 3260–1.

¹⁹⁹ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 22–3 [59(d)]; Exhibit 4.9A, Witness statement of Benjamin William Steinberg (Annexure A), 20 June 2018, 23 [92].

²⁰⁰ Transcript Benjamin William Steinberg, 27 June 2018, 3299; Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, Exhibit BWS-22 [ANZ.800.552.2654].

decision-making processes. Mr Steinberg explained that the Lending Services team try to make the Purpose an integral part of its culture, informing how members of the team act and behave each day.²⁰¹

Mr Steinberg said that a question he now often puts to his people in the Lending Services team is: 'Is this the right thing to do?'.²⁰²

1.10 What the case study showed

Mr Steinberg's evidence about ANZ's acquisition of Landmark's loan book, ANZ's handling of the accounts of former Landmark customers, and the changes that ANZ has made to its Lending Services team since August 2014 illustrated a number of issues that require consideration. They can be considered under three headings:

- community standards and Clause 2.2 of the Code;
- causes of ANZ's conduct; and
- appointment of external administrators.

1.10.1 Community standards and Clause 2.2 of the Code

At the time relevant to the dealings between ANZ and former Landmark customers, Clause 2.2 of the Code provided that:

We will act fairly and reasonably towards you in a consistent and ethical manner. In doing so we will consider your conduct, our conduct and the contract between us.

The same words are used in Clause 3.2 of the 2013 Code. By contrast, the 2019 Code provides that it 'is underpinned' by a Statement of Guiding Principles of which two are: 'We will act with honesty and integrity' and 'We will be fair and responsible in our dealings with you.'

Despite the different form of expression used in the 2019 Code, all three versions of the Code may be taken to reflect what the community expects of a bank – that it will act fairly and reasonably towards its customers and that it will act in its dealings with customers (and others) in a consistent and ethical manner. The fairness that is called for is not one-sided. Fairness must be understood as fair to both customer and bank. What is required can

²⁰¹ Transcript, Benjamin William Steinberg, 27 June 2018, 3299.

²⁰² Transcript, Benjamin William Steinberg, 27 June 2018, 3300.

be captured by asking: ‘In these circumstances, what is the right thing to do?’ Mr Steinberg accepted that the question could be put in this way and, as I have already noted, said that this is a question that he now often puts to the Lending Services team.²⁰³ His evidence reflected the need to ask more than whether there is power to take some step. Just because the bank has the power to do something does not mean that it is always right to exercise that power.²⁰⁴

In its submissions, however, ANZ sought to draw a distinction between community standards and expectations and the requirements of Clause 2.2 of the Code. ANZ said that, ‘[w]hile there may ... be broad agreement that banks should act fairly and reasonably in a consistent and ethical manner (as reflected in [C]lause 2.2 of the [Code]), the community’s expectations of what that may require in a particular case is susceptible to disagreement, and change, over time’.²⁰⁵ ANZ suggested a number of ways in which changes in community standards and expectations may occur: ‘greater public awareness of the circumstances or effect of particular conduct (after it occurred)’; ‘the development of different expectations as a result of a particular incident or set of incidents’; or ‘changes in community attitudes to align with current approaches to such circumstances’.²⁰⁶

Reasonable minds may differ as to what is fair and reasonable in the circumstances of a particular case. This may be especially so in the context of agricultural lending, if only because it may be necessary to take into account events and conditions over many years.

It is necessary, however, to distinguish between community standards and community pressure.²⁰⁷ An issue may come to the attention of the public at a particular time. This occurred with ANZ’s handling of the accounts of former Landmark customers in December 2014,²⁰⁸ and again in July 2015

²⁰³ Transcript, Benjamin William Steinberg, 27 June 2018, 3300.

²⁰⁴ See, eg, Transcript, Benjamin William Steinberg, 27 June 2018, 3300.

²⁰⁵ ANZ, *Hearing Round 4: ANZ’s Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 2–3 [12].

²⁰⁶ ANZ, *Hearing Round 4: ANZ’s Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 3 [13].

²⁰⁷ Transcript, Benjamin William Steinberg, 26 June 2018, 3188.

²⁰⁸ Transcript, Benjamin William Steinberg, 27 June 2018, 3293.

with the broadcast of the *60 Minutes* story about the Phillotts.²⁰⁹ Because the matter comes to public attention, what the community thinks should be done, or should have been done, may become well known and there may then be public pressure to respond. But that does not mean the relevant standards and expectations did not exist before the public scrutiny of the issue. Rather, the strength of the public reaction (for example to the case of the Phillotts) tends to demonstrate that those standards and expectations did exist, and that ANZ's conduct fell short of them.

At no point in its submissions did ANZ clearly articulate how the standards or expectations of the community had changed in any relevant way during the times considered in this case study and I am not persuaded that they did. Nor am I persuaded that Clause 2.2 of the Code could be understood as having some shifting content or application.

1.10.2 Causes of ANZ's conduct

The conduct examined in this case study can be attributed, at least in part, to two causes: first, ANZ's lack of preparation for the very high probability that it would have to deal (as it did) with significant numbers of agribusiness customers experiencing financial difficulties; and second, the then prevailing culture and practices in ANZ's Lending Services group.

As already noted, Mr Steinberg accepted that ANZ knew when it acquired the Landmark loan book that the book was of lower quality than ANZ's loan book.²¹⁰ He accepted that ANZ knew that there had been a poor control environment within Landmark and a lack of regulatory oversight of Landmark.²¹¹ But Mr Steinberg said that the documents that he had seen concerning ANZ's preparation for dealing with the impending financial difficulty that former Landmark customers would encounter had 'all centred around calculating ... the overall dollar provision'.²¹²

ANZ relied on its 'usual processes and procedures' to manage those accounts.²¹³ So far as Mr Steinberg could determine from the records he

²⁰⁹ Transcript, Benjamin William Steinberg, 27 June 2018, 3295–6.

²¹⁰ Transcript, Benjamin William Steinberg, 25 June 2018, 3147.

²¹¹ Transcript, Benjamin William Steinberg, 25 June 2018, 3152.

²¹² Transcript, Benjamin William Steinberg, 25 June 2018, 3152.

²¹³ Transcript, Benjamin William Steinberg, 25 June 2018, 3152.

looked at, ANZ took no step to try to predict how many of the accounts might be moved into Lending Services or how soon that might occur.²¹⁴ ANZ did not establish a specialist agribusiness team within Lending Services at the time of the acquisition.²¹⁵ And there was, at this time, what Mr Steinberg described as a lack of training of Lending Services staff about how to have difficult conversations with distressed customers.²¹⁶

Although ANZ intended to retain about 80% of the former Landmark Financial Services staff,²¹⁷ 10% of those staff departed in the first six months, and more departed after that.²¹⁸ As a result, there was a loss of established relationships between Landmark staff and their customers, and a loss of corporate memory of the former Landmark customers' files.²¹⁹

ANZ's lack of preparation for dealing with agribusiness customers in financial distress was made worse by the fact that more former Landmark customers fell into financial difficulties than ANZ had expected.

The evidence suggests that the due diligence inquiries made in relation to the Landmark loan book may have relied on some wrong assumptions about loan delinquencies. In particular, in October 2016, ANZ's board considered a report from the taskforce on their review of former Landmark customer files. The board minutes record that 'there is a lesson to be learned from the Landmark acquisition in connection with the assumptions that were made around delinquencies and expected losses that were not stress tested'.²²⁰ Mr Steinberg said that he was not aware that the expected losses were ever stress tested.²²¹

As already noted, before August 2014, there was no specialist agribusiness team within Lending Services. There were some instances where customers

²¹⁴ Transcript, Benjamin William Steinberg, 25 June 2018, 3153.

²¹⁵ Transcript, Benjamin William Steinberg, 25 June 2018, 3153.

²¹⁶ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 21 [54].

²¹⁷ Transcript, Benjamin William Steinberg, 25 June 2018, 3130.

²¹⁸ Transcript, Benjamin William Steinberg, 25 June 2018, 3131.

²¹⁹ Transcript, Benjamin William Steinberg, 25 June 2018, 3154.

²²⁰ Exhibit 4.12, 6 August 2015, Minutes of ANZ Board, 11.

²²¹ Transcript, Benjamin William Steinberg, 26 June 2018, 3161.

had not seen a bank manager for over two years,²²² and Mr Steinberg rightly acknowledged that this was not acceptable.²²³ There were also examples of files in Lending Services where customers were refused seasonal funding to plant crops, or interest payments were made due at the wrong time of a farm's working capital cycle (such as before harvest).²²⁴ That is, there were examples of the kinds of issue identified in the evidence given by Mr Wheatcroft of the Western Australian Rural Financial Counselling Service at the start of this round of evidence.²²⁵

Before August 2014, Lending Services relied more on external law firms to deal with customers in financial difficulty.²²⁶ It took a less flexible approach to dealing with customers in financial difficulty,²²⁷ and demonstrated a lack of understanding of farmers' emotional connection to their land (and the emotional impact that recovery and enforcement action can have on agribusiness customers).²²⁸ At times, Lending Services increased the interest rates of customers experiencing financial difficulty, placing an additional financial burden on those customers.²²⁹

As mentioned earlier, since August 2014, ANZ has made a number of changes to the culture, governance and policy of Lending Services, beginning with the establishment of a specialist agribusiness team within Lending Services. An important change was the introduction of the Lending Services Purpose. In a report by the General Manager of Regional Business Banking and the General Manager of Lending Services to ANZ's board in October 2016, it was said that these changes in the culture, governance and policy of Lending Services were to ensure that there would be no

²²² Transcript, Benjamin William Steinberg, 26 June 2018, 3209.

²²³ Transcript, Benjamin William Steinberg, 26 June 2018, 3209.

²²⁴ Exhibit 4.18, 1 June 2015, Lending Services Agribusiness Discussion Document, 2.

²²⁵ Exhibit 4.4, Witness statement of Chris Wheatcroft, 15 June 2018, 5 [17]; Transcript, Chris Wheatcroft, 25 June 2018, 3102–3.

²²⁶ Transcript, Benjamin William Steinberg, 26 June 2018, 3214.

²²⁷ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 21 [54].

²²⁸ Exhibit 4.8, Witness statement of Benjamin Steinberg, 18 June 2018, 21 [53].

²²⁹ Transcript, Benjamin William Steinberg, 26 June 2018, 3225.

repetition of the issues identified with ANZ's handling of former Landmark customers.²³⁰

In its submissions, ANZ said that 'the conduct about which the Commission heard evidence was not uniform or consistent, such as to suggest that particular cultural or systemic issues existed in Lending Services between 2010 and 2014'.²³¹ ANZ said that the conduct was 'fact specific and not attributable to broader cultural considerations'.²³² But this submission does not sit well with Mr Steinberg's repeated invocation, throughout his statements and across three days of oral evidence, of the subsequent development of the Lending Services Purpose and the other changes to the way Lending Services now operates. Mr Steinberg identified many decisions that he would make differently if presented with similar circumstances today. Standing alone this demonstrates that the decisions made at the time were a product of the then-prevailing culture in, and policies pursued by, Lending Services.

1.10.3 Appointment of external administrators

Although dealt with elsewhere in this report, it is useful to record here some of the evidence Mr Steinberg gave about circumstances in which it may be appropriate for a bank to appoint an external administrator such as a receiver and manager, or other insolvency practitioner.

Mr Steinberg accepted that, in deciding to appoint an external administrator, the objective of maximising the amount of money realised by the sale of assets was important, as was the objective of achieving certainty for the bank.²³³ He also accepted that, in some cases, it was necessary to balance these two interests.²³⁴ But when asked to consider whether there were cases where, by appointing an administrator, the bank might achieve certainty at the expense of getting the maximum realisable value for the property, Mr Steinberg said that he took comfort in the legal framework

²³⁰ Exhibit 4.24, 28 October 2016, Landmark Portfolio Upgrade Board Paper, 2.

²³¹ ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 12 [51].

²³² ANZ, *Hearing Round 4: ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 12 [51].

²³³ Transcript, Benjamin William Steinberg, 27 June 2018, 3273.

²³⁴ Transcript, Benjamin William Steinberg, 27 June 2018, 3273.

regulating the obligations of insolvency practitioners.²³⁵ (As explained elsewhere, I do not accept that ‘certainty’ should trump the search for the best available outcome for bank and customer.)

Mr Steinberg accepted that, in an agricultural finance context, it is comparatively infrequent for an external administrator to manage a property as a going concern.²³⁶ I infer that, in most cases where an external administrator is appointed, the administrator will move promptly to sell the security. This is what happened to with the Harleys. They had wanted to sell their properties in the spring, when they believed that interest in the properties would be highest. Instead, the agents appointed by ANZ sold the properties in August.²³⁷

Mr Steinberg gave evidence about the number of agricultural finance matters in which ANZ had taken enforcement action since 2015 (when ANZ’s records of such action begin). ANZ took enforcement action in 11 cases in 2015 and 12 cases in 2016, but only in four cases in 2017 and three cases in 2018.²³⁸ As noted above, in May 2016, ANZ introduced a requirement for a member of the Lending Services Global Leadership Team to approve any decision to commence enforcement action.²³⁹ I cannot say whether the introduction of this requirement contributed to the decline in cases involving enforcement action in 2017 and 2018.

2 Rabobank (the Brauers)

The second case study examined in these hearings concerned Rabobank and its dealings with Wendy and Adrian Brauer. The Commission heard evidence from Mrs Wendy Brauer and from Mr Bradley James, Rabobank’s regional manager for an area that includes the Brauers’ farm.

The case study raised a number of issues concerning appropriate lending and credit assessment, communications between banks and their

²³⁵ Transcript, Benjamin William Steinberg, 27 June 2018, 3273.

²³⁶ Transcript, Benjamin William Steinberg, 27 June 2018, 3273.

²³⁷ Transcript, Benjamin William Steinberg, 27 June 2018, 3274.

²³⁸ Exhibit 4.20, Witness statement of Benjamin Steinberg, 18 June 2018, 11 [38].

²³⁹ Transcript, Benjamin William Steinberg, 27 June 2018, 3298.

customers, the effectiveness of farm debt mediation, conflicts of interest, hardship policies, remuneration policies and the appropriateness of internal appraisals in valuing security property.

2.1 Background

The Brauers farm cattle and grow hay on Kia Ora, a property located around 280 kilometres south west of Rockhampton in Central Queensland.²⁴⁰ They acquired the farming business from Mr Brauer's parents in 2002.²⁴¹

The Brauers became customers of Rabobank in 2005, initially taking a single 'All in One' facility with a limit of \$700,000.²⁴² That facility was used to refinance their prior facilities and rebuild their cattle yards.²⁴³ The facility had a 15-year term.

Later in 2005, the Brauers took out a second facility with a \$200,000 limit. That facility also had a 15-year term.²⁴⁴

For various reasons, the All in One facility limit was increased in 2006²⁴⁵ and 2008.²⁴⁶ By 2008 the facility limit was \$1 million.

In March 2009, the Brauers relocated to the United States where Mrs Brauer's family lived. They planned to stay there for about two years. They purchased a home there, sold all of their cattle and leased out Kia Ora to another farming family.²⁴⁷

²⁴⁰ Transcript, Wendy Jolene Brauer, 27 June 2018, 3320.

²⁴¹ Transcript, Wendy Jolene Brauer, 27 June 2018, 3321.

²⁴² Transcript, Wendy Jolene Brauer, 27 June 2018, 3321; Exhibit 4.31.1, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-1 [RAL.0002.0001.0880 at .0880].

²⁴³ Transcript, Wendy Jolene Brauer, 27 June 2018 3321–2.

²⁴⁴ Transcript, Wendy Jolene Brauer, 27 June 2018, 3322; Exhibit 4.31.1, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-1 [RAL.0002.0001.0880 at .0885].

²⁴⁵ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-1 [RAL.0002.0001.0880 at .0889]; Transcript, Wendy Jolene Brauer, 27 June 2018, 3322.

²⁴⁶ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-1 [RAL.0002.0001.0880 at .0893]; Transcript, Wendy Jolene Brauer, 27 June 2018, 3322.

²⁴⁷ Transcript, Wendy Jolene Brauer, 27 June 2018, 3323.

2.2 Rabobank contacts the Brauers about Jamberoo

In June 2009, the Brauers' bank manager emailed them and advised that a property about 80 kilometres from Kia Ora (Jamberoo) was on the market. In the email the bank manager gave the location of the property, provided an estimate of the number of breeders that could be run on the property and estimated the sale price to be 'around the \$4 million mark, possibly less'.²⁴⁸

At the time the Brauers received that email, they were not actively looking for another property. After discussing the matter, the Brauers sought further information from the bank manager.²⁴⁹

The next day, the bank manager sent a further email stating that another family (the Wrights) were interested in purchasing a portion of Jamberoo, and providing further information about the potential sale price for the remaining portion of the property.²⁵⁰

On 30 July 2009, the bank manager valued Jamberoo, excluding the portion the Wrights were considering, at \$2.9 million.²⁵¹ He also valued the remaining portion at \$1.1 million.²⁵² This brought the total valuation of Jamberoo to \$4 million, the same figure the bank manager had estimated in his initial email to the Brauers. I will say something more about Rabobank's valuation policy later.

2.3 Negotiations in respect of Jamberoo

In the period between the bank manager's valuation of the property and the preparation of his written appraisal, the bank manager and Mrs Brauer exchanged further emails.

²⁴⁸ Transcript, Wendy Jolene Brauer, 27 June 2018, 3323–4; Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WJB-5 [RAL.0002.0003.3219].

²⁴⁹ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-6 [RAL.0002.0003.3216].

²⁵⁰ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-6 [RAL.0002.0003.3216].

²⁵¹ Exhibit 4.37, 30 July 2009, Property Inspection/Valuation Report, Jamberoo, 3.

²⁵² Exhibit 4.45, 29 July 2009, Property Inspection and Valuation Report, 4.

In July 2009,²⁵³ the bank manager emailed the Brauers and outlined how a possible purchase of part of Jamberoo could be financed. The bank manager explained that the Brauers' existing facility limits were \$1.2 million, not all of which was fully drawn. He suggested they borrow an additional \$3 million, taking their total borrowings to \$4.2 million. The Brauers understood this to mean that undrawn funds would remain in the facility following the purchase of Jamberoo.²⁵⁴

In late July 2009, Mr Brauer travelled to Australia to inspect Jamberoo with the bank manager. Mr Brauer and the manager had lengthy discussions while at Jamberoo. Mr Brauer expressed concern about the prospect of short term financial difficulties upon the family's return to Australia. At that point their lease income from Kia Ora would reduce and there would be no income from cattle sales. The bank manager replied that undrawn funds could be drawn down at that time.²⁵⁵

Based on that understanding, the Brauers planned to stock Kia Ora and Jamberoo with cattle once they returned to Australia by using the undrawn funds, along with funds held in farm management deposits and the realised equity on the sale of their home in the United States.²⁵⁶

In September 2009, the bank manager prepared a credit submission and submitted it to Rabobank's credit department.²⁵⁷ The credit submission proposed additional lending of \$3 million, taking the Brauers' total facility limits to \$4.2 million. It also included historical information about the Brauers' business and projections about cash flows.

In the credit submission, the bank manager stated that the Brauers' facilities were well managed, with no history of excesses or temporary limit increases. He also set out the Brauers' immediate plans for the two properties. Kia Ora, which was currently leased, would continue to be leased until March 2011. After 2011, the current lessee would lease half of

²⁵³ Exhibit 4.31.7, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-7 [RAL.0002.0003.3211].

²⁵⁴ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 6, 7 [29], [35].

²⁵⁵ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 6 [29].

²⁵⁶ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 6 [29], 7–8 [35].

²⁵⁷ Exhibit 4.33, Witness statement of Bradley Mark James, Exhibit BMJ-1 [RAL.0002.0001.3556]; Transcript, Wendy Brauer, 27 June 2018, 3326.

the property while the Brauers progressively restocked the other half. Jamberoo would be immediately leased back to the current owner at an agreed rate of \$175,000 per annum.

On 17 September 2009, a representative from Rabobank's credit department emailed the bank manager and expressed several concerns with the credit submission.²⁵⁸ These concerns included that the proposed gearing was high and 'serviceability is very hard to get a grip on'.²⁵⁹ The email said that from origination until 2012, the 'request does not work and most of 2013 is hypothetical', that the assumptions within the credit submission about cattle numbers and cattle prices were either wrong or debatable, and that living expenses had not been properly accounted for.²⁶⁰

The credit officer also raised a number of questions about the Brauers' investment properties, the substitution of agistment income if the vendor of Jamberoo was to move off the property, and the Brauers' current income and living expenses.

On the same day, the bank manager emailed the Brauers.²⁶¹ That email said nothing about the caveats the credit department had made. Instead it presented an optimistic view about the prospect of credit approval. The manager wrote that 'Sydney have come back to me with a few questions mainly to do with the rental properties and to your living expenses whilst overseas'.

Mr James agreed that the bank manager's email to the Brauers did not explain the credit department's most significant concerns about the credit submission.²⁶² Mr James also agreed that the Brauers should have been, but were not, told of the credit department's concerns about the viability of the proposal.²⁶³

²⁵⁸ Exhibit 4.47, 17 September 2009, Email from Gray.

²⁵⁹ Exhibit 4.47, 17 September 2009, Email from Gray.

²⁶⁰ Exhibit 4.47, 17 September 2009, Email from Gray.

²⁶¹ Exhibit 4.48, 17 September 2009, Email to Brauers.

²⁶² Transcript, Bradley Mark James, 28 June 2018, 3382–3.

²⁶³ Transcript, Bradley Mark James, 28 June 2018, 3390.

After obtaining a response from Mrs Brauer to the questions he (not the credit department) had asked in his email,²⁶⁴ and corresponding further with the credit department,²⁶⁵ the bank manager again emailed the Brauers on 22 September 2009.²⁶⁶ That email explained that after some 'back and forth ... with Sydney ... it would appear that we'll get approval'.²⁶⁷

In the email, the bank manager set out a proposed funding arrangement where facilities with limits of \$3.9 million would be offered rather than the \$4.2 million that had been discussed to that point. Under the proposed arrangement, a \$3.7 million facility would be put in place instead of the existing \$1 million facility, and the existing \$200,000 facility would be continued. The bank manager told the Brauers that in March 2011, when the lease of Kia Ora expired, the bank would provide a loan increase for livestock purchases.

Based on the communications with the bank manager, the Brauers understood that funds would be made available to them upon their return to Australia, in order to restock Kia Ora and Jamberoo.²⁶⁸ Mr James accepted that the Brauers were entitled to understand those statements as a commitment on the part of Rabobank to fund cattle purchases on the Brauers' return to Australia.²⁶⁹

The funding proposal was put to the Brauers by way of a formal letter of offer in January 2010.²⁷⁰ The Brauers accepted the offer and proceeded with the purchase of a portion of Jamberoo.

2.4 Conflict of interest

Unbeknown to the Brauers, the vendor of Jamberoo was also a client of their bank manager, as were the parents of one of the purchasers of the

²⁶⁴ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WJB-11 [RAL.0002.0003.3020].

²⁶⁵ Exhibit 4.49, 21 September 2009, Email to Gray.

²⁶⁶ Exhibit 4.50, 22 September 2009, Email to Brauers.

²⁶⁷ Exhibit 4.50, 22 September 2009, Email to Brauers.

²⁶⁸ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 7 [34].

²⁶⁹ Transcript, Bradley Mark James, 28 June 2018, 3388–9.

²⁷⁰ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WB-13 [RAL.0002.0001.3697].

other portion of Jamberoo. The bank manager did not, at that time, act for the purchasers of the other portion of Jamberoo, but was encouraging them to become clients of Rabobank.²⁷¹

In closing submissions, Senior Counsel Assisting submitted that the bank manager's failure to disclose this information to the Brauers was in breach of Rabobank's internal policies that required that appropriate disclosures be made in circumstances where the bank is acting on more than one side of a transaction.²⁷² Senior Counsel Assisting also submitted that Rabobank's conduct was unethical, in breach of Clause 2.2 of the Code. In its written submissions Rabobank accepted that the bank manager's conduct was in breach of its internal policies but contended that the conduct was not unethical.²⁷³

Rabobank's written submissions noted that the Brauers and the Wrights were well-known to each other, that Mr Wright was in fact negotiating on his son's behalf and that all parties to the transaction met to discuss the transaction in July 2009.²⁷⁴

The fact remains, however, that at no point did the bank manager disclose to the Brauers that the vendor was a Rabobank client. In circumstances where the bank manager had approached the Brauers about the potential purchase of Jamberoo, had provided an initial estimate of the sale price and had then conducted appraisals of the property, a potential conflict of interest was manifest. There would have been no difficulty in disclosing the fact to the Brauers. The failure to do so was conduct that I consider might have breached Clause 2.2 of the Code.

2.5 The sale completes

The settlement of Jamberoo did not occur until August 2010. The delay was principally caused by complications in splitting titles to the block.²⁷⁵

²⁷¹ Transcript, Bradley Mark James, 27 June 2018, 3349–50.

²⁷² Transcript, Closing Submissions, 6 July 2018, 4111; Transcript, Bradley Mark James, 27 June 2018, 3350–1; Exhibit 4.36, November 2006, Rabobank Worldwide Compliance Standards November '06.

²⁷³ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, B5 and C4.

²⁷⁴ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 16 [60(c)].

²⁷⁵ Transcript, Wendy Jolene Brauer, 27 June 2018, 3332.

Rabobank did not undertake a further assessment of the Brauers' financial position between the bank manager's September 2009 email and the formal offer of funding in January 2010, or between January 2010 and the settlement of the property in August 2010.²⁷⁶

At settlement there was insufficient credit available in the new Rabobank facility to meet the purchase price and expenses associated with the acquisition of Jamberoo.²⁷⁷ The Brauers had to contribute around \$60,000 of their own funds.²⁷⁸

2.6 Immediate difficulties arise

In December 2010 and January 2011, significant flooding occurred in parts of central Queensland, including at Kia Ora.²⁷⁹ The flooding destroyed the hay crop of the lessee of Kia Ora.²⁸⁰ The lessee elected not to renew the lease for a further two-year period.²⁸¹ Until that time, the Brauers had expected that the lessee would renew the lease over half of Kia Ora.²⁸²

The lessee's decision placed considerable financial pressure on the Brauers.²⁸³ They notified the bank manager of the lessee's decision almost immediately after they were told of it.²⁸⁴

²⁷⁶ Transcript, Bradley Mark James, 28 June 2018, 3393–4.

²⁷⁷ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 8 [40].

²⁷⁸ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 8 [40].

²⁷⁹ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 9 [43]; Transcript, Wendy Jolene Brauer, 27 June 2018, 3332–3.

²⁸⁰ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 9 [43]; Transcript, Wendy Jolene Brauer, 27 June 2018, 3332–3.

²⁸¹ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 9 [43]; Transcript, Wendy Jolene Brauer, 27 June 2018, 3332–3.

²⁸² Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 9 [43]; Transcript, Wendy Jolene Brauer, 27 June 2018, 3332–3.

²⁸³ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WJB-14 [RAL.0002.0003.2644].

²⁸⁴ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, Exhibit WJB-14 [RAL.0002.0003.2644].

In March 2011, the Brauers returned to Australia and to Kia Ora.²⁸⁵

2.7 Rabobank insists on repayment of \$3 million

Following their return to Australia, the Brauers enquired about borrowing a further \$300,000 from Rabobank to restock Kia Ora. At a meeting at Kia Ora a few weeks after their return, the bank manager introduced the Brauers to another Rabobank employee, Mr Brady, who was to be their new bank manager.²⁸⁶

Mr Brady considered the Brauers' request for further funds and responded that a further \$300,000 could be advanced, but on the condition that the sum of \$3 million be repaid within two years (by June 2013).²⁸⁷ At that time, the Brauers' income was insufficient to meet their loan repayments and they had to outlay capital to restock the farm in order to generate future income. Mrs Brauer's evidence was that she felt they had no choice but to accept the offer given their dire need for additional finance at that time.²⁸⁸

In June 2011, the Australian Government's ban on the live export of cattle to Indonesia came into effect.²⁸⁹ In oral evidence, Mrs Brauer said that the ban depressed cattle prices and generally made trading conditions more difficult.²⁹⁰ Mrs Brauer's evidence was that she enquired as to hardship arrangements with Mr Brady but was told that no such arrangements were available.²⁹¹

²⁸⁵ Transcript, Bradley Mark James, 27 June 2018, 3333.

²⁸⁶ Transcript, Bradley Mark James, 27 June 2018, 3334.

²⁸⁷ Transcript, Bradley Mark James, 27 June 2018, 3334.

²⁸⁸ Transcript, Bradley Mark James, 27 June 2018, 3334.

²⁸⁹ Transcript, Bradley Mark James, 27 June 2018, 3335.

²⁹⁰ Transcript, Bradley Mark James, 27 June 2018, 3335.

²⁹¹ Transcript, Bradley Mark James, 27 June 2018, 3335.

The Brauers were unable to repay \$3 million by 30 June 2013.²⁹² At the Brauers' request, Rabobank provided a further 12 months for that sum to be paid.²⁹³ They were still unable to repay the \$3 million by 30 June 2014.²⁹⁴

From 1 July 2014, default interest of 4% above the standard rate was applied to the Brauers' facilities.²⁹⁵

2.8 Farm debt mediation

In January 2015, Rabobank invited the Brauers to attend farm debt mediation.²⁹⁶

Before the mediation, the Brauers engaged Mr McMahon of Queensland Legal Aid. By email, Mr McMahon requested certain documents from Rabobank.²⁹⁷ He also asked some questions about Rabobank's conduct.²⁹⁸ Rabobank declined to provide the documents requested or to answer the questions asked.²⁹⁹

Mrs Brauer described the mediation as a stressful experience.³⁰⁰ By the end of the mediation, an agreement was struck that required the Brauers to sell Jamberoo for not less than \$2 million on or before December 2015 and to refinance the balance of their facilities with Rabobank by June 2016.³⁰¹

²⁹² Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 11 [57].

²⁹³ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 11 [57].

²⁹⁴ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 11 [57].

²⁹⁵ Transcript, Wendy Jolene Brauer, 27 June 2018, 3336 and 28 June 2018, 3415.

²⁹⁶ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 11 [58].

²⁹⁷ Transcript, Bradley Mark James, 28 June 2018, 3415–3416; Exhibit 4.34, Supplementary witness statement of Bradley Mark James, 21 June 2018, Exhibit BMJ-2 [RAL.0002.0003.0518].

²⁹⁸ Transcript, Bradley Mark James, 28 June 2018, 3415–3416; Exhibit 4.34, Supplementary witness statement of Bradley Mark James, 21 June 2018, Exhibit BMJ-2 [RAL.0002.0003.0518].

²⁹⁹ Transcript, Bradley Mark James, 28 June 2018, 3417.

³⁰⁰ Transcript, Wendy Jolene Brauer, 27 June 2018, 3337.

³⁰¹ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 11–12 [60]; Transcript, Bradley Mark James, 28 June 2018, 3419.

Rabobank agreed to rebate the default interest that had been charged, which to that point amounted to \$115,490.³⁰²

The Brauers later sold Jamberoo for \$2.4 million and refinanced the balance of their facilities through a private lender under a short term, high interest loan.³⁰³

Mrs Brauer estimated that as a consequence of the Jamberoo purchase and subsequent sale, the Brauer family had lost at least \$1 million.³⁰⁴

2.9 What the case study showed

The case study exposed a variety of issues, some that may be unique to the Brauers, and others of more general application.

2.9.1 Loan origination conduct

At one level of abstraction, the case study demonstrated the need for care in the proper assessment of credit application and effective communication to bank customers about the basis upon which any credit approval is given. While the need for care in both assessment and communication may be thought to be obvious, the case study demonstrated the very serious consequences that may result if the process miscarries in some way.

If, as here, credit approval is predicated on assumptions that differ from the stated intent of the customer, that fact must be made known to the customer. Approval of a credit application based on assumptions that are incongruous with the customer's intended plan will almost necessarily heighten the risk for both the customer and the bank. Providing funds to a customer on a basis that differs from the customer's stated plan will often be unfair to the customer. Absent notice from the bank, the customer is entitled to assume that the bank has assessed the application on its merits, including the purpose of the loan and the basis on which it will be repaid.

The deficiencies in Rabobank's communications with the Brauers only became apparent after careful scrutiny of the emails the bank manager sent to the Brauers before the loan approval and of the emails the credit

³⁰² Transcript, Bradley Mark James, 28 June 2018, 3415, 3419.

³⁰³ Exhibit 4.31, Witness statement of Wendy Jolene Brauer, 21 June 2018, 12 [61].

³⁰⁴ Transcript, Wendy Jolene Brauer, 27 June 2018, 3338.

department sent to the bank manager. In the draft version of his first statement, Mr James said that he did not consider that Rabobank had engaged in any misconduct or conduct falling below community standards and expectations. Further, he maintained that Rabobank would deal with the situation involving the Brauers in the same way under its existing policies.

After further reflection, Mr James revised those views. In the final version of his first statement, Mr James accepted that the contents of the email sent by the bank manager on 22 September 2009 could have caused the Brauers to consider that they had an assurance from Rabobank that further funds would be provided in March 2011 for livestock purchases.³⁰⁵ He further acknowledged that the terms on which the \$300,000 was provided to the Brauers in August 2011 did not meet an expectation on the part of the Brauers that may have been created by that email, and therefore fell below community standards and expectations.³⁰⁶ Mr James also accepted that Rabobank's conduct may have breached the Code of Banking Practice because it was unfair to the Brauers.³⁰⁷

In a supplementary statement provided prior to giving his evidence, Mr James also accepted that the conduct of Rabobank in approving the proposed facility without communicating to the Brauers that it could not be serviced if they ran both properties at full capacity, fell below community standards and expectations³⁰⁸ and could also be characterised as a breach of the Code, in that it was unfair to the Brauers.³⁰⁹

In the course of his oral evidence, Mr James also conceded that Rabobank had failed to exercise the care and skill of a diligent and prudent banker in selecting and applying its credit assessment methods and in informing its opinion about the Brauers' ability to repay the \$3.7 million loan, and that Rabobank had therefore breached Clause 25.1 of the Code.³¹⁰

³⁰⁵ Exhibit 4.33, Witness statement of Bradley Mark James, 15 May 2018, 35 [95].

³⁰⁶ Exhibit 4.33, Witness statement of Bradley Mark James, 15 May 2018, 35 [95].

³⁰⁷ Exhibit 4.33, Witness statement of Bradley Mark James, 15 May 2018, 35 [97].

³⁰⁸ Exhibit 4.34, Supplementary witness statement of Bradley Mark James, 22 June 2018, 2 [9].

³⁰⁹ Exhibit 4.34, Supplementary witness statement of Bradley Mark James, 22 June 2018, 2–3 [10].

³¹⁰ Transcript, Bradley Mark James, 28 June 2018, 3392, 3420.

Mr James was right to acknowledge that Rabobank's conduct amounted to misconduct and conduct falling below community standards and expectations in the ways he described.

In its written submissions, Rabobank did not accept that it had engaged in misconduct or conduct falling below the standards and expectations of the community by representing parties on each side of the Jamberoo transaction, without disclosing that fact to the Brauers.³¹¹ However, as I have explained above, by failing to disclose that the vendor was a Rabobank customer, Rabobank failed to disclose that it had an interest in the property being sold. It also had an interest in financing the purchasers of the property. By failing to disclose its competing interests, Rabobank's conduct might be a breach of Clause 2.2 of the Code, and thus amount to misconduct.

2.9.2 Hardship

In its written submissions, Rabobank accepted that by failing to 'consider activating its hardship policy' in circumstances where the Brauers' business had been affected by both flood and the live export ban, it engaged in conduct that fell below community standards and expectations.³¹² That acknowledgment was properly made. I would also add that Rabobank's failure to inform the Brauers that there was a hardship policy – even when asked³¹³ – was also conduct falling below community standards and expectations.

2.9.3 Pre-farm debt mediation conduct

As I have indicated above, Rabobank failed to provide documents before the farm debt mediation, despite requests from both Mrs Brauer and the Brauers' solicitor. Mr James acknowledged that Rabobank's refusal to provide the documents sought fell below community standards and

³¹¹ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 4 [16].

³¹² Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 5 [21].

³¹³ Transcript, Wendy Jolene Brauer, 27 June 2018, 3335.

expectations³¹⁴ and could also be characterised as misconduct within the meaning of the Code.³¹⁵

In order for a farm debt mediation process to be effective, it must be more than an opportunity for a bank to press its legal rights. Customers are entitled to enter a farm debt mediation fully apprised of the facts and circumstances as known to the bank. Banks should facilitate such understanding by providing any documents or information reasonably requested by a customer before a farm debt mediation. Information asymmetry will only serve to undermine confidence in the farm debt mediation process and to engender customer discontent.

I find that Rabobank engaged in conduct falling below community standards and expectations by failing to provide the documents sought without a reasonable basis. As Mr James accepted, it was conduct that might constitute misconduct.

2.10 Causes of the conduct

2.10.1 Adequacy of internal systems

In closing submissions, Senior Counsel Assisting submitted that Rabobank's misconduct and conduct falling below community standards and expectations in connection with the origination of the loan could be attributed to inadequate internal systems.³¹⁶ In its written submissions, Rabobank resisted such a finding,³¹⁷ but accepted that had the credit department's concerns being conveyed to the Brauers they 'may well have considered the Jamberoo acquisition in a different light'.³¹⁸ Rabobank also said that it 'is presently considering whether the provision of the kind of communication (and the monitoring of this communication) between critical

³¹⁴ Exhibit 4.34, Supplementary witness statement of Bradley Mark James, 22 June 2018, 3 [12].

³¹⁵ Exhibit 4.34, Supplementary witness statement of Bradley Mark James, 22 June 2018, 3 [12].

³¹⁶ Transcript, Closing Submissions, 6 July 2018, 4113

³¹⁷ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 8–11 [37]–[43].

³¹⁸ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 9 [39].

staff in control functions ... can be improved so as to avoid such an occurrence in the future'.³¹⁹

It remains unclear why the loan to the Brauers was approved. In its written submissions, Rabobank acknowledged that 'no document was provided to the Commission which records the credit manager's satisfaction of the questions and concerns that had been raised by him when the credit submission for the Brauers' loan application was first considered'.³²⁰

Rabobank did not point to any system or process designed to ensure that queries or concerns from the credit department were addressed before a loan could be approved.

Moreover, Rabobank appears to have had no system to ensure communication of the credit department's concerns to the customer. Rabobank's written submissions explained that the bank manager was under a duty to convey the credit department's concerns.³²¹ But it did not explain how compliance with that duty was superintended. There was no evidence that it was in the case of the Brauers. Indeed, it appears that the failure of the bank manager to perform that duty was not detected by Rabobank at any point during the continuation of the banking relationship with the Brauers.

Taken together, these matters point to Rabobank's conduct in relation to the making of the loan to have resulted, at least in part, from difficulties in internal controls and management systems.

2.10.2 Internal appraisal

Another important issue of relevance to this case study was Rabobank's systems for internal appraisals of property value. In its written submissions, Rabobank submitted that there was no evidence that the internal valuations of Jamberoo prepared by the bank manager resulted in an adverse outcome to the Brauers.³²² But the point advanced by Senior Counsel Assisting was of a more fundamental nature. It concerned the adequacy of the systems and policies in relation to valuations that were in place at the time.

³¹⁹ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 9 [39].

³²⁰ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 9–10 [41].

³²¹ Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 9 [39].

³²² Rabobank, *Submissions: Brauer Case Study*, 13 July 2018, 11 [47].

At the relevant times, Rabobank's policies regarding internal appraisal of property values did not divide the function of loan origination and security valuation. Rabobank placed both tasks in the hands of a banker who was incentivised to write loans, and did not have internal appraisals assessed by staff who were qualified and experienced in that field.

In 2009, Rabobank permitted all valuations for non-residential security properties to be conducted internally by bankers.³²³ No specific training in valuations was provided to Rabobank's front-line staff.³²⁴

That Rabobank's systems were deficient at the relevant time is demonstrated by subsequent events. In 2009, the Australian Prudential Regulation Authority (APRA) asked Rabobank to review its rural valuation policy and to clarify and tighten its requirements for internal valuations.³²⁵ That request led to Rabobank engaging Ernst & Young (EY) to conduct a targeted review of Rabobank's collateral and foreclosure management.³²⁶ The EY review recommended that collateral management systems and processes at Rabobank be made independent of the business origination function.³²⁷

APRA again wrote to Rabobank in December 2011.³²⁸ That letter recorded EY's findings that, in the majority of cases, the loan originator valued the secured property.³²⁹ It also noted that there was a risk of collateral being overvalued by the loan originator, either deliberately or in error.³³⁰

Despite EY's recommendation, and APRA's further correspondence, Rabobank did not take immediate steps to separate loan origination from security valuation. That step was only taken after the European Central Bank released draft regulations in 2014 that required valuations of secured property to be 'independent from the client and from the commercial

³²³ Exhibit 4.38, 19 February 2007, Rabobank Valuation Policy.

³²⁴ Transcript, Bradley Mark James, 27 June 2018, 3356–7.

³²⁵ Transcript, Bradley Mark James, 27 June 2018, 3357–8.

³²⁶ Exhibit 4.39, 30 June 2011, EY Report APRA Targeted Review.

³²⁷ Exhibit 4.39, 30 June 2011, EY Report APRA Targeted Review, 7–8 [2.1].

³²⁸ Exhibit 4.40, 2 December 2011, Letter APRA to Rabobank.

³²⁹ Exhibit 4.40, 2 December 2011, Letter APRA to Rabobank, 4.

³³⁰ Exhibit 4.40, 2 December 2011, Letter APRA to Rabobank, 4.

department that maintains the relationship with the client'.³³¹ In response to that draft regulation, Rabobank established an Asset Quality Management Department with responsibility for valuations.³³² It also removed the ability of loan originators to conduct valuations.³³³ Those steps were appropriate and should have been taken earlier.

As I said at the start of this chapter, I support APRA's intended promulgation of a standard that requires separation of security valuation from loan origination and urge its prompt implementation. In addition to that step, it is critical to the valuation process that those charged with preparing and assessing appraisals or valuations have appropriate training and experience in the field. Absent sufficient expertise, the utility of any appraisal or valuation will be open to question. And any underlying questions as to the value of collateral taken by an **authorised deposit-taking institution** (ADI) could give rise to questions as to the true financial position of the entity. It follows that it is in the interests of ADIs and their customers that appraisals and valuations be conducted by properly experienced staff.

2.10.3 Remuneration

In closing submissions, Senior Counsel Assisting submitted that it was also open for me to find that the identified misconduct and conduct falling below community standards and expectations was caused by Rabobank's remuneration system.³³⁴ That submission was founded upon concessions made by Mr James in cross-examination as to the predominant weighting of Rabobank's remuneration system, including a concession that the incentive component of that system did not meet the recommendations of the Sedgwick Review.³³⁵

In its written submissions filed after the hearing, Rabobank submits, and I accept, that Mr James was mistaken in certain aspects of his evidence concerning Rabobank's incentive program. Given that, I make no finding connecting Rabobank's conduct with its remuneration system.

³³¹ Exhibit 4.42, 22 July 2014, Memo to Executive Committee Rabobank.

³³² Transcript, Bradley Mark James, 27 June 2018, 3362.

³³³ Transcript, Bradley Mark James, 27 June 2018, 3362.

³³⁴ Transcript, Closing submissions, 6 July 2018, 4113.

³³⁵ Transcript, Closing submissions, 6 July 2018, 4113–14.

3 Bankwest (the Ruddys)

The third case study examined in the fourth round of hearings concerned the conduct of Bankwest in relation to Mr Melville Ruddy. Mr Ruddy is a 68-year-old cattle farmer from western Queensland. The Commission heard evidence from Mr Ruddy and from Ms Sinead Taylor, the Executive General Manager of Personal and Business Banking at Bankwest.

3.1 Background

Mr Ruddy and his wife owned two farms, Sunrise and Arranfield.³³⁶ Before 2007, the Ruddys had a stock account with Rural Bank. In 2007, they also took out loan facilities with Rural Bank.³³⁷ In 2010, a Bankwest bank manager approached the Ruddys about moving to Bankwest.³³⁸ The Ruddys declined the offer. Among other things, the Ruddys did not want to pay for external valuations for their properties, which would have been necessary if they moved to Bankwest.³³⁹

By 2011, Mr and Mrs Ruddy were seriously considering selling one of their properties, Sunrise.³⁴⁰ They were again approached by Bankwest.³⁴¹ Bankwest offered the Ruddys increased loan facilities and more competitive interest rates than those offered by Rural Bank.³⁴² Ms Taylor gave evidence that Bankwest put forward an aggressive price to attract the Ruddys' business.³⁴³ By that time, the bank manager with whom the Ruddys had been dealing had obtained his valuer's 'ticket' with Bankwest, and was able

³³⁶ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 2 [5], 2–3 [10].

³³⁷ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 3–4 [15].

³³⁸ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 2 [5], 4–5 [19]–[24].

³³⁹ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 5 [25].

³⁴⁰ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 6–7 [28]–[30].

³⁴¹ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 7 [30]–[31].

³⁴² Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 7 [32], 8 [36]–[37].

³⁴³ Transcript, Sinead Taylor, 28 June 2018, 3457.

to offer the Ruddys free internal valuations.³⁴⁴ The Ruddys agreed to move from Rural Bank to Bankwest.³⁴⁵

By letters of offer signed in October 2011, the Ruddys took out three separate facilities with Bankwest, totalling \$1.12 million. The facilities were secured by their two properties. The bank manager appraised both, valuing Arranfield at \$1.1 million and Sunrise at \$1.2 million.³⁴⁶

At the time that the bank manager brought the Ruddys to Bankwest, the bank manager's key performance indicators (KPIs) were heavily weighted towards 'profitable growth'.³⁴⁷ In the 2011 financial year, the bank manager had achieved 134% of his sales targets and processed more than 60 applications, most of which were new clients.³⁴⁸ Bankwest named him a Rural and Regional Champion as a result of this performance.³⁴⁹

In March 2012, the bank manager left the bank.³⁵⁰ At about that time, Bankwest began to uncover significant issues with the conduct of the bank manager, including that he had overstated valuations,³⁵¹ had engaged in inappropriate and improper mis-selling,³⁵² and had manipulated internal Bankwest systems to avoid behavioural triggers.³⁵³ By May 2012, these events had resulted in at least 15 separate complaints about the bank manager, and losses to Bankwest of about \$374,000.³⁵⁴ Ms Taylor accepted that there was no record of the bank manager's customers being informed of his misconduct.³⁵⁵

³⁴⁴ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 7 [30].

³⁴⁵ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 9 [39]–[40].

³⁴⁶ Transcript, Sinead Taylor, 28 June 2018, 3473.

³⁴⁷ Transcript, Sinead Taylor, 28 June 2018, 3460.

³⁴⁸ Transcript, Sinead Taylor, 28 June 2018, 3464.

³⁴⁹ Transcript, Sinead Taylor, 28 June 2018, 3463.

³⁵⁰ Exhibit 4.92, Witness statement of Sinead Taylor, 24 June 2018, 21 [73].

³⁵¹ Transcript, Sinead Taylor, 28 June 2018, 3468.

³⁵² Transcript, Sinead Taylor, 28 June 2018, 3468.

³⁵³ Transcript, Sinead Taylor, 28 June 2018, 3469.

³⁵⁴ Transcript, Sinead Taylor, 28 June 2018, 3469.

³⁵⁵ Transcript, Sinead Taylor, 28 June 2018, 3471.

Bankwest became aware of errors specific to the Ruddys' valuations in early May 2012.³⁵⁶ The errors detected in May 2012 included errors in relation to the date of the valuations, which Ms Taylor was unable to explain.³⁵⁷

It later became clear that there was a more material error in the valuation of Sunrise. Instead of valuing the property on the basis that it was 72 hectares (as it was), the bank manager had valued Sunrise on the basis that it was 896 hectares.³⁵⁸ Ms Taylor accepted that the valuation error should have been picked up long before it was.³⁵⁹

Throughout 2012 and 2013, the Ruddys' farming operations faced a number of challenges. These included Mr Ruddy's ill health,³⁶⁰ the live cattle export ban, low cattle prices and drought.³⁶¹ Bankwest continued to extend credit to the Ruddys throughout this period.

In about May 2013, Bankwest informed the Ruddys that it wanted to revalue their properties and that the Ruddys would be required to pay for those revaluations.³⁶² Before it received the May 2013 valuations, Bankwest issued two letters of offer to the Ruddys, which extended the Ruddys' facilities.³⁶³

The May 2013 revaluations were completed by an external firm, which used the correct inputs. The firm valued Arranfield at \$900,000, down from \$1.1 million, and Sunrise at \$750,000, down from \$1.2 million.³⁶⁴ Bankwest informed Mr Ruddy that, as a result of the revised valuations, the Ruddys were in breach of their loan-to-value ratio (LVR), and they would have to sell

³⁵⁶ Transcript, Sinead Taylor, 28 June 2018, 3478.

³⁵⁷ Transcript, Sinead Taylor, 28 June 2018, 3475–6.

³⁵⁸ Transcript, Sinead Taylor, 28 June 2018, 3476.

³⁵⁹ Transcript, Sinead Taylor, 28 June 2018, 3479.

³⁶⁰ Transcript, Melville William Ruddy, 28 June 2018, 3442.

³⁶¹ Transcript, Melville William Ruddy, 28 June 2018, 3443.

³⁶² Exhibit 4.90, Witness statement of Melville Ruddy, 21 June 2018, 12 [51]; Transcript, Melville William Ruddy, 28 June 2018, 3444; Exhibit 4.92, Witness statement of Sinead Taylor, 24 June 2018, 33 [120(a)(ii)], [120(d)].

³⁶³ Transcript, Sinead Taylor, 28 June 2018, 3483.

³⁶⁴ Transcript, Sinead Taylor, 28 June 2018, 3485.

Sunrise.³⁶⁵ Around this time, Bankwest issued further letters of offer reflecting these arrangements.³⁶⁶

Bankwest charged the Ruddys about \$6,600 to their overdraft accounts for the cost of the valuations.³⁶⁷ They were not given notice that these amounts would be charged.³⁶⁸ As a result of paying for these valuations, Mr Ruddy was not able to afford feed for his cattle and, over the next few months, he lost 80 head of cattle.³⁶⁹

The Ruddys lodged a dispute with the Financial Ombudsman Service (FOS). FOS determined that the internal valuation in 2011 had been flawed, and that Bankwest should not have relied on the 2013 revaluations to require the Ruddys to sell the properties.³⁷⁰ However, the Ruddys did not accept the Ombudsman's recommendation or determination.³⁷¹ The Ruddys subsequently participated in farm debt mediation. They ultimately settled with Bankwest on the basis that they would sell Sunrise within six months and would pay Bankwest 75% of the net sale proceeds.³⁷² The Ruddys also agreed to pay Bankwest an additional \$410,000 to discharge its mortgage over Arranfield.³⁷³ Mr Ruddy said that he felt that this was his only choice.³⁷⁴

³⁶⁵ Transcript, Melville William Ruddy, 28 June 2018, 3446.

³⁶⁶ Transcript, Melville William Ruddy, 28 June 2018, 3446; Transcript, Sinead Taylor, 28 June 2018, 3488–9.

³⁶⁷ Exhibit 4.90, Witness statement of Melville William Ruddy, 21 June 2018, 12 [51]; Exhibit 4.92, Witness statement of Sinead Taylor, 24 June 2018, 33 [119].

³⁶⁸ Transcript, Sinead Taylor, 28 June 2018, 3487; Exhibit 4.92, Witness statement of Sinead Taylor, 24 June 2018, 38 [141].

³⁶⁹ Transcript, Melville William Ruddy, 28 June 2018, 3445.

³⁷⁰ Transcript, Melville William Ruddy, 28 June 2018, 3448.

³⁷¹ Transcript, Melville William Ruddy, 28 June 2018, 3449.

³⁷² Transcript, Sinead Taylor, 29 June 2018, 3524.

³⁷³ Transcript, Sinead Taylor, 29 June 2018, 3524.

³⁷⁴ Transcript, Melville William Ruddy, 28 June 2018, 3450.

Ms Taylor gave evidence that Bankwest would not deal with the Ruddys' matter in the same way today, because Bankwest has introduced increased controls in respect of internal valuations.³⁷⁵

3.2 What the case study showed

CBA accepted that the bank manager made errors when valuing Sunrise. In particular, CBA accepted that, in valuing the property, the bank manager relied on a comparison with the values of properties that were significantly larger than Sunrise, and applied an incorrect land size.³⁷⁶ Ms Taylor conceded in her evidence,³⁷⁷ and CBA accepted in its submissions,³⁷⁸ that the errors in the valuation were apparent on the face of the valuation. CBA accepted that these errors should have been, but were not, detected during the loan approval process.³⁷⁹ CBA also noted that the errors were not detected by the several bank officers who reviewed the Ruddys' facilities at various times between October 2011 and May 2013.³⁸⁰

In her evidence, Ms Taylor conceded that, by getting the valuation wrong, Bankwest had engaged in conduct that fell below community standards and expectations.³⁸¹ CBA also accepted this in its submissions.³⁸²

In its submissions, CBA accepted that it was open to me to infer that the bank manager had deliberately and dishonestly engaged in the

³⁷⁵ Transcript, Sinead Taylor, 29 June 2018, 3525; Exhibit 4.92, Witness statement of Sinead Taylor, 24 June 2018, 38 [139].

³⁷⁶ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 3 [11].

³⁷⁷ Transcript, Sinead Taylor, 29 June 2018, 3528.

³⁷⁸ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 3 [12].

³⁷⁹ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 3 [12].

³⁸⁰ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 3 [13].

³⁸¹ Transcript, Sinead Taylor, 28 June 2018, 3477.

³⁸² CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 10 [53].

overvaluation of Sunrise.³⁸³ I agree that this is the proper inference to draw from the evidence.

CBA said that, in determining whether Bankwest may have breached Clause 2.2 of the Code, it was necessary to take into account the broader context of Bankwest's relationship with the Ruddys, including the fact that Bankwest ultimately wrote off more than \$600,000 in respect of the Ruddys' loan facility.³⁸⁴ However, CBA accepted that the broader context also included other deficiencies in Bankwest's conduct,³⁸⁵ and that, even taking into account the amount of the debt that was ultimately written off, it was open to me to find that the bank manager's action in overvaluing the Sunrise property had breached Clause 2.2 of the Code.³⁸⁶ Even taking into account the broader context to which CBA referred, I consider that, in deliberately and dishonestly overvaluing the Sunrise property, the bank manager did not act fairly, reasonably or ethically towards the Ruddys. It would follow that the conduct breached Clause 2.2 of the Code.

In its submissions, CBA accepted that Bankwest ought to have discovered the errors in the valuations by early April 2012,³⁸⁷ and that it ought to have alerted the Ruddys to concerns about the bank manager's conduct and its potential impact on their facilities.³⁸⁸ Ms Taylor conceded that it was inappropriate for Bankwest to have concluded, upon discovering unrelated errors in May 2012, that it should leave things as they were until a further review took place in August 2012.³⁸⁹ CBA also accepted that Bankwest did

³⁸³ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 4 [20].

³⁸⁴ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 4 [18], 4–5 [21].

³⁸⁵ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 4–5 [21].

³⁸⁶ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 5 [22].

³⁸⁷ Transcript, Sinead Taylor, 28 June 2018, 3470; CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 5–6 [28].

³⁸⁸ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 5–6 [28].

³⁸⁹ Transcript, Sinead Taylor, 28 June 2018, 3479.

not do enough when it became aware of the bank manager's conduct.³⁹⁰ I agree. CBA said that, at this time, Bankwest should have caused the files of all customers who may have been affected by the bank manager's conduct to be reviewed.³⁹¹ I agree that this should have been done.

CBA rightly acknowledged that CBA's failure to take adequate steps to inquire into the bank manager's valuations of the Ruddys' properties fell below community standards and expectations.³⁹² CBA also accepted that it was open to me to find that this conduct breached Clause 2.2 of the Code.³⁹³ I find that it did.

CBA also accepted, again correctly, that Bankwest failed to have adequate systems in place to detect that the valuation was incorrect, and that the community would expect that a bank would have controls in place to ensure that any inadequacies in a valuation were identified.³⁹⁴

More generally, Bankwest's processes in 2011 and 2012 were lax in several significant respects. This is revealed by the misdated valuations,³⁹⁵ the undated guarantees,³⁹⁶ and (separately) the guarantees that were signed before the letters of offer.³⁹⁷ CBA accepted that Ms Taylor was unable to explain these errors, including the fact that the valuation reports completed in 2011 were signed in late 2012, long after the bank manager had left

³⁹⁰ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 4 [20].

³⁹¹ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 6 [29].

³⁹² CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 6 [30]; see also Transcript, Sinead Taylor, 28 June 2018, 3471.

³⁹³ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 6 [30].

³⁹⁴ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 10 [54].

³⁹⁵ Transcript, Sinead Taylor, 28 June 2018, 3475–6.

³⁹⁶ Transcript, Sinead Taylor, 28 June 2018, 3472–3.

³⁹⁷ Transcript, Sinead Taylor, 28 June 2018, 3472.

Bankwest.³⁹⁸ CBA accepted, and I find, that the community would expect greater care to be taken by a bank in relation to these issues.³⁹⁹

As I have noted above, Bankwest failed to inform the Ruddys that it would charge the fees for the 2013 revaluations to their overdraft account. Both Ms Taylor and CBA accepted, and I find, that the failure to inform the Ruddys of the timing of the debit from the account fell below community standards and expectations.⁴⁰⁰

Both Ms Taylor and CBA also accepted that it was not fair for Bankwest to rely on the LVR breach occasioned by the 2013 revaluations to require a restructure of the Ruddys' facilities by requiring them to list Sunrise for sale and pay down \$50,000 of their debt by the end of 2012.⁴⁰¹ Ms Taylor accepted that it was open to me to find that this behaviour breached Clause 2.2 of the Code.⁴⁰² Although CBA sought to qualify this acknowledgment, it did not resile from it.⁴⁰³ Consistent with Ms Taylor's acknowledgment, I consider that CBA's conduct in relying on the 2013 revaluations to require a restructure of the Ruddys' facilities breached Clause 2.2 of the Code.

In her evidence, Ms Taylor accepted that, after Bankwest detected the bank manager's misconduct, all of the bank manager's customers should have been told there was an issue.⁴⁰⁴ She also accepted that the failure to inform the bank manager's customers of the issue constituted a breach of Clause 2.2 of the Code.⁴⁰⁵ CBA did not resile from this acknowledgment in its submissions, and accepted that there was no evidence that the bank

³⁹⁸ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 11 [57]; Transcript, Sinead Taylor, 28 June 2018, 3475–6.

³⁹⁹ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 11 [58].

⁴⁰⁰ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 9 [47]; Transcript, Sinead Taylor, 28 June 2018, 3488.

⁴⁰¹ Transcript, Sinead Taylor, 28 June 2018, 3489.

⁴⁰² Transcript, Sinead Taylor, 28 June 2018, 3489.

⁴⁰³ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 6 [33].

⁴⁰⁴ Transcript, Sinead Taylor, 28 June 2018, 3471.

⁴⁰⁵ Transcript, Sinead Taylor, 28 June 2018, 3472.

manager's customers were given the relevant information.⁴⁰⁶ I agree that CBA's conduct in failing to inform the bank manager's customers breached Clause 2.2 of the Code.

Ms Taylor also accepted that Bankwest did not deal with FOS in a full and frank way in relation to the Ruddys' dispute.⁴⁰⁷ In its submissions, CBA acknowledged that the manner in which Bankwest dealt with FOS fell below community standards and expectations, but said that this was not the result of a deliberate effort to conceal facts.⁴⁰⁸ Bankwest's conduct fell short of community standards and expectations.

Finally, the guarantee provided by the Ruddys' son changed multiple times during the life of the facility. Ms Taylor said that she was 'troubled' by the changes and accepted that there was 'no explanation as to why [the guarantee] wasn't maintained with the facilities'.⁴⁰⁹ In its submissions, CBA accepted, and I find, that the amendments to the guarantee fell below community standards and expectations.⁴¹⁰

3.3 Causes of the conduct

The evidence establishes that, at the time that Bankwest offered the facilities to the Ruddys, 60% of its KPIs for employees like the bank manager were weighted towards 'profitable growth'.⁴¹¹ Half of that was allocated to 'asset sales targets'.⁴¹² Provided that employees met a risk 'gate opener' (a condition that had to be met to be eligible for any incentive payment), they could receive short-term incentive payments.⁴¹³ The evidence established that, in the 2011 financial year, Bankwest employees

⁴⁰⁶ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 6–7 [34]–[36].

⁴⁰⁷ Transcript, Sinead Taylor, 29 June 2018, 3492.

⁴⁰⁸ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 13 [69].

⁴⁰⁹ Transcript, Sinead Taylor, 29 June 2018, 3522.

⁴¹⁰ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 13 [73].

⁴¹¹ Transcript, Sinead Taylor, 28 June 2018, 3460–1.

⁴¹² Transcript, Sinead Taylor, 28 June 2018, 3461.

⁴¹³ Transcript, Sinead Taylor, 28 June 2018, 3461.

were able to double their base salary through such bonus arrangements.⁴¹⁴ This was apt to create a culture of prioritising sales to the detriment of diligent and prudent conduct in relation to loan approvals. The Ruddys' bank manager received his base salary and was eligible for a short-term incentive of up to 57% of his salary by way of additional bonus.⁴¹⁵

In its submissions, CBA did not accept that these remuneration and incentive arrangements were a significant cause of the conduct that has been described. CBA did acknowledge, however, that performance on financial KPIs could have been a 'contributing factor' to the conduct.⁴¹⁶ It is not necessary for me to state with any specificity the extent to which Bankwest's remuneration and incentive arrangements contributed to the conduct described above. The important thing is that it was a contributing factor. CBA pointed out in its submissions that, since 2012, the maximum potential short-term incentive as a percentage of base salary has reduced for Bankwest Rural and Regional Business Relationship Managers and Business Development Managers. Between 2011 and 2017, the majority of employees in these roles have been eligible for a maximum potential short-term incentive of 20–30% of their base salary.⁴¹⁷

Another cause of the conduct referred to above was that Bankwest did not have in place adequate internal systems to minimise the risk of conflict of interest posed by internal valuations. The only 'cross-check' done on internal valuations in 2011 was for the internal valuation to be provided to the credit team with the credit submission. At that time, the credit officer was 'required to validate the valuation prior to approving the deal'.⁴¹⁸ In its submissions, CBA said that the purpose of this system was to ensure that a bank manager was not able to, in effect, sign off on his or her own business.⁴¹⁹ CBA accepted that this system did not operate as intended in

⁴¹⁴ Transcript, Sinead Taylor, 28 June 2018, 3466.

⁴¹⁵ Transcript, Sinead Taylor, 28 June 2018, 3465.

⁴¹⁶ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 14 [79].

⁴¹⁷ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 15 [82].

⁴¹⁸ Transcript, Sinead Taylor, 28 June 2018, 3474.

⁴¹⁹ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 15 [85].

the case of the Sunrise valuation.⁴²⁰ In light of the other defective valuations that were identified in due course (prepared by the same bank manager), CBA also accepted that this system did not provide an adequate control at the relevant time.⁴²¹ The 'cross-check' was not an adequate mechanism to address the risks posed by relying on internal valuations that were not made by persons separate from the processes of loan origination and credit approval.

Bankwest continues to permit internal valuations by its sales professionals, and applies growth-focused KPIs to such employees.⁴²² Bankwest does not consider that this places such sales professionals in a conflict of interest, as long as the valuations are checked by another employee.⁴²³ The review that takes place is solely a review on the papers.⁴²⁴ CBA described the current system in its submissions,⁴²⁵ and said that it was sufficient to address any inherent conflict of interest posed by internal valuations.⁴²⁶ CBA said that 'a process by which internal valuations may be undertaken is important in circumstances where it is not practicable or feasible to obtain an external valuation for rural and remote customers'.⁴²⁷

4 NAB (the Smiths)

The fourth case study examined in these hearings involved conduct by NAB in connection with Deborah and Kenneth Smith. The Commission heard

⁴²⁰ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 15 [86].

⁴²¹ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 15 [86].

⁴²² Transcript, Sinead Taylor, 29 June 2018, 3525–6.

⁴²³ Transcript, Sinead Taylor, 29 June 2018, 3526.

⁴²⁴ Transcript, Sinead Taylor, 29 June 2018, 3528.

⁴²⁵ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 15–16 [87].

⁴²⁶ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 16 [88].

⁴²⁷ CBA, *Round 4 Hearing – Agricultural Lending & Enforcement Practices – Closing Submissions*, 13 July 2018, 16 [88].

evidence from Mrs Deborah Smith and from Mr Ross McNaughton, NAB's General Manager, Strategic Business Services.

The case study focused on three issues: NAB's hardship policy, farm debt mediation and the charging of default interest.

4.1 Background

The Smiths are also Queensland cattle farmers.⁴²⁸ They own two properties, which are about 140km apart.⁴²⁹ The first, Oakvale, is a breeder property located outside of Pentland in the Charters Towers region.⁴³⁰ The second, Limbri, is a fattening property located outside of Hughenden in the Flinders Shire.⁴³¹

The Smiths became customers of NAB in March 2008.⁴³² NAB provided them with a business markets loan with a limit of \$3.1 million and an overdraft with a \$250,000 limit.⁴³³

A number of external events completely beyond their control have badly affected the Smith's business. First came the June 2011 live cattle export ban.⁴³⁴ Mrs Smith explained that the ban caused a dramatic decline in the price that they could obtain for their cattle.⁴³⁵ It also increased the cost of many of the inputs to their business.⁴³⁶ Mrs Smith said that those effects were felt for some time.⁴³⁷

Then, in 2012, the Cape River – which runs through Oakvale – flooded. The flood destroyed fences on Oakvale and damaged the dirt road by which the

⁴²⁸ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 1 [2].

⁴²⁹ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 2 [7].

⁴³⁰ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 2 [7].

⁴³¹ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 1–2 [2], [7].

⁴³² Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 2 [8].

⁴³³ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 2 [8].

⁴³⁴ Transcript, Deborah Allison Smith, 29 June 2018, 3545.

⁴³⁵ Transcript, Deborah Allison Smith, 29 June 2018, 3545–6.

⁴³⁶ Transcript, Deborah Allison Smith, 29 June 2018, 3546.

⁴³⁷ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 2–3 [9].

property was accessed.⁴³⁸ As a result the Smiths could not send cattle to market for a period.⁴³⁹

By August 2012, the Smiths were in financial difficulty.⁴⁴⁰ Their banker at NAB completed a Referral Form for Categorisation,⁴⁴¹ the first step in having the file managed by Strategic Business Services.

The form recorded that the Smiths had been unable to get cattle to market due to wet weather conditions, had 'been extremely unlucky' and had missed an interest payment.

Strategic Business Services declined to assume the conduct of the Smiths' file at that time.⁴⁴² Notwithstanding that their financial difficulties were assessed as being temporary and caused by a natural disaster, the Smiths were not told about NAB's hardship policy, nor were they offered any hardship relief.⁴⁴³ Instead, NAB increased the Smiths' overdraft facility limit so as to bring it back into order.⁴⁴⁴

Mr McNaughton agreed that it would be fair to let customers know of the fact of the hardship policy.⁴⁴⁵ Yet he seemed unsure of the reach of the policy, which, given Mr McNaughton's role as head of Strategic Business Services, I found both strange and concerning.

4.2 Default

By 1 November 2012, the Smiths' overdraft account was again drawn over its limit and NAB commenced charging default interest on that account.⁴⁴⁶

⁴³⁸ Transcript, Deborah Allison Smith, 29 June 2018, 3547.

⁴³⁹ Transcript, Deborah Allison Smith, 29 June 2018, 3547.

⁴⁴⁰ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 (Tab 38) [NAB.005.514.0001].

⁴⁴¹ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 (Tab 38) [NAB.005.514.0001].

⁴⁴² Transcript, Deborah Allison Smith, 29 June 2018, 3576.

⁴⁴³ Transcript, Deborah Allison Smith, 29 June 2018, 3564; Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 4 [20].

⁴⁴⁴ NAB, *Submission: Smith Case Study*, 13 July 2018, 8 [35].

⁴⁴⁵ Transcript, Ross Hugh McNaughton, 29 June 2018, 3581.

⁴⁴⁶ Transcript, Ross Hugh McNaughton, 29 June 2018, 3586.

Again, no hardship relief was offered at that time, nor were the Smiths notified of the fact of the hardship policy.⁴⁴⁷

On 5 November 2012, a NAB banker completed a second Referral Form for Categorisation.⁴⁴⁸ The banker recommended that the Smiths 'be retained'. Mr McNaughton explained that this indicated that the banker believed that the Smiths could be financially rehabilitated.⁴⁴⁹

The Smiths' file was accepted by Strategic Business Services in late 2012.⁴⁵⁰

In her oral evidence Mrs Smith said that it was dry on Limbri throughout 2012.⁴⁵¹ In early 2013, drought was declared in the Flinders Shire.⁴⁵² The Smiths began reducing the number of cattle on Limbri and transferring cattle to Oakvale.⁴⁵³

The Smiths' business markets loan expired on 28 February 2013.⁴⁵⁴ NAB granted the Smiths a one month extension.⁴⁵⁵ At the end of the extension period, the business markets loan facility again expired and NAB commenced charging default interest on the amount outstanding under the loan.⁴⁵⁶ Notwithstanding that Limbri was officially in drought at that stage, NAB did not tell the Smiths about its hardship policy, or offer any relief under that policy.⁴⁵⁷

⁴⁴⁷ Transcript, Deborah Allison Smith, 29 June 2018, 3564.

⁴⁴⁸ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 (Tab 41) [NAB.005.481.0001].

⁴⁴⁹ Transcript, Deborah Allison Smith, 29 June 2018, 3586.

⁴⁵⁰ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 24 [81].

⁴⁵¹ Transcript, Deborah Allison Smith, 29 June 2018, 3547.

⁴⁵² Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 3 [10].

⁴⁵³ Transcript, Deborah Allison Smith, 29 June 2018 3548; Exhibit 4.110, Witness statement of Deborah Allison Smith, 29 June 2018, 3 [11].

⁴⁵⁴ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 39 [147].

⁴⁵⁵ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 39 [147].

⁴⁵⁶ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 39 [147].

⁴⁵⁷ Transcript, Ross Hugh McNaughton, 29 June 2018, 3579–80.

4.3 Farm debt mediation

In April 2013, NAB wrote to the Smiths. NAB noted that the Smiths' facilities had fallen into arrears, expressed concern about the viability of the Smiths' business and advised that it was considering commencing recovery action, which could include possible sale of the Smiths' farming property.⁴⁵⁸ NAB invited the Smiths to attend farm debt mediation.

In oral evidence Mrs Smith said that on receiving the letter, both she and her husband were 'very frightened'.⁴⁵⁹ She said that neither Limbri nor Oakvale was then saleable due to the dry conditions.⁴⁶⁰

A farm debt mediation took place in Townsville in September 2013.⁴⁶¹ The Smiths attended along with their solicitor from Legal Aid and their Rural Financial Counsellor.⁴⁶² Mrs Smith described the mediation as 'very intimidating'.⁴⁶³ The mediation resulted in NAB and the Smiths entering into a deed of forbearance.⁴⁶⁴

The deed imposed various obligations on the Smiths and NAB. Of present relevance.⁴⁶⁵

- NAB was to allow the Smiths access to funds so that they could continue to tend to their cattle and meet their expenses;⁴⁶⁶

⁴⁵⁸ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.148.032.8970].

⁴⁵⁹ Transcript, Deborah Allison Smith, 29 June 2018, 3549.

⁴⁶⁰ Transcript, Deborah Allison Smith, 29 June 2018, 3549.

⁴⁶¹ Transcript, Deborah Allison Smith, 29 June 2018, 3550.

⁴⁶² Transcript, Deborah Allison Smith, 29 June 2018, 3550.

⁴⁶³ Transcript, Deborah Allison Smith, 29 June 2018, 3550.

⁴⁶⁴ Transcript, Deborah Allison Smith, 29 June 2018, 3551.

⁴⁶⁵ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.005.451.1023].

⁴⁶⁶ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.005.451.1023 at .1031].

- the Smiths were to:⁴⁶⁷
 - list either Oakvale or Limbri for sale by 1 March 2014;
 - have exchanged a contract for sale by 31 May 2014; and
 - have sold one of the properties by 30 June 2014.

The Smiths were also obliged to remit:⁴⁶⁸

- \$200,000 to NAB – from the proceeds of sale of cattle – by 30 April 2014;
- a further \$200,000 by 30 May 2014; and
- \$400,000 by 30 June 2014.

If the Smiths complied with their obligations under the deed, NAB was to rebate \$50,000 of the default interest charged to the Smiths' accounts.⁴⁶⁹

Mrs Smith said that the repayments required by cattle sales could only have been possible if they had had a 'super year'.⁴⁷⁰ The Smiths listed Limbri for sale with a real estate agent.⁴⁷¹ Mrs Smith's oral evidence was that the agent advised that it was highly unlikely that a purchaser would be found because of the dry conditions.⁴⁷²

Throughout 2014, Limbri remained in drought. The Smiths did not find a purchaser for the property in the time required by the deed. Nor were they able to make the repayments required.⁴⁷³

⁴⁶⁷ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.005.451.1023 at .1031].

⁴⁶⁸ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.005.451.1023 at .1031].

⁴⁶⁹ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.005.451.1023 at .1030].

⁴⁷⁰ Transcript, Deborah Allison Smith, 29 June 2018, 3554.

⁴⁷¹ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 6 [29].

⁴⁷² Transcript, Deborah Allison Smith, 29 June 2018, 3556.

⁴⁷³ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 6 [29]–[30].

On 25 July 2014 the Smiths' financial counsellor wrote to NAB and sought an extension of time for them to complete their obligations under the deed.⁴⁷⁴ The letter explained:

- that neither Limbri nor Oakvale could be sold to their best advantage due to the drought;
- the poor state of the cattle market at that time and the low prices obtained by the Smiths in their most recent sales; and
- that the Smiths were endeavouring to refinance their NAB facilities.

NAB declined to grant the extension and reserved its rights.⁴⁷⁵

Oakvale was also dry and it too was officially drought-declared in 2015.⁴⁷⁶

In December 2014, the Smiths' relationship manager changed, but the file continued to be supervised by the same person within Strategic Business Services.⁴⁷⁷ Mrs Smith's oral evidence was that she was unaware of the change and has not spoken with the new relationship manager.⁴⁷⁸

Both Limbri and Oakvale remained in drought from 2015.⁴⁷⁹ There has been no significant step taken by NAB or the Smiths since that time. NAB has not taken any step to enforce its securities over either Oakvale or Limbri, but default interest has continued to accrue on both facilities. As a result, the Smiths' have been charged in excess of \$2.6 million in default interest, in addition to ordinary interest charged on the accounts.⁴⁸⁰

NAB's decision not to take enforcement action must be understood in context. In his oral evidence Mr McNaughton said that '[NAB] wanted to

⁴⁷⁴ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, Exhibit DS-11 [NAB.005.451.2196].

⁴⁷⁵ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, Exhibit RHM-2 [NAB.005.451.1282].

⁴⁷⁶ Transcript, Deborah Allison Smith, 29 June 2018, 3557.

⁴⁷⁷ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 20–1 [66]; Transcript Ross Hugh McNaughton, 29 June 2018, 3597.

⁴⁷⁸ Transcript, Deborah Allison Smith, 29 June 2018, 3564.

⁴⁷⁹ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 8 [39].

⁴⁸⁰ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 38–9 [145].

find a solution whereby the Smiths remained on the property'.⁴⁸¹ He also agreed that that NAB was not in a position to realise either property given their condition.⁴⁸²

4.4 What the case study showed

The case study was a clear example of the difficulties faced by both borrowers and lenders when external events strike and impair or destroy the short- or medium-term viability of an agricultural business.

4.4.1 Hardship

Hardship policies can be an effective means of assisting a client in times of unexpected financial stress. To the extent that they assist a client to return to financial health more quickly, they work in the interests of both the bank and the customer. But the existence of such policies is only of use to customers if they are given relief. The mere existence of the policy alone serves no end. It is in the interests of both banks and their customers for banks to tell customers that they may be entitled to relief.

In August 2012, when Oakvale flooded and the Smiths' overdraft went beyond its limit, NAB had a hardship policy that applied in circumstances of natural disaster. The Strategic Business Services group was responsible for the administration of the NAB hardship policy to certain types of customers, including agricultural borrowers.⁴⁸³ Mr McNaughton's evidence was that Strategic Business Services would not become involved in the grant of hardship relief unless it accepted a referred file.⁴⁸⁴ In August 2012, Strategic Business Services did not accept the Smiths file.⁴⁸⁵ It follows that, on Mr McNaughton's evidence, it was for the Smiths' banker to raise the prospect of hardship relief. He did not.

In its written submissions, NAB resisted a finding that it had engaged in conduct falling below community standards and expectations by failing to notify the Smiths of the existence of the hardship policy. The first ground on

⁴⁸¹ Transcript, Ross Hugh McNaughton, 29 June 2018, 3598.

⁴⁸² Transcript, Ross Hugh McNaughton, 29 June 2018, 3598.

⁴⁸³ Transcript, Ross Hugh McNaughton, 29 June 2018, 3569, 3577.

⁴⁸⁴ Transcript, Ross Hugh McNaughton, 29 June 2018, 3578.

⁴⁸⁵ Transcript, Ross Hugh McNaughton, 29 June 2018, 3576.

which it opposed that finding was that there was insufficient evidence for the Commission to be satisfied that the Smiths had not been told of the policy.⁴⁸⁶ NAB noted that it had not been asked to address that topic in its witness statement.⁴⁸⁷ However the submission ignores that Mrs Smith dealt with the issue in her witness statement, which was provided to NAB in advance of the hearing. In her statement Mrs Smith said that neither she, nor Mr Smith were 'at any time, informed of any hardship processes offered by NAB'.⁴⁸⁸ In oral evidence, Mrs Smith gave evidence to the same effect.⁴⁸⁹

NAB was free to challenge Mrs Smith's assertions in cross-examination. It did not do so. Nor did it point to any document that contradicted that evidence. I do not accept NAB's submission that I should not be satisfied on the evidence that the Smiths were not told about hardship arrangements.

NAB raised other arguments in seeking to resist a finding that it failed to meet community expectations by not informing the Smiths of the hardship policy. It contended that:

- such a failure was not a breach of any legal obligation, which suggested it would not be a breach of community standards and expectations;⁴⁹⁰
- failure to notify was not a breach of any NAB policy;⁴⁹¹
- in August 2012, NAB understood that the Smiths were about to clear the excess very soon;⁴⁹² and
- the Smiths were given other assistance in any event.⁴⁹³

The first two contentions expressly or implicitly reject the notion that the community would expect a bank with a policy designed to assist customers in financial distress to tell the customer that the policy exists. I do not accept

⁴⁸⁶ NAB, *Submission: Smith Case Study*, 13 July 2018, 9–10 [41].

⁴⁸⁷ NAB, *Submission: Smith Case Study*, 13 July 2018, 9–10 [41].

⁴⁸⁸ Exhibit 4.110, Witness statement of Deborah Allison Smith, 22 June 2018, 4 [20].

⁴⁸⁹ Transcript, Ross Hugh McNaughton, 29 June 2018, 3564.

⁴⁹⁰ NAB, *Submission: Smith Case Study*, 13 July 2018, 10 [42].

⁴⁹¹ NAB, *Submission: Smith Case Study*, 13 July 2018, 10 [43].

⁴⁹² NAB, *Submission: Smith Case Study*, 13 July 2018, 10 [44].

⁴⁹³ NAB, *Submission: Smith Case Study*, 13 July 2018, 10 [45].

that the community would expect so little. It is to be remembered that the focus here is only upon informing the customer of the *existence* of the policy, that is, to tell the customers of the *prospect* of assistance.

The third contention ignores that the Smiths' banker was sufficiently concerned about their position to refer the file to Strategic Business Services. Given the fact of the referral and the basis for it (flood), NAB was aware of sufficient facts to appreciate that the hardship policy may be engaged. It did not need to form a view on whether any application would ultimately be granted.

The fourth contention points to other conduct by NAB to the benefit of the Smiths. In 2013 NAB advanced the Smiths money to pay local rates and avoid enforcement proceedings by the local Regional Council. In late 2015 the Australian Tax Office started bankruptcy proceedings against the Smiths. While these proceedings were pending, NAB provided funds for the Smiths to buy feed for their cattle. While this conduct may be commendable, it did not disentitle the Smiths from being told of the existence of the hardship policy as soon as they were affected by the first of the succession of natural disasters that have affected them.

NAB's not telling the Smiths of the bank's hardship policy in August 2012, when the Smiths' business had suffered as a result of flooding at Oakvale, was conduct that fell below community standards and expectations.

4.4.2 Default interest

Mr McNaughton said that NAB 'could have potentially done more in its communications with the Smiths after the farm debt mediation ... to ensure that they were conscious of the practical consequences' of continuing to be in default.⁴⁹⁴ He characterised the Smiths' file as a particularly difficult one 'even by [Strategic Business Services] standards'.⁴⁹⁵

There can be no doubt that the file is, and has been, difficult. The difficulty for NAB has always been to choose between unpalatable outcomes: do nothing, or remove a farming family from their land at a time when the security is worth far less than once it was. And it is clear that the potential

⁴⁹⁴ Exhibit 4.112, Witness statement of Ross Hugh McNaughton, 18 June 2018, 44–5 [174]–[175].

⁴⁹⁵ Transcript, Ross Hugh McNaughton, 29 June 2018, 3593.

adverse publicity and political attention that enforcement action would attract weighed heavily on the minds of some at NAB.⁴⁹⁶ NAB's difficulty is amplified if the bank cannot now realise the secured property and cannot compel the Smiths to do so.⁴⁹⁷

The difficulty for the Smiths is caused by their continued inability to earn income sufficient to service their loans, or to take action to sell one of their properties to clear at least some debt. Their difficulty is then amplified by the compounding effect of interest charged at the default rate.

It is unclear what good is served by the application of default interest in a circumstance such as this. Mr McNaughton said in his oral evidence that he understood that NAB would hold additional capital as a consequence of an impaired loan, but was unable to answer whether there was any relationship between the bank's cost of capital and the charging of default interest.⁴⁹⁸ He explained that it was customary in Australia for banks to charge default interest as an incentive to comply with the terms of the loan.⁴⁹⁹

Mr McNaughton agreed that farmers in drought are under heightened levels of stress,⁵⁰⁰ and that the imposition of default interest on farmers in such situations could add to their stress.⁵⁰¹ He also agreed that as events transpired, it was impossible for the Smiths to comply with their obligations under the deed of forbearance⁵⁰² and that had the bank enforced at any point, it would not have been able to realise the asset.⁵⁰³ But notwithstanding those factors, NAB continued to charge default interest.

Given that neither Mr McNaughton in oral evidence, nor NAB in subsequent written submissions, was able to point to any commercial rationale for the continued charging of default interest in this case, I consider that NAB

⁴⁹⁶ Transcript, Ross Hugh McNaughton, 29 June 2018, 3598–602; Exhibit 4.115, 10 November 2014, Emails between Avent, Starky and others.

⁴⁹⁷ Transcript, Ross Hugh McNaughton, 29 June 2018, 3598.

⁴⁹⁸ Transcript, Ross Hugh McNaughton, 29 June 2018, 3591.

⁴⁹⁹ Transcript, Ross Hugh McNaughton, 29 June 2018, 3591.

⁵⁰⁰ Transcript, Ross Hugh McNaughton, 29 June 2018, 3593.

⁵⁰¹ Transcript, Ross Hugh McNaughton, 29 June 2018, 3593.

⁵⁰² Transcript, Ross Hugh McNaughton, 29 June 2018, 3594.

⁵⁰³ Transcript, Ross Hugh McNaughton, 29 June 2018, 3598.

engaged in conduct that fell below the standards and expectations of the community. I am fortified in that view by the fact that Mr McNaughton agreed that no good is served by continuing to apply default interest that 'will almost certainly not be repaid'⁵⁰⁴ and said that, in all probability, NAB will ultimately waive the default interest.⁵⁰⁵

4.4.3 Culture

Why then has NAB continued to charge default interest in this case? Senior Counsel Assisting submitted that NAB's charging default interest to the Smiths over such a long period was the product of a culture by which default interest was used as a strategic tool to place pressure on borrowers in default.

Mr McNaughton's evidence was that a custom had developed within Australian banks to charge default interest 'as an incentive to comply'.⁵⁰⁶ Mr McNaughton also said that he would expect default interest to be waived at a future farm debt mediation and that his experience has been that 'all or a large element' of default interest is waived by that process.⁵⁰⁷

At least two points might be inferred from those answers. The first is that default interest is not, or at least is not exclusively, charged to reflect NAB's cost of capital. Secondly, at least in the context of agricultural loans, it is not charged in the anticipation of recoupment. Each of those inferences supports the submission of Senior Counsel Assisting. The fact that a higher amount of indebtedness and a higher prevailing rate of interest may reduce the negotiating power of the borrower and enhance the position of the bank at farm debt mediation also supports that view.

That the farm debt mediation was held long ago does not alter that conclusion. NAB's position has continued to strengthen as the amount of indebtedness has grown.

On the evidence, I am satisfied that one reason for the application of default interest in this case was the strategic benefit pointed to by Senior Counsel

⁵⁰⁴ Transcript, Ross Hugh McNaughton, 29 June 2018, 3596.

⁵⁰⁵ Transcript, Ross Hugh McNaughton, 29 June 2018, 3596.

⁵⁰⁶ Transcript, Ross Hugh McNaughton, 29 June 2018, 3591.

⁵⁰⁷ Transcript, Ross Hugh McNaughton, 29 June 2018, 3591.

Assisting. No doubt there were other causes. Those causes may include the inability of the bank to fix upon another way to deal with the file, apathy resulting from the very long period in which the file has been under the management of Strategic Business Services, the failure of more senior members of NAB staff to become actively involved the management of the file and a standard position of relying upon contractual rights.

As I have already mentioned, after submissions were filed following the fourth round of hearings, NAB announced a change of policy regarding the application of default interest to properties in drought. That policy change will prevent the bank from again engaging in the type of conduct that affected the Smiths.

5 Rural Bank

The fifth case study examined in these hearings related to loans made by Rural Bank to farmers in the Queensland cattle industry. The Commission heard evidence from Alexandra Gartmann, the Chief Executive Officer and Managing Director of Rural Bank Limited.

5.1 Background

In December 1998, Bendigo Bank established Rural Bank, then known as Elders Rural Bank, as a joint venture with Elders.⁵⁰⁸ In May 2009, Bendigo and Adelaide Bank acquired a controlling interest in Rural Bank. In late 2010, Rural Bank became a wholly owned subsidiary of Bendigo and Adelaide Bank.⁵⁰⁹ Bendigo and Adelaide Bank's primary engagement with agricultural clients is through Rural Bank, which describes itself as a dedicated agribusiness bank.⁵¹⁰

In its submission to the Commission on 29 January 2018, Bendigo Bank told the Commission that a number of loans made by Rural Bank to customers in the Queensland cattle industry had become non-performing.⁵¹¹ Bendigo

⁵⁰⁸ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3612.

⁵⁰⁹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3612–13.

⁵¹⁰ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3613.

⁵¹¹ Exhibit 4.123, 15 December 2017, Response to Letter from Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 20 [80].

Bank said that contributing factors included weak underwriting and an overreliance on security values.⁵¹² These factors were compounded by the live cattle export ban, falling cattle prices, prolonged and severe drought and a fall in property values.⁵¹³

In a further letter of 18 May 2018 from Mike Hirst, then the Managing Director of Bendigo and Adelaide Bank, Bendigo and Adelaide Bank told the Commission that a number of factors had contributed to these loans becoming non-performing. These factors included (again) an overreliance on security values and a failure to appropriately establish loan serviceability.⁵¹⁴ But Mr Hirst also said that loan performance was exacerbated by inadequate loan management, with evidence of: a lack of follow up of excesses, arrears and out of order accounts; failures to conduct timely reviews or to collect updated farm performance information; failures to otherwise detect signs of financial distress at an appropriately early time; and failures in relation to Rural Bank's enforcement processes.⁵¹⁵ In addition, Mr Hirst referred to a failure to make appropriate inquiries and verification of valuations and appraisals, including failures to ensure valuation accuracy, independence and integrity, and failures to physically visit and inspect livestock and properties.⁵¹⁶

In her statement, Ms Gartmann said that Rural Bank had made 62 loans to Queensland cattle producers that became non-performing between 1 January 2008 and 31 December 2017.⁵¹⁷ Ms Gartmann referred to a

⁵¹² Exhibit 4.123, 15 December 2017, Response to Letter from Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 20 [80].

⁵¹³ Exhibit 4.123, 15 December 2017, Response to Letter from Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 20 [80].

⁵¹⁴ Exhibit 4.124, 18 May 2018, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Response to Letter dated 11 May 2018, 8 [48].

⁵¹⁵ Exhibit 4.124, 18 May 2018, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Response to Letter dated 11 May 2018, 8 [49].

⁵¹⁶ Exhibit 4.124, 18 May 2018, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Response to Letter dated 11 May 2018, 8 [50].

⁵¹⁷ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 12 [53].

number of external events in Queensland, including the live export ban, Cyclone Yasi-related flooding and severe drought, which she said created the ‘perfect storm’ for Queensland cattle farmers.⁵¹⁸ Ms Gartmann said that the conduct of Rural Bank had made the 62 loans more vulnerable to those external factors.⁵¹⁹ In particular, Ms Gartmann referred to issues internal to Rural Bank relating to:

- poor judgments in the exercise of discretions to authorise individuals to act outside of normal policy parameters;
- inadequate management oversight of the manner in which those discretions were being exercised and policies being applied;
- inadequacies in staff training;
- insufficient performance management of some individuals; and
- matters of sales and credit culture, governance framework, approval process, and portfolio management.⁵²⁰

Ms Gartmann exhibited a number of reports to her statement by way of explanation of how Rural Bank discovered these issues. These reports included:

- a report prepared for Rural Bank by KPMG dated 27 September 2010 entitled ‘Assistance with Rural Bank Limited’s Credit Risk Internal Control Program’.⁵²¹ KPMG prepared this report after having undertaken a review of 10 Rural Bank client files across five district banking managers. KPMG identified a number of major themes from the review, including:
 - suppression of information pertinent to credit;
 - misrepresentation of data in Rural Bank’s systems, which was described as going beyond ‘window dressing of credit submissions’;

⁵¹⁸ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3635, 3684–5.

⁵¹⁹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3635.

⁵²⁰ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 14–15 [69].

⁵²¹ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, Exhibit AEMG-8 [BAB.5022.0001.0254].

- reasons for excesses provided by district banking managers in the seasonal/overdraft accounts not reflecting the actual cause of excesses of customer's accounts;
- instances of livestock appraisal values appearing to have been inflated to improve the security position of the exposures;
- deteriorating features not being reported to Rural Bank in a timely manner;
- non-compliance with conditions precedent, including confirmation that all tax liabilities were up to date and in order, with no arrears or repayment arrangements;
- failures to comply with loan conditions prior to loan drawdown;
- failures to follow up on loan conditions; and
- inadequate financial and cash flow analysis.⁵²²

Ms Gartmann accepted that the KPMG Report returned a number of very concerning findings.⁵²³

Ms Gartmann also exhibited a report presented at a Board Credit Committee meeting on 27 July 2011 by Mr Taso Corolis, General Manager, Risk, entitled 'Credit Structure and Portfolio Trends' dated 18 May 2011.⁵²⁴ In his report, Mr Corolis undertook a detailed analysis of a number of aspects of Rural Bank's lending portfolio. He found that a number of the issues identified by KPMG were clearly systemic, and not isolated.⁵²⁵ Some of the issues Mr Corolis identified were:

- a bias towards asset lending on the assumption that rural property values would continue to increase;

⁵²² Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3645.

⁵²³ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3644.

⁵²⁴ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, Exhibit AEMG-9 [BAB.5022.0001.0009].

⁵²⁵ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, Exhibit AEMG-9 [BAB.5022.0001.0009 at .0019].

- a failure to disclose, recognise and identify the risk profile of the borrower;
- a valuation process in which valuations were instructed or influenced by sales;
- inflated appraisals arising from the appraiser not inspecting the property, or possibly from a conflict of interest;
- cash flows being prepared without input or agreement from the borrower;
- lending against defective or poor securities;
- permitting customer risk rating overrides without proper justification; and
- allowing pressure from sales or management to compromise the independence of credit decisions.⁵²⁶

Mr Corolis found that these issues were a material contributor to the credit issues that were then being faced by the bank.⁵²⁷ In her oral evidence, Ms Gartmann told the Commission that she disagreed with the severity of Mr Corolis's assessment, and that she believed that the findings in his report were overstated.⁵²⁸

Ms Gartmann also exhibited a report by HSW Partners entitled 'Credit Framework and Operations Review', dated November 2011, which was presented by Mr Graeme Willis of HSW Partners at a board meeting of Rural Bank in December 2011.⁵²⁹

Ms Gartmann told the Commission in her statement that, based on the findings in these reports, and especially the Willis Report, Rural Bank made a number of significant changes to its processes and procedures, including:

- rebalancing Rural Bank's focus on loan serviceability;

⁵²⁶ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3677–8.

⁵²⁷ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, Exhibit AEMG-9 [BAB.5022.0001.0009 at .0019]; see also Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3679.

⁵²⁸ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3661, 3665.

⁵²⁹ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, Exhibit AEMG-10 [BAB.5022.0003.0001].

- improving staff training;
- tightening performance management;
- making changes in relation to valuations and appraisals; and
- implementing new governance practices.⁵³⁰

5.2 APRA and serviceability issues

In the course of Ms Gartmann's evidence, the Commission also heard that APRA had highlighted issues with Rural Bank's approach to loan serviceability as early as 2006 and 2009.⁵³¹ In 2009, APRA had noted that a high proportion of Rural Bank's loan proposals were being approved notwithstanding the failure of one or more policy tests. APRA also raised concerns about the appropriateness of Rural Bank's credit risk rating system.⁵³² Ms Gartmann did not agree that APRA's recommendations in 2006 and 2009 should have put Rural Bank on notice 'of potential systemic issues with its loan serviceability policies and practices' – Ms Gartmann preferred to characterise the communication as having identified 'areas to strengthen and improve'.⁵³³ In the end, the difference is one of words not substance. The APRA communication together with the various reports described above all pointed clearly towards important deficiencies in Rural Bank's policies, processes and practices.

5.3 Evidence about approach to enforcement

Ms Gartmann also gave evidence about Rural Bank's approach to its customers once their files were transferred to asset management. Ms Gartmann said that once customers are brought within Rural Bank's Asset Management Unit, Rural Bank will 'work with the customer to identify a strategy that will help to address some of the financial challenges that they are facing', and that Rural Bank would 'always look to try and trade out of challenges'.⁵³⁴ Amongst other things, Rural Bank frequently extends

⁵³⁰ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 15 [71].

⁵³¹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3651–2.

⁵³² Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3652.

⁵³³ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3653.

⁵³⁴ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3618.

terms, changes loan arrangements and tries to make repayments more manageable.⁵³⁵

5.4 What the case study showed

This case study highlighted some of the ways in which poor loan origination and management practices may leave farmers more vulnerable to the kinds of external events that all too frequently affect the agricultural industry.

Between 2008 and 2011, a combination of these events affected the Queensland cattle industry: severe drought, followed by widespread flooding, and the live export ban. That combination of events saw many farmers face severe financial hardship.

As Ms Gartmann accepted, issues within Rural Bank made the 62 loans to Queensland cattle farmers that became non-performing between 2008 and 2011 more vulnerable to external factors than they might otherwise have been.⁵³⁶ As already noted, those issues related to:

- poor judgments in the exercise of discretions to authorise individuals to act outside normal policy parameters;
- inadequate management oversight of the manner in which those discretions were being exercised and policies being applied;
- inadequacies in staff training;
- insufficient performance management of some individuals; and
- matters of sales and credit culture, governance framework, approval process, and portfolio management.⁵³⁷

⁵³⁵ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3619.

⁵³⁶ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3635.

⁵³⁷ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 14–15 [69].

In her statement, Ms Gartmann accepted these aspects of Rural Bank's conduct fell below community standards and expectations,⁵³⁸ and I agree that they did.

The issues were identified in a series of reports into Rural Bank's internal practices, including the KPMG Report, the Corolis Report and the Willis Report.⁵³⁹

As has been noted, Ms Gartmann expressed her own views about the findings made in the reports about Rural Bank's business that have been mentioned above. In many respects, she did not agree with them. In particular, she resisted any characterisation of the issues identified in those reports as having been 'systemic'. In its submissions, Bendigo and Adelaide Bank also resisted any reliance by the Commission on the findings and opinions expressed in those reports – in particular, the KPMG Report.⁵⁴⁰

Each of the reports that has been mentioned reflected the contemporaneous findings and opinions of persons engaged to examine and report on Rural Bank's practices at that time. The Corolis Report, in particular, represented the views of the then Chief Risk Officer of the business, in a report prepared at the request of the chairman of the board.⁵⁴¹ I see no reason to doubt the views expressed in that report (or the other reports).

The findings in the reports are concerning. Ms Gartmann accepted this in relation to the KPMG Report.⁵⁴² On receiving the Corolis Report, Rural Bank's chairman observed that the situation was 'unsatisfactory'.⁵⁴³ Rural Bank went on to take significant steps to improve its policies and procedures relating to loan serviceability, securities, valuations and loan

⁵³⁸ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 14–15 [69], 22 [114].

⁵³⁹ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 14 [67]–[68].

⁵⁴⁰ BAB, *Submissions of Bendigo and Adelaide Bank in Response to Counsel Assisting's Closing Submissions on Case Study 5, Round 4*, 13 July 2018, 3–4 [14].

⁵⁴¹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3672.

⁵⁴² Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3644.

⁵⁴³ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3680.

monitoring.⁵⁴⁴ These changes reflect an acceptance on the part of the bank that its existing practices were insufficient.

It is concerning that Rural Bank did not implement these changes sooner. As I have noted above, in 2006 and 2009, APRA made recommendations that might be thought to have put Rural Bank on notice of potential systemic issues with its loan serviceability policies and practices.⁵⁴⁵ Ms Gartmann accepted that APRA had identified 'areas to strengthen and improve'.⁵⁴⁶ However, it was not until 2010 that Rural Bank commissioned the KPMG Report.

It is also concerning that, in 2010, after the occurrence of many of the external events affecting the Queensland cattle industry referred to above, Rural Bank did not rebalance its priorities to emphasise the maintenance of existing loans. Instead, the minutes of a board meeting from March 2010 record that, at that time, '[p]riority [was] being given to new business and additional lending to existing clients over no increase annual reviews'.⁵⁴⁷ Ms Gartmann accepted that it was 'not an appropriate time' to prioritise generating new business.⁵⁴⁸ This prioritisation was not fair to existing Rural Bank clients, who were entitled to expect regular and careful loan management.

In her oral evidence, Ms Gartmann dealt with the cases of two cattle farmers referred to specifically in the KPMG Report.

Before turning to those customers, I note that Rural Bank was not a signatory to the Code of Banking Practice at the time of its conduct in relation to those customers. It did not become a signatory to the Code until December 2017.⁵⁴⁹ In its submissions, Bendigo and Adelaide Bank said that, because Rural Bank did not become a signatory to the Code until 2017, any failure by Rural Bank to comply with the Code before that time would not constitute misconduct within the Commission's Terms of

⁵⁴⁴ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3682.

⁵⁴⁵ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3653.

⁵⁴⁶ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3653.

⁵⁴⁷ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3663–4.

⁵⁴⁸ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3663, 3664.

⁵⁴⁹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3620–1.

Reference.⁵⁵⁰ It said that, in circumstances where adoption of the Code was voluntary and at all relevant times Rural Bank had determined not to adopt it, findings of misconduct for non-compliance with the Code would be inappropriate and unsound.⁵⁵¹ I do not accept that submission.

The majority of the loans referred to in this case study were made between 2003 and 2007.⁵⁵² Many of Australia's largest banks became signatories to the then current version of the Code in 2003. By August 2004, all of the big four banks, as well as BankSA, HSBC, St George Bank and Suncorp Metway, had subscribed to the 2004 version of the Code. Others soon followed.⁵⁵³ I consider that, by at least the end of 2004, if not earlier, the Code was a 'recognised and widely adopted benchmark for conduct'. Accordingly, non-compliance with the Code by Rural Bank would have constituted misconduct within the Commission's Terms of Reference.

Returning to the KPMG Report, KPMG found that Rural Bank staff had engaged in a number of breaches of lending standards in relation to serviceability.⁵⁵⁴ In general terms, these included a failure to properly assess loan serviceability,⁵⁵⁵ suppressing information pertinent to credit, misrepresenting data into the Rural Bank systems,⁵⁵⁶ and failing to verify information provided by customers.⁵⁵⁷

The first example considered in oral evidence related to a Queensland farmer who applied for a loan in around 2007. KPMG found that this application was approved in circumstances where it was known that

⁵⁵⁰ BAB, *Submissions of Bendigo and Adelaide Bank in Response to Counsel Assisting's Closing Submissions on Case Study 5, Round 4*, 13 July 2018, 2–3 [7]–[9].

⁵⁵¹ BAB, *Submissions of Bendigo and Adelaide Bank in Response to Counsel Assisting's Closing Submissions on Case Study 5, Round 4*, 13 July 2018, 2–3 [9].

⁵⁵² Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, 12 [53].

⁵⁵³ See Exhibit 4.122, 2 July 2018, Banks that have adopted versions of the Code of Banking Practice.

⁵⁵⁴ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3646.

⁵⁵⁵ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3646, 3673.

⁵⁵⁶ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3646.

⁵⁵⁷ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3646.

\$1 million that had been provided by the farmer's aunt had been sourced from a margin loan.⁵⁵⁸ In relation to this file, KPMG found in its report that:

- the district banking manager had misrepresented the bank's position to the borrower;⁵⁵⁹
- the district banking manager had acted dishonestly both towards the bank and towards the customer;⁵⁶⁰ and
- this led to a loan being originated in circumstances where Rural Bank lacked material information about whether the debt could be repaid.⁵⁶¹

Ms Gartmann accepted that, had Rural Bank been a signatory to the Code at the time of this conduct, the conduct would have breached Clause 25.1 of the Code.⁵⁶² In its submissions, however, Bendigo and Adelaide Bank sought to call into question the accuracy of several of the findings made in the KPMG Report in relation to this customer.⁵⁶³ Bendigo and Adelaide Bank also argued that the views in the KPMG Report more generally should not be adopted.⁵⁶⁴

On the material before me, it is not possible to say whether the matters reported by KPMG did in fact occur. If they did, then I consider that Ms Gartmann would be right to acknowledge, as she did, that the conduct would have breached Clause 25.1 of the Code. It follows that, in respect of this customer, Rural Bank might have engaged in conduct that fell short of the 'recognised and widely adopted benchmark for conduct' set out in Clause 25.1 of the Code.

⁵⁵⁸ Exhibit 4.121, Witness statement of Alexandra Esme Maria Gartmann, 20 June 2018, Exhibit AEMG-8 [BAB.5022.0001.0254 at .0259–.0261].

⁵⁵⁹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3648.

⁵⁶⁰ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3649.

⁵⁶¹ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3649.

⁵⁶² Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3649.

⁵⁶³ BAB, *Submissions of Bendigo and Adelaide Bank in Response to Counsel Assisting's Closing Submissions on Case Study 5, Round 4*, 13 July 2018, 5–6 [18].

⁵⁶⁴ BAB, *Submissions of Bendigo and Adelaide Bank in Response to Counsel Assisting's Closing Submissions on Case Study 5, Round 4*, 13 July 2018, 3–4 [14].

The second example related to a Victorian farmer with a livestock mortgage. In respect of this file, KPMG found that Rural Bank had lent this customer more than the value of his security.⁵⁶⁵ Ms Gartmann accepted that the judgment of the district banking manager responsible for the initial valuation was not appropriate when he increased the customer's facility.⁵⁶⁶

In its submissions, Bendigo and Adelaide Bank said that Rural Bank's files record that this customer had significant other assets.⁵⁶⁷ The relevant file was not in evidence before me. Again, it is not possible for me to say whether the matters reported by KPMG did in fact occur or, if they did, whether they represented all of the relevant circumstances. However, it remains the case that, in respect of this customer, Rural Bank might have engaged in conduct that fell short of the 'recognised and widely adopted benchmark for conduct' set out in Clause 25.1 of the Code.

6 CBA failure to apply fee waivers and package benefits

The sixth and final case study relating to agricultural finance concerned CBA. Two statements of Joanna White, CBA's Managing Director, Corporate and Commercial Banking, were tendered into evidence.

The statements addressed CBA's failure to apply fee waivers and ongoing package benefits to eligible Agri Advantage Plus Package customers.

6.1 Background

Between 2005 and 2014, CBA offered a package called the 'Agri Advantage Plus Package' to agribusiness customers.⁵⁶⁸ To access the fee waivers and rate discounts, customers paid a one-off establishment fee of \$1,000

⁵⁶⁵ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3655.

⁵⁶⁶ Transcript, Alexandra Esme Maria Gartmann, 2 July 2018, 3656.

⁵⁶⁷ BAB, *Submissions of Bendigo and Adelaide Bank in Response to Counsel Assisting's Closing Submissions on Case Study 5, Round 4*, 13 July 2018, 6 [20].

⁵⁶⁸ Exhibit 4.135, Witness statement of Joanna White, 21 June 2018, 1 [7].

or 0.25% of their borrowing limit, whichever was greater.⁵⁶⁹ In addition to the establishment fee, an annual fee of \$500 was payable.⁵⁷⁰ In return, customers were entitled to fee waivers and rate discounts on 22 CBA products.⁵⁷¹

The brochure for the package said:

It's an exclusive package of discounted research, advice, banking services and financial solutions designed especially for Australian farmers ...

When you join Agri Advantage Plus, you'll receive discounts and preferential rates on specially selected Commonwealth Bank products and services. So you'll pay less interest and fewer fees ...⁵⁷²

On 20 June 2014, CBA commenced a review of its adherence to the terms of the package, following an earlier review by the bank of another package (the Retail Banking Services Wealth Package).⁵⁷³ The earlier review had revealed that a number of wealth package customers had not obtained the package benefits because of 'a breakdown in the package control environment over a number of years', caused by errors related to matters such as the incorrect set up of products within the package and reports not working correctly to identify when a customer was not receiving the required benefits.⁵⁷⁴ The errors had not been prevented or detected through the bank's risk management systems.

The review of the Agri Advantage Plus Package revealed similar issues. In particular, fee waivers had not been properly applied.⁵⁷⁵

⁵⁶⁹ Exhibit 4.135, Witness statement of Joanna White, 21 June 2018, Exhibit JCW-1 [CBA.0517.0157.6000 at .6003].

⁵⁷⁰ Exhibit 4.135 Witness statement of Joanna White, 21 June 2018, Exhibit JCW-1 [CBA.0517.0157.6000 at .6003].

⁵⁷¹ Exhibit 4.135, Witness statement of Joanna White, 21 June 2018, 1 [7].

⁵⁷² Exhibit 4.135 Witness statement of Joanna White, 21 June 2018, Exhibit JCW-1 [CBA.0517.0157.6000 at .6002].

⁵⁷³ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, 1 [8].

⁵⁷⁴ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 16 [66].

⁵⁷⁵ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, 1–3 [8]–[16].

CBA made an initial breach report to ASIC on 14 July 2014. At the time of reporting, the bank had 2,655 active Agri Advantage Plus Packages on offer.⁵⁷⁶

On 18 September 2014, CBA wrote to ASIC, indicating that they had reassessed the potential breaches as 'significant' for the purposes of Section 912D of the *Corporations Act 2001* (Cth).⁵⁷⁷ CBA also said that additional information discovered as part of its investigation 'support(ed) the view that there had been a breach of Section 912A(c) of the *Corporations Act*', being a failure to comply with 'financial services laws'.⁵⁷⁸ More specifically, the bank considered there was likely to have been a breach of Sections 12DA (prohibiting misleading and deceptive conduct) and 12DB (prohibiting the making of false or misleading representations) of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act).⁵⁷⁹

It took CBA approximately 11 months – from October 2014 to August 2015 – to quantify the financial impact to customers of the package benefits being incorrectly applied.⁵⁸⁰ Between September 2015 and November 2015, \$7.673 million in remediation was paid to 8,408 customers, in five tranches.⁵⁸¹

CBA identified the causes of the failures to apply relevant benefits as:

- product complexity;
- manual and cumbersome processes to link, maintain and de-link products to and from the package;
- multiple systems hosting eligible products; and

⁵⁷⁶ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, Exhibit JCW-7 [CBA.0001.0388.0544 at .0544].

⁵⁷⁷ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, Exhibit JCW-8 [CBA.0001.0039.9361 at .9361].

⁵⁷⁸ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, Exhibit JCW-8 [CBA.0001.0039.9361 at .9362].

⁵⁷⁹ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, Exhibit JCW-8 [CBA.0001.0039.9361 at .9362].

⁵⁸⁰ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, 3 [15].

⁵⁸¹ Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, 6 [23].

- a control environment for the package that was weak, with no ultimate ‘owner’ responsible for its operation and execution.⁵⁸²

CBA first notified the Commission of its failure to apply fee waivers to eligible Agri Advantage Plus customers by the production of voluminous RiskInSite spreadsheets on 13 February 2018. In response to concerns expressed by the Commission as to the volume of material produced and the difficulties caused in assessing the material in that form, CBA provided a table of incidents on 22 March 2018. Both the RiskInSite spreadsheets and the table identified conduct considered by CBA to potentially fall within the definition of misconduct.

On 18 May 2018, in response to a request from the Commission to identify any misconduct or conduct falling below community standards and expectations relating to agricultural finance, CBA provided a submission that identified a number of incidents, including the failure to apply fee waivers to Agri Advantage Plus customers.

6.2 What the case study showed

The case study was another demonstration of the importance of promises being met. When a financial entity makes a promise to a customer, its internal systems must be set to meet the promise. Failing to meet the promise will inevitably diminish the customer’s trust in the entity.

Failing to deliver what is promised is a breach of community standards and expectations. If the promise is contractual, the breach will very probably be misconduct for that reason alone. Whether a failure of the type identified in this case will breach a statutory provision will, as always, turn on the particular facts.

CBA was aware that it may have engaged in misconduct. It acknowledged as much when it notified ASIC of possible breaches of Sections 12DA and 12DB of the ASIC Act.

Conduct sufficient to breach those sections will ordinarily also breach the provisions of the Code that require fair and reasonable treatment. The conduct may also amount to a breach of Section 912A(1)(a) of the Corporations Act, which requires the holder of an **Australian financial**

⁵⁸² Exhibit 4.135, Witness statement of Joanna Charlene White, 21 June 2018, 6 [29].

services licence to do *all* things necessary to *ensure* that the services covered by the licence are provided efficiently, honestly and fairly.

Whether, absent a misleading or deceptive, or false and misleading, statement, the failure to perform a contractual obligation will be a breach of Section 912A(1)(a) will again turn on the facts. But it is also to be recognised that a failure to take steps to notify customers of the breach and rectify the position may separately amount to a breach of the Section.

On the facts presented, it is possible that CBA breached one or more statutory provision. It is sufficient to record that the failure to provide what was promised was not fair. CBA may not have done all things necessary to ensure that it delivered the services efficiently, honestly and fairly. Plainly CBA's conduct did not accord with the standards and expectations of the community.

6.3 Adequacy of internal systems

What happened can be attributed, at least in part, to the inadequacy of CBA's 'control environment'. The errors were not prevented or detected by the bank's risk management systems and CBA's IT systems were at least not set properly to deal with the product and (given the reliance on cumbersome manual processes) may have been inadequate to do so.

Case studies:

Remote communities

1 Aboriginal Community Benefit Fund

The Commission's first case study relating to the interactions of Aboriginal and Torres Strait Islander people with **financial services entities** concerned a funeral insurance provider, the Aboriginal Community Benefit Fund (ACBF). In this case study, the Commission heard evidence from Ms Tracey Walsh, an Aboriginal and Torres Strait Islander woman from Mooroopna, Victoria. The Commission also heard evidence from Mr Bryn Jones, the CEO and a current Director of ACBF.

1.1 Background

ACBF was founded in about 1993.¹ It markets itself as 'Australia's only funeral insurance plan dedicated to the Aboriginal community'.² The organisation is not affiliated with or sponsored by any Aboriginal or Torres Strait Islander organisation or any government organisation.³ None of its directors or managers are Aboriginal or Torres Strait Islander people,⁴ and only a small number of its employees identify as Aboriginal or Torres Strait Islander.⁵

ACBF has three types of funeral insurance policy on issue:

- The first policy, Fund 2, is only available to Aboriginal or Torres Strait Islander people.⁶ Fund 2 has not accepted any new members since

¹ Exhibit 4.146, Witness statement of Bryn Jones, 13 June 2018, 10 [12.1].

² Exhibit 4.149, undated, ACBF Website Screenshot, 1.

³ Transcript, Bryn Jones, 3 July 2018, 3790.

⁴ Transcript, Bryn Jones, 3 July 2018, 3789.

⁵ Transcript, Bryn Jones, 3 July 2018, 3790.

⁶ Transcript, Bryn Jones, 3 July 2018, 3793.

around 2004. At that time, following Federal Court proceedings⁷ brought by Australian Securities and Investments Commission (ASIC) alleging breach of the **anti-hawking provisions** in the *Corporations Act 2001* (Cth) (the Corporations Act),⁸ ACBF gave an undertaking to ASIC that it would stop taking new members.⁹

- The second policy is the Community Plan.¹⁰ The Community Plan has been offered by ACBF since 2005, as a result of ACBF's undertaking to ASIC to cease accepting new members of Fund 2.¹¹ The Community Plan is a 'funeral expenses policy', which means that it is not a **financial product** and the corporate entity that offers the policy is not required to hold an **Australian financial services licence**.¹² The only restrictions on membership are age and health-related.
- The third policy is the ACBF Plan,¹³ which was also established in 2005 as a result of ACBF's undertaking to ASIC to cease accepting new members of Fund 2.¹⁴ Like the Community Plan, the ACBF Plan is a 'funeral expenses policy'.¹⁵ It is available to Aboriginal and Torres Strait Islander people under the age of 70.¹⁶ There are now 13,460 policies under the ACBF Plan – almost five times the number of policies under Fund 2 and the Community Plan put together.¹⁷ Approximately 36% of policy holders of the ACBF Plan are under the age of 18.¹⁸

⁷ *ASIC v Aboriginal Community Benefit Fund Pty Ltd* (2004) 136 FCR 155; see also *ASIC v Aboriginal Community Benefit Fund Pty Ltd* (2004) 50 ACSR 9.

⁸ Transcript, Bryn Jones, 3 July 2018, 3792; Corporations Act s 992A.

⁹ Transcript, Bryn Jones, 3 July 2018, 3793.

¹⁰ Transcript, Bryn Jones, 3 July 2018, 3793–4.

¹¹ Transcript, Bryn Jones, 3 July 2018, 3799.

¹² Transcript, Bryn Jones, 3 July 2018, 3794; *Corporations Regulations 2001* (Cth) reg 7.1.07D.

¹³ Transcript, Bryn Jones, 3 July 2018, 3799.

¹⁴ Transcript, Bryn Jones, 3 July 2018, 3799.

¹⁵ Transcript, Bryn Jones, 3 July 2018, 3800.

¹⁶ Transcript, Bryn Jones, 3 July 2018, 3801.

¹⁷ Transcript, Bryn Jones, 3 July 2018, 3807.

¹⁸ Transcript, Bryn Jones, 3 July 2018, 3807.

1.2 Ms Walsh and ACBF

In late 2005, a representative from ACBF came to Ms Walsh's workplace. Ms Walsh understood ACBF to be an 'Aboriginal organisation', because the brochures and posters that ACBF had displayed around her workplace used images and colours associated with Aboriginal culture,¹⁹ and because the name of the organisation included the word 'Aboriginal'.²⁰

After speaking with the representative of ACBF, who Ms Walsh understood to be an Aboriginal person, Ms Walsh signed up to the ACBF Plan.²¹ Ms Walsh's initial application form recorded her health level at 'Level 1', the best health rating. The application recorded that she would be offered a benefit amount of \$12,000, with premiums of \$18 each fortnight.²² ACBF later told Ms Walsh that it had re-assessed her health level as 'Level 3', the worst health rating, because she was taking medication for depression. As a result, ACBF offered her a reduced benefit amount of \$8,000, for premium payments of \$36 each fortnight.²³

Ms Walsh thought that the ACBF Plan worked like a savings plan.²⁴ She thought that, if she paid less than her benefit amount, she would be entitled to a payout of the full benefit amount. If she paid over the benefit amount, she thought that any overpayments would be paid to her family upon her death.²⁵

¹⁹ Transcript, Bryn Jones, 3 July 2018, 3765–6, 3769.

²⁰ Transcript, Bryn Jones, 3 July 2018, 3766.

²¹ Transcript, Tracey Walsh, 3 July 2018, 3766–7; Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, 2–3 [9].

²² Transcript, Tracey Walsh, 3 July 2018, 3769; Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-1 [RCD.0024.0016.0003 at .0004]; Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-2 [RCD.0024.0016.0001].

²³ Transcript, Tracey Walsh, 3 July 2018, 3767–3770; Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-1 [RCD.0024.0016.0003 at .0004]; Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-2 [RCD.0024.0016.0001].

²⁴ Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, 4 [13].

²⁵ Transcript, Tracey Walsh, 3 July 2018, 3767.

During the life of the policy, Ms Walsh unsuccessfully attempted to increase her benefit amount on at least two occasions.²⁶ By the end of 2016, Ms Walsh had paid over \$10,000 to ACBF, for a maximum benefit amount of \$8,000.²⁷

In May 2018, Ms Walsh's lawyers assisted her to lodge a complaint with the Financial Ombudsman Service (FOS), which alleged misleading and deceptive conduct, unconscionable conduct and unlawful discrimination. This followed earlier correspondence between Ms Walsh's lawyers and ACBF on these matters, in which ACBF had sought to dissuade Ms Walsh from lodging a complaint with FOS.²⁸

On 7 June 2018, ACBF made submissions to FOS strongly encouraging FOS to reject Ms Walsh's claims.²⁹ On the same day, ACBF wrote to Ms Walsh's lawyers with a settlement offer.³⁰ ACBF offered to raise Ms Walsh's maximum benefit amount to \$10,000 and to waive future payments. Mr Jones gave evidence that he had instructed ACBF's lawyers to settle the claim. He said that this was to avoid the legal costs associated with the claim and because he felt sympathetic towards Ms Walsh, given she had paid premiums over her benefit amount.³¹ Mr Jones said that he did not believe that Ms Walsh had been misled about the character of ACBF, although he accepted that some documentation sent to Ms Walsh, relating to the nature of the payout to which she would be entitled, had included inaccurate wording.³²

Ms Walsh said, in her evidence, that she will accept ACBF's offer.³³ She said that before the offer was made, she did not feel as though she had any

²⁶ Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018 4–5 [18], [20], [21].

²⁷ Transcript, Tracey Walsh, 3 July 2018, 3774.

²⁸ Transcript, Tracey Walsh, 3 July 2018, 3773–6.

²⁹ Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-8 [FOS.0039.0001.0139 at .0139–.0146].

³⁰ Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-9 [CALC.0001.0001.0001].

³¹ Transcript, Bryn Jones, 4 July 2018, 3874.

³² Transcript, Bryn Jones, 4 July 2018, 3869.

³³ Exhibit 4.144, Witness statement of Tracey Walsh, 26 June 2018, Exhibit TLW-9 [CALC.0001.0001.0001]; Transcript, Tracey Walsh, 3 July 2018, 3777.

choice about whether to continue to pay ACBF for her plan. She felt as though ACBF had her ‘over a barrel’ and she could not walk away from the large amount of money she had already paid.³⁴

1.3 ACBF’s business

1.3.1 Marketing ACBF products

Since 1999, following action taken by ASIC, ACBF has been required by court order to include a disclaimer in its advertising materials.³⁵ The disclaimer is to the effect that ACBF is a private company, and that it is not sponsored by or otherwise connected with any governmental body or Aboriginal organisation.³⁶ Mr Jones conceded that, notwithstanding this, some of ACBF’s advertising material (including internet³⁷ and radio³⁸ advertising) had not included the disclaimer.³⁹

The orders also required ACBF to remove from its marketing materials the Aboriginal flag and any suggestion that ACBF was established to advance the welfare of the Aboriginal community.⁴⁰ In 2012, in accordance with a new advertising strategy, ACBF adopted a new logo (using red, yellow and orange colours), accompanied by the tagline ‘For you, for your family’.⁴¹ ACBF’s recent promotional material includes the phrase: ‘over 20 years working in the Aboriginal community’,⁴² and ACBF’s website features imagery that resembles Indigenous dot artwork, as well as photos of Aboriginal and Torres Strait Islander people.⁴³ Mr Jones conceded that

³⁴ Transcript, Tracey Walsh, 3 July 2018, 3777.

³⁵ Transcript, Bryn Jones, 4 July 2018, 3822.

³⁶ Transcript, Bryn Jones, 4 July 2018, 3824–5; Exhibit 4.156, 24 September 1999, Consent Orders Federal Court of Australia, 6 [12].

³⁷ Exhibit 4.157, 23 April 2014, Web Banner Screenshot National Indigenous Times Website, 1.

³⁸ Exhibit 4.158, 29 November 2012, Radio Script, 1.

³⁹ Transcript, Bryn Jones, 4 July 2018, 3825–6.

⁴⁰ Exhibit 4.156, 24 September 1999, Consent Orders Federal Court of Australia, 8–9 [15].

⁴¹ Exhibit 4.152, 28 August 2012, Aboriginal Community Funeral Plan Branding Concepts, 4–5.

⁴² Transcript, Bryn Jones, 4 July 2018, 3827.

⁴³ Transcript, Bryn Jones, 3 July 2018, 3804.

there had been confusion over the years about whether ACBF was an Aboriginal-owned company.⁴⁴

1.3.2 Selling ACBF products

Until recently, ACBF had an arrangement with the Commonwealth Department of Human Services.⁴⁵ Under this arrangement, ACBF could deduct the premiums of policy holders who received Centrelink payments directly from those Centrelink payments, by using the Centrepay system. ACBF was the only funeral insurer receiving payments through the Centrepay system.⁴⁶ As a condition of its arrangement with the Department of Human Services, ACBF was not permitted to sell its policies in an unsolicited setting.⁴⁷ Following a decision by the government to remove funeral insurance from the Centrepay system (a decision that was the subject of an unsuccessful court challenge by ACBF), the condition regarding unsolicited sales no longer applies.⁴⁸

Mr Jones said that ACBF currently sells its products through in-bound phone and website enquiries.⁴⁹ Until recently, ACBF also engaged in door-to-door selling. Mr Jones told the Commission that ACBF has now ceased door-to-door selling.⁵⁰ However, he said that there were four Indigenous employees who were 'networking and working in the field to create connections with bodies'.⁵¹ Mr Jones conceded that their work involved looking for sales opportunities, including through land councils.⁵²

Mr Jones said that ACBF's sales representatives ask customers and prospective customers about whether they have children they may want to

⁴⁴ Transcript, Bryn Jones, 4 July 2018, 3822.

⁴⁵ Transcript, Bryn Jones, 4 July 2018, 3836.

⁴⁶ Exhibit 4.161, 30 June 2016, Reasons for Judgment: ACBF v Chief Executive Centrelink, 6 [10].

⁴⁷ Transcript, Bryn Jones, 4 July 2018, 3837.

⁴⁸ Transcript, Bryn Jones, 4 July 2018, 3836–8.

⁴⁹ Transcript, Bryn Jones, 4 July 2018, 3833.

⁵⁰ Transcript, Bryn Jones, 4 July 2018, 3836.

⁵¹ Transcript, Bryn Jones, 4 July 2018, 3834.

⁵² Transcript, Bryn Jones, 4 July 2018, 3834.

sign up to funeral insurance policies.⁵³ In ASIC's 2014 internal report, ASIC found that ACBF had the 'highest proportion of insurees in the lower age brackets'.⁵⁴ The report found that 64% of persons insured by ACBF were aged under 30, and 36% were under 15.⁵⁵

Mr Jones emphasised that ACBF had recently had a 'cultural audit' report provided by an organisation called Mura Connect. The report recommended that ACBF continue to leverage its existing customer base for the purpose of signing up new customers, including children and families.⁵⁶ The Mura Connect report also recommended that ACBF offer referral incentives to existing policy holders and research the benefits of offering family policies.⁵⁷ In relation to the sale of policies for children, Mr Jones accepted that a motivating factor for ACBF is to sell as many policies as possible.⁵⁸ He said that ACBF intended to implement its recommendations.

1.3.3 Health statements

ACBF explained that new policy holders are required to submit an application form that includes a health statement.⁵⁹ ACBF then uses a customer's disclosed pre-existing health conditions to determine a health level ranking from Level 1 to Level 3.⁶⁰ This health level, along with the customer's age, determines the fortnightly premiums paid by the customer. Mr Jones said that the basis for designating certain conditions as Level 1, Level 2 or Level 3 was the 'assumed risk associated with insuring someone with certain health' issues.⁶¹ I understood Mr Jones to accept that this

⁵³ Transcript, Bryn Jones, 3 July 2018, 3809.

⁵⁴ Exhibit 4.151, April 2014, ASIC Analysis Funeral Insurance Sector in Australia, 8 [35]; see also Exhibit 4.164, October 2015, ASIC, Report 454: Funeral Insurance: A Snapshot, 18 [43].

⁵⁵ Exhibit 4.151, April 2014, ASIC Analysis Funeral Insurance Sector in Australia, 8 [35].

⁵⁶ Exhibit 4.160, undated, Cultural Audit Report Mura Connect, 8; Transcript, Bryn Jones, 4 July 2018, 3832.

⁵⁷ Exhibit 4.160, undated, Cultural Audit Report Mura Connect, 8; Transcript, Bryn Jones, 4 July 2018, 3832.

⁵⁸ Transcript, Bryn Jones, 3 July 2018, 3809.

⁵⁹ Transcript, Bryn Jones, 4 July 2018, 3843.

⁶⁰ Transcript, Bryn Jones, 4 July 2018, 3843.

⁶¹ Transcript, Bryn Jones, 4 July 2018, 3844.

meant that ACBF's health classification system resulted in 'higher premiums for people with medical conditions that are more common amongst Aboriginal and Torres Strait Islander people'.⁶²

1.3.4 ACBF's premium structure

ACBF uses a stepped premium structure. That is, as each nominee under the policy enters a new age bracket, the holder of the policy must pay a higher premium.⁶³ Mr Jones accepted that, other than providing a copy of a contribution table at the time of application, ACBF does not disclose to its customers that their premiums will increase over time.⁶⁴ Mr Jones also conceded that ACBF does not provide any upfront estimate of the total cost of its policy to its customers, contrary to recommendations ASIC had made about funeral insurance in 2015.⁶⁵

Mr Jones accepted that ACBF plan holders could end up paying more in premiums than they would ever be entitled to recover under their policies.⁶⁶ He accepted that ACBF did not clearly and prominently disclose this as a risk, again contrary to ASIC's recommendations in relation to funeral insurance.⁶⁷ Mr Jones said that, from January 2018, ACBF has released customers from paying further premiums if they have exceeded their maximum benefit payable, but said that ACBF has done this only where the customer contacts ACBF and identifies that they are struggling to make contributions.⁶⁸ Since January 2018, ACBF has waived the future payments of only 24 customers who have paid more than their entitlement.⁶⁹

⁶² Transcript, Bryn Jones, 4 July 2018, 3844.

⁶³ Transcript, Bryn Jones, 4 July 2018, 3846.

⁶⁴ Transcript, Bryn Jones, 4 July 2018, 3846.

⁶⁵ Transcript, Bryn Jones, 4 July 2018, 3846–7.

⁶⁶ Transcript, Bryn Jones, 4 July 2018, 3847.

⁶⁷ Transcript, Bryn Jones, 4 July 2018, 3849.

⁶⁸ Transcript, Bryn Jones, 4 July 2018, 3847–8.

⁶⁹ Exhibit 4.165, undated, ACBF List of Future Payments Waived, 1.

1.3.5 ACBF policy cancellations

Mr Jones gave evidence that a policy holder's policy will be cancelled if they miss four payments within a year.⁷⁰ Over the last five years, ACBF has cancelled 13,175 ACBF Plan policies as a result of non-payment of premiums.⁷¹ Mr Jones said that 6,000 of those policies were cancelled following the decision by the government in August 2015 that funeral insurance providers could no longer be listed on Centrepay.⁷² Mr Jones said that those people whose payments were cancelled as a result of the direct debits from Centrepay being discontinued were 'uncontactable', and the location of those persons was not known to ACBF.⁷³

Mr Jones said that, generally speaking, once a policy is cancelled, the customer will lose their cover and they will not be entitled to any refund or credit in respect of the amounts they had paid to ACBF.⁷⁴

1.3.6 ACBF payouts upon suicide

Until mid-2017, ACBF would not pay claims where the cause of death was suicide, although it would refund premiums in those circumstances.⁷⁵ In his statement, Mr Jones said that ACBF's previous position had been adopted because ACBF believed that customers and local community groups thought that paying out suicide claims could be seen to condone suicide.⁷⁶ In cross-examination, however, Mr Jones accepted that at least one staff member had taken the view that ACBF had received harsh criticism for not paying out upon suicide.⁷⁷

Mr Jones was taken to ACBF media releases dated 27 June 2018, 29 June 2018 and 2 July 2018.⁷⁸ Mr Jones conceded that there were errors

⁷⁰ Transcript, Bryn Jones, 4 July 2018, 3850.

⁷¹ Transcript, Bryn Jones, 4 July 2018, 3852.

⁷² Transcript, Bryn Jones, 4 July 2018, 3852.

⁷³ Transcript, Bryn Jones, 4 July 2018, 3852.

⁷⁴ Transcript, Bryn Jones, 4 July 2018, 3850.

⁷⁵ Transcript, Bryn Jones, 4 July 2018, 3860.

⁷⁶ Transcript, Bryn Jones, 4 July 2018, 3860.

⁷⁷ Transcript, Bryn Jones, 4 July 2018, 3862.

⁷⁸ Exhibit 4.150, 27 June 2018, ACBF Media Release; Exhibit 4.148, 29 June 2018, ACBF Media Release; Exhibit 4.169, 2 July 2018, ACBF Media Release.

in relation to ACBF's claims about suicide payments in the 27 June and 29 June media releases, and that the incorrect statements were repeated in the media release dated 2 July 2018.⁷⁹

1.4 What the case study showed

1.4.1 Misleading and deceptive conduct

As noted above, ACBF represents that it uniquely 'provides a product and service tailored to meet the needs of Australia's [Aboriginal and Torres Strait Islander] people'.⁸⁰ It also represents that its policies are beneficial for Aboriginal and Torres Strait Islander people. In its submissions to the Commission, ACBF accepted that it promotes its products in this way and submitted that it was not misleading or deceptive for it do so.⁸¹

ACBF submitted that its products were tailored to the needs of Aboriginal and Torres Strait Islander people for three reasons. The first was that its products are 'specifically intended for Aboriginal and Torres Strait Islander clients'.⁸² The second was that ACBF permits its clients to miss up to four premium instalment payments, and then allows a further period of 31 days, before cancelling a policy for non-payment.⁸³ The third was that ACBF had undertaken certain 'cultural awareness activities'.⁸⁴

Of these reasons, only the second identifies a feature of ACBF's products that ACBF considers will be of particular benefit to Aboriginal and Torres Strait Islander people. By contrast, I consider that there are a number of features of ACBF's products that indicate that those products are neither tailored to meet the needs of Aboriginal and Torres Strait Islander people nor beneficial for them.

First, it appears that ACBF's health classification system is structured in such a way that if a person has a medical condition that occurs more commonly in the Aboriginal and Torres Strait Islander population, he or she

⁷⁹ Transcript, Bryn Jones, 4 July 2018, 3864.

⁸⁰ Exhibit 4.150, 27 June 2018, ACBF Media Release, 1.

⁸¹ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 3 [9].

⁸² ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 3 [10(a)].

⁸³ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 3 [10(b)].

⁸⁴ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 4 [10(c)].

is likely to pay higher premiums. As noted above, Mr Jones appeared to accept that ACBF's system resulted in 'higher premiums for people with medical conditions that are more common amongst Aboriginal and Torres Strait Islander people'.⁸⁵

Second, until recently, ACBF policies did not pay out for suicide, despite the high rates of suicide in the Aboriginal and Torres Strait Islander community.⁸⁶ Mr Jones said that, under the policy that applied until recently, in cases where a nominee committed suicide, or died as a result of intentional self-injury, the payout was limited to refunding the amount that ACBF determined had been paid as premiums.⁸⁷

Third, as found in ASIC's 2015 report, ACBF is the 'only insurer with significant numbers of persons insured under 30 for whom premiums were being paid'.⁸⁸ An available inference is that ACBF plays on the cultural significance of funerals to Aboriginal and Torres Strait Islander people, and to Indigenous mortality statistics, to actively sell its policies to children and young people in those communities in circumstances where they have little need for the product. In its submissions, ACBF said I should not draw this inference.⁸⁹ It suggested instead that the reason a high number of young people hold ACBF policies is that the largest proportion of the population of Aboriginal and Torres Strait Islander people is under the age of 18 years.⁹⁰ On balance, in light of the evidence about ACBF's marketing to young people,⁹¹ I prefer the inference that ACBF does rely on the cultural significance of funerals to Aboriginal and Torres Strait Islander people, and to Indigenous mortality statistics, to actively sell its policies to children and young people in those communities.

⁸⁵ Transcript, Bryn Jones, 4 July 2018, 3844.

⁸⁶ Transcript, Bryn Jones, 4 July 2018, 3860.

⁸⁷ Transcript, Bryn Jones, 4 July 2018, 3860.

⁸⁸ Exhibit 4.164, October 2015, ASIC, Report 454: Funeral Insurance: A Snapshot, 18 [43].

⁸⁹ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 9–10 [15]–[18].

⁹⁰ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 5–6 [11(c)(i)].

⁹¹ Transcript, Bryn Jones, 3 July 2018, 3809.

Fourth, ACBF is not an Aboriginal organisation nor is it affiliated with any Aboriginal or government organisation.

Fifth, the ACBF Plan is an 'expenses only' policy. ACBF did not dispute in its submissions that this is not sufficiently clear from some of ACBF's promotional and marketing material.⁹²

Sixth, unlike some other policies available in the market,⁹³ it is a feature of the ACBF Plan that any policy holder may pay more in premiums than they will ever be entitled to receive. ACBF accepted in its submissions that there were ACBF policies that may result in the policy holder paying more in premiums than the benefit amount provided under the policy.⁹⁴

For these reasons, I consider that it is at least arguable that ACBF does not, in fact, provide policies that are beneficial for, or tailored to, the needs of Aboriginal and Torres Strait Islander people.

Separately, ACBF's current advertising materials (even with the disclaimer, which has not always been used) may induce consumers into thinking that it is an Aboriginal-owned company. Its materials use colours (red, yellow and orange) associated with Aboriginal culture, and use imagery that is significant in Aboriginal and Torres Strait Islander culture. The name of the plan includes the word 'Aboriginal'. Its promotional material includes references to ACBF having spent 'over 20 years working in the Aboriginal community'⁹⁵, and the ACBF Plan is described as 'Australia's only funeral insurance plan dedicated to the Aboriginal community'.⁹⁶ As previously noted, some of ACBF's advertising material has failed to include a disclaimer that ACBF is a privately owned company with no government or Aboriginal community affiliations.⁹⁷

For these reasons, I consider that ACBF may have breached its obligations under Section 12DA of the *Australian Securities and Investments*

⁹² Transcript, Bryn Jones, 4 July 2018, 3869; ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 7 [11(e)(i)–(ii)].

⁹³ Exhibit 4.164, October 2015, ASIC, Report 454: Funeral Insurance: A Snapshot, 20 [47].

⁹⁴ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 8 [11(f)].

⁹⁵ Transcript, Bryn Jones, 4 July 2018, 3827.

⁹⁶ Transcript, Bryn Jones, 3 July 2018, 3804.

⁹⁷ Transcript, Bryn Jones, 4 July 2018, 3825–6.

Commission Act 2001 (Cth) (the ASIC Act) to not engage in conduct that is misleading or deceptive, or is likely to mislead or deceive, and under Section 12DF(1) of the ASIC Act, which prohibits a person from ‘engaging in conduct that is liable to mislead the public as to the nature, the characteristics, the suitability for their purpose or the quantity of any financial services’.⁹⁸

I further consider that ACBF may have breached Section 12DB(e) of the ASIC Act, which prohibits the making of a ‘false or misleading representation that services have sponsorship, approval, performance characteristics, uses or benefits’. ACBF’s marketing materials as a whole, and specifically ACBF’s statements about its dedication to the Aboriginal community, may convey a representation that ACBF has the approval or endorsement of the Aboriginal community in a general sense.

1.4.2 Conduct falling below community standards and expectations

I consider it clear that ACBF engaged in conduct that fell below community standards and expectations in a number of respects:

- First, contrary to ASIC’s recommendation, ACBF does not adequately warn its policy holders that they may pay more under their policies than they will ever be entitled to receive by way of payout.⁹⁹ ACBF acknowledged in its submissions that it had not yet implemented this recommendation.¹⁰⁰
- Second, again contrary to ASIC’s recommendation, ACBF does not provide an upfront estimate of the total cost of the policy.¹⁰¹ ACBF also acknowledged in its submissions that it had not yet implemented this recommendation.¹⁰²

⁹⁸ ASIC Act ss 12DA and 12DF(1).

⁹⁹ Transcript, Bryn Jones, 4 July 2018, 3849.

¹⁰⁰ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 11 [26(a)].

¹⁰¹ Transcript, Bryn Jones, 4 July 2018, 3846–7.

¹⁰² ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 12 [26(b)].

- Third, as discussed above, ACBF actively seeks to sell policies for children and young people, in circumstances where they are unlikely to receive any benefit from the policy.
- Fourth, where a plan is cancelled for non-payment of premiums, the amount paid under the previous policy will generally not be carried across.¹⁰³ This is despite ACBF understanding that there is a very high rate of cancellations amongst its plan holders.
- Fifth, ACBF fails to adequately disclose its waiting period to plan holders, and (at least historically) provided confusing information to its plan holders about the completion of their waiting periods.¹⁰⁴
- Sixth, the product provided by ACBF is a low value product, when understood in light of the claims paid as a percentage of premiums received. In an ASIC internal report dated April 2014, the claims paid by ACBF, between 1 July 2012 to 30 June 2013, as a percentage of the premiums received was 13%.¹⁰⁵ This was the lowest percentage of premiums paid by the insurers surveyed. Mr Jones rightly accepted that this data was concerning.¹⁰⁶ In its submissions, ACBF said that I should not draw any conclusions from data for a single year and ACBF criticised the Commission for not requiring ACBF to produce data about different measurements of value.¹⁰⁷ But it is important to recognise that ACBF was granted leave to appear and it was open to it to adduce evidence of the value that its policies presented. Based on the evidence available to me, it appears that ACBF's product was low value compared with other products referred to in the ASIC report.
- Seventh, ACBF appears to have breached the consent orders made by the Federal Court in 1999 by not always using the required disclaimer in its advertising materials.¹⁰⁸

¹⁰³ Transcript, Bryn Jones, 4 July 2018, 3853.

¹⁰⁴ Transcript, Bryn Jones, 4 July 2018, 3858.

¹⁰⁵ Transcript, Bryn Jones, 4 July 2018, 3866; Exhibit 4.151, April 2014, ASIC Analysis Funeral Insurance Sector in Australia, 22 [73].

¹⁰⁶ Transcript, Bryn Jones, 4 July 2018, 3867.

¹⁰⁷ ACBF, *Submissions on Behalf of ACBF Group Holdings Pty Ltd*, 13 July 2018, 14 [26(f)].

¹⁰⁸ Transcript, Bryn Jones, 4 July 2018, 3824–6.

1.4.3 Culture, governance and remuneration practices

The conduct criticised above can be attributed, at least in part, to ACBF's remuneration and bonus scheme for its sales and field representatives. This scheme actively encouraged ACBF employees to aggressively target vulnerable persons and incentivised them to pursue signing up entire families, including infant children. This is particularly the case in relation to the key performance indicator (KPI) structure evidenced in the 2018 letter of employment that was tendered during the cross-examination of Mr Jones.¹⁰⁹ In that letter, the staff member was to be paid \$20 in respect of each of the first 29 nominees signed up, \$30 in respect of each of the next 10, and so on, culminating in payments of \$70 per nominee for the 70th to 100th nominees signed up.¹¹⁰

The conduct can also be attributed, in part, to the fact that ACBF did not have a corporate culture that enabled it to communicate and sell its products to Aboriginal and Torres Strait Islander people in a respectful manner. The Mura Connect report found that the majority of ACBF staff are non-Indigenous, and that there was a lack of cultural understanding and confidence amongst ACBF staff.¹¹¹ This in turn resulted in an environment in which Aboriginal and Torres Strait Islander people were unlikely to be offered a service that was tailored to their needs.

1.4.4 Effectiveness of response and redress

ACBF did not respond effectively and adequately to the detriment suffered by Ms Walsh, one of its customers, as a result of its conduct. After it misrepresented the ACBF Plan to Ms Walsh, and after Ms Walsh challenged ACBF's actions, ACBF corresponded with Ms Walsh in an aggressive and hostile manner over a significant period of time before finally making an offer to settle Ms Walsh's dispute. This was despite the fact that, at the time that Ms Walsh's lawyers first complained to ACBF, Ms Walsh had already paid substantially more than she would ever be entitled to receive under her policy.¹¹²

¹⁰⁹ Exhibit 4.163, 4 April 2018, Offer of Employment ACBF Administration Proprietary Limited, 15.

¹¹⁰ Transcript, Bryn Jones, 4 July 2018, 3842.

¹¹¹ Exhibit 4.160, undated, Cultural Audit Report Mura Connect, 3.

¹¹² Transcript, Tracey Walsh, 3 July 2018, 3774.

2 Select

The second case study relating to funeral insurance concerned Select AFSL Pty Ltd (Select). Select promotes and distributes various insurance products, including, until relatively recently, funeral insurance.

The Commission heard evidence from Kathy Marika, a Yolngu woman from East Arnhem Land who now lives in regional New South Wales. Ms Marika is 60 years old and English is not her first language. Ms Marika was sold two funeral insurance policies by Select, trading as Let's Insure, in 2015. The Commission also heard evidence from Mr Russell Howden, the Managing Director of Select.

2.1 Background

In August 2015, an external lead provider rang Ms Marika.¹¹³ Ms Marika does not know how the lead provider obtained her phone number.¹¹⁴ The person told Ms Marika they were calling to conduct a one minute survey.¹¹⁵ In the course of the call, Ms Marika told the person that she already had funeral insurance. The salesperson responded that he was 'not here to sell [her] a second insurance, obviously that would be pointless'.¹¹⁶

The next day, a Let's Insure representative called Ms Marika to see if he could 'switch'¹¹⁷ her to Let's Insure. Ms Marika told the representative

¹¹³ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 2 [6].

¹¹⁴ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 2 [7].

¹¹⁵ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-2 [SAF.0001.0001.0080 at .0080].

¹¹⁶ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-2 [SAF.0001.0001.0080 at .0080].

¹¹⁷ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-4 [SAF.0001.0001.0082] records at .0084 that the Agent said '... we deal with Insurance Line customers, like yourself, actually, every day. I'd say about 80 per cent of my day, I deal with switching Insurance Line customers over to us, because we are able to save them money.'

that she couldn't have two policies and that she was 'happy with the other one'.¹¹⁸

Mr Howden accepted that both representatives were aware that Ms Marika already had funeral insurance and that she clearly indicated that she did not have any interest in taking out further funeral insurance.¹¹⁹

Despite this, Let's Insure called Ms Marika again on 9 September 2015. On that day, Let's Insure sold Ms Marika two funeral insurance policies covering herself, her three children and her five grandchildren.¹²⁰ Before Ms Marika agreed to take out the policies, the salesperson said to her: 'you can actually have two at the same time, and that is what most people tend to do, cause with their one with work, it only covers them, and they say it expires when they stop working, which means your family don't get the money ...'.¹²¹ Mr Howden accepted that the representative was not authorised to make these statements and that the 'statements should not have been made in circumstances where the representative did not have details of the work policy to which Ms Marika referred'.¹²²

Before Ms Marika agreed to take out the policies, she received an oral product disclosure statement (PDS). She was not asked for her consent to receive the product disclosure statement in this way.¹²³

Ms Marika's evidence was that she found the Select representative difficult to understand. Among other things, he spoke 'really fast, like a train', and before she could 'think about how to answer [his] questions, he would just

¹¹⁸ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-4 [SAF.0001.0001.0082] transcript records at .0084 that Ms Marika said 'I can't have two. ... I'm happy with the other one.'

¹¹⁹ Transcript, Russell Howden, 5 July 2018, 3976.

¹²⁰ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-4 [SAF.0001.0001.0085] transcript records at .0089 that Ms Marika said 'yeah, might as well join'.

¹²¹ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-4 [SAF.0001.0001.0085 at .0087].

¹²² Exhibit 4.174, Witness statement of Russell Howden, 13 June 2018, 3–4 [4.5]; Transcript, Russell Howden, 5 July 2018, 3977–8.

¹²³ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KMB-6 [SAF.0001.0001.0085 at .0098].

start speaking again'.¹²⁴ She said she was just trying to 'catch up with the language so [she] kept saying yes'.¹²⁵ Ms Marika said that she found the call confusing and frustrating. The representative did not wait for her to speak or to finish what she was saying.¹²⁶ Ms Marika said she felt the representative did not treat her with respect.¹²⁷

Mr Howden accepted that there were several occasions in the call when Ms Marika appeared confused.¹²⁸ He also accepted that there were 'sufficient signals during the call that suggest [Ms Marika] may not have fully understood the product she was purchasing and the consequences of the purchase'.¹²⁹

The following day, the same Select representative called Ms Marika, offering her Coles Myer vouchers, if she provided the contact details of family friends and they took out policies with Let's Insure. The representative said at one point: 'you never know, if you've got like 30 [names and numbers], you get \$600!'.¹³⁰ Despite being induced to go through her old phone and her new phone to find and provide the contact details of family and friends, Ms Marika never received any vouchers.¹³¹ Mr Howden accepted that the conduct on the part of the representative was unreasonable, and constituted a 'gross abuse of Select's referral program'.¹³²

Less than a week later, on 16 September 2015, Ms Marika called Let's Insure to try to cancel her policies¹³³ because she could not afford to keep

¹²⁴ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 3 [11].

¹²⁵ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 3 [11].

¹²⁶ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 3 [11]–[12].

¹²⁷ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 3 [12].

¹²⁸ Transcript, Russell Howden, 5 July 2018, 3979.

¹²⁹ Exhibit 4.174, Witness statement of Russell Howden, 13 June 2018, 4 [4.7].

¹³⁰ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-10 [SAF.0001.0001.0105 at 0107].

¹³¹ Transcript, Kathy Marika, 4 July 2018, 3888–9.

¹³² Exhibit 4.174, Witness statement of Russell Howden, 13 June 2018, 5 [5.2]; Transcript, Russell Howden, 5 July 2018, 3980.

¹³³ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KMB-12 [SAF.0001.0001.0075].

them.¹³⁴ Another Let's Insure employee called her back. Ms Marika told her 'I'm not getting enough money to be able to pay for the insure'.¹³⁵ The employee convinced Ms Marika to retain the policies, on the basis that she would waive the premium payments for a month. When asked whether this was a fair way to conduct the call, in light of the statutory cooling off period, Mr Howden said that it was.¹³⁶

In December 2016, with legal assistance, Ms Marika was able to cancel her policies.¹³⁷ In a letter to her lawyers containing a settlement offer, Let's Insure maintained that 'at all times [it had] acted properly and in accordance with the law' but said that it was prepared to refund the premiums.¹³⁸ There was no evidence that any disciplinary action was taken at this time against the sales representative who had sold the policy, although Mr Howden conceded that representatives of Select would have listened to the recording of the call in which the sale was made.¹³⁹ Mr Howden accepted that, although the payment to Ms Marika had been described to her lawyers as an 'act of good will', it was really a recognition that Ms Marika had been paying for a policy that she did not need, she did not want and she did not understand.¹⁴⁰

2.2 The 2015 spike in funeral insurance sales

Ms Marika was only one of a significant number of Aboriginal and Torres Strait Islander people who were mis-sold funeral insurance by Select in 2015.

¹³⁴ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, 4 [18]; Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-14 [SAF.0001.0001.0122 at .0122–.0123].

¹³⁵ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-14 [SAF.0001.0001.0122 at .0122].

¹³⁶ Transcript, Russell Howden, 5 July 2018, 3983–4.

¹³⁷ See Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-16 [SAF.0001.0001.0067] indicating that Select would refund all premiums subject to Ms Marika's authorisation to cancel the policies.

¹³⁸ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit KBM-16 [SAF.0001.0001.0067].

¹³⁹ Transcript, Russell Howden, 5 July 2018, 3982.

¹⁴⁰ Transcript, Russell Howden, 5 July 2018, 3984.

Mr Howden gave evidence about a spike in sales to customers living in 43 postcodes with a high proportion of Aboriginal and Torres Strait Islander people.¹⁴¹ Mr Howden attributed the spike to two sales incentive arrangements and to abuses of Select's referral processes by two particular sales representatives.¹⁴²

Mr Howden was asked about three other possible causes: the sales tactics that its representatives were trained to use, the KPIs and incentives it had in place, and the adequacy of Select's quality assurance and disciplinary frameworks.

In relation to Select's sales tactics, the Commission heard that Select representatives were trained to actively overcome 'obstacles', including potential customers already having a funeral insurance policy¹⁴³ or not being able to afford a policy.¹⁴⁴ Select emphasised to its representatives that:

- there was no impediment to making a sale to a customer who already held funeral insurance with another company;¹⁴⁵
- it was permissible to play on a customer's fears in order to sell policies;¹⁴⁶ and
- the representative should assume the customer's response is positive and lead the customer to mandatory confirmation.¹⁴⁷

Mr Howden maintained that Select did not sanction aggressive sales tactics. But he did accept that Select did push its agents with productivity targets and that this may have been a contributor to the spike in sales.¹⁴⁸

In relation to remuneration and incentives, the evidence was that, in 2015, commissions were payable on the first year's premium for sales originated

¹⁴¹ Exhibit 4.173, Witness statement of Russell Howden, 13 June 2018, 28–9 [28.1]–[28.2].

¹⁴² Transcript, Russell Howden, 4 July 2018, 3908.

¹⁴³ Transcript, Russell Howden, 4 July 2018, 3911.

¹⁴⁴ Transcript, Russell Howden, 4 July 2018, 3916.

¹⁴⁵ Transcript, Russell Howden, 4 July 2018, 3911.

¹⁴⁶ Transcript, Russell Howden, 4 July 2018, 3912.

¹⁴⁷ Transcript, Russell Howden, 4 July 2018, 3913.

¹⁴⁸ Transcript, Russell Howden, 4 July 2018, 3909.

by a sales representative.¹⁴⁹ These commissions comprised, on average, 30% of a sales representative's total remuneration.¹⁵⁰ In addition, during 2015, Select ran sales incentives campaigns offering a Vespa scooter¹⁵¹ and a cruise as prizes for high volumes of sales.¹⁵² (Select had a number of other incentives in place from time to time.) Select's commission structure and sales incentives campaigns encouraged its representatives to sell aggressively.

In relation to quality assurance, Mr Howden gave evidence that, at the time Select sold the policies to Ms Marika, Select undertook random reviews of sales calls by its agents. Select listened to more calls from junior agents than from senior agents.¹⁵³ For these reviews, Select used a scorecard that featured binary questions such as whether a product disclosure statement was given.¹⁵⁴ Where a representative had not met some criteria, Select provided coaching and feedback to that representative.¹⁵⁵

From 2016, Select moved to a system of 'phone licences', by which Select would record points against a sales agent for certain specified 'breaches'.¹⁵⁶ Points were allocated according to severity of the breach.¹⁵⁷ The breaches for each call were not cumulative. Agents would be penalised for only the most significant breach on a particular call,¹⁵⁸ meaning that a maximum of 10 points could be deducted per call.¹⁵⁹ Agents were allocated a maximum of 30 points, which were reinstated every six weeks.¹⁶⁰ If, within a period of six weeks a representative:

¹⁴⁹ Transcript, Russell Howden, 5 July 2018, 3923.

¹⁵⁰ Transcript, Russell Howden, 5 July 2018, 3925.

¹⁵¹ Exhibit 4.181, undated, Vespa Sales Battle Rounds 1 and 2.

¹⁵² Exhibit 4.182, undated, Let's Insure Sailors Sale Incentive February to June 2015.

¹⁵³ Transcript, Russell Howden, 5 July 2018, 3936.

¹⁵⁴ Transcript, Russell Howden, 5 July 2018, 3937.

¹⁵⁵ Transcript, Russell Howden, 5 July 2018, 3937.

¹⁵⁶ Transcript, Russell Howden, 5 July 2018, 3938.

¹⁵⁷ Transcript, Russell Howden, 5 July 2018, 3938.

¹⁵⁸ Transcript, Russell Howden, 5 July 2018, 3938.

¹⁵⁹ Transcript, Russell Howden, 5 July 2018, 3939.

¹⁶⁰ Transcript, Russell Howden, 5 July 2018, 3939.

- lost 10 points, the representative was given a formal warning;
- lost 20 points, the representative was given a second formal warning; and
- if a representative lost 30 points, the representative would be dismissed.¹⁶¹

Under this system, a representative could complete an unethical sale, or could provide personal advice to a potential customer in breach of the Corporations Act, and have only 10 points deducted from the agent's phone licence.¹⁶²

Mr Howden was asked whether Select's quality assurance systems were sufficiently robust to deter and detect misconduct. He maintained that they were.¹⁶³ But he conceded that they had not been sufficient to deter the misconduct of the two Select representatives who had significantly contributed to the 2015 spike in funeral insurance sales to Aboriginal and Torres Strait Islander customers.¹⁶⁴

One other point should be made about the policies issued by Select. Most Select policies have a stepped premiums structure.¹⁶⁵ Select does not provide an upfront estimate of the total cost of its policies.¹⁶⁶ Mr Howden said it would be 'complex' for Select to do that.¹⁶⁷

2.3 Correspondence with ASIC

Mr Howden gave evidence about its dealings with ASIC and with St Andrew's, the issuer of the funeral insurance policies sold by Select.

¹⁶¹ Transcript, Russell Howden, 5 July 2018, 3940.

¹⁶² Transcript, Russell Howden, 5 July 2018, 3940.

¹⁶³ Transcript, Russell Howden, 5 July 2018, 3942.

¹⁶⁴ Transcript, Russell Howden, 5 July 2018, 3942.

¹⁶⁵ Transcript, Russell Howden, 4 July 2018, 3899.

¹⁶⁶ Transcript, Russell Howden, 4 July 2018, 3899.

¹⁶⁷ Transcript, Russell Howden, 4 July 2018, 3899–901.

On 17 January 2017, St Andrew's made a voluntary disclosure to ASIC in relation to the potential mis-selling of funeral insurance by Select in 2015.¹⁶⁸ Select maintains that no significant breach notification was required in respect of its mis-selling of funeral insurance to Aboriginal and Torres Strait Islander people.¹⁶⁹ Nevertheless, Select has agreed to remediate affected customers.

In early 2018, ASIC expressed concerns to Select about Select's life insurance sales practices. ASIC characterised its concerns as being similar to the concerns that had been identified in relation to Select's sales of funeral insurance in 2015.¹⁷⁰ The concerns included, but were not limited to, applying 'pressure to close sales, even where the consumer raises a concern; use of the cooling off period and delayed payment to close sales' and failing to explain features of the policy.¹⁷¹ Mr Howden accepted that there was some overlap between the funeral insurance mis-selling conduct in 2015 and the life insurance-related conduct in 2018.¹⁷²

On 19 March 2018, Select ceased distributing funeral insurance.¹⁷³ Mr Howden did not accept that Select had done so as a result of St Andrew's asking Select to stop distributing until it had improved its compliance and sales practices.¹⁷⁴

Around this time, Select had corresponded with St Andrew's and Bank of Queensland (BOQ) about how to deal with this Commission. On 19 February 2018, BOQ asked for Select's consent to voluntarily disclose to the Commission issues relating to Select's sales of funeral and life insurance.¹⁷⁵ Select refused and said that it 'did not consider there to have been any misconduct or conduct falling short of community standards or

¹⁶⁸ Transcript, Russell Howden, 5 July 2018, 3952.

¹⁶⁹ Exhibit 4.173, Witness statement of Russell Howden, 5 July 2018, Exhibit RH-15 [SAF.0002.0001.0222 at .0226].

¹⁷⁰ Transcript, Russell Howden, 5 July 2018, 3954.

¹⁷¹ Transcript, Russell Howden, 5 July 2018, 3954.

¹⁷² Transcript, Russell Howden, 5 July 2018, 3962.

¹⁷³ Transcript, Russell Howden, 5 July 2018, 3968.

¹⁷⁴ Transcript, Russell Howden, 5 July 2018, 3969–70.

¹⁷⁵ Exhibit 4.190, undated, Annexure B to Email Howden to ASIC, 1–2; Transcript, Russell Howden, 5 July 2018, 3970.

expectations arising out of any matter which would bring it within the scope' of the Commission's Terms of Reference.¹⁷⁶ Select maintained this position in subsequent correspondence with St Andrew's.¹⁷⁷ As a result, Select's mis-selling of funeral insurance was not voluntarily disclosed to the Commission.

2.4 What the case study showed

2.4.1 Conduct in relation to Ms Marika

In the course of selling the funeral insurance policies to Ms Marika in September 2015, the representative of Select took into account the fact that Ms Marika already had a funeral insurance policy through her work. The representative of Select relied on this information about Ms Marika's financial situation as the basis for:

- comparing the features of the funeral insurance product offered by Select to the features of funeral insurance products that people commonly hold through their work;¹⁷⁸ and
- comparing the price of the product offered by Select to the price of other funeral insurance products.¹⁷⁹

In particular, the sales representative advised Ms Marika that she could have more than one funeral insurance policy in place at one time and suggested that she would cease to be covered by her existing funeral insurance policy when she stopped working.¹⁸⁰ Mr Howden accepted that the representative was not authorised or licensed to provide personal advice and that the representative had 'probably' contravened Section 952C of the Corporations Act.¹⁸¹

¹⁷⁶ Exhibit 4.190, undated, Annexure B to Email Howden to ASIC, 1.

¹⁷⁷ Exhibit 4.191, 4 April 2018, Letter Howden of Select to Way of St Andrews.

¹⁷⁸ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit RBM-6 [SAF.0001.0001.0085 at .0086–.0087].

¹⁷⁹ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit RBM-6 [SAF.0001.0001.0085 at .0087].

¹⁸⁰ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit RBM-6 [SAF.0001.0001.0085 at .0087].

¹⁸¹ Transcript, Russell Howden, 5 July 2018, 3978.

In its submissions, Select argued that the statements made by the representative did not constitute personal advice, but instead constituted statements of fact.¹⁸² I disagree. The representative took into account information about Ms Marika's financial circumstances and used that information to draw comparisons between Select's product and the type of product that Ms Marika said she already had. Further, the representative specifically told Ms Marika 'you can actually have two at the same time'.¹⁸³ The representative was not authorised to provide personal advice. His conduct, and the conduct of Select as the licensee might have contravened Section 952C of the Corporations Act.

Ms Marika's conversations with those who rang her about Select funeral insurance have been described earlier. It will be recalled that in the second of those conversations, Ms Marika said that she did not want to have a second policy. Despite this, Let's Insure rang her again and sold her Select funeral insurance. Contrary to Select's submissions, I consider that this third call might have breached the anti-hawking provisions of the Corporations Act. That is, I consider that it is arguable that calling her after her unequivocal rejection of interest in buying a second funeral insurance policy was to make 'an unsolicited telephone call' to her for the purposes of Section 992A(3)(aa). I also consider that in the course of that call, Select might have provided an oral product disclosure statement to Ms Marika without expressly obtaining her consent to do so, which might have breached Section 992A(3)(e) of the Corporations Act.

Mr Howden accepted that in circumstances that included Ms Marika's expressed wish not to purchase the insurance, her lack of understanding about the product that she was purchasing and her lack of understanding of the consequences of the purchase, it was unconscionable for Select to have sold the policies to Ms Marika.¹⁸⁴ Select sought to resile from this position in its written submissions¹⁸⁵ but I consider that Mr Howden's concession was properly made. It follows that Select's conduct might have contravened Section 12CA or Section 12CB of the ASIC Act.

¹⁸² Select ASFL, *Written Submissions*, 13 July 2018, 3 [8]–[12].

¹⁸³ Exhibit 4.171, Witness statement of Kathy Marika, 19 June 2018, Exhibit RBM-6 [SAF.0001.0001.0085 at .0087].

¹⁸⁴ Transcript, Russell Howden, 5 July 2018, 3976, 3979–80.

¹⁸⁵ Select AFSL, *Submissions on behalf of Select AFSL*, 13 July 2018, 4–5 [16]–[20].

It was not right for the Select sales representative to induce Ms Marika to provide the names and contact details of a significant number of family and friends during the phone call on 10 September 2015. Mr Howden accepted that this conduct was unreasonable and that it represented a gross abuse of Select's referral program.¹⁸⁶ This conduct fell below community standards and expectations.

It was also inappropriate for a Select representative to dissuade Ms Marika from cancelling her policies a week after she took them out. Ms Marika had expressed serious concerns about whether she could afford the policies. The representative dissuaded Ms Marika from cancelling her policies in circumstances where Ms Marika had a statutory right to cancel her policy in writing for 14 days, and the product disclosure statement that was applicable to her policy afforded her 30 days to cancel her policy.¹⁸⁷ Again, this conduct fell below community standards and expectations.

2.4.2 Conduct of Select more generally

The two sales representatives to whom Select attributed the 2015 spike in funeral insurance sales used the referral program to target Aboriginal and Torres Strait Islander people for potential sales. In the termination letters that Select gave the two representatives, Select told them that 'there was no doubt in the company's mind that they had failed to act in the utmost good faith by taking advantage of people in the postcodes with high proportions of Indigenous clients'.¹⁸⁸

Select's reference to failing to act in the utmost good faith invites attention to Section 13 of the *Insurance Contracts Act 1984* (Cth) and its provision that failure by a party to a contract of insurance to comply with that standard 'is a breach of the requirements' of the Act.¹⁸⁹ It may be that the actions of the representatives engaged Section 13(2) (and Select did not submit to the contrary¹⁹⁰) but it is not necessary to pursue that question further. Instead, it

¹⁸⁶ Exhibit 4.174, Witness statement of Russell Howden, 13 June 2018, 5 [5.2]; Transcript, Russell Howden, 5 July 2018, 3980.

¹⁸⁷ Transcript, Russell Howden, 5 July 2018, 3983.

¹⁸⁸ Transcript, Russell Howden, 5 July 2018, 3951.

¹⁸⁹ Transcript, Russell Howden, 5 July 2018, 3951; *Insurance Contracts Act 1984* (Cth) s 13(2).

¹⁹⁰ Select AFSL, *Submissions on Behalf of Select AFSL*, 13 July 2018, 6–7 [30]–[31].

may be noted that conduct of the kind engaged in by those representatives might properly be described as unconscionable. It follows that they may have contravened Section 12CA or Section 12CB of the ASIC Act. Again, Select did not challenge this conclusion in its submissions.¹⁹¹

Select did not prevent the conduct of the two representatives who significantly contributed to the 2015 spike in funeral insurance sales. Not only did it not prevent that conduct, it had in place a system of remuneration and incentives that most likely contributed to it. Select encouraged its employees to sell aggressively and to overcome objections in a way that was designed not to permit potential purchasers to exit the selling process. As I have noted, Mr Howden accepted that Select pushed its agents with productivity targets.¹⁹² Select also provided incentives that induced its representatives to sell policies at all costs. Select did not have adequate internal systems in place to detect or deter misconduct within its organisation. Select's quality assurance system in 2015, and even as varied in 2016, was inadequate to stop Select representatives from engaging in misconduct on calls and was insufficient to allow Select to detect when there was misconduct. Indeed, Mr Howden became aware of the mis-selling to Ms Marika only upon being told about Ms Marika's case by the Commission.¹⁹³

It follows that it is at least arguable that Select failed to ensure that it did 'all things necessary to ensure that the financial services [it provided were] provided ... honestly and fairly'; failed to have 'in place adequate arrangements for the management of conflicts of interest' between the interests of its policy holders, or potential policy holders, and the interests of its sales representatives; and it failed to take 'reasonable steps to ensure that its representatives compl[ied] with the financial services laws', as required by Section 912A of the Corporations Act.

The referral program used by Select is troubling. When coupled with Select's sales culture and Select's remuneration and KPI arrangements, the referral program used by Select carried with it a substantial risk that Select representatives would mis-sell funeral insurance policies. It fell below

¹⁹¹ Select AFSL, *Submissions on Behalf of Select AFSL*, 13 July 2018, 5 [22]–[23].

¹⁹² Transcript, Russell Howden, 4 July 2018, 3909.

¹⁹³ Transcript, Russell Howden, 5 July 2018, 3980.

community standards and expectations for Select to use such a program, in circumstances where it had not put in place adequate safeguards to ensure that the program would not be abused.

Finally, contrary to ASIC's recommendation, Select failed to provide an upfront estimate of the total cost of its policies.¹⁹⁴ This fell short of what the community would expect.

3 ANZ Basic accounts

The third case study focused on the experience of an ANZ customer who lived in a remote community in the Northern Territory, whose nearest bank branch was in Katherine, around 100 kilometres away. The case study raised issues about the availability of basic accounts and ANZ's interaction with customers, particularly those living in remote locations.

The Commission heard evidence from Ms Thy Do, a Senior Family Support Worker with Save the Children and from Mr Tony Tapsall, ANZ's General Manager, Retail Branch Network, Northern Queensland and Northern Territory.

3.1 Background

Ms Do works with Save the Children in Katherine.¹⁹⁵ She gave evidence about the assistance she provided to a client to open an ANZ Access Basic account.

Ms Do's client is a woman in her 30s and single mother of three school-age children.¹⁹⁶ Her client lives in a remote community about 100 kilometres

¹⁹⁴ Transcript, Russell Howden, 4 July 2018, 3899–901.

¹⁹⁵ Exhibit 4.198, Witness statement of Thy Do, 30 June 2018, 1 [2].

¹⁹⁶ Transcript, Thy Do, 5 July 2018, 3988.

from Katherine and speaks two Aboriginal languages.¹⁹⁷ English is not her first language.¹⁹⁸ Her main source of income is Centrelink payments.¹⁹⁹

The community in which Ms Do's client lives has one privately owned ATM. Ms Do's client was charged an ATM fee each time she checked her balance or tried to withdraw money from this ATM.²⁰⁰ She had incurred a significant amount of ATM fees.²⁰¹ She also incurred significant dishonour fees and overdrawn fees on her transaction account.²⁰² The dishonour fees resulted from rejected direct debit payments.²⁰³

Together with a colleague, Ms Do researched available fee-free accounts for her client.²⁰⁴ Ms Do determined that ANZ had a particular product – the Access Basic account – suitable for her client.²⁰⁵ Ms Do thought the Access Basic account was appropriate because it was designed for concession cardholders, had no monthly service fee and did not incur dishonour or overdrawn fees.²⁰⁶

On 19 December 2017, Ms Do drove to the remote community to pick up her client's sister.²⁰⁷ The journey from Katherine to the community is about one and a half hours each way.²⁰⁸ The purpose of the trip was to attend at ANZ's Katherine branch in order to open an Access Basic account.²⁰⁹ As later explained, the chief reason for the bank requiring the client to make

¹⁹⁷ Transcript, Thy Do, 5 July 2018, 3988.

¹⁹⁸ Transcript, Thy Do, 5 July 2018, 3988.

¹⁹⁹ Transcript, Thy Do, 5 July 2018, 3988.

²⁰⁰ Transcript, Thy Do, 5 July 2018, 3988.

²⁰¹ Transcript, Thy Do, 5 July 2018, 3990; Exhibit 4.198, Witness statement of Thy Do, 30 June 2018, 2 [6].

²⁰² Transcript, Thy Do, 5 July 2018, 3990.

²⁰³ Transcript, Thy Do, 5 July 2018, 3990.

²⁰⁴ Transcript, Thy Do, 5 July 2018, 3991.

²⁰⁵ Transcript, Thy Do, 5 July 2018, 3991.

²⁰⁶ Transcript, Thy Do, 5 July 2018, 3991.

²⁰⁷ Transcript, Thy Do, 5 July 2018, 3992; Exhibit 4.198, Witness statement of Thy Do, 30 June 2018, 4 [15].

²⁰⁸ Transcript, Thy Do, 5 July 2018, 3992.

²⁰⁹ Transcript, Thy Do, 5 July 2018, 3992.

an appointment is to create an opportunity for the bank to sell the client other products.

Once at the branch, an ANZ staff member explained to the group that it would not be possible to open a new account without a prior appointment.²¹⁰ Mr Tapsall said that it was now the common practice of ANZ branches to require a customer to make an appointment to open a bank account.²¹¹

Ms Do made an appointment for both her client and her client's sister on 21 December 2017.²¹²

Ms Do drove again to the remote community on 21 December 2017 to collect her client and her client's sister. Ms Do's client asked Ms Do to support her in the appointment with ANZ to help her understand the conversation.²¹³

Ms Do said that at the appointment, she told the banker that her client wished to open an Access Basic account.²¹⁴ She explained that her client wanted a fee-free account, particularly one that did not attract dishonour or overdrawn fees, and a savings account.²¹⁵

The banker asked Ms Do's client a series of questions in relation to her budget, expenses and savings.²¹⁶ As Mr Tapsall's evidence later showed, the banker conducted an 'A–Z review' intended to discover the customer's 'needs'.²¹⁷ But as this case vividly demonstrated, the review was no more than a chance for the banker to sell additional products. The client was asked, in effect, whether she would 'like' to save some money to buy something.²¹⁸ Unsurprisingly she answered yes and with some prompting,

²¹⁰ Transcript, Thy Do, 5 July 2018, 3994.

²¹¹ Transcript, Tony Tapsall 5 July 2018, 4040.

²¹² Transcript, Thy Do, 5 July 2018, 3994.

²¹³ Transcript, Thy Do, 5 July 2018, 3995.

²¹⁴ Transcript, Thy Do, 5 July 2018, 3995.

²¹⁵ Transcript, Thy Do, 5 July 2018, 3995.

²¹⁶ Transcript, Thy Do, 5 July 2018, 3995–6.

²¹⁷ Transcript, Tony Tapsall 5 July 2018, 4042.

²¹⁸ Transcript, Thy Do, 5 July 2018, 3995.

said she would like to save \$5,000 to buy some furniture.²¹⁹ This expression of hope was then treated as a statement of ‘need’, resulting in the banker opening a savings account for the client. Ms Do said that she was not sure whether her client understood the purpose or implications of the questions she was asked or whether the client meant her answers to be taken literally by the banker.²²⁰ At the end of the questions, the banker suggested that the client set up a direct debit arrangement to transfer \$100 of her Centrelink payments each fortnight into the new savings account.²²¹ Ms Do told the banker that she wasn’t sure that her client understood the implications of the direct debit and that this was a significant portion of her client’s income.²²² The banker did not put the direct debit arrangement in place.²²³

During the appointment the banker set up internet banking for Ms Do’s client, including setting up security questions.²²⁴

Ms Do said that towards the end of the meeting, the banker turned her computer screen around to show the accounts that had been established. Ms Do saw that the screen listed a Progress Saver account and an Access Advantage account.²²⁵ Ms Do expressed confusion about why an Access Advantage account had been opened as there had been no discussion of an Access Advantage account during the meeting.²²⁶ What had been discussed was an Access Basic account. Ms Do said that the banker told her that it was not possible to open an Access Basic account at the branch.²²⁷

Ms Do said that she asked the banker about the Access Advantage account and was told that the account attracts monthly fees but that the fees could

²¹⁹ Transcript, Thy Do, 5 July 2018, 3996.

²²⁰ Transcript, Thy Do, 5 July 2018, 3995–6.

²²¹ Transcript, Thy Do, 5 July 2018, 3996.

²²² Exhibit 4.198, Witness statement of Thy Do, 30 June 2018, 6–7 [26].

²²³ Transcript, Thy Do, 5 July 2018, 3997.

²²⁴ Transcript, Thy Do, 5 July 2018, 3997.

²²⁵ Transcript, Thy Do, 5 July 2018, 3998.

²²⁶ Transcript, Thy Do, 5 July 2018, 3998.

²²⁷ Transcript, Thy Do, 5 July 2018, 3998.

be waived.²²⁸ Ms Do also said that she was told that the account attracted dishonour and overdrawn fees but that they should not be an issue, so long as the customer did not overdraw her account.²²⁹

Ms Do's evidence was that she again travelled to her client's remote community on 4 January 2018, in order to assist her client to access internet banking.²³⁰ Upon logging in, Ms Do noticed that the accounts listed for her client were a Progress Saver Account and a Pensioner Advantage account.²³¹ No Access Advantage Account was listed.²³²

On 15 February 2018, Ms Do again met with her client and they called ANZ with the intention of changing her Pensioner Advantage Account to an Access Basic account.²³³ Ms Do said that at first, she was told that it was not possible to make such a change over the phone. After making a second phone call, Ms Do was told that it would be possible for her client to change her account but, because her client had failed to verify her identity using a verbal password on a previous occasion, it was not possible to do it on that day.²³⁴ The operator suggested that Ms Do and her client attend the Katherine ANZ branch to verify the client's identity. That verification could not take place that day as the Katherine branch was closed due to an unexpected plumbing issue.²³⁵ Ms Do made a formal complaint to ANZ that day.²³⁶

On 1 March 2018, Ms Do attended the ANZ Katherine branch with her client and they successfully re-verified her client's identity.²³⁷ They also asked to

²²⁸ Transcript, Thy Do, 5 July 2018, 3999.

²²⁹ Transcript, Thy Do, 5 July 2018, 3999.

²³⁰ Transcript, Thy Do, 5 July 2018, 4001.

²³¹ Transcript, Thy Do, 5 July 2018, 4001.

²³² Transcript, Thy Do, 5 July 2018, 4001.

²³³ Transcript, Thy Do, 5 July 2018, 4001–2.

²³⁴ Transcript, Thy Do, 5 July 2018, 4002.

²³⁵ Transcript, Thy Do, 5 July 2018, 4002.

²³⁶ Transcript, Thy Do, 5 July 2018, 4003.

²³⁷ Transcript, Thy Do, 5 July 2018, 4003.

change the Pensioner Advantage account to an Access Basic account but were told that this was not possible.²³⁸

On the same day, Ms Do and her client telephoned ANZ to change her client's account over the phone. They were told that it was not possible for her client to change from a Pensioner Advantage account to an Access Basic account.²³⁹ Instead, the operator opened an Access Basic account as an additional account for Ms Do's client.²⁴⁰ In order to obtain a keycard for the account the operator required the client to send a text message to confirm that she was requesting a new keycard for the Access Basic account.²⁴¹ The client was unable to send a text message at that time because she did not have credit on her mobile phone that day.²⁴²

Ms Do's evidence was that by the end of the phone conversation, her client had a Progress Saver account, a Pensioner Advantage account and an Access Basic account (which she could not access because she was not able to request a new keycard in the way required by ANZ).²⁴³

Altogether, even with Ms Do's assistance and despite being at all times eligible for such an account, it took about four months for Ms Do's client to open a fee free account with ANZ.²⁴⁴

Ms Do explained that she subsequently contacted ASIC's Indigenous Outreach Program and provided feedback in writing about her client's experience.²⁴⁵ Ms Do was later contacted by ANZ's complaints department.²⁴⁶ As a result of that discussion, and subsequent discussions, Ms Do has received further correspondence in relation to delivery of a

²³⁸ Transcript, Thy Do, 5 July 2018, 4003.

²³⁹ Transcript, Thy Do, 5 July 2018, 4004.

²⁴⁰ Transcript, Thy Do, 5 July 2018, 4004.

²⁴¹ Transcript, Thy Do, 5 July 2018, 4004.

²⁴² Transcript, Thy Do, 5 July 2018, 4004.

²⁴³ Transcript, Thy Do, 5 July 2018, 4005.

²⁴⁴ Transcript, Thy Do, 5 July 2018, 4006.

²⁴⁵ Transcript, Thy Do, 5 July 2018, 4005.

²⁴⁶ Transcript, Thy Do, 5 July 2018, 4005.

keycard to her client. In order to activate the keycard, Ms Do's client will need to telephone ANZ.²⁴⁷

3.2 Disputed events

Mr Tapsall told the Commission that in preparing to give evidence, he spoke with the ANZ employees who dealt with Ms Do and her client.²⁴⁸

Mr Tapsall's statement outlined two versions of events: that of Ms Do and that of the banker responsible for establishing the accounts at the initial meeting. The banker gave her version of events to Mr Tapsall at a meeting in Melbourne.²⁴⁹ Both Mr Tapsall and the banker had travelled to Melbourne for that meeting.²⁵⁰

Mr Tapsall told the Commission that he was 'not making a call' on which version was right.²⁵¹ It is to be remembered that ANZ elected not to offer evidence from the relevant banker.

In its written submissions ANZ submitted that inconsistencies in the evidence of Ms Do and the banker ought be resolved in favour of the banker's account.²⁵² I reject that submission. Ms Do presented as a truthful and honest witness with a strong recollection of the events about which she gave evidence. To the extent that there are inconsistencies between the two accounts, I prefer the sworn account given by Ms Do to the hearsay account in Mr Tapsall's statement.

3.3 What the case study showed

The case study demonstrated some of the difficulties faced by those in remote locations in dealing with banks. Where remoteness of location is coupled with language and cultural differences, those difficulties are very significant.

²⁴⁷ Transcript, Thy Do, 5 July 2018, 4006.

²⁴⁸ Transcript, Tony Tapsall, 5 July 2018, 4037.

²⁴⁹ Transcript, Tony Tapsall, 5 July 2018, 4046.

²⁵⁰ Transcript, Tony Tapsall, 5 July 2018, 4046.

²⁵¹ Transcript, Tony Tapsall, 5 July 2018, 4040.

²⁵² ANZ, *ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 13–14 [57]–[60].

ANZ's conduct fell below community standards and expectations in a number of respects.

First, ANZ did not take reasonable steps to make information about its banking services accessible to Ms Do's client and failed to tell Ms Do's client about accounts and services that were relevant to her.²⁵³

- the banker did not explain the availability of a fee-free account to Ms Do's client, although it was clear that she was entitled to open one; and
- the banker opened an account for Ms Do's client that was inappropriate for a person in her circumstances, due (in particular) to the risk of attracting dishonour and overdrawn fees.²⁵⁴

The most appropriate account should have been opened immediately. That it was not would cause frustration in any circumstance. That the account was not opened immediately in circumstances where the client had to make a three hour return trip to attend the branch could only have aggravated that frustration.²⁵⁵

Second, on several occasions, ANZ failed to open the appropriate account type or to assist Ms Do's client to change her account type over the phone after a less appropriate account was opened. The community is entitled to expect that once a mistake is identified by a customer, it will be resolved promptly. This did not happen here.

Third, the questions asked of Ms Do's client during the appointment in ANZ's A–Z review were not appropriately adapted for somebody with limited English, and limited financial literacy, and the security questions posed to Ms Do's client in respect of internet banking lacked real significance or relevance to her.

Fourth, to the extent that the A–Z review was treated as an opportunity to sell the client other products, I consider that the conduct fell short of what the community would expect. A client had asked the bank to open a Basic Bank Account *because* operating her existing account had run up fees and

²⁵³ They will be required to do this under the new Code of Banking Practice – Exhibit 4.142, undated, Proposed Code of Banking Practice, 10 [35].

²⁵⁴ Transcript, Thy Do, 5 July 2018, 3991, 3998.

²⁵⁵ Transcript, Thy Do, 5 July 2018, 3992.

charges. It was not appropriate to try to have her open (and in fact open) other accounts.

Fifth, ANZ failed to help Ms Do's client to meet identification requirements over the phone²⁵⁶ and failed to take into account the large geographical barriers that made it difficult for Ms Do's client to attend the Katherine branch to verify her identity. Mr Tapsall agreed that at least two of the calls where Ms Do's client failed the identification process provided a graphic demonstration of the difficulties that can be encountered by some Aboriginal and Torres Strait Islander people when dealing with banks by telephone.²⁵⁷ It was plain that Ms Do's client was struggling to answer the verification questions²⁵⁸ and that other clients of ANZ have encountered similar difficulties.²⁵⁹

3.3.1 Culture and adequacy of internal systems

ANZ's internal systems and, in particular, its systems for dealing with Aboriginal and Torres Strait Islander customers, including its staff training, were a cause of the conduct that fell below community expectations.

While ANZ has taken some steps to modify its processes and procedures to accommodate Aboriginal and Torres Strait Islander customers, and to offer basic banking products, those systems are not adapted in a way that makes dealing effectively with the bank readily accessible for Aboriginal and Torres Strait Islander customers whose first language is not English, especially when the customers live in remote areas. The absence of specifically adapted telephone banking questions is perhaps the most obvious example of ANZ's systems and processes unintentionally presenting barriers to some Aboriginal and Torres Strait Islander customers.

Further, the staff members in question in this case study (and perhaps more broadly) were inadequately trained in those procedures and products. Mr Tapsall's evidence was that staff members in branches with higher concentrations of Aboriginal and Torres Strait Islander customers are not

²⁵⁶ Exhibit 4.142, undated, Proposed Code of Banking Practice, 10 [35].

²⁵⁷ Transcript, Tony Tapsall, 6 July 2018, 4061, 4064–6.

²⁵⁸ Transcript, Tony Tapsall, 6 July 2018, 4065.

²⁵⁹ Transcript, Tony Tapsall, 6 July 2018, 4065.

given any specific training to assist those customers.²⁶⁰ That position was accepted in ANZ's written submissions.²⁶¹ ANZ also accepted that the banker's response regarding overdrawn and dishonour fees was inappropriate.²⁶²

Given the particular difficulties faced by some Aboriginal and Torres Strait Islander consumers, ANZ's failure to specifically train those staff most likely to have interaction with those Aboriginal and Torres Strait Islander customers who would benefit from a modified approach, contributed to the events outlined by Ms Do.

4 ANZ (Groote Eylandt)

The final case study in this topic concerned ANZ's practice of providing informal overdrafts on some transaction accounts. The case study focused, in particular, on the position of ANZ customers on Groote Eylandt, although some statistical evidence was also received of the position throughout the Northern Territory.

The Commission heard evidence from Mr Philip Bowden, a financial counsellor with Anglicare NT, and from Mr Tony Tapsall, ANZ's General Manager, Retail Branch Network, Northern Queensland and Northern Territory.

4.1 Background

Mr Bowden is a qualified financial counsellor employed by Anglicare NT. He assists clients throughout East Arnhem Land, including Groote Eylandt.²⁶³

²⁶⁰ Transcript, Tony Tapsall, 6 July 2018, 4069.

²⁶¹ ANZ, *ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 15 [65].

²⁶² ANZ, *ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 15–16 [66].

²⁶³ Transcript, Philip Bowden, 5 July 2018, 4014–15; Exhibit 4.200, Witness statement of Phillip Bowden, 4 July 2018, 1 [5], 3 [11], [14].

Groote Eylandt has a population of about 1,500 people, a high proportion of whom are Aboriginal and Torres Strait Islander people. There are three main townships and a privately operated mine.²⁶⁴

There is a wide range of both literacy and financial literacy levels in the Groote Eylandt community, but most of the clients who Mr Bowden assists have low levels of financial literacy.²⁶⁵ As an example, Mr Bowden referred to a client with a negative account balance who had not understood the effect of the minus symbol.²⁶⁶ The client was confused as to why she could not withdraw funds.²⁶⁷

Mr Bowden said that English was not the first language of many of his clients on Groote Eylandt and that it was often a person's third or fourth language.²⁶⁸

4.2 Informal overdrafts

Informal overdrafts, sometimes referred to as 'shadow limits', provide an account holder with the capacity to draw more funds from their account than the amount standing to the credit of the account. Informal overdrafts attach to certain ANZ accounts unless automatic exclusionary criteria are applied to the account by ANZ's information technology system.²⁶⁹

There is no action required by an ANZ customer to establish an informal overdraft.²⁷⁰ It attaches to an account at the sole discretion of ANZ.²⁷¹ Mr Tapsall said that ANZ customers are notified of the possible availability of an informal overdraft by Clause 2.19 of ANZ's Terms and Conditions – a 104 page document.²⁷² Mr Tapsall agreed that, even after reading the

²⁶⁴ Transcript, Philip Bowden, 5 July 2018, 4015.

²⁶⁵ Transcript, Philip Bowden, 5 July 2018, 4016.

²⁶⁶ Transcript, Philip Bowden, 5 July 2018, 4016.

²⁶⁷ Transcript, Philip Bowden, 5 July 2018, 4016.

²⁶⁸ Transcript, Philip Bowden, 5 July 2018, 4016.

²⁶⁹ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 7, 14 [22], [57].

²⁷⁰ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 14–15 [55]–[59A].

²⁷¹ Transcript, Tony Tapsall, 6 July 2018, 4070.

²⁷² Exhibit 4.204, Witness statement of Tony Tapsall, 21 June 2018, 15 [63]; Transcript, Tony Tapsall, 6 July 2018, 4071–3.

Terms and Conditions, a customer would only know whether there was a *possibility* that they may be offered an informal overdraft.²⁷³

At all relevant times, ANZ customers were permitted to opt out of informal overdrafts, including by attending at a branch or by telephone banking.²⁷⁴ Mr Tapsall said that at the time of his first statement to the Commission, he did not know that an informal overdraft could be turned off over the phone.²⁷⁵

Once an account with an informal overdraft becomes overdrawn by \$50 or more, a fee of \$6 per day is applied for each business day the account remains overdrawn.²⁷⁶ The maximum fee is capped at 10 business days per month.²⁷⁷ Interest is also charged at the ANZ retail index rate plus a margin of 8.5%.²⁷⁸ At the time of Mr Tapsall's witness statement concerning informal overdrafts,²⁷⁹ the rate of interest charged by ANZ on overdrawn amounts was 17.2% per annum.²⁸⁰

Mr Tapsall agreed that it is difficult for an ANZ customer to ascertain the rate of interest charged on overdrawn amounts.²⁸¹

4.3 The extent of informal overdrafts in the Northern Territory

In each of 2016 and 2017, ANZ had charged in excess of \$1.27 million in informal overdraft fees to account holders in the Northern Territory and in excess of \$215,000 in interest on informal overdrafts.²⁸²

²⁷³ Transcript, Tony Tapsall, 6 July 2018, 4073.

²⁷⁴ Exhibit 4.205, Supplementary witness statement of Tony Tapsall, 4 July 2018, 3 [17]–[18]; Transcript, Tony Tapsall, 6 July 2018, 4082–3.

²⁷⁵ Transcript, Tony Tapsall, 6 July 2018, 4083.

²⁷⁶ Transcript, Tony Tapsall, 6 July 2018, 4074.

²⁷⁷ Transcript, Tony Tapsall, 6 July 2018, 4074.

²⁷⁸ Transcript, Tony Tapsall, 6 July 2018, 4074.

²⁷⁹ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018.

²⁸⁰ Transcript, Tony Tapsall, 6 July 2018, 4074.

²⁸¹ Transcript, Tony Tapsall, 6 July 2018, 4074.

²⁸² Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 23 [100].

Mr Tapsall's first witness statement contained some information on the prevalence of informal overdrafts on Groote Eylandt and the use of the so-called '90% arrangements' under the Code of Operation, about which I will say more later.²⁸³ As at 23 May 2018, 179 account holders on Groote Eylandt had an informal overdraft attached to their account.²⁸⁴ In the period from 1 January 2018 to 31 May 2018, 768 account holders on Groote Eylandt received a payment capable of engaging the Code of Operation.²⁸⁵ The statement did not reveal how many of those account holders had a debt to ANZ at any relevant period. In the same period, eight account holders had taken up the '90% arrangements'.²⁸⁶

4.4 Client 1 and Client 2

Mr Bowden gave evidence of the particular circumstances of two of Anglicare NT's clients. Each client had met with a financial capability worker employed by Anglicare NT.²⁸⁷ Mr Bowden had reviewed the financial capability worker's notes and spoke with her before giving evidence.²⁸⁸

Client 1 was referred to the financial capability worker by Centrelink.²⁸⁹ The referral was made because the client's family would often take his bank card and spend money from his account, resulting in his account being overdrawn on multiple occasions.²⁹⁰ As a consequence, the client's Centrelink payments were sometimes used to clear the overdrawn amount, leaving him without funds in the account after receiving his fortnightly benefit.²⁹¹

Client 1 spoke little or no English and struggled to understand the concept of an overdraft.²⁹² With the assistance of a Centrelink translator, the

²⁸³ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 8 [27], 17–18 [75]–[79].

²⁸⁴ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 8 [27].

²⁸⁵ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 22 [93].

²⁸⁶ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, 21–2 [95].

²⁸⁷ Transcript, Philip Bowden, 5 July 2016, 4017.

²⁸⁸ Transcript, Philip Bowden, 5 July 2016, 4017.

²⁸⁹ Transcript, Philip Bowden, 5 July 2016, 4017.

²⁹⁰ Transcript, Philip Bowden, 5 July 2016, 4018.

²⁹¹ Transcript, Philip Bowden, 5 July 2016, 4018.

²⁹² Transcript, Philip Bowden, 5 July 2016, 4018.

financial capability worker explained to Client 1 what an overdraft was.²⁹³ The client then agreed to turn off the overdraft feature on his account.²⁹⁴ The financial capability worker assisted the client to talk to ANZ so that the informal overdraft was removed.²⁹⁵

Once the informal overdraft was removed, the client had a debt of \$600.²⁹⁶ That debt was to be progressively paid off from his Centrelink payments.²⁹⁷ The financial capability worker ensured that the '90% arrangements' applied, so that only 10% of each of his Centrelink payment could be applied towards the outstanding debt.²⁹⁸

Client 2 was referred to the financial capability worker because she wanted to learn how to save and because her account was overdrawn by \$310.²⁹⁹ When first referred to Anglicare NT, the client did not understand what an overdraft was.³⁰⁰ The financial capability worker provided some education about overdrafts and the client decided to contact the bank to cancel any overdraft available on her account.³⁰¹

The financial capability worker assisted the client to call ANZ but was informed that the request to switch off an informal overdraft could not be made over the phone and that it would be necessary to visit a branch.³⁰² The financial capability worker drove the client to the Groote Eylandt branch.³⁰³ At the branch, the client was told that it was possible to cancel the overdraft but that because the account was locked at that time, it would be necessary to return to the bank on Friday after the client's Centrelink

²⁹³ Transcript, Philip Bowden, 5 July 2016, 4018.

²⁹⁴ Transcript, Philip Bowden, 5 July 2016, 4018.

²⁹⁵ Transcript, Philip Bowden, 5 July 2016, 4018.

²⁹⁶ Transcript, Philip Bowden, 5 July 2016, 4019.

²⁹⁷ Transcript, Philip Bowden, 5 July 2016, 4019.

²⁹⁸ Transcript, Philip Bowden, 5 July 2016, 4019.

²⁹⁹ Transcript, Philip Bowden, 5 July 2016, 4019.

³⁰⁰ Transcript, Philip Bowden, 5 July 2016, 4019.

³⁰¹ Transcript, Philip Bowden, 5 July 2016, 4019.

³⁰² Transcript, Philip Bowden, 5 July 2016, 4019–20.

³⁰³ Transcript, Philip Bowden, 5 July 2016, 4020.

payment had been deposited so that the outstanding balance could be cleared.³⁰⁴

After this payment had been received, the financial capability worker assisted the client to return to the branch and take out cash from her account.³⁰⁵ The '90% arrangements' applied to the account.³⁰⁶ Ten% of the client's Centrelink payment was used to pay back the overdraft.³⁰⁷ Because the client took out money, leaving the account overdrawn, her account remained locked until the overdraft was paid off.³⁰⁸

4.5 Code of Operation

The '90% arrangements', which I have mentioned in connection with both Client 1 and Client 2, arise under a Code of Operation between the Commonwealth Department of Human Services, the Commonwealth Department of Veterans Affairs (DVA) and various **authorised deposit-taking institutions** (ADIs). Under the Code of Operation, 'the default position is that a customer should be able to retain at least 90% of their income support payment or DVA payments in any fortnightly period.'³⁰⁹

The Code of Operation places the onus on the bank to implement the '90% arrangements' where applicable. Mr Tapsall said that ANZ only implements the '90% arrangements' after a customer has asked to make the arrangements.³¹⁰ He accepted that ANZ's current practices do not meet the requirements of the Code of Operation.³¹¹

Mr Tapsall also said that at the time he gave evidence (during the week of 2 July 2018), there were discussions underway within ANZ in relation to the

³⁰⁴ Transcript, Philip Bowden, 5 July 2016, 4020.

³⁰⁵ Transcript, Philip Bowden, 5 July 2016, 4020.

³⁰⁶ Transcript, Philip Bowden, 5 July 2016, 4020.

³⁰⁷ Transcript, Philip Bowden, 5 July 2016, 4020.

³⁰⁸ Transcript, Philip Bowden, 5 July 2016, 4020.

³⁰⁹ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, Exhibit TCT-17 [ANZ.800.643.0441 at 0442].

³¹⁰ Transcript, Tony Tapsall, 6 July 2018, 4084.

³¹¹ Transcript, Tony Tapsall, 6 July 2017, 4086.

application of the Code of Operation, with a view to bringing ANZ's systems and processes into compliance with the Code of Operation's terms.³¹²

4.6 What the case study showed

4.6.1 Implementation of the Code of Operation

The Code of Operation is a widely-adopted benchmark for conduct to which ANZ is a signatory. Mr Tapsall accepted that ANZ's current policies and procedures in respect of the '90% arrangements' do not conform with the Code of Operation.³¹³ Contrary to the Code of Operation, ANZ places the onus on its customers to 'opt in' to the arrangements. I consider that this conduct might be misconduct.

In its written submissions, ANZ submitted that there was insufficient evidence to demonstrate the Code of Operation is a widely adopted benchmark for conduct.³¹⁴ I find that a surprising submission. The version of the Code of Operation exhibited to Mr Tapsall's first witness statement states that it was 'developed and endorsed by', among others, two Departments of the Commonwealth Government and the Australian Bankers' Association.³¹⁵ It is said to be a 'statement of best practice between' those departments and 'the representative bodies on behalf of relevant members' that are ADIs.³¹⁶

ANZ's submission did not allude to those matters. Rather, it sought to draw support from evidence of Ms Lynda Edwards, a financial counsellor who gave general evidence at the start of the second sitting week. The particular

³¹² Transcript, Tony Tapsall, 6 July 2018, 4087.

³¹³ Transcript, Tony Tapsall, 6 July 2018, 4084–6; see also ANZ, *ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 19 [79].

³¹⁴ ANZ, *ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 19 [79].

³¹⁵ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, Exhibit TCT-17 [ANZ.8000.643.0441 at .0441].

³¹⁶ Exhibit 4.202, Witness statement of Tony Tapsall, 21 June 2018, Exhibit TCT-17 [ANZ.8000.643.0441 at .0442].

evidence relied upon was a statement by Ms Edwards that the Code of Operation is not applied by banks in a systemic way.³¹⁷

Ms Edwards' evidence suggests that the Code of Operation may not be universally implemented. That does not demonstrate that it is not a 'widely adopted benchmark'. That the Code of Operation was developed and endorsed by the Australian Bankers' Association on behalf of its members leads inevitably to the conclusion the Code of Operation is a document that if breached is a form of misconduct.

4.6.2 Disclosure of information

ANZ did not provide effective and readily accessible information about the attachment of informal overdrafts to transaction accounts or about the fees and interest charges applicable to informal overdrafts. Mr Tapsall rightly accepted that the community would expect ANZ to be more forthcoming about the prospect of an informal overdraft being attached to an account.³¹⁸ That expectation finds reflection in Clause 3.1(b)(i) and Clause 8(a) of the 2013 Code of Banking Practice, which require effective disclosure of information in an accessible manner. The little information disclosed by ANZ about informal overdrafts was opaque.

As Mr Tapsall recognised, even after reading the Terms and Conditions applicable to transaction accounts, a customer would only be aware of the *possibility* that they may be offered an informal overdraft.³¹⁹ Mr Tapsall did not point to any other document that would better inform customers nor was any such document referred to in ANZ's written submissions.

ANZ submitted that no finding should be made about possible breach of Clause 3.1(b)(i) or 8(a) because 'there is no evidence that the Terms and Conditions or Fees and Charges documents are inaccessible to all customer[s], or to any particular customers'.³²⁰ That submission is not to the point. Objectively assessed, the information as to informal overdrafts is not

³¹⁷ Exhibit 4.140, Witness statement of Lynda Edwards, 22 June 2018, 5 [29(b)]; Transcript, Lynda Edwards, 3 July 2018, 3739–40.

³¹⁸ Transcript, Tony Tapsall, 6 July 2018, 4072–3.

³¹⁹ Transcript, Tony Tapsall, 6 July 2018, 4073.

³²⁰ ANZ, *ANZ's Submissions on Findings Concerning Case Studies Involving ANZ*, 13 July 2018, 19 [82].

effective or accessible. A customer cannot readily ascertain if an informal overdraft is attached to an account, or ascertain the circumstances in which an overdraft may be attached, by reading either or both of the documents pointed to by ANZ. This conduct might amount to a breach of one or both of the identified provisions of the Code.

No less importantly, however, I consider ANZ's conduct in providing informal overdrafts with high rates of interest and high fees to customers with low incomes on an opt-out rather than opt-in basis, was conduct falling below community standards and expectations.

4.6.3 Culture, governance practices and adequacy of internal systems

The conduct described (apart from conduct about the '90% arrangements') was attributable to a culture that was insufficiently concerned with providing customers with an appropriate product. Informal overdrafts may be a useful tool for some customers on some occasions but by granting shadow limits on an opt-out, rather than opt-in, basis – including to accounts held by low income earners – ANZ prioritised its own position over that of some of its customers.

The conduct of not applying the '90% arrangements' automatically was the result of inadequate internal systems at ANZ. While the Code of Operation anticipates that the default position is that customers who receive a defined benefit and have an account that is overdrawn should be placed on the 90% arrangements, ANZ has no systems for identifying those who are eligible for their application.



Interim Report

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

VOLUME 3:
APPENDICES

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Contents

Volume 3: Appendices

Appendix 1: Letters Patent	1
Appendix 2: Letters to entities	9
Appendix 3: Entities sent initial letters	23
Appendix 4: Hearing dates	29
Appendix 5: Witnesses	31
Appendix 6: Exhibits	47
Appendix 7: Submissions from parties	93
Appendix 8: Public engagement	99
Appendix 9: Background Papers	105

Appendix 1: Letters Patent



ENTERED ON RECORD by me in Register of Patents No. 52

page 67

on 14 December

2017

Secretary to the Federal Executive Council

Handwritten signature

ELIZABETH THE SECOND, by the Grace of God Queen of Australia and Her other Realms and Territories, Head of the Commonwealth:

TO

The Honourable Kenneth Madison Hayne AC QC

GREETING

WHEREAS Australia has one of the strongest and most stable banking, superannuation and financial services industries in the world, which performs a critical role in underpinning the Australian economy.

AND Australia's banking system is systemically strong with internationally recognised and world's best prudential regulation and oversight.

AND most Australians are consumers of banking, superannuation and other financial services. The superannuation system alone in Australia has created more than a \$2 trillion retirement savings pool, which continues to grow rapidly and which compels all working Australians to defer income today for their retirement.

AND all Australians have the right to be treated honestly and fairly in their dealings with banking, superannuation and financial services providers. The highest standards of conduct are critical to the good governance and corporate culture of those providers.

AND these standards should continue to be complemented by strong regulatory and supervisory frameworks that ensure

that all Australian consumers, including business, have confidence and trust in the financial system.

NOW THEREFORE We do, by Our Letters Patent issued in Our name by Our Governor-General of the Commonwealth of Australia on the advice of the Federal Executive Council and under the Constitution of the Commonwealth of Australia, the Royal Commissions Act 1902 and every other enabling power, appoint you to be a Commission of inquiry, and require and authorise you, to inquire into the following matters:

- (a) whether any conduct by financial services entities (including by directors, officers or employees of, or by anyone acting on behalf of, those entities) might have amounted to misconduct and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency;
- (b) whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and expectations;
- (c) whether the use by financial services entities of superannuation members' retirement savings, for any purpose, does not meet community standards and expectations or is otherwise not in the best interests of those members;
- (d) whether any findings in respect of the matters mentioned in paragraphs (a), (b) and (c):
 - (i) are attributable to the particular culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant subsector; or
 - (ii) result from other practices, including risk management, recruitment and remuneration practices, of a financial services entity, or in the relevant industry or relevant subsector;

(e) the effectiveness of mechanisms for redress for consumers of financial services who suffer detriment as a result of misconduct by financial services entities;

(f) the adequacy of:

(i) existing laws and policies of the Commonwealth (taking into account law reforms announced by the Commonwealth Government) relating to the provision of banking, superannuation and financial services; and

(ii) the internal systems of financial services entities; and

(iii) forms of industry self-regulation, including industry codes of conduct;

to identify, regulate and address misconduct in the relevant industry, to meet community standards and expectations and to provide appropriate redress to consumers;

(g) the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities;

(h) whether any further changes to any of the following are necessary to minimise the likelihood of misconduct by financial services entities in future (taking into account any law reforms announced by the Commonwealth Government):

(i) the legal framework;

(ii) practices within financial services entities;

(iii) the financial regulators;

(i) any matter that has occurred or is occurring overseas, to the extent the matter is relevant to a matter mentioned in paragraphs (a) to (h);

(j) any matter reasonably incidental to a matter mentioned in paragraphs (a) to (i).

AND, without limiting the scope of your inquiry or the scope of any recommendations arising out of your inquiry that you may consider appropriate, for the purpose of your inquiry and recommendations in relation to the matter mentioned in paragraph (f):

(k) We direct you to have regard to the implications of any changes to laws, that you propose to recommend, for the economy generally, for access to and the cost of financial services for consumers, for competition in the financial sector and for financial system stability; and

(l) We authorise you to have regard to comparable international experience, practices and reforms.

AND We further declare that you are not required by these Our Letters Patent to inquire, or to continue to inquire, into a particular matter to the extent that you are satisfied that the matter has been, is being, or will be, sufficiently and appropriately dealt with by another inquiry or investigation or a criminal or civil proceeding.

AND We further declare that you are not required by these Our Letters Patent to inquire, or to continue to inquire, into a particular matter to the extent that the matter relates to macro-prudential policy and regulation.

AND We direct you to give priority to matters that in your opinion, have greater potential for harm if not addressed expeditiously.

AND We further declare that you may decide not to inquire into a particular matter falling within the scope of paragraphs (a) to (j), but any such decision is yours alone.

AND We further declare that you may inquire into any matter mentioned in paragraphs (a) to G) to the extent that the matter relates to or is connected with the peace, order and good government of the Commonwealth and any public purpose or any power of the Commonwealth.

AND We direct you to make any recommendations arising out of your inquiry that you consider appropriate.

AND We declare that you are a relevant Commission for the purposes of sections 4 and 5 of the Royal Commissions Act 1902.

AND We declare that, in exercising your powers under Part 2 of the Royal Commissions Act 1902, you are to inquire into the matters falling within the scope of paragraphs (a) to (j) only to the extent that Commonwealth constitutional power extends to those subjects of inquiry.

AND We declare that you are a Royal Commission to which item 5 of the table in subsection 355-70(1) in Schedule 1 to the Taxation Administration Act 1953 applies.

AND We declare that in these Our Letters Patent:

financial services entity means:

- (a) an ADI (authorised deposit-taking institution) within the meaning of the Banking Act 1959; or
- (b) an entity that carries on a business of taking liability, by way of insurance (including reinsurance), in respect of any loss or damage, including liability to pay damages or compensation, contingent upon the happening of a specified event, including:
 - (i) a general insurer (within the meaning of the Insurance Act 1973); and
 - (ii) an entity that carries on life insurance business (within the meaning of the Life Insurance Act 1995); or
- (c) a person or entity required by section 911A of the Corporations Act 2001 to hold an Australian financial services licence, or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative; or
- (d) a person or entity that:
 - (i) is an RSE licensee of a registrable superannuation entity (within the meaning of the Superannuation Industry (Supervision) Act 1993); or
 - (ii) has any connection (other than an incidental connection) to such an RSE licensee; or
- (e) a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders;

but does not include an entity that is a Commonwealth company or Commonwealth entity (both within the meaning of the *Public Governance, Performance and Accountability Act 2013*).

macro-prudential policy and regulation means policy and regulation, including as to the structure, role and purpose of financial regulators, that is concerned with containing systemic risk, which can have widespread implications for the financial system as a whole.

misconduct includes conduct that:

- (a) constitutes an offence against a Commonwealth, State or Territory law, as in force at the time of the alleged misconduct; or

- (b) is misleading, deceptive, or both; or
- (c) is a breach of trust, breach of duty or unconscionable conduct; or
- (d) breaches a professional standard or a recognised and widely adopted benchmark for conduct.

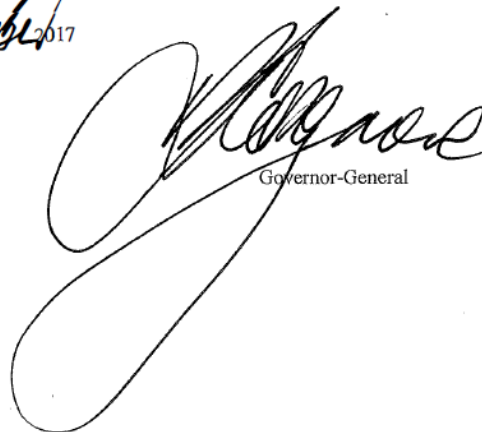
AND We:

- (m) require you to begin your inquiry as soon as practicable; and
- (n) require you to make your inquiry as expeditiously as possible; and
- (o) authorise you to submit to Our Governor-General an interim report, that you consider appropriate, not later than 30 September 2018; and
- (p) require you to submit to Our Governor-General a final report of the results of your inquiry, and your recommendations, not later than 1 February 2019.

IN WITNESS, We have caused these Our Letters to be made Patent.

WITNESS General the Honourable Sir Peter Cosgrove AK MC
(Ret'd), Governor-General of the Commonwealth of Australia.

Dated *14th December* 2017



Governor-General

By His Excellency's Command



Prime Minister

Appendix 2:

Letters to entities

Letter to financial services entities

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

As you know, I have been appointed to conduct this Royal Commission. I attach the Commission's Terms of Reference.

I am writing to a number of entities in the Banking, Superannuation and Financial Services industry to invite each to make an early written submission to the Commission addressing a number of questions. I attach the questions directed to this entity and its associated entities (within the meaning of s 50AAA of the *Corporations Act 2001* (Cth)).

I will be assisted if you would provide answers to the questions jointly on behalf of this entity and its associated entities. As you would expect, the questions use the language of the Terms of Reference.

I ask that you provide your response no later than 29 January 2018 in the form described in the attachment. The response should be comprehensive but should not exceed 50 pages.

[Signed]

K M Hayne

Questions

- 1 Excluding cases of theft from the entity itself, or from an associated entity, has the entity identified any misconduct by the entity (including by its directors, officers or employees, or by anyone otherwise acting on its behalf) which occurred at any time since 1 January 2008? If so, what is the nature, extent and effect of that misconduct?

- 2 Has the entity identified any conduct, practice, behaviour or business activity it has engaged in (including by its directors, officers or employees, or by anyone otherwise acting on its behalf) since 1 January 2008, which it considers has fallen below community standards and expectations? If so, what is the nature, extent and effect of that conduct, practice, behaviour or activity?

- 3 If yes to either or both of questions one and two:
 - (a) Is the identified conduct, practice, behaviour or activity the subject of another inquiry or investigation, or a criminal or civil proceeding?

 - (b) Does the entity attribute any of the identified conduct, practice, behaviour or activity to the particular culture or governance practices of the entity? If so, describe that culture or governance practice.

 - (c) Does the entity attribute any of the identified conduct, practice, behaviour or activity to some broader cultural or governance practices in the industry or sector of the industry in which the entity operates? If so, describe those cultural or governance practices.

 - (d) Does the entity consider that the identified conduct, practice, behaviour or activity results from other practices (including risk management, recruitment or remuneration practices)? If so, describe those practices.

 - (e) What steps has the entity taken to:
 - (i) remedy the consequences for consumers or other businesses of the identified conduct, practice, behaviour or activity;

 - (ii) prevent recurrence of conduct, practice, behaviour or activity of the kind identified?

- 4 For an entity that is, or has a connection (other than an incidental connection) to, an RSE licensee of a registrable superannuation entity (as defined in the *Superannuation Industry (Supervision) Act 1993* (Cth)):
 - (a) During each of the past ten years (according to whatever annual reporting periods the entity has employed in the ordinary course of its

operations) to what uses and in what amounts has the entity applied members' funds other than the investment of those funds, the administration of the superannuation fund and the payment of member benefits?

- (b) In respect of each kind of those other applications of members' funds, why was that application in the best interests of members?
- (c) What are the cost centres that make up costs attributed to administration in each of those years?

Providing the answers

Answers to the questions are to be submitted electronically to FSRCSolicitor@royalcommission.gov.au in PDF format that is machine-readable and word-searchable.

Each question is to be answered separately.

The answers should provide the contact details of the officer or officers of the entity from whom further information may be obtained in relation to the answers.

Letter to external dispute resolution and consumer peak bodies

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

As you know, I have been appointed to conduct this Royal Commission. I attach the Commission's Terms of Reference.

I am writing to a number of bodies in the Banking, Superannuation and Financial Services industry to invite each to make an early written submission to the Commission addressing a number of questions. I attach the questions directed to this body. As you would expect, the questions use the language of the Terms of Reference.

Because I have only a short time in which to conduct my inquiries, it will be useful if I may have a response as soon as reasonably practicable. In the first instance, I would ask for your response to questions one and two by 22 January 2018. The response should be comprehensive, but should not exceed 25 pages. I would be grateful then to receive your complete response, including to question three, and any other information you think appropriate, by 5 February 2018. The complete responses should not exceed 50 pages.

It will also be useful if the responses were submitted in the form of machine readable PDF documents sent to the Commission at FSRCSolicitor@royalcommission.gov.au.

[Signed]

K M Hayne

Questions

- 1 What kinds of misconduct by financial services entities occurring since 1 January 2008 has the body identified? What was the nature, prevalence and effect of each of those kinds of misconduct?
- 2 What kinds of conduct, practices, behaviours or business activities by financial services entities occurring since 1 January 2008 has the body identified which it considers have fallen below community standards and expectations? What was the nature, prevalence and effect of each of those kinds of conduct?
- 3 For each of the kinds of conduct, practice, behaviour or activity identified in response to questions one or two:
 - (a) Does the body attribute the identified kind of conduct, practice, behaviour or activity to broader cultural or governance practices in the relevant industry or sector of the relevant industry? If so, describe those cultural or governance practices.
 - (b) Does the body consider that the identified kind of conduct, practice, behaviour or activity results from other practices (including risk management, recruitment or remuneration practices)? If so, describe those practices.
 - (c) To what extent, and in what respects, does the body consider that there are effective mechanisms for redress available to consumers of financial services who suffer detriment as a result of the identified kinds of conduct?

Letter to peak bodies

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

As you know, I have been appointed to conduct this Royal Commission. I attach the Commission's Terms of Reference.

I am writing to a number of representative bodies in the Banking, Superannuation and Financial Services industry to invite each to make an early written submission to the Commission addressing a number of questions. I attach the questions directed to this body. As you would expect, the questions use the language of the Terms of Reference.

I ask that you provide your response no later than 29 January 2018 in the form described in the attachment. The response should be comprehensive, but should not exceed 50 pages.

[Signed]

K M Hayne

Questions

- 1 Excluding cases of theft from member entities, has the body identified or become aware of any misconduct by member entities (including by directors, officers or employees, or by anyone otherwise acting on their behalf) which occurred at any time since 1 January 2008? If so, what was the nature, extent and effect of that misconduct?
- 2 Has the body identified or become aware of any conduct, practice, behaviour or business activity engaged in by member entities (including by directors, officers or employees, or by anyone otherwise acting on their behalf) since 1 January 2008, which it considers has fallen below community standards and expectations?
- 3 If yes to either or both of questions one and two:
 - (a) Is the identified conduct, practice, behaviour or activity the subject of another inquiry or investigation, or a criminal or civil proceeding?
 - (b) Does the body attribute any of the identified conduct, practice, activity or behaviour to broader cultural or governance practices in the relevant industry or sector of the relevant industry? If so, describe those cultural or governance practices.
 - (c) Does the body consider that the identified conduct, practice, behaviour or activity results from other practices (including risk management, recruitment or remuneration practices)? If so, describe those practices.

Providing the answers

Answers to the questions are to be submitted electronically to FSRCSolicitor@royalcommission.gov.au in PDF format that is machine-readable and word-searchable.

Each question is to be answered separately.

The answers should provide the contact details of the officer or officers from whom further information may be obtained in relation to the answers.

Letter to the ACCC

Mr Rod Sims
Chairman
Australian Competition & Consumer Commission
GPO Box 3131
Canberra ACT 2601

Dear Mr Sims

As you will know, I have been appointed to conduct a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. I attach a copy of the Terms of Reference.

It will be of assistance if the ACCC could let me have information about misconduct by financial services entities (as defined in the Terms of Reference).

The information I now seek is information that will tell me what inquiries the ACCC has conducted into misconduct by financial services entities that has occurred since 1 January 2008, what kinds of misconduct have been identified and what steps the ACCC took in response to the identification of misconduct. The information I seek includes (but is not limited to):

- (a) a list of the investigations which the ACCC has made into misconduct by one or more financial services entities that has occurred since 1 January 2008, identifying (in each case) the entity concerned, what misconduct was alleged and what misconduct was identified;
- (b) a list of the court proceedings brought, and of any other activity undertaken by the ACCC in consequence of those investigations.

It would also be of assistance if the ACCC could identify how and where the results of its inquiries are recorded and, if published, where they have been published. If, in addition, the ACCC has other information relevant to my request or considers that there are other matters that should be drawn to my attention, I would be glad to receive that information.

Because I have only a short time in which to conduct my inquiries, it will be useful if I may have a response as soon as reasonably practicable. In the first instance, I would ask for an overview that outlines, to the extent practicable, your answers to the above questions and any other information you think appropriate by 15 January 2018. I would

be grateful to receive your complete response, including any supporting documents, by 5 February 2018.

It will also be useful if the response were submitted in the form of machine readable PDF documents submitted to the Commission at FSRCSolicitor@royalcommission.gov.au.

[Signed]

K M Hayne

Letter to APRA

Mr Wayne Byres
Chairman
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Dear Mr Byres

As you will know, I have been appointed to conduct a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. I attach a copy of the Terms of Reference.

It will be of assistance if APRA could let me have information about misconduct by financial services entities (as those terms are used in the Commission's Terms of Reference).

I am, of course, aware of the provisions of Part 6 of the *Australian Prudential Regulation Authority Act* 1998. In that regard, however, I particularly note the provisions of s 56(5)(b) permitting APRA to approve disclosure of protected information and the production of protected documents to a person approved by APRA by instrument in writing. The disclosure I now seek is disclosure to me, counsel assisting me and the solicitors to the Commission.

I seek information that will tell me first, what APRA has identified as misconduct by financial services entities (other than Lloyd's or Lloyd's underwriters and private health insurers) that has occurred since 1 January 2008; second, what kinds of misconduct APRA has identified; and third, what steps APRA took in response to the identification of misconduct. The information I seek includes (but is not limited to):

- (a) a list of the cases in which APRA formed an opinion that a financial services entity had engaged in misconduct identifying in each case what was the misconduct; and
- (b) a description of the action taken by APRA in relation to each of those cases.

If APRA has other information which it considers relevant to my request, I would be glad to receive it. Similarly, if, in addition to the matters I have raised, there are other matters which APRA considers should be drawn to my attention I would be glad to have them.

Because I have only a short time in which to conduct my inquiries, it will be useful if I may have a response as soon as reasonably practicable. In the first instance, I would ask

for an overview that outlines, to the extent practicable, your answers to the above questions and any other information you think appropriate by 15 January 2018. I would be grateful to receive your complete response, including any supporting documents, by 5 February 2018.

It will also be useful if the response were submitted in the form of machine readable PDF documents submitted to the Commission at
FSRCSolicitor@royalcommission.gov.au.

[Signed]

K M Hayne

Letter to ASIC

Mr Peter Kell
Acting Chairman
Australian Securities & Investments Commission
PO BOX 4000
Gippsland Mail Centre Vic 3841

Dear Mr Kell

As you will know, I have been appointed to conduct a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. I attach a copy of the Terms of Reference.

It will be of assistance if ASIC could let me have information about misconduct by financial services entities (as those terms are used in the Commission's Terms of Reference).

I now seek information that will tell me what inquiries ASIC has conducted into misconduct by financial services entities that has occurred since 1 January 2008, what kinds of misconduct have been identified and what steps ASIC took in response to the identification of misconduct. The information I seek includes (but is not limited to):

- (a) a list of the investigations which ASIC has made into misconduct by one or more financial services entities that has occurred since 1 January 2008, identifying (in each case) the entity concerned, what misconduct was alleged and what misconduct was identified;
- (b) a list of the court proceedings brought, and of any other activity undertaken by ASIC in consequence of those investigations.

It would also be of assistance if ASIC could identify how and where the results of its inquiries are recorded and, if published, where they have been published. If, in addition, ASIC has other information relevant to my request or considers that there are other matters that should be drawn to my attention, I would be glad to receive that information.

Because I have only a short time in which to conduct my inquiries, it will be useful if I may have a response as soon as reasonably practicable. In the first instance, I would ask for an overview that outlines, to the extent practicable, your answers to the above questions and any other information you think appropriate by 15 January 2018. I would be grateful to receive your complete response, including any supporting documents, by 5 February 2018.

It will also be useful if the responses were submitted in the form of machine readable PDF documents submitted to the Commission at FSRCSolicitor@royalcommission.gov.au.

Finally, in order to assist with my inquiries about Australian financial services licensees and authorised representatives of licensees, I also seek from ASIC annual lists of those entities, other than natural persons, registered with ASIC as Australian Financial Services Licensees. When I say “annual lists” I have in mind a list struck at a suitable date (such as calendar or financial year’s end) for each of the last 10 years. If it is practicable, ASIC should provide the lists by way of Excel spreadsheets containing the relevant entity name and its contact details. It would be helpful if I could have at least the more recent lists by 19 December 2017.

[Signed]

K M Hayne

Appendix 3:

Entities sent initial letters

Banks

No.	Entity name
1.	Australia and New Zealand Banking Group
2.	Commonwealth Bank of Australia
3.	National Australia Bank Ltd
4.	Westpac Banking Corporation
5.	Macquarie Bank Limited
6.	HSBC Bank Australia Ltd
7.	AMP Bank Ltd
8.	Bank of Queensland Ltd
9.	Bendigo and Adelaide Bank Ltd
10.	Citigroup Pty Ltd (trading as Citibank and Citi)
11.	ING Bank (Australia) Ltd
12.	Rabobank Australia Ltd
13.	Suncorp Bank

Mortgage brokers

No.	Entity name
14.	Aussie Home Loans
15.	Mortgage Choice Limited
16.	RAMS
17.	Yellow Brick Road
18.	Smartline Personal Mortgage Advisers
19.	1 st Street Home Loans
20.	Loan Market Group Pty Ltd
21.	eChoice Home Loans Pty Ltd

Superannuation entities

No.	Entity name
22.	AustralianSuper Pty Ltd
23.	AMP Superannuation Limited (formerly AXA) (part of AMP)
24.	AON Superannuation Pty Limited
25.	BT Funds Management Limited (part of Westpac Group)
26.	Colonial First State Investments Limited
27.	Colonial Mutual Superannuation Pty Ltd (registered business name of CommInsure)
28.	First State Super
29.	I.O.O.F. Investment Management Limited
30.	QSuper (the largest public sector fund)
31.	Suncorp Portfolio Services Limited
32.	TAL Superannuation Limited
33.	Zurich Australian Superannuation Pty Ltd
34.	AustralianSuper
35.	UniSuper
36.	REST Industry Super
37.	Sunsuper Pty Ltd
38.	H.E.S.T. Australia Ltd.
39.	Host-Plus Pty Ltd
40.	CBUS
41.	CareSuper

Insurers

No.	Entity name
42.	Allianz Australia Insurance Limited
43.	CGU Insurance Limited
44.	QBE Insurance Group
45.	HBF Insurance Pty Ltd
46.	Insurance Australia Limited (also owns CGU)
47.	Suncorp
48.	Zurich Australia Insurance
49.	Commonwealth Insurance Limited (CommInsure)
50.	Westpac General Insurance Limited
51.	Youi Holdings
52.	MLC Life Insurance (part of NAB)
53.	The Colonial Mutual Life Assurance Society Limited (CommInsure)
54.	TAL Life Limited
55.	OnePath Life Limited (part of ANZ)
56.	AMP Life Limited (part of AMP)
57.	Westpac Life Insurance Services Limited (part of Westpac)
58.	MetLife Insurance
59.	Suncorp Life & Superannuation Limited
60.	Zurich Australia Limited
61.	IOOF Ltd

Regulators

No.	Entity name
62.	ASIC
63.	ACCC
64.	APRA

Peak bodies

No.	Entity name
65.	Mortgage and Finance Association of Australia
66.	Finance Brokers Association of Australia Limited
67.	The Association of Financial Advisors
68.	The Financial Planning Association
69.	Financial Rights Legal Centre
70.	CHOICE
71.	Consumer Action Law Centre

External dispute resolution bodies

No.	Entity name
72.	Superannuation Complaints Tribunal
73.	Financial Services Ombudsman
74.	Credit and Investment Ombudsman

Appendix 4: Hearing dates

Round	Dates	Location
Consumer lending	13-Mar-2018 – 23-Mar-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Financial advice	16-Apr-2018 – 27-Apr-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Small and medium enterprises	21-May-2018 – 01-Jun-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Regional and remote communities	25-Jun-2018 – 29-Jun-2018	Brisbane Magistrates Court, 363 George St, Brisbane QLD 4000
	02-Jul-2018 – 06-Jul-2018	Supreme Court of the Northern Territory, Supreme Court Building, State Square, Darwin NT 0800

Appendix 5: Witnesses

Consumer lending

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
1. Karen Cox	1.2	Statement of Karen Cox – 10-Mar-2018	13-Mar-2018	13-Mar-2018
2. Anthony Waldron	1.4	Statement of Anthony Waldron – 02-Mar-2018	13-Mar-2018	13, 14-Mar-2018
	1.18	Exhibits to the Statement of Anthony Waldron – 02-Mar-2018	14-Mar-2018	
3. Angus Gilfillan	1.20	Statement of Angus Gilfillan – 05-Mar-2018	14-Mar-2018	14-Mar-2018
4. Mark Harris	1.24	Statement of Mark Harris – 07-Mar-2018	14-Mar-2018	14-Mar-2018
	1.25	Supplementary statement of Mark Harris – 12-Mar-2018	14-Mar-2018	
5. Daniel Huggins	1.27	Statement of Daniel Huggins – 02-Mar-2018	15-Mar-2018	15-Mar-2018
	1.28	Supplementary statement of Daniel Huggins – 07-Mar-2018	15-Mar-2018	
6. Lynda Harris	1.41	Statement of Lynda Harris – 07-Mar-2018	15-Mar-2018	15, 16-Mar-2018
7. Giles Boddy	1.73	Statement of Giles Boddy – 05-Mar-2018	16-Mar-2018	16-Mar-2018
8. David Smith	1.78	Statement of David Smith – 06-Mar-2018	16-Mar-2018	16-Mar-2018
9. Robert Regan	1.82	Statement of Robert Regan – 08-Mar-2018	16-Mar-2018	16-Mar-2018
10. William Ranken	1.86	Statement of William Ranken – 04-Mar-2018	19-Mar-2018	19-Mar-2018

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
11. Irene Savidis	1.92	Statement of Irene Savidis – 09-Mar-2018	19-Mar-2018	19-Mar-2018
12. Clive van Horen	1.95	Statement of Clive van Horen – 09-Mar-2018	19-Mar-2018	19, 20, 22-Mar-2018
	1.96	Statement of Clive van Horen – 09-Mar-2018	19-Mar-2018	
	1.97	Supplementary statement of Clive van Horen – 05-Mar-2018	19-Mar-2018	
	1.113	Statement of Clive van Horen – 09-Mar-2018	20-Mar-2018	
13. Heang Forbes	1.122	Statement of Heang Forbes – 01-Mar-2018	20-Mar-2018	20-Mar-2018
14. Sarah Mary Stubbings	1.126	Statement of Sarah Stubbings – 05-Mar-2018	20-Mar-2018	20, 21-Mar-2018
15. Nalini Devi Thiruvangadam	1.138	Statement of Nalini Thiruvangadam – 15-Mar-2018	21-Mar-2018	21-Mar-2018
16. Phillip George Godkin	1.141	Statement of Phillip Godkin – 05-Mar-2018	21-Mar-2018	21-Mar-2018
	1.142	Statement of Phillip Godkin – 05-Mar-2018	21-Mar-2018	
17. Guy Samuel Mendelson	1.149	Statement of Guy Mendelson – 04-Mar-2018	22-Mar-2018	22-Mar-2018
18. Michael Saadat	1.158	Statement of Michael Saadat – 05-Mar-2018	22-Mar-2018	1-Jun-2018
19. David James Harris	1.160	Statement of David Harris – 18-Mar-2018	22-Mar-2018	22-Mar-2018
20. Clive van Horen	1.161	Statement of Clive van Horen – 22-Mar-2018	22-Mar-2018	19, 20, 22-Mar-2018
21. William David Malcolm	1.164	Statement of William Malcolm – 19-Mar-2018	23-Mar-2018	23-Mar-2018

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
	1.165	Further statement of William Malcolm – 21-Mar-2018	23-Mar-2018	
22. Carol Separovich	1.178	Statement of Carol Separovich – 12-Mar-2018	23-Mar-2018	23-May-2018
	1.179	Further statement of Carol Separovich – 22-Mar-2018	23-Mar-2018	
23. Gareth Russell	1.181	Statement of Gareth Russell – 22-Mar-2018	23-Mar-2018	N/A
24. Alan Machet	1.183	Witness statement of Alan Machet – 28-Feb-2018	23-Mar-2018	N/A
	1.184	Further statement of Alan Machet – 22-Mar-2018	23-Mar-2018	N/A

Financial advice

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
25. Peter Kell	2.1	Statement of Peter Kell – 12-Apr-2018	16-Apr-2018	16-Apr-2018
26. Donald Sillar	2.3	Statement of Donald Sillar – 11-Apr-2018	16-Apr-2018	N/A
27. Bradley Green	2.4	Statement of Bradley Green – 12-Apr-2018	16-Apr-2018	N/A
28. Hugh Humphrey	2.5	Statement of Hugh Humphrey – 13-Apr-2018	16-Apr-2018	N/A
29. Mark Ballantyne	2.6	Statement of Mark Ballantyne – 13-Apr-2018	16-Apr-2018	N/A
30. Linda Elkins	2.7	Statement of Linda Elkins – 13-Apr-2018	16-Apr-2018	18-Apr-2018
	2.71	Witness statement of Linda Elkins – 05-Apr-2018	18-Apr-2018	
31. Ross Barnwell	2.8	Statement of Ross Barnwell – 13-Apr-2018	16-Apr-2018	N/A
32. Matthew Lawrance	2.9	Statement of Matthew Lawrance – 15-Apr-2018	16-Apr-2018	N/A
33. Michael Wright	2.10	Statement of Michael Wright – 16-Apr-2018	16-Apr-2018	19, 20-Apr-2018
34 Constandina Kotsopoulos	2.11	Statement of Constandina Kotsopoulos – 16-Apr-2018	16-Apr-2018	N/A
35. Anthony Regan	2.13	Statement of Anthony Regan – 11-Apr-2018	16-Apr-2018	16, 17-Apr-2018
	2.171	Statement of Anthony Regan – 11-Apr-2018	23-Apr-2018	
36. Marianne Perkovic	2.73	Statement of Marianne Perkovic – 03-Apr-2018	18-Apr-2018	18, 19-Apr-2018

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
	2.74	Supplementary statement of Marianne Perkovic – 04-Apr-2018	18-Apr-2018	
	2.75	Further statement of Marianne Perkovic – 03-Apr-2018	18-Apr-2018	
	2.76	Further statement of Marianne Perkovic – 04-Apr-2018	18-Apr-2018	
	2.77	Further statement Marianne Perkovic – 03-Apr-2018	18-Apr-2018	
	2.78	Further statement of Marianne Perkovic – 09-Apr-2018	18-Apr-2018	
	2.79	Further statement of Marianne Perkovic – 05-Apr-2018	18-Apr-2018	
	2.172	Statement of Marianne Perkovic – 13-Apr-2018	23-Apr-2018	
	2.196	Statement of Marianne Perkovic – 13-Apr-2018	24-Apr-2018	
37. Darren Williams	2.92	Statement of Darren Williams – 13-Apr-2018	19-Apr-2018	N/A
38. Adrian Kwa	2.93	Statement of Adrian Kwa – 10-Apr-2018	19-Apr-2018	N/A
39. Sarah Britt	2.94	Statement of Sarah Britt – 10-Apr-2018	19-Apr-2018	23 Apr-2018
	2.161	Statement of Sarah Britt – 10-Apr-2018	23-Apr-2018	
40. Mark Pankhurst	2.95	Statement of Mark Pankhurst – 13-Apr-2018	19-Apr-2018	N/A
41. Cameron Garrett	2.96	Statement of Cameron Garrett – 14-Apr-2018	19-Apr-2018	N/A

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
42. Michelle Weber	2.97	Statement of Michelle Weber – 16-Apr-2018	19-Apr-2018	N/A
43. Jacqueline McDowall	2.98	Statement of Jacqueline McDowall – 04-Apr-2018	19-Apr-2018	19-Apr-2018
44. Michael Wright	2.101	Statement of Michael Wright – 05-Apr-2018	19-Apr-2018	19, 20-Apr-2018
	2.102	Second statement of Michael Wright – 05-Apr-2018	19-Apr-2018	
45. Darren Whereat	2.129	Statement of Darren Whereat – 05-Apr-2018	20-Apr-2018	20-Apr-2018
46. Kylie Rixon	2.152	Statement of Kylie Rixon – 05-Apr-2018	23-Apr-2018	23-Apr-2018
	2.153	Supplementary statement of Kylie Rixon – 18-Apr-2018	23-Apr-2018	
47. Renato Mota	2.173	Statement of Renato Mota – 12-Apr-2018	23-Apr-2018	N/A
48. Michelle Weber	2.174	Statement of Michelle Weber – 13-Apr-2018	23-Apr-2018	N/A
	2.175	Second statement of Michelle Weber – 13-Apr-2018	23-Apr-2018	
49. Marti Crane	2.176	Statement of Marti Carne – 13-Apr-2018	23-Apr-2018	N/A
50. Andrew Hagger	2.178	Statement of Andrew Hagger – 05-Apr-2018	23-Apr-2018	23, 24-Apr-2018
	2.179	Statement of Andrew Hagger – 13-Apr-2018	23-Apr-2018	
51. Kieran Forde	2.194	Statement of Kieran Forde – 12-Apr-2018	24-Apr-2018	24-Apr-2018
	2.195	Supplementary statement of Kieran Forde – 23-Apr-2018	24-Apr-2018	
52. Donna McKenna	2.197	Statement of Ms McKenna – 16-Apr-2018	24-Apr-2018	24-Apr-2018

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
53. Sam Henderson	2.200	Statement of Sam Henderson – 29-Mar-2018	24-Apr-2018	24-Apr-2018
	2.201	Second statement of Sam Henderson – 05-Apr-2018	24-Apr-2018	
	2.202	Corrections to statements of Sam Henderson (Exhibit 2.200 and 2.201) – 29-Mar-2018	24-Apr-2018	
54. Dante De Gori	2.219	Statement of Dante De Gori – 20-Apr-2018	26-Apr-2018	26-Apr-2018
55. Philip Kewin	2.230	Statement of Philip Kewin – 04-Apr-2018	26-Apr-2018	26-Apr-2018
56. Terrence McMaster	2.236	Statement of Terrence McMaster – 10-Apr-2018	26-Apr-2018	26-Apr-2018
57. Louise Macaulay	2.247	Statement of Louise Macaulay – 25-Apr-2018	27-Apr-2018	27-Apr-2018

Small and medium enterprises

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
58. Philip Khoury	3.4	Statement of Philip Khoury – 18-May-2018	21-May-2018	21-May-2018
59. Carolyn Flanagan	3.6	Statement of Carolyn Flanagan – 14-May-2018	21-May-2018	21-May-2018
60. Dana Beiglari	3.8	Statement of Dana Beiglari – 16-May-2018	21-May-2018	21-May-2018
61. Alastair Welsh	3.10	Statement of Alastair Welsh (Rubric 3-12) –15-May-2018	21-May-2018	21, 22-May-2018
	3.22	Statement of Alastair Welsh (Rubric 3-11) –19-May-2018	23-May-2018	
	3.59	Statement of Alastair Welsh (Rubric 3-10) –17-May-2018	25-May-2018	
	3.132	Statement of Alastair Welsh (Rubric 3-3) – 08-May-2018	30-May-2018	
62. Kate Gibson	3.15	Statement of Kate Gibson (Rubric 3-7) –17-May-2018	22-May-2018	22, 23-May-2018
63. Marion Messih	3.17	Statement of Marion Messih – 16-May-2018	22-May-2018	22-May-2018
64. Carol Separovich	3.27	Statement of Carol Separovich (Rubric 3-10) – 21-May-2018	23-May-2018	23-May-2018
	3.28	Statement of Carol Separovich (Rubric 3-11) – 21-May-2018	23-May-2018	
65. Suzanne Riches	3.30	Statement of Suzanne Riches – 18-May-2018	23-May-2018	23-May-2018
66. Douglas Snell	3.34	Statement of Douglas Snell (Rubric 3-8) – 15-May-2018	24-May-2018	24-May-2018

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
	3.133	Statement of Douglas Snell (Rubric 3-6) – 08-May-2018	30-May-2018	
67. Clive van Horen	3.42	Statement of Clive van Horen (Rubric 3-15) – 15-May-2018	24-May-2018	24-May-2018
	3.43	Statement of Clive van Horen (Rubric 3-16) – 14-May-2018	24-May-2018	
68. Bradley Wallis	3.54	Statement of Bradley Wallis – 22-May-2018	24-May-2018	24-May-2018
69. Rien Low	3.73	Statement of Rien Low – 23-May-2018	25-May-2018	25-May-2018
70. David Carter	3.75	Statement of David Carter (Rubric 3-21) – 21-May-2018	25-May-2018	25-May-2018
71. Philip Field	3.84	Witness statement of Philip Field (Part A) – 18-May-2018	28-May-2018	28-May-2018
	3.85	Witness statement of Philip Field (Part B) – 18-May-2018	28-May-2018	
72. Michael Kelly	3.88	Statement of Michael Kelly – 24-May-2018	28-May-2018	28-May-2018
73. Brett Perry	3.93	Statement of Brett Perry (Rubric 3-26) – 18-May-2018	28-May-2018	28-May-2018
74. Stephen Weller	3.97	Statement of Stephen Weller – 21-May-2018	28-May-2018	28-May-2018
75. Michael Doherty	3.99	Statement of Michael Doherty – 24-May-2018	28-May-2018	28, 29-May-2018
76. Peter Clark	3.101	Statement of Peter Clark (Rubric 3-24) – 27-May-2018	29-May-2018	29-May-2018
	3.102	Statement of Peter Clark (Rubric 3-25) – 27-May-2018	29-May-2018	
77. Sinead Taylor	3.104	Statement of Sinead Taylor (Rubric 3-13) – 17-May-2018	29-May-2018	28, 29-May-2018

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
	3.134	Statement of Sinead Taylor (Rubric 3-1) – 08-May-2018	30-May-2018	
78. Brendan Stanford	3.106	Statement of Brendan Stanford – 24-May-2018	29-May-2018	29-May-2018
79. David Cohen	3.111	Statement of David Cohen (Rubric 3-13) – 17-May-2018	29-May-2018	29-May-2018
	3.112	Statement of David Cohen (Rubric 3-13) – 17-May-2018	29-May-2018	
80. Issac Rankin	3.129	Statement of Isaac Rankin (Rubric 3-2) – 08-May-2018	30-May-2018	N/A
81. Joanna White	3.130	Statement of Joanna White (Rubric 3-1) – 08-May-2018	30-May-2018	N/A
82. Howard Silby	3.131	Statement of Howard Silby (Rubric 3-4) – 23-May-2018	30-May-2018	N/A
	3.184	Statement of Howard Silby (Rubric 3-19) – 22-May-2018	01-Jun-2018	
83. Ross Dillion	3.136	Statement of Ross Dillon – 28-May-2018	30-May-2018	30, 31-May-2018
84. Shaun Bassett	3.137	Statutory declaration of Shaun Bassett – 18-May-2018	31-May-2018	31-May-2018
85. Ross McNaughton	3.140	Statement of Ross McNaughton – 22-May-2018	31-May-2018	31-May-2018
86. Anna Bligh	3.144	Statement of Anna Bligh – 17-May-2018	31-May-2018	31-May-2018
87. Brian Zacharias	3.145	Statement of Brian Zacharias (Rubric 3-6) – 15-May-2018	31-May-2018	N/A
88. Sean Cash	3.146	Statement of Sean Cash (Rubric 3-4) – 16-May-2018	31-May-2018	N/A
89. Chris Williams	3.147	Statement of Chris Williams (Rubric 3-1) – 16-May-2018	31-May-2018	N/A

Witness	Exhibit no.	Statement	Tendered	Oral evidence given
90. Kate Gibson	3.148	Statement of Kate Gibson (Rubric 3-2) – 17-May-2018	31-May-2018	22, 23-May-2018
91. Ivan Mardjetko	3.149	Statement of Ivan Mardjetko (Rubric 3-4) – 16-May-2018	31-May-2018	N/A
92. Kristen O'Donoghue	3.151	Statement of Kirsten O'Donoghue – 18-May-2018	31-May-2018	31-May-2018
93. Steven Kluss	3.157	Statement of Steven Kluss – 28-May-2018	31-May-2018	31-May-2018
94. Scott Gregson	3.160	Statement of Scott Gregson – 23-May-2018	31-May-2018	31-May-2018
95. Michael Saadat	3.162	Statement of Michael Saadat – 18-May-2018	1-Jun-2018	1-June-2018
	3.163	Further statement of Michael Saadat – 24-May-2018	1-Jun-2018	
96. Timothy Mullaly	3.171	Statement of Timothy Mullaly – 30-May-2018	1-Jun-2018	1-Jun-2018

Regional and remote communities

Witness	Exhibit no.	Statement	Date tendered	Date/s oral evidence given
97. Dennis McMahon	4.2	Statement of Dennis McMahon – 19-Jun-2018	25-Jun-2018	25-Jun-2018
98. Chris Wheatcroft	4.4	Statement of Chris Wheatcroft – 15-Jun-2018	25-Jun-2018	25-Jun-2018
99. Warren Day	4.6	Statement of Warren Day – 08-Jun-2018	25-Jun-2018	25-Jun-2018
100. Benjamin Steinberg	4.8	Statement of Benjamin Steinberg (Rubric 4-1) – 18-Jun-2018	25-Jun-2018	25, 26, 27-Jun-2018
	4.9	Statement of Benjamin Steinberg (Rubric 4-20) – 20-Jun-2018	25-Jun-2018	
	4.9A	Benjamin Steinberg Annexure A – 20-Jun-2018	25-Jun-2018	
	4.9B	Benjamin Steinberg Annexure B – 20-Jun-2018	25-Jun-2018	
	4.9C	Benjamin Steinberg Annexure C – 20-Jun-2018	25-Jun-2018	
	4.9D	Benjamin Steinberg Annexure D – 20-Jun-2018	25-Jun-2018	
	4.9E	Benjamin Steinberg Annexure E – 20-Jun-2018	25-Jun-2018	
	4.10	Statement of Benjamin Steinberg (Rubric 4-38) – 21-Jun-2018	25-Jun-2018	
	4.10F	Benjamin Steinberg Annexure F – 21-Jun-2018	25-Jun-2018	
	4.10G	Benjamin Steinberg Annexure G – 21-Jun-2018	25-Jun-2018	

Witness	Exhibit no.	Statement	Date tendered	Date/s oral evidence given
	4.11	Supplementary statement of Benjamin Steinberg (Rubric 4-38) – 22-Jun-2018	25-Jun-2018	
	4.20	Statement of Benjamin Steinberg (Rubric 4-17) – 18-Jun-2018	26-Jun-2018	
101. Wendy Brauer	4.31	Statement of Wendy Brauer – 21-Jun-2018	27-Jun-2018	27-Jun-2018
102. Bradley James	4.33	Statement of Bradley James (Rubric 4-16) – 15-Jun-2018	27-Jun-2018	27, 28-Jun-2018
	4.34	Supplementary statement of Bradley James (Rubric 4-16) – 22-Jun-2018	27-Jun-2018	
103. Melville Ruddy	4.90	Statement of Melville Ruddy – 21-Jun-2018	28-Jun-2018	28-Jun-2018
104. Sinead Taylor	4.92	Statement of Sinead Taylor – 24-Jun-2018	28-Jun-2018	28, 29-May-2018
105. Deborah Smith	4.110	Statement of Deborah Smith – 22-Jun-2018	29-Jun-2018	29-Jun-2018
106. Ross McNaughton	4.112	Statement of Ross McNaughton – 18-Jun-2018	29-Jun-2018	29-June-2018
	4.113	Supplementary statement of Ross McNaughton – 25-Jun-2018	29-Jun-2018	
107. Alexandra Gartmann	4.121	Statement of Alexandra Gartmann (Rubric 4-36) – 20-Jun-2018	02-Jul-2018	2-Jul-2018
108. Grant Cairns	4.133	Statement of Grant Cairns – 16-Jun-2018	02-Jul-2018	N/A
109. Mark Wlossak	4.134	Statement of Mark Wlossak – 19-Jun-2018	02-Jul-2018	N/A
110. Johanna White	4.135	Statement of Johanna White – 21-Jun-2018	02-Jul-2018	N/A

Witness	Exhibit no.	Statement	Date tendered	Date/s oral evidence given
	4.136	Statement of Johanna White – 29-Jun-2018	02-Jul-2018	
111. Nathan Boyle	4.138	Statement of Nathan Boyle – 25-Jun-2018	03-Jul-2018	03-Jul-2018
112. Lynda Edwards	4.140	Statement of Lynda Edwards – 22-Jun-2018	03-Jul-2018	03-Jul-2018
113. Tracey Walsh	4.144	Statement of Tracey Walsh – 26-Jun-2018	03-Jul-2018	03-Jul-2018
114. Bryn Jones	4.146	Statement of Bryn Jones – 13-Jun-2018	03-Jul-2018	03, 04-Jul-2018
	4.147	Statement of Bryn Jones – 11-Jun-2018	03-Jul-2018	
115. Kathy Marika	4.171	Statement of Kathy Marika – 19-Jun-2018	04-Jul-2018	04-Jul-2018
116. Russell Howden	4.173	Statement of Russell Howden (Rubric 4-23) – 13-Jun-2018	04-Jul-2018	04, 05-Jul-2018
	4.174	Statement of Russell Howden (Rubric 4-31) – 13-Jun-2018	04-Jul-2018	
	4.175	Statement of Russell Howden (Rubric 4-42) – 28-Jun-2018	04-Jul-2018	
117. Thy Do	4.198	Statement of Thy Do – 30-Jun-2018	05-Jul-2018	05-Jul-2018
118. Philip Bowden	4.200	Statement of Phillip Bowden – 04-Jul-2018	05-Jul-2018	05-Jul-2018
119. Tony Tapsall	4.202	Statement of Tony Tapsall (Rubric 4-13) – 21-Jun-2018	05-Jul-2018	05, 06-Jul-2018
	4.204	Statement of Tony Tapsall (Rubric 4-41) – 25-Jun-2018	05-Jul-2018	
	4.205	Supplementary statement of Tony Tapsall – 04-Jul-2018	05-Jul-2018	

Witness	Exhibit no.	Statement	Date tendered	Date/s oral evidence given
120. Sian Lewis	4.220	Statement of Sian Lewis – 28-Jun-2018	06-Jul-2018	N/A
121. Robert Musgrove	4.221	Statement of Robert Musgrove – 15-Jun-2018	06-Jul-2018	N/A
122. Anthony Hampton	4.222	Statement of Anthony Hampton – 19-Jun-2018	06-Jul-2018	N/A
123. Gavin Teichner	4.223	Statement of Gavin Teichner – 22-Jun-2018	06-Jul-2018	N/A

Appendix 6: Exhibits

Consumer lending

Day 2 – 13 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.1	Summons to Karen Margaret Cox	50
1.2	Statement of Karen Margaret Cox	50
1.3	Summons to Anthony John Waldron	63
1.4	Statement of Anthony John Waldron dated 02-Mar-2018	64
1.5	Email from Windridge to Bosnich dated 02-Apr-2015	94
1.6	ASIC Regulatory Guide, RG78	106

Day 3 – 14 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.7	Notice to Produce Numbered NP006 to the Proper Officer NAB dated 07-Feb-2018	115
1.8	NAB Minutes Principal Board Risk Committee Meeting Minutes dated 04-Nov-2016	116
1.9	Task Force Summary	125
1.10	Entitled People Update	127
1.11	LSR Report dated 30-Mar-2016	137
1.12	Memo for Personal Bank Risk Committee dated May 2016	179
1.13	Page 5 of the NAB Group Response dated 29-Jan-2018	185
1.14	Email from Alex Milliss to Fiona Lynch dated 16-Oct-2015	186
1.15	NAB Media Release dated 16-Nov-2017	186
1.16	NAB Group Short Term Incentive Plan for 2017 to 2018	186
1.17	Media article entitled NAB Retail and Call Centre Staff to be Rewarded for Great Customer Outcomes dated 01-Aug-2017	187
1.18	Exhibits to Mr Waldron's Statement dated 02-Mar-2018	187

Exhibit no.	Exhibit	Page no. from transcript
1.19	Summons to Mr Gilfillan	197
1.20	Statement of Angus Gilfillan with 36 attachments dated 05-Mar-2018	197
1.21	Ernst & Young Report dated April 2017	203
1.22	Letter to APRA dated 15-Sept-2017	208
1.23	Summons to Mark Andrew Harris	216
1.24	Statement of Mark Andrew Harris dated 07-Mar-2018	216
1.25	Statement of Mark Andrew Harris dated 12-Mar-2018	216

Day 4 – 15 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.26	Summons to Daniel James Huggins	230
1.27	Witness statement of Daniel James Huggins dated 02-Mar-2018	230
1.28	Supplementary witness statement of Daniel James Huggins dated 07-Mar-2018	230
1.29	ACA Research identifying Optimal Mortgage Broker Commission Structure	251
1.30	Mortgage Broker Head Group Review Working Parties	265
1.31	Draft Deaccreditation Letter dated 20-Feb-2017	277
1.32	Standard Form Notice of Revocation of Authority to Act	277
1.33	Reputational Impact Brief dated 10-Mar-2017	279
1.34	Reputational Impact Brief dated 11-Apr-2017	281
1.35	Email Huggins to Vaswani dated 24-Feb-2017	284
1.36	Email Baseley to Boer dated 24-Feb-2017	286
1.37	Letter from Mr Narev to Mr Sedgwick dated 10-Feb-2017 and the Annexed Issues Paper Submission dated 10-Feb-2017	288
1.38	Internal Audit Report dated 16-Aug-2017	296
1.39	Issues Logs dated September 2017	302

Exhibit no.	Exhibit	Page no. from transcript
1.40	Summons to Lynda Harris	310
1.41	Statement of Lynda Harris with Exhibits dated 07-Mar-2018	311
1.42	Email from McKenzie to MacDonald dated 08-Aug-2013	324
1.43	Email from McKenzie dated 09-Aug-2013	324
1.44	Contract of Shiv Sahay	325
1.45	Incident Report	325
1.46	Email from Melissa Good to Melanie Tomkins dated 19-Sep-2013	325
1.47	Email to McKenzie and accompanying emails	326
1.48	Bankwest Broker Investigation dated 17-Sep-2013	328
1.49	Email from Rakhit to McKenzie dated 17-Sep-2013	328
1.50	Action Plan email from Klenner to Symond and others dated 13-Sep-2013	330

Day 5 – 16 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.51	Panel Lender summary dated 12-Nov-2013	338
1.52	Email from Fitzgerald to Meekin dated 10-Dec-2013	339
1.53	Email from Tomkins to Rasby dated 10-Dec-2013	343
1.54	Email from Kennedy dated 03-Feb-2014	346
1.55	Email from Matthew Whyte to Joanne Gilbey dated 07-Mar-2014	355
1.56	Email to McKenzie and associated email dated 13-Mar-2014	356
1.57	Email from Howell to Whyte and associated emails dated 26-Mar-2014	358
1.58	ASIC Cessation of Credit Representative Form dated 10-Apr-2014	360
1.59	Aussie response to ASIC letter dated 13-Oct-2014	361
1.60	Email from Whyte to Gilbey dated 24-Jun-2014	366
1.61	Email from Gilbey to Whyte dated 24-Jun-2014	367

Exhibit no.	Exhibit	Page no. from transcript
1.62	Email from Gilbey to Whyte dated 25-Jun-2014	368
1.63	Termination letter from AHL to Nair dated 07-Jul-2014	369
1.64	Document entitled Matter of Bernie Meehan, overview dated 10-Feb-2015	374
1.65	AHL Incident Report dated 20-Feb-2015	376
1.66	Letter from Aussie to MFAA dated 10-Apr-2015	378
1.67	Contract between AHL and Nair dated 03-Sep-2008	380
1.68	Contract between AHL and Khalil dated 27-Jun-2007	382
1.69	Copy letter from AHL to ASIC re Meehan dated 10-Apr-2015	386
1.70	Letter from ASIC to AHL dated 23-Sep-2014	386
1.71	Findings from Risk Culture Workshops dated 11-Feb-2016	389
1.72	Summons to Giles Edward Boddy	390
1.73	Witness statement of Giles Edward Boddy dated 05-Mar-2018	391
1.74	Group Audit and Assurance Internal Audit Report dated 11-Dec-2017	410
1.75	Risk Culture Summary dated 17 November	416
1.76	CBA Audit Committee Report Paper Number 12 dated 05-Feb-2018	421
1.77	AHL Responsible Lending Policy	423
1.78	Statement of David Lee Smith dated 06-Mar-2018	432
1.79	Summons to David Lee Smith	433
1.80	Paragraphs 170 to 177 of CBA Submission	433
1.81	Summons for Robert Emmett Regan	434
1.82	Statement of Robert Emmett Regan dated 08-Mar-2018	435
1.83	Email dated 09-Mar-2018	447
1.84	Email from ANZ to CALC dated 15-Mar-2018	447

Day 6 – 19 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.85	Summons to William Andrew Ranken	453
1.86	Witness statement of William Andrew Ranken	454
1.87	KPMG Targeted Review 2016/2017	476
1.88	ANZ to Horton and APRA	477
1.89	Loan Review Regan dated 15-Feb-2018	482
1.90	Log of Assessor's comments re Regan	486
1.91	Summons to Irene Savidis	492
1.92	Statement of Irene Savidis dated 09-Mar-2018	492
1.93	Card from CommInsure to Savidis received 28-Feb-2018	499
1.94	Summons to Clive Richard van Horen	500
1.95	Statement of Clive van Horen	501
1.96	Statement of Clive van Horen in relation to Ms Savidis	502
1.97	Supplementary statement of Clive Richard van Horen	n/a
1.98	KPI Direct Banking Financial Year FY2016	508
1.99	ASIC Report numbered 256	513
1.100	Unemployed EGM Update dated 06-Feb-2017	532
1.101	ASIC Media Release MR17-268	536
1.102	Risk Insight Incident Report dated 31-May-2017	545
1.103	ASIC File Note 21 dated 21-Sep-2017	550
1.104	Email Shafir to Comyn and others dated 27-Sep-2017	551
1.105	Email Troup to Narev and associated emails dated 04-Oct-2017	555
1.106	APOLLO II dated 04-Oct-2017	556
1.107	Paragraphs 131 to 138 of CBA Group Response dated 29-Jan-2018	558
1.108	Email Troup to Kerins and others dated 05-Mar-2018	559
1.109	CBA Media Release dated 07-Mar-2018	560
1.110	Draft memo re CCI Troup and van Horen dated 04-Mar-2018	562
1.111	Life Product Strategy Bank Channel Distribution dated 05-Mar-2018	565
1.112	Emails between van Horen and Comyn dated 28-Feb-2018	569

Day 7 – 20 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.113	Statement of Mr Clive Richard van Horen dated 09-Mar-2018	582
1.114	Retail Banking Services Report dated 12-Aug-2013	599
1.115	Letter from CBA to ASIC dated 21-Oct-2014	600
1.116	Risk Management Leadership Team Purpose and Operating Principles dated 29-Jun-2016	602
1.117	Gender Risk Management Leadership Team dated 06-Jul-2016	606
1.118	Email from Fiona Larnach to David Cohen dated 23-Aug-2016	614
1.119	Agenda Data Governance Committee dated 17-Oct-2016	616
1.120	Paragraph 56 of CBA Response dated 13-Feb-2018	620
1.121	Summons to Heang Forbes	623
1.122	Witness statement of Heang Forbes	624
1.123	Extract from ANZ Response to 2 February 2018 Inquiry	646
1.124	Email from ANZ to ASIC dated 19-Jan-2017	646
1.125	Summons to Sarah Stubbings	648
1.126	Witness statement of Sarah Mary Stubbings (and attached Exhibits)	649
1.127	Items 134, 135, 137, 138 and 151 of ANZ Response to 2 February 2018 Inquiry	653
1.128	PWC Report Mortgage, Breakfree and Offset Remediation Program dated 29-Nov-2013	658
1.129	Report of CEO to Board	662
1.130	Audit Committee Report Year End of 30 September 2010, KPMG	663
1.131	ASIC Briefing Pack	671
1.132	PWC QA Review dated 30-Sep-2013	674
1.133	Key Learnings Document dated April 2014	678
1.134	Operational Risk Executive Committee Agenda dated 16-Nov-2012	680

Day 8 – 21 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.135	Notice to Produce NP078, directed to ANZ	689
1.136	Offset Remediation Project Summary dated 20-Feb-2018	696
1.137	Summons to Nalini Devi Thiruvangadam	717
1.138	Statement of Nalini Devi Thiruvangadam	717
1.139	St George Sovereign screenshot dated 24-Jul-2012	730
1.140	Summons to Phillip George Godkin	731
1.141	Statement of Phillip George Godkin dated 05-Mar-2018	732
1.142	Witness statement of Phillip George Godkin dated 05-Mar-2018	732
1.143	Compliance Assessment Summary	746
1.144	Group Assurance Report	759
1.145	Page from the Second Line Controls Assurance Memo dated 24-Feb-2017	768
1.146	Memorandum to CEO Westpac Banking Corporation dated 22-Sep-2016	786
1.147	Page from the Board Risk and Compliance Committee dated 24-Apr-2017	787

Day 9 – 22 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.148	Summons to Guy Samuel Mendelson	796
1.149	Witness statement of Mr Mendelson and exhibits	796
1.150	Paragraphs 6.46 to 6.52 of ANZ Submission in response to Commission Letters at 0030 to 0031 dated 15-Dec-2017	799
1.151	Circular letter Esanda to Accredited Dealers dated 5-Dec-2014	814
1.152	ANZ Media Release dated 16-Mar-2018	848
1.153	Minutes Operating Risk Executive Committee ANZ dated 12-Feb-2018	850

Exhibit no.	Exhibit	Page no. from transcript
1.154	Chief Risk Officer Report dated 21-Feb-2018	856
1.155	Dealer Contract	857
1.156	Business Partnership and Dealer Arrangement Form	857
1.157	Summons to Michael Saadat	858
1.158	Statement of Michael Saadat dated 05-Mar-2018	858
1.159	Summons to David James Harris	862
1.160	Statement of David James Harris	862
1.161	Statement of Mr van Horen	869
1.162	Credit Card Repayment Calculator	893

Day 10 – 23 March 2018

Exhibit no.	Exhibit	Page no. from transcript
1.163	Summons to William David Malcolm	905
1.164	Statement of William David Malcolm dated 19-Mar-2018	905
1.165	Further statement of William David Malcolm dated 21-Mar-2018	906
1.166	Westpac response Paragraph B Credit Cards dated 29-Jan-2018	910
1.167	Further submission of Westpac Item 26	910
1.168	Email from Love to Malcolm dated 27-Mar-2011	913
1.169	2013 Code of Banking Practice	925
1.170	Letter ASIC to ABA dated 12-Sep-2012	928
1.171	WBC email re ASIC Letter dated 05-Oct-2012	931
1.172	ASIC letter to Westpac dated 13-Jan-2014	941
1.173	Letter WBC to ASIC re Section 253 Notice dated 23-Aug-2014	942
1.174	Letter Westpac to ASIC dated 20-Feb-2015	943
1.175	ASIC Speaking Notes for Meeting with Chairman of Westpac dated 28-May-2015	951
1.176	ASIC Note dated 18-Jun-2015	955

Exhibit no.	Exhibit	Page no. from transcript
1.177	Memorandum dated 04-Sep-2015	957
1.178	Statement of Carol Separovich dated 12-Mar-2018	963
1.179	Further statement of Carol Separovich dated 22-Mar-2018	963
1.180	Summons to Carol Separovich	964
1.181	Statement of Gareth Robin William Russell dated 22-Mar-2018	964
1.182	Summons to Gareth Robin William Russell	964
1.183	Witness statement of Alan Saul Machet dated 28-Feb-2018	964
1.184	Further statement of Alan Saul Machet dated 22-Mar-2018	965
1.185	Summons to Alan Saul Machet	965
1.186	Letter from Westpac to ASIC dated 12-Jul-2016	966
1.187	Draft ASIC Report entitled Car Loan Commissions and Consumer Credit Regulation (undated but agreed as being issued in 2013)	966
1.188	Sovereign screen prints relevant to Mrs Thiruvangadam's Loan Commencing 24-Jul-2012	966
1.189	Letter from Westpac to APRA dated 15-Sep-2017	967
1.190	Report for Westpac from PWC dated May 2017 as part of APRA Targeted Review	967
1.191	Memo to Westpac Board, Risk and Compliance Committee in respect of the APRA Targeted Review dated 29-Jul-2017	967
1.192	Memo to Westpac Board regarding Mortgage Responsible Lending Update dated 25-Aug-2017	967
1.193	Document entitled Attachment 1: Westpac Response to Targeted Review Findings	967
1.194	Email entitled Westpac Targeted Review Report dated 25-May-2017	968
1.195	Spreadsheet entitled Information Requested by APRA in Attachment B	968
1.196	Letter from CBA to APRA dated 15-Sep-2017	968

Exhibit no.	Exhibit	Page no. from transcript
1.197	PWC Report for CBA as part of the APRA Targeted Review dated May 2017	968
1.198	Code of Practice of the Mortgage & Finance Association of Australia	969
1.199	Current Version of the Banking Code of Practice	969
1.200	Witness statement of Lynda Maree Dean dated 15-Aug-2018	NA
1.201	Witness statement of Daniel James Huggins dated 26-Jul-2018	NA

Financial advice

Day 11 – 16 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.1	Statement of Peter Kell dated 12-Apr-2018	1030
2.2	Summons to Peter Kell	1030
2.3	Statement of Mr Donald Sillar dated 11-Apr-2018	1046
2.4	Statement of Bradley John Green dated 12-Apr-2018	1048
2.5	Statement of Mr Hugh Humphrey dated 13-Apr-2018	1048
2.6	Statement of Mr Mark Robert Ballantyne dated 13-Apr-2018	1049
2.7	Statement of Ms Linda Maree Elkins dated 13-Apr-2018	1049
2.8	Statement of Mr Ross Andrew Barnwell dated 13-Apr-2018	1051
2.9	Statement of Matthew Russell Lawrance dated 15-Apr-2018	1051
2.10	Statement of Mr Michael Wright dated 16-Apr-2018	1052
2.11	Statement of Ms Constandina Kotsopoulos dated 16-Apr-2018	1052
2.12	Summons to Anthony George Regan	1054
2.13	Statement of Anthony George Regan	1055
2.14	Emails of January 2011 concerning approval of dial-up fees for Buyer of Last Resort	1082
2.15	Future Financial Advice Program Steering Committee Pack dated 06-May-2013	1084
2.16	2010 email Galletta to Steinthal	1086
2.17	Email Turner to Marsh and Morgan re ongoing service fees BOLR and Orphans dated 19-May-2015	1089
2.18	Email Morgan to Caprioli and others dated 20-May-2015	1089
2.19	Letter AMP to ASIC dated 19-Jun-2015	1092
2.20	Letter AMP to ASIC dated 31-Aug-2015	1093
2.21	Letter AMP to ASIC dated 17-Aug-2015	1096
2.22	PowerPoint presentation AMP to ASIC dated 17-Sep-2015	1097
2.23	Letter AMP to ASIC	1099

Day 12 – 17 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.24	PWC AMP Financial Advice Review dated 30-Mar-2015	1108
2.25	Letter AMP to ASIC dated 23-Jun-2015	1109
2.26	Emails between Morgan, Guggenheimer and others dated 12-Jun-2015	1113
2.27	Letter AMP to ASIC dated 26-Nov-2015	1118
2.28	Letter AMP to ASIC dated 14-Dec-2015	1120
2.29	Emails between Marsh, Collins and others dated 11-Nov-2016	1123
2.30	Emails Baker Cook to Mavrakis and others dated 21-Jun-2017	1124
2.31	Practice Propositions Project Steering Committee Pack dated 24-May-2013	1132
2.32	FOFA Practice Proposition Stream Orphan Contracts Document Version 1.2 dated 21-May-2013	1134
2.33	Emails Rakich to Parra and others dated 14-Jun-2013	1141
2.34	Decision Log Spreadsheet re Meeting dated 24-May-2013	1142
2.35	Emails between Byrne and Marsh and others dated 30-Aug-2013	1148
2.36	PowerPoint presentation Client Transfer Policies and Processes	1148
2.37	Fee Remediation Outbound Call Script dated January 2016	1156
2.38	Agenda, Advice Culture and Compliance Board Committee dated 15-Dec-2017	1163
2.39	Meeting Pack Advice Culture and Compliance Board Committee dated 23-Jan-2018	1164
2.40	Meeting Pack Advice Culture and Compliance Board Committee dated 16-Feb-2018	1166
2.41	Group Risk and Compliance Committee Meeting Pack, Meeting 4 of 2015	1167
2.42	Group Risk and Compliance Committee Meeting Papers dated 14-Nov-2016	1168
2.43	Emails between Baker Cook and Zhang dated 17-Oct-2017	1173
2.44	Notice to Produce AMP Limited NP160	1174

Exhibit no.	Exhibit	Page no. from transcript
2.45	Spreadsheet extract recording production in response to Notices to Produce	1175
2.46	Notice to Produce to AMP Limited, NP216	1175
2.47	Four spreadsheets recording Tranches 1 to 4 of Production by AMP Limited in Response to Notice to Produce NP216	1176
2.48	Emails between Salter and Mavrakis dated 18-Sep-2017	1177
2.49	Emails between Mavrakis and Salter dated 19-Sep-2017	1179
2.50	Email Mavrakis to Salter dated 24-Sep-2017	1179
2.51	Email Salter to Baker Cook dated 21-Sep-2017	1179
2.52	Draft Clayton Utz Report Mark Up dated 24-Sep-2017	1181
2.53	Emails between Salter, Meller, Regan and Mavrakis dated 24-Sep-2017	1181
2.54	Emails between Mavrakis and Brenner dated 25-Sep-2017	1182
2.55	Emails between Mavrakis and Salter dated 04-Oct-2017	1182
2.56	Emails between Salter and Mavrakis dated 04-Oct-2017	1184
2.57	Draft Clayton Utz Report with Annotations by Salter	1185
2.58	Emails between Salter and Mavrakis dated 05-Oct-2017	1186
2.59	Draft Clayton Utz Report with Annotations by Salter dated 05-Oct-2017	1187
2.60	Emails between Salter and Mavrakis dated 05-Oct-2017 and 06-Oct-2017	1188
2.61	Drafts Sent by Salter to Mavrakis attached to Exhibit 2.60	1188
2.62	Bundle of documents relating to Final Report comprising email Mavrakis to Brenner submitting final BOLR Report dated 06-Oct-2017, Letter Clayton Utz to Brenner and Report	1190
2.63	Email Salter to Mavrakis dated 11-Oct-2017	1191
2.64	Emails between Brenner, Salter and Mavrakis dated 15-Oct-2017	1192
2.65	Email Salter to Medcraft, Brenner and others dated 04-Oct-2017	1193
2.66	Email Mavrakis to Salter dated 15-Oct-2017	1194
2.67	Emails between Mavrakis and Salter dated 15-Oct-2017	1195

Day 13 – 18 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.68	Summons to John Patrick Keating	1209
2.69	Statement of John Patrick Keating (and attached Exhibits)	1210
2.70	Summons to Linda Maree Elkins	1240
2.71	Witness statement of Linda Maree Elkins (and attached Exhibits)	1241
2.72	Summons to Marianne Perkovic	1265
2.73	Statement of Marianne Perkovic dated 03-Apr-2018 (with attached Exhibits)	1266
2.74	Supplementary statement for Marianne Perkovic dated 04-Apr-2018	1266
2.75	Further statement of Marianne Perkovic dated 03-Apr-2018	1267
2.76	Further statement of Marianne Perkovic dated 04-Apr-2018 (and attached Exhibits)	1267
2.77	Further statement of Marianne Perkovic dated 03-Apr-2018	1268
2.78	Further statement of Marianne Perkovic dated 09-Apr-2018	1268
2.79	Further statement of Ms Perkovic dated 05-Apr-2018 (and attached Exhibits)	1269
2.80	Appendix 1 Response to Notice of Direction	1278
2.81	Memorandum from Henderson to Chambers and others dated 12-Apr-2012	1303
2.82	Email from Sutherland to Perkovic and others dated 03-May-2012	1304
2.83	Email from Perkovic to Spring and others dated 11-May-2012	1310
2.84	Draft Report of Deloitte dated 06-Jun-2012	1313
2.85	Business Issues Management Report of Deloitte's dated 09-Jul-2012	1319
2.86	Licensee Risk Committee Agenda and papers dated 01-Mar-2013	1323
2.87	Appendix 1 to CFPL Response to Notice of Direction	1329
2.88	Email Taylor to Macaulay and others dated 11-Jul-2014	1332
2.89	Draft Deloitte Report concerning Count, Business Issues Management dated 20-Nov-2012	1336
2.90	Count Risk and Compliance Forum dated December 2015	1342

Day 14 – 19 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.91	Statement of Advice dated 30-Oct-2014	1348
2.92	Statement of Darren Williams dated 13-Apr-2018	1351
2.93	Statement of Adrian Kwa dated 10-Apr-2018	1352
2.94	Statement from AMP in relation to Fees for No Service of Sarah Caroline Britt dated 10-Apr-2018	1352
2.95	Statement of Mark James Pankhurst dated 13-Apr-2018	1352
2.96	Statement of Cameron Garrett dated 14-Apr-2018	1352
2.97	Statement of Michelle Weber dated 16-Apr-2018	1353
2.98	Witness statement of Jacqueline McDowall dated 04-Apr-2018	1354
2.99	Summons to Jacqueline McDowall	1354
2.100	Summons to Michael Wright	1375
2.101	Statement of Michael Wright together with the Corrigenda dated 05-Apr-2018	1377
2.102	Second statement of Michael Wright dated 05-Apr-2018	1377
2.103	Letter Westpac to Mahadevan dated 17-Oct-2011	1382
2.104	Letter Westpac Solicitors to Solicitor Assisting Royal Commission dated 17-Apr-2018	1382
2.105	Draft Employment Agreement Mahadevan dated 07-Oct-2011	1383
2.106	Westpac Financial Consultants Limited Employment Terms and Conditions effective September 2010	1384
2.107	Financial Planner Incentive Scheme Participant Guide dated October 2014 to September 2015	1387
2.108	Bank Financial Planners Remuneration and Benefits Financial Incentives Payment Plan dated April 2015	1388
2.109	WBC Consequence Management Policy dated 25-Feb-2015	1391
2.110	Best Interest Duty Policy dated 01-Jul-2013	1407
2.111	Response Westpac to ASIC under Section 912C dated 27-Jul-2015	1407
2.112	Westpac Letter and Compliance Review concerning Mahadevan dated 16-Mar-2009	1414

Exhibit no.	Exhibit	Page no. from transcript
2.113	WBC Letter and Compliance Review concerning Mahadevan dated 28-Sep-2009	1414
2.114	BT Finance Group Remuneration Oversight Committee Papers dated 18-Aug-2017	1416
2.115	Bank Financial Planning Consequence Management Policy dated December 2012	1418
2.116	Bank Financial Planning Regional Manner Supervision Policy dated February 2013	1419

Day 15 – 20 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.117	ABA Banking Industry Conduct Background Check Protocol	1459
2.118	Letter Dover to Westpac dated 06-May-2015	1460
2.119	Email Thompson dated 14-May-2015	1462
2.120	Email Thompson dated 30-Jun-2015	1463
2.121	Draft Report of Deloitte dated April 2018	1469
2.122	Report to BTFG Advice Risk Forum dated 14-Jul-2015	1473
2.123	Report to BT Advice Risk Forum dated 31-Jan-2018	1473
2.124	Memo to BTFG Risk Review Committee dated 06-Mar-2018	1475
2.125	Provision of Appropriate Personal Advice Control Deep Dive Memorandum dated 26-Jan-2018	1476
2.126	Document entitled Another Exciting Move, BTFA Remuneration Framework	1482
2.127	Dated version of email at MW2 and Web Archive print dated 28-Mar-2015	1483
2.128	Summons to Mr Whereat	1485
2.129	Witness statement of Darren John Whereat and Exhibits	1486
2.130	RI Advice Group Principal Authorised Representative Agreement with Carrington Corporation Proprietary Limited dated 08-May-2018	1489

Exhibit no.	Exhibit	Page no. from transcript
2.131	ASIC Media Release concerning Australian Financial Services Limited, 11-243 MR	1490
2.132	Memorandum AFS Retention Strategy dated 22-Mar-2013	1493
2.133	Advice and Distribution Risk and Compliance Board Committee Papers dated 29-May-2013	1495
2.134	Email Younger to Williams dated 15-Apr-2013 and attachment	1496
2.135	Authorised Representative Application Form by Doyle dated 13-Apr-2013	1496
2.136	Commitment Deed dated 06-May-2013	1497
2.137	Doyle Exam Results for Financial Planning Knowledge dated 15-Jul-2013	1499
2.138	Complaint Letter concerning Doyle dated 07-Aug-2013	1500
2.139	Advice Vetting Standard dated May 2013	1504
2.140	Individual Representative's Deed with Doyle	1509
2.141	Email from Peter Ornsby to Mr Doyle dated 19-May-2016	1528
2.142	Authorised Representative Deed, Millennium3 and Harris	1528
2.143	Letter Millennium3 to Harris dated 04-Jun-2008	1529
2.144	Email Nolan to Klipin and others dated 09-Aug-2015	1538
2.145	ASIC Report 251	1540
2.146	ASIC Report 362	1542
2.147	CPS 510 Remuneration Compliance dated 12-Dec-2017	1542
2.148	Letter from Dover Financial Advisers to Millennium3 Financial Services dated 24-May-2017	1547
2.149	Letter from Millennium3 to Dover in reply	1548

Day 16 – 23 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.150	Summons to Kylie Elizabeth Rixon	1555
2.151	2018 Performance Assessment Framework ANZ Financial Planning dated 12-Apr-2018	1557
2.152	Witness statement of Kylie Elizabeth Rixon dated 09-Apr-2018 (and attached Exhibits)	1557
2.153	Supplementary statement of Kylie Elizabeth Rixon dated 18-Apr-2018	1558
2.154	Business Risk and Compliance Committee Report dated January 2014	1581
2.155	Global Wealth Business Risk and Compliance Committee Meeting Papers dated 26-Aug-2014	1583
2.156	Business Risk and Compliance Committee Meeting Papers dated 23-Jun-2016	1584
2.157	Minutes of the Business Risk and Compliance Committee Meeting dated 23-Jun-2016	1586
2.158	Internal Audit Update Align Dealer Groups Risk and Compliance Board Committee dated 21-Nov-2016	1590
2.159	Emails between Warner and McKinnon re Doyle dated 22-Apr-2013 and 23-Apr-2013	1590
2.160	Summons to Sarah Caroline Britt	1592
2.161	Witness statement of Sarah Caroline Britt concerning Rubric 2.27 dated 10-Apr-2018	1593
2.162	Quality Review and Statement of Actions dated 22-Sep-2016	1599
2.163	ASIC Regulatory Guide RG256	1610
2.164	Representative Services Agreement Charter Financial Planning Limited and Coleman	1612
2.165	Advice Assessment re Palmer dated 10-Dec-2012	1627
2.166	Authorised Representative Application by Palmer	1629
2.167	Email Issue Notification Form July 2014	1631
2.168	Emails of July 2014 between Carter Learning and others concerning Palmer	1634

Exhibit no.	Exhibit	Page no. from transcript
2.169	Email Issue Notification Form re Palmer	1635
2.170	AMP Advice Recruitment Background and Reference Checking Policy Version 2.0 dated 25-Nov-2017	1649
2.171	Statement of Anthony George Regan dated 11-Apr-2018	1650
2.172	Statement of Marianne Perkovic dated 13-Apr-2018	1651
2.173	Statement of Renato Mota	1651
2.174	First statement of Michelle Weber dated 13-Apr-2018	1651
2.175	Second statement of Michelle Weber dated 13-Apr-2018	1651
2.176	Statement of Marti Carne	1651
2.177	Summons to Andrew Paul Hagger	1653
2.178	Statement of Andrew Paul Hagger dated 05-Apr-2018 (and attached Exhibits)	1654
2.179	Statement of Andrew Paul Hagger dated 13-Apr-2018 (and attached Exhibits)	1654
2.180	MLC Application Form	1660
2.181	MLC Application Form	1661
2.182	MLC Application Form as amended	1662
2.183	MLC Application Form as amended	1663

Day 17 – 24 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.184	Managing Values Report dated 27-Nov-2015	1680
2.185	Minutes of the Breach Review Committee dated 31-May-2017	1687
2.186	Wealth Advice Leadership Consequence Management dated 02-Nov-2017	1692
2.187	Specific Concerns for Tim Steele Given to Mr Hagger on 3-Nov-2017	1693
2.188	File Note dated 30-Oct-2017	1693

Exhibit no.	Exhibit	Page no. from transcript
2.189	Emails between Hagger and Thorburn dated 03-Nov-2017 and 06-Nov-2017	1701
2.190	Minutes of the Board of NAB Limited dated 04-Oct-2017	1702
2.191	Memorandum for the NAB Principal Board from Customer Advocate Wealth	1705
2.192	Memorandum for the Board of NAB Limited, Management Response to Exhibit 2.191	1707
2.193	Summons to Kieran Myles Forde	1709
2.194	Statement of Kieran Myles Forde and Exhibit dated 12-Apr-2018	1710
2.195	Supplementary statement of Kieran Myles Forde and its Exhibit dated 23-Apr-2018	1710
2.196	Statement of Marianne Perkovic dated 13-Apr-2018	1725
2.197	Statement of Donna McKenna dated 16-Apr-2018	1726
2.198	Summons to Donna McKenna	1726
2.199	Summons to Sam Maxwell Henderson	1744
2.200	Statement of Sam Maxwell Henderson and Exhibits dated 29-Mar-2018	1746
2.201	Statement and Exhibits dated 05-Apr-2018	1746
2.202	Corrections to Statements Exhibit 2.200 and 2.201	1746
2.203	Henderson Maxwell Financial Services Guide dated 20-Jan-2016	1754
2.204	Telephone recording dated 07-Nov-2016	1766
2.205	Telephone recording dated 10-Jan-2017	1766
2.206	Emails between Murphy of FPA and Henderson dated April 2017	1768
2.207	Email and Letter, Murphy to Henderson dated 28-Apr-2017	1769
2.208	Two emails, Henderson to Murphy dated 12-May-2017	1770
2.209	Emails between Murphy and Henderson dated May 2017	1771
2.210	FPA Code of Professional Practice	1772
2.211	Emails between Henderson and De Gori of FPA dated June 2017	1774
2.212	Report, Conduct Review Commission	1775
2.213	Henderson Response to Investigator's Report	1776

Exhibit no.	Exhibit	Page no. from transcript
2.214	Email and attachment concerning Agreed Disposal of CRC Disciplinary Proceedings	1777
2.215	Email of 13-Apr-2018 and Revised Summary Disposal Agreement	1779
2.216	Document described as Letter of Authority, McKenna to Henderson Maxwell dated 07-Nov-2016	1779
2.217	File Note concerning Ms McKenna dated 07-Nov-2016	1780

Day 18 – 26 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.218	Summons to Dante Guiseppe De Gori	1787
2.219	Witness statement of Dante Guiseppe De Gori dated 20-Apr-2018	1788
2.220	Emails between Henderson and De Gori dated 03-Jul-2017	1797
2.221	Email Murphy to McKenna dated 20-Dec-2017	1800
2.222	Email Bacon to Plater dated 22-Dec-2017	1802
2.223	Emails between Bacon and McKenna dated 05-Feb-2018 to 07-Feb-2018	1805
2.224	FPA Professional Accountability Actions and Outcomes at February 2018	1811
2.225	Letter Bacon to Solicitors Assisting the Commissioner dated 18-Apr-2018	1814
2.226	Transcript Crc Directions Conference dated 06-Mar-2018	1815
2.227	FPA Budget 2017/2018	1821
2.228	FPA Professional Ongoing Fees Code	1823
2.229	Summons to Philip Michael Kewin	1825
2.230	Witness statement of Philip Michael Kewin and its Exhibits	1826
2.231	AFA Summary of Issues re Tindall	1835
2.232	AFA Investigating Officer's Recommendation re Tindall	1837

Exhibit no.	Exhibit	Page no. from transcript
2.233	AFA Membership Review Committee Report re Tindall and other Matters	1839
2.234	AFA Annual Report Year Ended 30-Jun-2017	1842
2.235	Summons to Terrence Paul McMaster	1844
2.236	Witness statement of Terrence Paul McMaster dated 10-Apr-2018	1844
2.237	Minutes of the Meeting of Dover Compliance Committee dated 10-Apr-2013	1862
2.238	Dover Group Website Article concerning Financial Ombudsman Service dated 21-Jan-2016	1863
2.239	Financial Adviser Combined Compliance Manual and Adviser's Handbook dated 01-Feb-2018	1865
2.240	Reference Checking Financial Industry Form re Palmer	1871
2.241	Emails between Palmer and Thompson and others dated 25-Sep-2014	1874
2.242	ASIC Register of Financial Advisers Record concerning Hamilton	1883
2.243	ASIC Register of Financial Advisers Record concerning Houghton	1886
2.244	Letter FOS to ASIC, re Dover dated 08-Dec-2016	1890

Day 19 – 27 April 2018

Exhibit no.	Exhibit	Page no. from transcript
2.245	Dover Client Protection Policy	1902
2.246	Summons to Louise Macaulay	1903
2.247	Statement of Louise Anne Macaulay and its Exhibits dated 25-Apr-2018	1903
2.248	ABA Financial Advice Recruitment and Termination Reference Checking and Information Sharing Protocol dated 20-Sep-2016	1918
2.249	Minutes of Meeting of Board AMP Limited dated 16-Oct-2017	1928
2.250	Email from Nicholas Mavrakis to Brian Salter attaching marked-up Pages of Clayton Utz Report dated 15-Oct-2017	1928

Exhibit no.	Exhibit	Page no. from transcript
2.251	Attachment to email in Exhibit 2.250	1929
2.252	Email from Brian Salter to Nicholas Mavrakis and Melissa Baker-Cook dated 11-Oct-2017	1929
2.253	Attachment to email in Exhibit 2.252 being a Section 33 Notice from ASIC dated 06-Oct-2017	1929
2.254	Second attachment to email in Exhibit 2.252 being an attachment to the Section 33 Notice, a paper prepared by Brian Magellan entitled FOFA Practice Proposition Stream, Orphan Contracts, Policy and Process Changes and Recommendations	1929
2.255	Email chain between Brian Salter of AMP and Tim Mullaly of ASIC dated 18-Oct-2017	1930
2.256	Email from Brian Salter of AMP to Tim Mullaly of ASIC dated 07-Feb-2018	1930
2.257	Letter from Tim Mullaly of ASIC to Brian Salter of AMP dated 14-Mar-2018	1930
2.258	Letter from Brian Salter of AMP to Peter Kell of ASIC dated 14-Nov-2017	1930
2.259	Notice Issued by ASIC under Section 33 of ASIC Act dated 09-Jan-2018	1931
2.260	Email from Larissa Baker-Cook to Nicholas Mavrakis and Edmond Park dated 12-Sep-2017	1931
2.261	Email chain between Larissa Baker-Cook and Nicholas Mavrakis dated 25-Sep-2017	1931
2.262	Email chain between Brian Salter and Nicholas Mavrakis dated 08-Oct-2017 and 09-Oct-2017	1931
2.263	Email from Nicholas Mavrakis to Brian Salter dated 09-Oct-2017	1931
2.264	Email chain between Brian Salter and Nicholas Mavrakis dated 13-Oct-2017	1932
2.265	Attachment to email in Exhibit 2.264 being an email chain between Tom Galletta and Maria Corpell dated 06-Sep-2011	1932
2.266	Second attachment to email in Exhibit 2.264 being AMP's Internal Audit Report dated 18-Oct-2017	1932
2.267	Email from Nicholas Mavrakis to Brian Salter and Larissa Baker Cook attaching Final Report of Clayton Utz dated 16-Oct-2017	1932

Exhibit no.	Exhibit	Page no. from transcript
2.268	Attachment to email Exhibit 2.267 being Final Report of Clayton Utz dated 16-Oct-2017	1933
2.269	Microsoft Outlook Schedule acceptance of meeting to take place on 17-Aug-2017	1933
2.270	Email from Larissa Baker Cook to Nicholas Mavrakis and Edmond Park dated 13-Sep-2017	1933
2.271	Email from Nicholas Mavrakis to Brian Salter regarding BOLR Report Revised Draft dated 04-Oct-2017	1933
2.272	Attachment to email Exhibit 2.271 being BOLR Report incorporating changes in mark-up following discussions with Catherine Brenner	1934
2.273	Email from Larissa Baker Cook to Nicholas Mavrakis and Edmond Park regarding Final Draft of BOLR Report dated 24-Sep-2017	1934
2.274	Email from Brian Salter to Members of the Board regarding update on CU Report dated 15-Oct-2017	1934
2.275	Attachment to email Exhibit 2.274 being pages of Clayton Utz Report with updates in mark-up	1934
2.276	Email from Nicholas Mavrakis to Brian Salter regarding liability under the Corporations and ASIC Acts dated 15-Oct-2017	1935
2.277	Updated CFP Board Pack	NA
2.278	Witness statement of Michael Wright dated 15-Aug-2018	NA

Small and medium enterprises

Day 20 – 21 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.1	Tier 1 Capital Ratios June 2008 to June 2015	2012
3.2	Letter CBA dated 10-Nov-2015	2013
3.3	Summons to Mr Philip George Khoury	2021
3.4	Witness statement of Philip George Khoury and Exhibits dated 18-May-2018	2021
3.5	Summons to Ms Carolyn Joy Flanagan	2042
3.6	Statement of Ms Carolyn Joy Flanagan	2042
3.7	Summons to Ms Dana Beiglari	2051
3.8	Statement of Ms Dana Beiglari dated 16-May-2018	2052
3.9	Summons to Mr Alastair Derek Dawson Welsh	2059
3.10	Witness statement of Mr Alastair Derek Dawson Welsh in relation to Rubric 3-12 dated 15-May-2018	2060

Day 21 – 22 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.11	Emails between Fletcher and De Ocampo dated 20-Oct-2010	2108
3.12	Company search dated 20-Oct-2010	2109
3.13	Westpac File concerning Flanagan	2144
3.14	Summons to Ms Kate Griffith Gibson	2147
3.15	Witness statement of Ms Kate Gibson relating to Rubric 3-7 and Exhibits dated 27-May-2018	2148
3.16	Summons to Ms Marion Angelika Messih	2174
3.17	Statement of Ms Marion Angelika Messih dated 14-May-2018	2174

Day 22 – 23 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.18	Performance Management Plan and Review, first half 2014	2213
3.19	Performance Management Plan and Review, second half 2014	2214
3.20	Bundle of disciplinary process documents 2017	2218
3.21	Summons to Mr Alastair Derek Dawson Welsh	2224
3.22	Witness statement of Mr Alastair Derek Dawson Welsh concerning Rubric 3-11 dated 19-May-2018	2225
3.23	Emails between Skujins, Jacquier and others dated 26-Jul-2013	2248
3.24	Email Jacquier, Watt and others dated 30-Jul-2013	2249
3.25	Franchise System Profile dated August 2012	2263
3.26	Summons to Ms Carol Separovich	2264
3.27	Witness statement of Ms Carol Separovich concerning Rubric 3-10 dated 21-May-2018	2265
3.28	Witness statement of Ms Carol Separovich concerning Rubric 3-11 dated 21-May-2018	2266
3.29	Summons to Ms Suzanne Gail Riches	2275
3.30	Statement of Ms Suzanne Gail Riches dated 18-May-2018	2276
3.31	Email between Riches and Vlassis dated 15-Jun-2012	2280
3.32	Letter from BOQ to Suzanne Riches received on 18-May-2018	2298

Day 23 – 24 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.33	Summons to Mr Douglas Robert Snell	2302
3.34	Witness statement of Mr Douglas Robert Snell concerning Rubric 3-8 dated 15-May-2018	2303
3.35	2012 Credit Risk Review, Pirie Street Branch	2312
3.36	Group Assurance Commercial Credit Risk Review, Pirie Street Branch, 2013	2313
3.37	Letter BOQ to the Owner-Manager Pirie Street Branch dated 10-Dec-2012	2316

Exhibit no.	Exhibit	Page no. from transcript
3.38	Letter FOS to BOQ dated 09-Dec-2014	2333
3.39	Email from Vine of BOQ to Gardini, FOS dated 13-Feb-2015	2340
3.40	Emails between Vine, Mouat and others dated May and June 2015	2343
3.41	Summons to Mr Clive Richard van Horen	2358
3.42	Statement of Mr Clive Richard van Horen concerning Rubric 3-15 dated 15-May-2018	2358
3.43	Statement of Mr Clive Richard van Horen relating to Rubric 3-16 dated 14-May-2018	2358
3.44	Executive Risk Committee Memorandum, December 2014	2363
3.45	Small Business Risk Subcommittee agenda and accompanying documents dated 26-May-2016	2374
3.46	Letter to Whom It May Concern concerning interest overcharging dated 05-Nov-2015	2381
3.47	Email to C & Cs Escalations dated 14-Jul-2015	2384
3.48	Email to C & Cs Escalations dated 28-Jul-2015	2385
3.49	Email to GCR, First Point Correspondence dated 06-Aug-2015	2386
3.50	Emails between Leo and van Horen dated 17-Feb-2017	2389
3.51	DDI Scrum Minutes dated 24-Nov-2016	2390
3.52	DDI Scrum Minutes dated 15-Sep-2016	2393
3.54	Statement of Mr Bradley Paul Wallis dated 22-May-2018	2399
3.55	Summons to Mr Bradley Paul Wallis	2399
3.56	Excel spreadsheet Profit and Loss	2404
3.57	Home Loan Application document dated 06-Jun-2016	2415

Day 24 – 25 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.58	Summons to Mr Alastair Derek Dawson Welsh	2420
3.59	Statement of Mr Alastair Derek Dawson Welsh and its Exhibits in response to Rubric 3-10	2420
3.60	Screenshot events concerning Byabarra Property dated 4 to 17 May 2016	2435
3.61	Emails between Athanasopoulos, Brander and others dated 16-May-2016	2438
3.62	Emails between Handley, O'toole and others dated 20-May-2016	2440
3.63	Internal notes, Bank of Melbourne	2447
3.64	Emails between Mei Zhao and Wallis dated 10-Jul-2017	2447
3.65	Advance Application File	2449
3.66	Emails between Goel, Conder and others dated October 2017	2451
3.67	Emails between Li and Zhao dated 19-Oct-2017	2452
3.68	Internal Bank of Melbourne notes dated October 2017	2456
3.69	Letter from FOS to Bank of Melbourne dated 14-Dec-2017	2462
3.70	Letter from Bank of Melbourne to FOS dated 19-Dec-2017	2463
3.71	St George Consumer Lending Policy dated January 2009	2467
3.72	Summons to Rien Peter Low	2469
3.73	Statement of Rien Peter Low dated 23-May-2018	2469
3.74	Summons to David Anthony Carter	2494
3.75	Statement of David Antony Carter relating to Rubric 3-21 and Exhibits	2494
3.76	Outline of evidence of Jennifer Low	2495
3.77	Outline of evidence of Rien Low	2495
3.78	Letter Suncorp to FOS dated 14-Jun-2016	2501
3.79	Suncorp emails of May 2017 to Jackson and others	2518
3.80	Online conversation Goldspring dated 13-Jul-2017	2522
3.81	Emails Calcott and others dated 28-Jul-2017	2522
3.82	Email chain Goldspring, Calcott and others dated August 2017	2525

Day 25 – 28 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.83	Summons to Philip Field	2538
3.84	Witness statement of Philip Field Part A dated 18-May-2018	2539
3.85	Witness statement of Philip Field Part B dated 18-May-2018	2539
3.86	FOS Responsible Lending Series, How We Assess Customer Loss	2546
3.87	Summons to Michael Lawrence Kelly	2555
3.88	Statement of Michael Lawrence Kelly dated 24-May-2018	2555
3.89	Letter Bankwest to Silversun, March 2011	2576
3.90	Emails between Kelly and O'Brien dated March 2011	2577
3.91	Emails between Kelly and O'Brien dated March 2011	2577
3.92	Summons to Brett Robert Perry	2585
3.93	Statement and Exhibits of Brett Robert Perry in relation to Rubric 3-26	2585
3.94	Ail Houwen to Galbraith dated 26-May-2010	2602
3.95	Emails between Nathan, Howe, O'Brien and other dated March 2011	2615
3.96	Summons to Stephen Francis Weller	2617
3.97	Statement of Stephen Francis Weller and Exhibits dated 21-May-2018	2618
3.98	Summons to Michael Edwin Doherty	2632
3.99	Witness statement of Michael Edwin Doherty	2632

Day 26 – 29 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.100	Summons to Peter Nathaniel Clark	2664
3.101	Statement and Exhibits of Peter Nathaniel Clark relating to Rubric 3-24 dated 27-May-2018	2665
3.102	Statement of Peter Nathaniel Clark and Exhibits relating to Rubric 3-25	2665
3.103	Summons to Sinead Taylor	2699
3.104	Statement of Sinead Taylor in response to Rubric 3-13	2700
3.105	Summons to Brendan John Stanford	2701
3.106	Statement and Exhibits of Brendan John Stanford dated 24-May-2018	2702
3.107	Email Medway to Bankwest dated 26-Jun-2014	2719
3.108	Email between Bankwest Medway and Stanford and others dated 27-Jun-2014	2720
3.109	Emails between Bankwest, Medway and others dated 02-Jul-2014	2721
3.110	Summons to David Cohen	2723
3.111	Statement of David Cohen with respect to Questions 8 to 34 of Rubric 3-13 dated 17-May-2018	2724
3.112	Statement of David Cohen in relation to Questions 23, 29 and 30 of Rubric 3-13 and Exhibits dated 17-May-2018	2724
3.113	Submission to Risk Committee dated 25-Mar-2009	2729
3.114	Strategy Memorandum dated 01-Apr-2009	NA
3.115	Bankwest Business Portfolio Review dated 07-Apr-2009	2732
3.116	Memorandum to Executive Risk Committee dated 11-Sep-2009	2733
3.117	Presentation March 2010 Watch List Troublesome and Impaired Account Update	2737
3.118	Email from Sutton to Blair dated 17 March 2010 and attachment Property Finance Unit National Survey Credit Review	2739
3.119	Email dated 17-May-2010 to Pike and others and attached presentation concerning Project Magellan	2740

Day 27 – 30 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.120	Report to CBA Executive Risk Committee dated 05-Mar-2013	2754
3.121	Credit Risk Form Executive Summary	2781
3.122	Email Goldsmith to State Manager dated 25-Oct-2010	2782
3.123	Email Goldsmith to Hensman dated 15-Nov-2010	2783
3.124	Memorandum Maxwell Bankwest Risk Management dated 28-Nov-2011	2793
3.125	Strategy Paper dated 12-Apr-2013	2797
3.126	Emails between Fragar and Medway dated 27-Jun-2014	2803
3.127	Email between Bates and Hornstra dated 01-Jul-2014	2804
3.128	Emails between Reeves, Leo and others dated 12-Jan-2017	2823
3.129	Witness statement of Isaac Rankin in response to Rubric 3-2	2824
3.130	Witness statement of Joanna White in response to Rubric 3-1	2824
3.131	Witness statement of Howard Silby in response to Rubric 3-4	2824
3.132	Witness statement of Alastair Welsh in response to Rubric 3-3	2825
3.133	Douglas Snell in response to Rubric 3-6	2825
3.134	Statement of Sinead Taylor in response to Rubric 3-1	2825
3.135	Summons to Ross Alan Dillon	2827
3.136	Statement of Ross Alan Dillon dated 28-May-2018	2827

Day 28 – 31 May 2018

Exhibit no.	Exhibit	Page no. from transcript
3.137	Statutory Declaration of Mr Bassett dated 18-May-2018	2878
3.138	Summons to Mr Bassett	2879
3.139	Summons to Ross Hugh McNaughton	2886
3.140	Statement of Ross Hugh McNaughton as amended with accompanying Exhibits	2888

Exhibit no.	Exhibit	Page no. from transcript
3.141	Business Memorandum of Increase dated 25-Mar-2013	2897
3.142	Email Moynahan to Bassett dated 05-May-2015	2906
3.143	Summons to Anna Maria Bligh	2911
3.144	Statement of Anna Maria Bligh with its Exhibits	2911
3.145	Statement of Brian Zacharias prepared in response to Part C of Rubric 3-6 dated 15-May-2018	2929
3.146	Statement of Sean Leo Cash prepared in response to Part C of Rubric 3-4 dated 16-May-2018	2929
3.147	Statement of Christopher John Williams prepared in response to Part C of Rubric 3-1 dated 16-May-2018	2929
3.148	Statement of Kate Gibson prepared in response to Part C of Rubric 3-2 dated 17-May-2018	2930
3.149	Statement of Ivan Mardjetko prepared in response to Part C of Rubric 3-4 dated 16-May-2016	2930
3.150	Summons to Kirsten Marne O'Donoghue	2931
3.151	Statement of Kirsten Marne O'Donoghue and Exhibits	2931
3.152	Email Brooks to Lindberg and others dated 13-Apr-2017	2932
3.153	Email from Moyes and others dated 10-May-2017	2933
3.154	Agenda of meeting: Small Business Loans Unfair Contract Terms dated 19-Jun-2017	2934
3.155	Emails between Brooks, Green and others dated 07-Mar-2018	2934
3.156	Summons to Steven John Kluss	2936
3.157	Statement of Steven John Kluss	2936
3.158	CT Contract Term Protections Information Sheet	2942
3.159	Summons to Scott Gregson	2949
3.160	Witness statement of Scott Peter Gregson	2950

Day 29 – 1 June 2018

Exhibit no.	Exhibit	Page no. from transcript
3.161	Summons to Mr Saadat	2965
3.162	Witness statement of Mr Saadat and Exhibits dated 18-May-2018	2966
3.163	Further witness statement of Mr Saadat dated 24-May-2018	2966
3.164	Emails between Curtis, Saadat and others dated July 2015	2976
3.165	Emails between Tanzer, Saadat and others dated January 2016	2977
3.166	Preliminary Planning Document Unfair Contracts Terms with accompanying email concerning Project Planning dated May 2016	2979
3.167	Emails between Curtis, Saadat and others dated September 2016	2985
3.168	Joint Media Release ASIC and ASBFEO dated 09-Mar-2017	2995
3.169	Media Release of ASIC and ASBFEO dated 16-May-2017	3001
3.170	Summons to Mr Mullaly	3008
3.171	Statement of Mr Mullaly and Exhibits dated 30-May-2018	3008
3.172	ASIC Media Release 16-009MR	3017
3.173	ASIC Media Release 14-235MR	3022
3.174	Credit Memo PDF file	
3.175	FOS Case number 369034 PDF file	NA
3.176	Dispute 369034 Suzanne Riches	
3.178	BWA email 25-Aug-2008, Andrew Steel annual review and increase in interest margin	NA
3.179	Re: Problem Loan Identification	NA
3.180	Strategy Paper Stanford	NA
3.183	RG 183 PDF file	NA
3.184	Statement of Howard Silby, National Australia Bank, made in response to Rubric 3-19 and Exhibits	NA
3.185	Email with subject heading 'FW: Thir Pty Ltd ATF The Wallis Family Trust – 502574'	NA
3.186	Expert Determination Report Pursuant to the Share Deed dated 8-Oct-2008 (as amended) CBA and HBOS Australia Pty Ltd dated 7-Jul-2009	NA
3.187	CBA, Profit Announcement for the half year ended 31-Dec-2008 dated 11-Feb-2009	NA

Exhibit no.	Exhibit	Page no. from transcript
3.188	Australian Small Business and Family Enterprise Ombudsman, The Need for Further Inquiry into BWA/CBA's Treatment of Corporate and SME Customers Post Acquisition of BWA, undated	NA
3.189	CBA, Profit Announcement for the Full Year ended 30-Jun-2010 dated 11-Aug-2010	NA
3.190	CBA, Basel II Pillar 3 – Capital Adequacy and Risk Disclosures: Quarterly Update as at 31-Mar-2009	NA
3.191	CBA, Basel II Pillar 3 – Capital Adequacy and Risk Disclosures: Quarterly Update as at 30-Sep-2009	NA
3.192	CBA, Basel II Pillar 3 – Capital Adequacy and Risk Disclosures as at 31-Dec-2009	NA
3.193	CBA, Annual Report 2010 dated 11-Aug-2010	NA
3.194	Credit Sanctioning Increase dated 23-Jan-2009	NA
3.195	CBA, Joint Statement by Commonwealth Bank and Rory O'Brien dated 2-May-2014	NA
3.196	Bankwest, Annual Financial Report 31 December 2008 dated 30-Apr-2009	NA
3.197	CBA, Acquisition of BankWest and St Andrew's Australia – A Compelling Strategic Growth Opportunity 8-Oct-2008	NA
3.198	Letters from Bankwest and BOS International (Australia) Limited to Rory O'Brien dated 19-Dec-2008, 23-Dec-2008	N/A
3.199	Letter from Jane Couchman, CBA, to Chris Green, ASIC, dated 15-May-2018	NA
3.200	Share Sale Deed dated 08-Oct-2008	N/A

Regional and remote communities

Day 30 – 25 June 2018

Exhibit no.	Exhibit	Page no. from transcript
4.1	Summons to Mr Denis McMahon	3087
4.2	Statement of Mr Denis McMahon dated 19-Jun-2018	3088
4.3	Summons to Mr Chris Wheatcroft	3090
4.4	Statement of Mr Chris Wheatcroft dated 15-Jun-2018	3090
4.5	Summons to Mr Warren Day	3092
4.6	Statement of Mr Warren Day dated 08-Jun-2018	3093
4.7	Summons to Mr Benjamin William Steinberg	3124
4.8	Witness statement of Mr Benjamin William Steinberg concerning Rubric 4-1	3124
4.9	Witness statement of Mr Benjamin William Steinberg in relation to Rubric 4-20 With Annexures	3126
4.10	Witness statement of Mr Benjamin William Steinberg in relation to Rubric 4-38	3127
4.11	Supplementary statement of Mr Benjamin William Steinberg concerning Rubric 4-38	3127

Day 31 – 26 June 2018

Exhibit no.	Exhibit	Page no. from transcript
4.12	Minutes of ANZ Board dated 06-Aug-2015	3161
4.13	Code of Banking Practice	3164
4.14	Letter ANZ to Cheesmans dated 30-Aug-2012	3196
4.15	Diary Note dated 27-Sep-2012	3197
4.16	Diary Note dated 31-Dec-2012	3199
4.17	Memorandum, Landmark Taskforce Consideration re Cheesmans dated 26-Apr-2016	3207
4.18	Lending Services Agribusiness Discussion Document dated 01-Jun-2015	3209
4.19	Letter Corrs Chambers Westgarth re Farm Debt Mediation dated 21-May-2014	3245
4.20	Statement of Mr Benjamin William Steinberg concerning Rubric 4-17 dated 18-Jun-2018	3249
4.21	Emails between Steinberg, Saliba and others dated 23-Apr-2014	3258

Day 32 – 27 June 2018

Exhibit no.	Exhibit	Page no. from transcript
4.22	Group Wholesale Portfolio Management Strategy 2015	3275
4.23	Farming Segment Support Strategy Board Paper dated 06-Aug-2015	3298
4.24	Landmark Portfolio Upgrade Board Paper	3303
4.25	Credit Memorandum concerning Hirsts dated 02-Aug-2011	3310
4.26	Letter of Offer to Hirsts dated 02-Aug-2011	3310
4.27	Diary note dated 15-Aug-2011	3311
4.28	Email chain ANZ to Hirsts dated 23-Aug-2011	3313
4.29	Summons to Mr Michael Hirst	3315
4.30	Summons to Mrs Wendy Jolene Brauer	3320
4.31	Statement of Mrs Wendy Jolene Brauer dated 21-Jun-2018	3320

Exhibit no.	Exhibit	Page no. from transcript
4.32	Summons to Mr Bradley Mark James	3340
4.33	Statement of Mr Bradley Mark James dated 15-Jun-2018	3340
4.34	Statement of Mr Bradley Mark James dated 22-Jun-2018	3341
4.35	2009 Appraisal Form, Manager Dalby Branch, Rabobank	3347
4.36	Rabobank Worldwide Compliance Standards dated November 2006	3352
4.37	Property Inspection/Valuation Report, Jamberoo dated 30-Jul-2009	3355
4.38	Rabobank Valuation Policy dated 19-Feb-2007	3357
4.39	EY Report APRA Targeted Review dated 30-Jun-2011	3359
4.40	Letter APRA to Rabobank dated 02-Dec-2011	3360
4.41	Letter Rabobank to APRA dated 16-Dec-2011	3361
4.42	Memo to Executive Committee Rabobank dated 22-Jul-2014	3362
4.43	Letter APRA to Rabobank re Prudential Review Report dated 10-Nov-2017	3365
4.44	Letter Rabobank to APRA dated 28-Nov-2017	3366
4.45	Property Inspection and Valuation Report dated 29-Jul-2009	3370
4.46	Email to Brauers dated 23-Jul-2009	3370
4.47	Email from Gray dated 17-Sep-2009	3377

Day 33 – 28 June 2018

Exhibit no.	Exhibit	Page no. from transcript
4.48	Email to Brauers dated 17-Sep-2009	3383
4.49	Email to Gray dated 21-Sep-2009	3386
4.50	Email to the Brauers dated 22-Sep-2009	3389
4.51	Email from the Brauers to Rabobank dated 03-Jun-2010	3387
4.52	Emails to the Brauers dated August 2010	3401
4.53	Email from Brauer dated 17-Sep-2010	3402
4.54	Emails from the Brauers dated 25-Sep-2010	3403
4.55	Emails between the Brauers and Rabobank dated 14-Jan-2011	3404

Exhibit no.	Exhibit	Page no. from transcript
4.56	Email from Rabobank dated 14-Jan-2011	3405
4.57	Sedgwick Retail Banking Remuneration Review	3411
4.58	Rabobank Lending Ratio Guidelines dated 24-Dec-2008	3425
4.59	Email dated 04-Jul-2009	3426
4.60	Email dated 07-Jul-2009	3426
4.61	Email dated 08-Jul-2009	3426
4.62	Email dated 22-Jul-2009	3426
4.63	Email dated 22-Jul-2009	3426
4.64	Email dated 23-Jul-2009	3426
4.65	Email dated 23-Jul-2009	3426
4.66	Email dated 05-Aug-2009	3426
4.67	Email dated 05-Aug-2009	3426
4.68	Email dated 05-Aug-2009	3426
4.69	Email dated 13-Aug-2009	3426
4.70	PDF file dated 13-Aug-2009	3426
4.71	Email dated 13-Aug-2009	3426
4.72	PDF file dated 13-Aug-2009	3426
4.73	Email dated 25-Aug-2009	3426
4.74	Email dated 25-Aug-2009	3426
4.75	PDF file dated 25-Aug-2009	3427
4.76	Email dated 31-Aug-2009	3427
4.77	XPS file dated 31-Aug-2009	3427
4.78	Email dated 31-Aug-2009	3427
4.79	Email dated 31-Aug-2009	3427
4.80	Email dated 01-Sep-2009	3427
4.81	Email dated 18-Sep-2009	3427
4.82	Email dated 18-Sep-2009	3427
4.83	PDF file dated 22-Sep-2009	3427
4.84	Email dated 22-Sep-2009	3427

Exhibit no.	Exhibit	Page no. from transcript
4.85	VSD file dated 22-Sep-2009	3427
4.86	Email dated 14-Jan-2011	3427
4.87	Rabobank KPIs Rural Manager (current)	3428
4.88	Performance Improvement Plan, Brauers' Manager	3428
4.89	Summons to Mr Melville Ruddy	3430
4.90	Statement of Mr Melville Ruddy dated 21-Jun-2018 and Annexures	3431
4.91	Summons to Ms Sinead Taylor	3453
4.92	Statement of Ms Sinead Taylor dated 24-Jun-2018	3453
4.93	Rural and Regional Banking KPIs for Financial Year 2012	3463
4.94	Rural and Regional Champions, August 2011	3464
4.95	Spreadsheet Remuneration Packages Bankwest Bank Managers 2011	3466
4.96	Commercial Business and Private Bank FY12 KPIs and Incentive Scheme Overview	3467
4.97	Emails Nilsson to King	3479
4.98	Emails between Durack and Douglas dated 13-Jun-2013	3488
4.99	Policy GCS Team, Management of FOS Complaints dated 02-Jul-2013	3491
4.100	Bankwest response to FOS re Ruddy dated 13-Apr-2015	3492
4.101	FOS Determination dated 25-Nov-2014	3498

Day 34 – 29 June 2018

Exhibit no.	Exhibit	Page no. from transcript
4.102	Notice to Produce Number 653	3509
4.103	Manager's Resignation Letter	3510
4.104	Emails between Ellul, Watson and others at Bankwest, dated 02-Apr-2012 to 03-Apr-2012	3514
4.105	Email from King, Bankwest dated 02-Apr-2012	3516

Exhibit no.	Exhibit	Page no. from transcript
4.106	Memorandum Toowoomba Business Centre Process Issues	3517
4.107	Briefing note Bankwest	3520
4.108	Email chain Status and Update Toowoomba dated 04-Apr-2012	3520
4.109	Summons to Mrs Deborah Smith	3537
4.110	Statement of Mrs Deborah Smith dated 22-Jun-2018	3537
4.111	Summons to Mr Ross McNaughton	3567
4.112	Witness statement of Mr Ross McNaughton with Exhibits dated 18-Jun-2018	3567
4.113	Supplementary statement of Mr McNaughton dated 25-Jun-18	3568
4.114	SBS Hardship Procedural	3589
4.115	Emails between Avent, Starky and others dated 10-Nov-2014	3600
4.116	Emails Ashley Smith to Starky dated 11-Jan-2017	3604
4.117	Standard APS 220	3605
4.118	Financial Hardship Document HAR101.1	3605
4.119	Hardship Notice HAR102	3605

Day 35 – 2 July 2018

Exhibit no.	Exhibit	Page no. from transcript
4.120	Summons to Ms Alexandra Esma Maria Gartmann	3611
4.121	Statement and Exhibits to the Statement of Ms Alexandra Esma Maria Gartmann in response to Rubric 4.36	3612
4.122	List of Banks adopting Code of Banking Practice	3623
4.123	Submission Bendigo Bank dated 29-Jan-2018	3625
4.124	Bendigo Adelaide Bank letter to Royal Commission dated 18-May-2018	3634
4.125	KPMG Engagement Letter dated 18-Mar-2010	3645
4.126	Letter APRA to Elders Rural Bank dated 01-Jul-2009	3653

Exhibit no.	Exhibit	Page no. from transcript
4.127	Letter APRA to Rural Bank Limited dated 07-Jan-2011	3666
4.128	Board Credit Committee Meeting Pack dated 17-Aug-2011	3682
4.129	Letter APRA to Rural Bank dated 14-Mar-2012	3683
4.130	Rural Bank Response to 1 July 2009 APRA Prudential Review Report dated 24-Aug-2009	3687
4.131	Rural Bank Response to 7 January 2011 APRA Prudential Review Report dated 14-Feb-2011	3687
4.132	Rural Bank's Response to 14 March 2012 APRA Prudential Review Report with attachment, 24 April 2012 APRA Prudential Review Action Plan dated 26-Apr-2012	3688
4.133	Statement from Mr Grant Michael Cairns dated 19-Jun-2018	3688
4.134	Statement from Mr Mark Wlossak dated 19-Jun-2018	3689
4.135	Statement from Johanna White dated 21-Jun-2018	3689
4.136	Statement from Johanna White dated 29-Jun-2018	3689

Day 36 – 3 July 2018

Exhibit no.	Exhibit	Page no. from transcript
4.137	Summons to Mr Nathan Boyle	3712
4.138	Statement of Mr Nathan Boyle dated 25-Jun-2018	3713
4.139	Summons to Mrs Lynda Edwards	3716
4.140	Statement of Mrs Lynda Edwards dated 22-Jun-2018	3717
4.141	Visual Tool used by Financial Capability Workers	3735
4.142	Proposed Code of Banking Practice	3738
4.143	Summons to Ms Tracey Walsh	3764
4.144	Statement of Ms Tracey Walsh dated 26-Jun-2018	3764
4.145	Summons to Mr Bryn Jones	3784
4.146	Statement and Exhibits of Mr Bryn Jones dated 13-Jun-2018	3785
4.147	Statement of Mr Bryn Jones and its Exhibits dated 11-Jun-2018	3786

Exhibit no.	Exhibit	Page no. from transcript
4.148	Media Release dated 29-Jun-2018	3800
4.149	ACBF Website Screenshot	3805
4.150	ACBF Media Release dated 27-Jun-2018	3807
4.151	ASIC Analysis Funeral Insurance Sector as at 30-Jun-2013	3811

Day 37 – 4 July 2018

Exhibit no.	Exhibit	Page no. from transcript
4.152	Aboriginal Community Funeral Plan Branding Concepts	3819
4.153	ASIC Internal Memorandum Investigation into ACBF	3820
4.154	ACBF Advertisement Koori Mail	3820
4.155	ACBF Advertisement National Indigenous Times	3821
4.156	Consent Orders Federal Court of Australia dated 24-Sep-1999	3824
4.157	Web Banner Screenshot National Indigenous Times Website	3826
4.158	Radio Script dated 29-Nov-2012	3826
4.159	Supporting Palm Island Customers, CBA Presentation dated January 2018	3829
4.160	Cultural Audit Report Mura Connect	3833
4.161	Reasons for Judgment ACBF v Chief Executive Centrelink	3838
4.162	Letter of Appointment ACBF Administration Proprietary Limited dated 13-Feb-2017	3842
4.163	Offer of Employment ACBF Administration Proprietary Limited dated 04-Apr-2018	3843
4.164	ASIC Report 454 Funeral Insurance: A Snapshot dated October 2015	3847
4.165	ACBF List of Future Payments Waived	3849
4.166	ACBF Training Manual dated April 2013	3856
4.167	ACBF Letter to Tracey Walsh dated 10-Jan-2007	3858
4.168	ACBF Internal Memorandum concerning Payout Restrictions for Suicide	3862
4.169	ACBF Media Release dated 02-Jul-2018	3865

Exhibit no.	Exhibit	Page no. from transcript
4.170	Summons to Ms Kathy Marika	3880
4.171	Statement of Ms Kathy Balngayngu Marika dated 19-Jun-2018	3880
4.172	Summons to Mr Russell Howden	3894
4.173	Witness statement of Mr Russell Howden in answer to Rubric 4-23 dated 13-Jun-2018	3894
4.174	Witness statement of Mr Russell Howden in relation to Rubric 4-31 dated 13-Jun-2018	3894
4.175	Witness statement of Mr Russell Howden in relation to Rubric 4-42 dated 28-Jun-2018	3895
4.176	Let's Refer a Friend Flyer	3905
4.177	Select AFSL file note concerning meeting of 27-Feb-2017	3907
4.178	Emails to Howden and others	3908
4.179	Service Training Let's Insure dated 2015	3911

Day 38 – 5 July 2018

Exhibit no.	Exhibit	Page no. from transcript
4.180	BlueInc Quarterly Awards 2015 to date	3926
4.181	Vespa Sales Battle Rounds 1 and 2	3929
4.182	Let's Insure Sailors Sale Incentive dated February to June 2015	3932
4.183	Select AFSL Compliance Training Manual dated 2015	3934
4.184	Let's Insure First Quarter 2016 Incentives	3936
4.185	Let's Insure Product Script 25-Aug-2015 to 23-Sep-2015	3946
4.186	Email ASIC to Select dated 09-Jan-2018	3955
4.187	St Andrews Risk Management Committee Meeting Papers dated 28-Mar-2018	3966
4.188	Letter St Andrews to Howden dated 14-Mar-2018	3968
4.189	Letter from Howden of Select to Way of St Andrews dated 04-Apr-2018	3970
4.190	Annexure B to Email Howden to ASIC dated 04-Apr-2018	3971

Exhibit no.	Exhibit	Page no. from transcript
4.191	Letter Howden of Select to Way of St Andrews dated 04-Apr-2018	3975
4.192	Dismissal Letter dated 05-Jun-2018	3983
4.193	Select Response to NP 475 dated 14-Jun-2018	3985
4.194	Select Response to NP 495 dated 13-Jun-2018	3985
4.195	Select Response to NP 497 dated 13-Jun-2018	3985
4.196	Select Response to NP 654 dated 13-Jun-2018	3985
4.197	Summons to Ms Thy Do	3987
4.198	Statement of Ms Thy Do dated 30-Jun-2018	3987
4.199	Summons to Mr Philip Stewart Bowden	4012
4.200	Statement of Mr Philip Stewart Bowden dated 04-Jul-2018	4013
4.201	Summons to Mr Tony Colin Tapsall	4023
4.202	Statement of Mr Tony Colin Tapsall dated 21-Jun-2018	4023
4.203	Further summons to Mr Tony Colin Tapsall dated 02-Jul-2018	4023
4.204	Statement of Mr Tony Colin Tapsall in response to Further Summons dated 25-Jun-2018	4023
4.205	Supplementary statement of Mr Tony Colin Tapsall dated 04-Jul-2018	4024
4.206	Branch Options Final Recommendation	4031
4.207	Accelerated Branch Closures Presentation dated 26-Apr-2017	4034

Day 39 – 6 July 2018

Exhibit no.	Exhibit	Page no. from transcript
4.208	Statement relating to ANZ client identified by Mr Bowden as Client 1	4077
4.209	Draft flowchart for Code of Operation	4085
4.210	Request to Restrict Informal Overdraft Facility Form dated 08-Dec-2017	4094
4.211	Profile page iKnow System Client Number 1	4095

Exhibit no.	Exhibit	Page no. from transcript
4.212	Request to Restrict Informal Overdraft Facility Form concerning Client 2 dated 29-Nov-2017	4096
4.213	Call recording relating to Client 2 dated 30-Nov-2017	4096
4.214	Transcript of call recording dated 30-Nov-2017	4096
4.215	Call recording relating to Client 2 dated 01-Dec-2017	4097
4.216	Transcript of call recording dated 01-Dec-2017	4097
4.217	iKnow record relating to Client 2	4097
4.218	Summary of certain evidence in ANZ/Landmark Case Study	4099
4.219	Submissions of Counsel Assisting in relation to the CBA Processing Errors Case Study	4127
4.220	Statement of Sian Lewis of CBA dated 28-Jun-2018	4128
4.221	Statement of Robert Vivian Musgrove dated 14-Jun-2018	4128
4.222	Statement of Anthony Hampton dated 19-Jun-2018	4128
4.223	Statement of Gavin Teichner dated 22-Jun-2018	4129

Appendix 7: Submissions from parties

Consumer lending

Received from	Date
ASIC	03-Apr-2018
Aussie Home Loans – Part A	03-Apr-2018
Aussie Home Loans – Part B	03-Apr-2018
Australia and New Zealand Banking Group Limited	Not dated
Australian Prudential Regulation Authority (APRA)	Not dated
Choice	03-Apr-2018
Citi International	03-Apr-2018
Commonwealth Bank of Australia	03-Apr-2018
Consumer Action Law Centre	03-Apr-2018
Finance Sector Union	Not dated
Legal Aid NSW	Not dated
National Australia Bank	03-Apr-2018
National Australian Bank – Introducer case study	Not dated
Smartline Home Loans Pty Ltd	03-Apr-2018
Westpac	03-Apr-2018
Westpac – Auto Finance	03-Apr-2018
Westpac – Credit Card Credit Limit Increases	03-Apr-2018

Financial advice

Received from	Date
AMP – Submission – General Questions	07-May-2018
AMP – Case Study 1 – Fees for no service	04-May-2018
AMP – Case Study 2 – Investment platform fees	04-May-2018
AMP – Case Study 3 – Inappropriate Financial Advice	04-May-2018
Andrew Smith - Submission	Not dated
APRA	Not dated
ASIC	07-May-2018
Association of Financial Advisers (AFA)	07-May-2018
Australia and New Zealand Banking Group Limited (ANZ)	07-May-2018
Choice	07-May-2018
Commonwealth Bank of Australia (CBA) – Part A Wealth Management	04-May-2018
Commonwealth Bank of Australia (CBA) – Part B	07-May-2018
Dover Financial Advisers	Not dated
Finance Sector Union (FSU)	Not dated
Financial Planners Association of Australia (FPA) – Part A	Not dated
Financial Planners Association of Australia (FPA) – Part B	04-May-2018
Henderson Maxwell Entities	04-May-2018
M3 and RI – Case Study Submissions	Not dated
M3 and RI – Supplementary Case Study Submission	09-May-2018
Mr John Doyle – Submission	04-May-2018
National Australia Bank – General Questions	07-May-2018
National Australia Bank – Case Study Submissions	04-May-2018
National Australia Bank – Case Study Supplementary Submissions	09-May-2018
Treasury	Not dated
Westpac Banking Corporation – General Submission	04-May-2018
Westpac Banking Corporation – Financial Advice Case Study	07-May-2018

Small and medium enterprises

Received from	Date
ABA written submission	08-Jun-2018
ANZ written submission	12-Jun-2018
ANZ case study submission	08-Jun-2018
APRA written submission	Not dated
ASIC written submission	12-Jun-2018
BOQ written submission	12-Jun-2018
BOQ case study submission	08-Jun-2018
CBA written submission	Not dated
CBA case study submission	Not dated
CBA written response to Doherty submission	19-Jun-2018
Consumer Action Law Centre written submission	12-Jun-2018
Doherty written submission	19-Jun-2018
Finance Sector Union written submission	Not dated
FOS case study submission	08-Jun-2018
Legal Aid NSW case study submission	Not dated
Mr Dillon case study submission	08-Jun-2018
NAB written submission	12-Jun-2018
NAB case study submission	08-Jun-2018
Suncorp case study submission	08-Jun-2018
Treasury written submission	Not dated
Westpac written submission	12-Jun-2018
Westpac case study submission – Flanagan	08-Jun-2018
Westpac case study submission – Marjo	08-Jun-2018
Westpac case study submission – Thir	08-Jun-2018

Regional and remote communities

Received from	Date
ACBF case study submission	13-Jul-2018
ANZ written submission	16-Jul-2018
ANZ case study submission	13-Jul-2018
APRA written submission	Not dated
ASIC written submission	16-Jul-2018
Bendigo Bank (Rural Bank) written submission	16-Jul-2018
Bendigo Bank (Rural Bank) case study submission	13-07-2018
CBA written submission	Not dated
CBA case study submission	Not dated
Consumer Action Law Centre written submission	16-Jul-2018
Consumer Action Law Centre case study submission	13-07-2018
Financial Counselling Australia written submission	16-Jul-2018
Financial Counselling Australia written submission	16-Jul-2018
Finance Sector Union written submission	Not dated
Legal Aid NSW written submission	Not dated
Legal Aid NSW case study submission	Not dated
NAB written submission	16-Jul-2018
NAB case study submission	13-Jul-2018
Rabobank Australia Limited written submission	16-Jul-2018
Rabobank Australia Limited case study submission	13-Jul-2018
St Andrews Life Insurance (AFSL) case study submission	13-Jul-2018
Westpac written submission	16-Jul-2018

Appendix 8: Public engagement

Introduction

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was established on 14 December 2017.

From the outset, the Commission has been committed to ensuring the public has easy access to information about the Commission and its work through a dedicated information line (phone and email), a website and email distribution services.

These channels, combined with the online public submission form, have aided the Commission in its understanding of the extent of misconduct or conduct falling short of community standards within the banking, superannuation and financial services industry.

This Appendix shows data for the period 14 December 2017 to 31 August 2018.

Online public submissions

The public submission form became available on 22 January 2018. The online form was available 24 hours a day, seven days a week ensuring those with a story are able to share it with the Commission at a time convenient to them. A hard copy version of the form was also available on request for those without internet access.

As of 31 August 2018, the Commission had received 8,646 public submissions about past conduct. Of the total submissions received, 87% indicated that they were unsatisfied with how their complaint had been handled by the financial services entity.

All public submissions received, whether online or hardcopy, were reviewed and considered repeatedly as the Commission's staff, counsel and solicitors assisting looked to what the public had shared to help inform which case studies would be examined.

Submissions by State/Territory

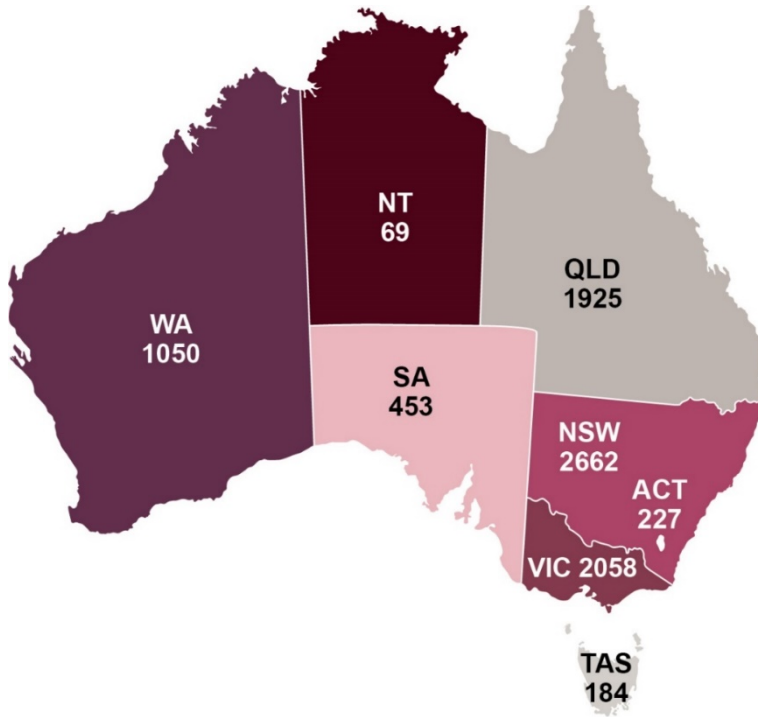


Figure 1: Number of submissions received from each State/Territory

Submissions were received from all states and territories of Australia. The largest proportion of submissions came from New South Wales, Victoria, Queensland and Western Australia.

Submissions by industry

As part of the public submission process, people were asked to indicate which part of the financial services industry their matter relates. Of all the submissions received during the period, the largest proportion were received in relation to banking at 68%, superannuation at 12% and financial advice at 9%.

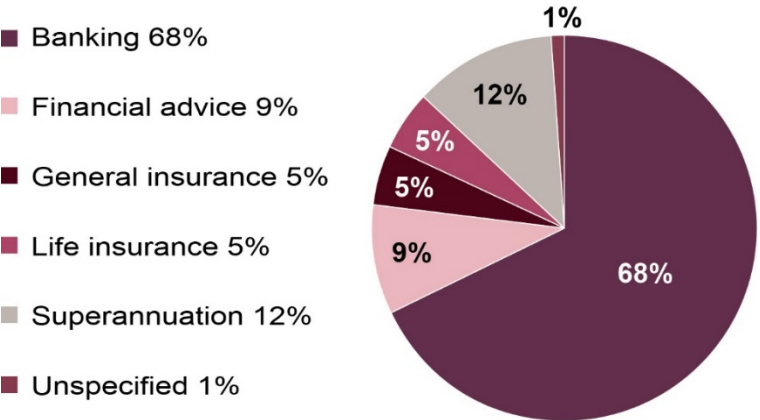


Figure 2: Submissions by industry

Submissions by nature of dealing

People were also asked to indicate in their submissions the nature of their dealings with an entity and the majority of people making submissions selected 'personal financial' as the relevant dealing (42%).

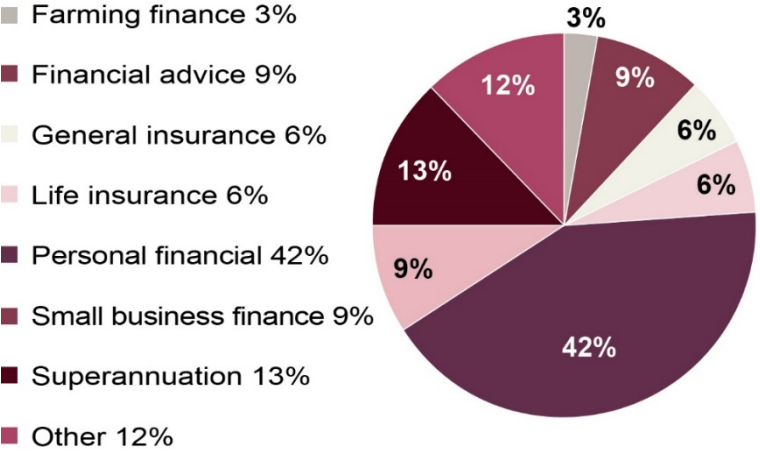


Figure 3: Submissions by nature of dealing

Information line

The Commission operates an information line that is available by phone and email. The phone line is available during business hours, five days a week, while emails can be sent 24 hours a day, seven days a week.

The information line provides a range of services to support those with questions about the Commission, those needing assistance with making a submission, and those wishing to talk further about their concerns.

Since commencing on 22 January 2018 the phone line has taken over 3,200 phone calls and responded to over 5,500 emails.

Website

The Commission's website went live on 18 December 2017. The website is used by the Commission to make information available and engage with a range of audiences including the public, parties, institutions and the media.

The website provides easy access to exhibits, transcripts, the Commission's Terms of Reference, procedures relating to the conduct of hearings and a number of background papers.

Since February 2018, the Commission has published over 9,500 exhibits, 49 days of transcripts and 29 background papers.

In the eight months since the website went live, the website has had 350,600 unique users. Of those, 63% of users accessed the website on a desktop computer, 25% a mobile device and 12% on a tablet.

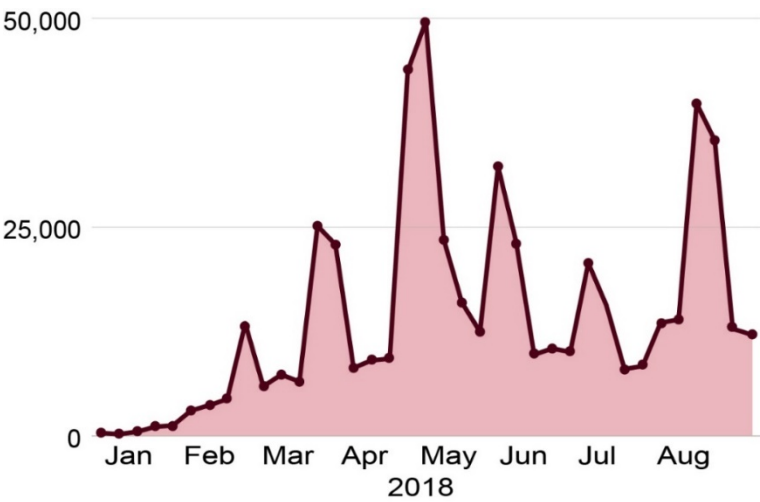


Figure 4: Overview of website users

The website also hosts the Commission’s live webcast that provides a live stream of the proceedings and a permanent record of each hearing day (transcripts, exhibits, witness lists and webcast recordings).

From the commencement of the initial hearing on 12 February 2018 to 31 August 2018, the webcast had a total of 901,100 views and 571,900 unique views.

Appendix 9: Background Papers

Appendix 9 includes full copies of the Background Papers, as listed in the following tables. Please note that some Background Papers have not been included in the *Interim Report* because they relate to subsequent rounds of hearings.

Each of these Background Papers can be found on the [Publications page of the Commission's website](#).

Title of Background Paper	Date of publication
Background Paper 1: Some Features of the Australian Banking Industry	09-Feb-2018
Background Paper 2: Some Features of the Australian Mortgage Broking Industry	22-Feb-2018
Background Paper 3: Some Features of Car Financing in Australia	09-Mar-2018
Background Paper 4: Everyday Consumer Credit – Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans	12-Mar-2018
Background Paper 5: Request for Information Reforms to Consumer Lending	19-Mar-2018
Background Paper 6 (Part A): Some Features of the Australian Financial Planning Industry	05-Apr-2018
Background Paper 6 (Part B): Education and Training Requirements for Financial Advisers	
Background Paper 6 (Part C): Financial Products Available to Retail Investors	
Background Paper 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households	05-Apr-2018
Background Paper 8: Key Reforms in the Regulation of Financial Advice	13-Apr-2018
Background Paper 9: The Regulatory Capital Framework for Authorised Deposit-Taking Institutions (ADIs)	27-Apr-2018
Background Paper 10: Credit for Small Business – An Overview of Australian Law Regulating Small Business Loans	07-May-2018 16-May-2018
Background Paper 11: Request for Information Reforms to Small Business Lending	09-May-2018

Title of Background Paper	Date of publication
Background Paper 12: Financial Services and Small and Medium-Sized Enterprises	14-May-2018
Background Paper 13: The Regulatory Capital Framework – Impairment, Provisioning and Enforcing Security	18-May-2018
Background Paper 16: Some Features of Finance in the Agriculture, Forestry and Fishing Industry	15-Jun-2018
Background Paper 17: Department of Agriculture and Water Resources	28-Jun-2018
Background Paper 18: Some Features of Financial Services in Regional and Remote Communities	15-Jun-2018
Background Paper 19: Aboriginal and Torres Strait Islander Consumers of Financial Products	21-Jun-2018
Background Paper 21: Aboriginal and Torres Strait Islander Consumers' Interactions with Financial Services	22-Jun-2018
Background Paper 24: Submission on Key Policy Issues	26-Jul-2018