

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

Commonwealth Bank of Australia and its Australian associated entities (CBA)

Business Lending

17 April 2018

1. CBA provides the following response to the letter from the Honourable K M Hayne AC QC dated 5 April 2018 (**SME Lending Letter**) that requested further information in relation to lending for business purposes where the bank's total credit exposure to the relevant business customer is \$20 million or less (**SME lending**). CBA notes that this response covers Bankwest, which is a business unit of CBA.
2. The Commissioner's letter of 15 December 2017 sought details as to both misconduct and conduct considered to fall below community standards and expectations. The Commissioner's letter of 2 February 2018 requested more specific information in respect of misconduct only. CBA has provided responses to those letters on 29 January 2018, 13 February 2018 and 22 March 2018 (**Previous Submissions**). The SME Lending Letter invites CBA to identify any feature of the Previous Submissions which related to SME lending, and whether there is anything that CBA wishes to add to those responses specifically relating to SME lending.
3. CBA undertakes SME lending predominately under the CBA brand through the Business and Private Banking and, to a much smaller extent, Retail Banking Services business units of CBA.¹ Products for SME lending are manufactured in the Institutional Banking and Markets business unit whilst some products are also manufactured by the Retail Banking Services business unit for small business customers. In addition, SME lending is also provided to customers under the Bankwest brand.
4. This submission is structured as follows.
5. First, CBA provides the Commission with an overview of the recent public inquiries into SME lending and CBA's response to allegations made against it in those inquiries. As the SME Lending Letter notes, those inquiries have examined numerous aspects of SME lending including the conduct of banks and their dealings with customers. As part of those inquiries, CBA and Bankwest have carefully examined their lending practices and the manner in which they have dealt with SME lending customers who experience financial difficulty. The inquiries have also invited CBA and Bankwest to review specific customer cases where allegations of misconduct or other poor behaviour have been made. As part of those inquiries, CBA and Bankwest have undertaken numerous reviews of customer cases to assist those inquiries and have responded to the allegations made against them. Details of the work that CBA and Bankwest have undertaken are discussed below.
6. Second, CBA's experience in reviewing customer cases and responding to questions raised by those public inquiries, together with its own internal complaint management systems, has demonstrated that customers raise concerns about SME lending which can be broadly grouped into three categories:
 - (a) Loan origination issues - for example, loans not being granted, or complaints raised when a customer defaults on their loan and alleges that they should not have been provided with the loan (or size of loan) approved in the first place;
 - (b) Account management issues - issues identified during the term of the loan, for example poor customer service during the period of the loan; and

¹ Further detail as to how CBA and Bankwest provide SME lending can be found in the witness statements of Joanna Charlene White dated 13 April 2018 at paragraphs [18] – [21] and Sinead Taylor dated 13 April 2018 at paragraphs [11] – [20].

- (c) Loan defaults and hardship - issues and concerns which arise when customers default on their loan.

This submission outlines, in respect of each category above, the relevant entries from CBA's Previous Submissions.

7. Third, CBA provides an overview of relevant Financial Ombudsman Service (**FOS**) determinations which involve SME lending.
8. Finally, CBA provides information about customer complaints which it has received in the period since 2010 which relate to SME lending.
9. If the Commission would be assisted by further information in relation to any specific case referred to in these submissions, CBA would be pleased to provide it to assist the Commission.

Public Inquiries into SME lending

10. In the period since the Global Financial Crisis (**GFC**), there have been a number of inquiries into SME lending. The key inquiries are outlined below.

2012 - Inquiry into the post-GFC banking sector (Senate Economics References Committee)

11. One of the key case studies examined by this Committee concerned allegations that Bankwest mistreated a number of its business lending customers after Bankwest was acquired by CBA. There were two main categories of allegations made against Bankwest:
 - (a) Chapter 7 of the final report of the Committee (**Final Report**) examined allegations that a review of Bankwest following its acquisition by CBA (called "Project Magellan") resulted in the reassessment of many commercial loans to small business, particularly loans linked to property and property development. It was alleged that in many cases, Bankwest required properties associated with their loans to be revalued, with the outcome being an assessed value of the property that was significantly lower than the valuation that was undertaken before the loan was agreed, which then placed the borrower outside their Loan-to-Value Ratio (**LVR**) covenant. This, it was said, led to high rates of default interest being imposed creating unsustainable situations and leading to loans being terminated.²
 - (b) Chapter 8 of the Final Report examined the "HBOS Clawback" allegations, referred to at paragraph [181] to [183] of CBA's 29 January 2018 submission. Some customers alleged that CBA directed Bankwest to raise provisions and take recovery action in respect of various commercial loans to receive a benefit from the operation of the share sale deed entered into on 8 October 2008 (**Deed**), and claw back part of the Bankwest purchase price from HBOS (**Clawback Allegations**).
12. Paragraphs 7.11 - 7.17 of the Final Report outline the evidence CBA provided to the Committee regarding its review of the Bankwest business after its acquisition. In particular:
 - (a) CBA initiated a thorough review of the Bankwest portfolio post acquisition which was described in its 2009-2010 results presentation as 'comprehensive and in-depth'. By the end of June 2010, around 1100 loans had been reviewed, the results of which identified issues predominantly with loans on the east coast of Australia that had unrealistic security valuations. CBA identified many pre-acquisition loans reflecting poor asset quality, high LVRs and insufficient covenant coverage.³

² See [7.1] of the report of the Final Report.

³ See [7.12] of the Final Report.

- (b) Under CBA's ownership, risk management practices were significantly strengthened and Bankwest shifted away from certain business lending activities.⁴

13. As noted above, Chapter 7 of the Final Report considered a number of allegations made against Bankwest and various customers' experiences following the acquisition of Bankwest by CBA.⁵ Those allegations were carefully reviewed by Bankwest. In Bankwest's submission to the Inquiry, it responded to the evidence received by the Committee (see paragraph [7.21] of the Final Report):

- (a) Lending policies – Bankwest's lending policies and procedures require an appropriate assessment of a number of matters. Prior to and since the GFC, Bankwest, like many financial institutions, has continually reviewed and adjusted its lending policies;
- (b) CBA acquisition – in respect of the Clawback Allegations, the Deed and purchase price adjustment process did not have any impact on Bankwest's approach to dealing with customers. The acquisition of Bankwest did not cause any change to existing contractual arrangements between Bankwest and its customers;
- (c) Defaults – it is not in Bankwest's interests, and it makes no commercial sense, to "manufacture" defaults or to cause or increase losses. Rather, the most profitable outcome for Bankwest is when a customer repays their loan in full plus interest;
- (d) Customers in financial difficulty – customers in difficulty have been dealt with appropriately and on an individual basis;
- (e) Receiverships – Bankwest's level of receivership appointments have not been unreasonable or aggressive and are in line with its market share; and
- (f) Valuation process – where Bankwest uses valuers they are independent and have in place proper standards and processes.

2015 - Inquiry into the impairment of customer loans (Parliamentary Joint Committee on Corporations and Financial Services).

14. The Inquiry into the impairment of customer loans examined a number of issues including non-monetary defaults, timeframes for customers including notice to roll over loans, responsible lending requirements, the role of the FOS, the role of valuers, and the need for a nationally consistent farm debt mediation scheme. The final report of the inquiry was published on 4 May 2016.

15. As part of this Inquiry, CBA and Bankwest examined a significant number of customer cases to assist the Committee in its work. In particular:

- (a) CBA reviewed 36 customer submissions provided to the Committee. CBA's analysis of the 36 cases found that the customer was in monetary default in 33 cases. Of the:
 - (i) three cases that were not in monetary default, in one case, no enforcement action was taken, in the second case, the customer appointed a voluntary administrator and as a result of this significant default a receiver was appointed, and in the third case, Bankwest appointed a receiver after the customer invited Bankwest to do so.
 - (ii) 36 cases, receivers were appointed to 28 cases which were presented to the Committee. In no case was a receiver appointed on the basis of a

⁴ See [7.13] - [7.14] of the Final Report.

⁵ See [7.18] - [7.62] of the Final Report.

LVR breach only. Significant other defaults were evident in all circumstances.

- (b) CBA also conducted a review of 67 customers who had previously been considered as part of an Ernst & Young Expert Determination Report dated 7 July 2009. Ernst & Young were appointed to make an expert determination as part of the price adjustment mechanism of the Deed for CBA's acquisition of Bankwest. CBA conducted an analysis of those cases to determine the reason for the default of their loans. Eight customer cases were excluded - six because they overlapped with the review in part (a) above, one because it was not a business lending customer and one because it had complex needs which were well publicised (ABC Learning). Of the remaining 59 customers reviewed, 53 were in monetary default. Of those six customers where no monetary default existed: in three cases, no receiver was appointed; in two cases, the customer or another secured creditor appointed a voluntary administrator; and in the final case, another creditor commenced liquidation proceedings in court against the customer.
- (c) CBA also conducted a detailed review of eight customer cases who provided evidence to the inquiry who, in CBA's opinion, made highly inaccurate comments about the actions of CBA or Bankwest.

- 16. The Inquiry into the impairment of customer loans also re-examined a number of the allegations considered by the Inquiry into the post-GFC banking sector in 2012 about CBA's purchase of Bankwest, the conduct of CBA following its acquisition of Bankwest, and its motivations for that conduct (i.e. the Clawback Allegations).

2017 - Australian Small Business and Family Enterprise Ombudsman - Small Business Loans Inquiry (Carnell Inquiry)

- 17. The Ombudsman's final report as part of the Carnell Inquiry was released in February 2017.
- 18. The Carnell Inquiry reviewed a number of cases, including two CBA cases and four Bankwest cases. Two of these cases were not related to SME Lending. For all six cases, there was evidence of significant default and that CBA worked with each customer to attempt to resolve their financial difficulties.
- 19. The Carnell Inquiry resulted in a number of recommendations, many of which CBA and Bankwest have implemented, or are in the process of implementing. This is discussed in further detail in paragraph 25 below.

2017 - Inquiry into Lending to Primary Production Customers (Senate Select Committee).

- 20. In 16 February 2017, the Senate established the Senate Select Committee on Lending to Primary Production Customers to inquire into and report on the regulation and practices of financial institutions in relation to primary production industries, including agriculture, fisheries and forestry.
- 21. CBA participated in the Inquiry, including providing the Inquiry with evidence in relation to four CBA and Bankwest customers. The Inquiry reported late last year and recommended a number of reforms for both government and the industry, many of which focused on the use of receivers and valuers. The Committee also supported the establishment of a national farm debt mediation scheme.

Response to allegations raised in the inquiries

Bankwest allegations

22. In its submission dated 29 January 2018, CBA provided details of two major issues which have been raised by segments of the community, and at a number of the inquiries noted above, following the Group's acquisition of Bankwest in 2008:
- (a) Bankwest acquisition: Clawback Allegations - at paragraphs [181] to [183];
 - (b) Review of customer cases - at paragraphs [184] to [186].
23. CBA has consistently rejected the clawback allegations which are without foundation. Reasons are set out in its 29 January 2018 submission, and its previous submissions to the inquiries noted above. Both the Parliamentary Joint Committee and the 2012 Post GFC banking inquiry did not find any evidence to substantiate these claims. Further, where the substance of allegations has been tested in court it has been found in favour of CBA.
24. In relation to the review of Bankwest customer cases, as noted in the 29 January 2018 submission, in no cases did CBA's review suggest that it had acted inappropriately (although we did conclude in one case that the customer's experience had been poor). However, CBA understands that enduring financial difficulty and failure of a business is very stressful for customers, and, when a bank takes recovery action against secured assets the relationship between the bank and customer is often placed under strain. Rather, the better outcome for both parties and the most profitable outcome for Bankwest is when a default does not occur and a customer repays their loan in full plus interest.

Recent changes to approach to SME lending

25. Following the Carnell Inquiry, CBA made a number of changes to its approach to lending contracts in the small business sector. Those changes were summarised in CBA's 29 January 2018 submission as follows:

[197] We have responded to concerns we were hearing from the small business sector about our lending contracts and we have simplified the way we provide finance to them. For customers with total lending facilities below \$3m we:

- removed financial indicator covenants (excluding property development, foreign currency loans, loans to super funds, margin loans);*
- removed material adverse change "catch-all" clauses and reduced the non-monetary events of default down to seven key areas, which are all within the customer's control;*
- provided a minimum 30 day cure right where the default is capable of being remedied by the customer;*
- provided customers with 45...days' notice period when making changes to all general restriction clauses and covenants; and*
- provided 120 day notice prior to term loans maturing and providing an additional 90 day notice if a decision is made to not roll-over a term loan.*

[198] For all loans using standard documentation we are in the process of simplifying and rewriting in plain English the business funding documents, Letters of Variation and the standard Terms and Conditions for business lending, trade finance and corporate cards customers. A new one-page summary of default and key detrimental outcomes will also be included.

[199] These changes impact 96% of our small business customers.

26. These amended, simplified terms and conditions better reflect both CBA's practices and evolving community expectations.

SME lending issues - Loan origination

27. In its submission dated 29 January 2018, CBA identified, at Annexure C, a list of final determinations in which an adverse comment or finding has been made against CBA. The following case concerns SME lending issues associated with loan origination: *Commonwealth Bank of Australia v Doggett & Ors* [2014] VSC 423 and *Doggett & Anor v Commonwealth Bank of Australia* [2015] VSCA 351. In this case CBA made a loan to a company which was guaranteed by the 2 directors. The borrower defaulted and CBA sought to enforce the guarantee. The guarantee contained a statement acknowledging that it was subject to the Code of Banking Practice (**Code**). The guarantors argued they were not bound by the guarantee as CBA had not exercised due care and skill in its credit assessment of the borrower as required by cl 25 of the Code.
28. The Court ruled (both at first instance and on appeal) that CBA had breached cl 25 of the Code. This is because CBA's credit officer made certain oversight errors in the credit assessment process (most significantly he did not factor in the wages that would need to be paid to onsite managers of the business). This would be regarded as misconduct as it is a breach of a professional standard that applies to all banks who subscribe to the Code.
29. As part of its submission dated 13 February 2018, CBA provided the Commission with data from its RiskInSite system, which contains all details of Compliance Incidents records for the period 1 January 2013 to date (see section [2.2] of the submission).⁶ In response to feedback from Counsel Assisting that the RiskInSite information was voluminous, CBA subsequently provided a table of misconduct on 22 March 2018, which excluded the large number of Compliance Incident records that were rated insignificant or low. In order to assist the Commission, CBA has reviewed that data in order to identify entries which relate to SME lending in order to consider and provide the Commission the categories or themes that can be observed in the RiskInSite data.⁷ If the Commission would be assisted by information about any specific incident or category, CBA would be pleased to provide further details. The RiskInSite data contains:
- (a) 59 instances of provision of a business lending product(s) for a potentially ineligible purpose (typically residential construction), which do not comply with a policy or business rule. For example, IN-016509: The purpose of the loan is to 'construct 3 townhouses' which is considered a consumer purpose as the applicants are individuals investing in residential property. Thus a business loan cannot be offered for this purpose. Bankwest recorded a further five instances of this nature;
 - (b) 17 instances of inadequate or inaccurate disclosure being made to customers in relation to a SME lending product. For example, IN-085157: A Better Business Loan customer has reported to Group Customer Relations that the figures displayed in the summary section of a statement issued to them are incorrect. The Interest, Repayments and Other Payments and Charges totals show inaccurate figures. There is no financial impact to any customers. A further 85 instances were recorded in relation to Bankwest;
 - (c) 16 instances relating to loan conditions (including servicing). For example, IN-076098: Customer has complained to FOS in response to a loan approval condition

⁶ As noted in its 13 February 2018 submission, a Compliance Incident is "an actual, suspected, potential, likely or imminent contravention or breach of a Compliance Obligation of any applicable law, regulation, industry standard, industry codes which have been subscribed to, or an external business rule or guideline (such as ASX Market Rules, APRA guidance notes)".

⁷ The categories below exclude recorded incidents relating to general process errors which have been deemed non-specific to SME lending, for example privacy obligations (e.g. failure to appropriately redact information stored in CBA systems) and general disclosure errors (e.g. failing to advise that a call was being recorded).

requiring that equity be contributed to a 15 townhouse development; Customers claim there was no consideration of equity in initial deal discussions with CBA. A further 63 instances have been recorded by Bankwest.

30. The following entry from the table produced to the Commission on 22 March 2018 concerns a loan origination issue: Row 51 - Non-compliance with *National Credit Consumer Protection Act 2009 (Cth)* (Commercial Advance on residential borrowing) disclosure obligations.

SME lending issues - Account management

31. CBA has identified the following categories of Compliance Incidents contained in the 13 February RiskInSite data that relate to Account Management:
- (a) 25 incidents relating to fee and interest inaccuracy. For example, IN-131691: CBA identified that customers who had defaulted on their Commonwealth Portfolio Loan were being charged the incorrect excess interest rate.
 - (b) 27 account management incidents. For example, IN-171148: Customer expressed dissatisfaction at not being informed that the monthly loan repayments on both his loans had increased, as a result his account became overdrawn. An additional 49 incidents have been recorded by Bankwest.
32. In addition, the following entries from the table produced to the Commission on 22 March 2018 concern loan account management issues:
- (a) Row 20 - Required repayment amounts for existing CBA liabilities were not being included in the servicing calculations for new credit applications in some cases, leading to the possible offer of an unsuitable credit contract for some customers;
 - (b) Row 50 - Estimated overcharging of fees in place for the quarantined AgriOptions product of at least \$330,000;
 - (c) Row 287 - 7,000 Better Business Loans have been identified with a potentially incorrect loan service fee being charged to the account;
 - (d) Row 289 - Agri Advantage Package - Overdraft Line Fee overcharging. Over 700 customers were incorrectly charged an Overdraft Line Fee on their Temporary Excess Limit, which should have been waived under the AgriAdvantage Plus Package;
 - (e) Row 294 - AgriAdvantage Plus Package Review - It was identified based upon a review of discount packages across CBA that a number of AgriAdvantage Plus customers may not be receiving the correct concessions/ benefits due to an inconsistent application of these benefits to their facilities and associated products. A further six instances have been recorded by Bankwest;
 - (f) Row 301 - CL SAP Platform Stability and Refunds;
 - (g) Row 303 - Errors in BetterBusiness Loan repayment recast calculations; and
 - (h) Row 307 - System defect resulting in overdraft double debit interest being charged on Business Transaction Account (on both Overdrafts and Simple Business Overdrafts).

SME lending issues - Hardship and default

33. At paragraph [184] of the 29 January 2018 submission, there is a reference to one case where Bankwest acknowledged that the customer's experience had been poor. CBA accepts that its conduct in respect of that customer, who made a submission to the Loan Impairment Inquiry, fell short of community standards and expectations.

34. In addition, the following two cases, listed at Annexure C of CBA's submission dated 29 January 2018, may be of relevance to the Commission's inquiry into SME lending.

Mastronado V Commonwealth Bank of Australia t/as Bankwest [2017] NSWSC 1052

35. In this case CBA (t/as Bankwest) provided lending in a set of transactions involving several companies and individuals. The plaintiff and his wife were both borrowers and guarantors and mortgaged their home as security. Under one of the facilities there was a provision that stated the plaintiff's home would be released from the security package if no event of default subsisted and the LVR for the facility was no greater than 70% after the release (**release provision**).

36. Justice Hammerschlag, of the Supreme Court of New South Wales, found that CBA repudiated the release provision. His Honour described it as "common or garden breach of contract" [136]. However, his Honour also held that there was no evidence that the plaintiff would have been able to satisfy the LVR calculation after the release of the property as that would have required a significant payment to CBA to reduce the loan outstanding. Therefore, at best, the plaintiff would have been entitled to nominal damages only which were not sought. Finally, his Honour held that CBA's conduct did not amount to unconscionable conduct.

37. The matter was appealed by the plaintiffs and was heard on 9 March 2018. The central argument on appeal by the customers was that the judge erred in finding that CBA did not act unconscionably in the repudiation of the release provision. By Notice of Contention, CBA challenged the finding of Justice Hammerschlag that CBA had repudiated the release provision. Judgment has been reserved.

Bankwest v Mann [2015] WASC 187

38. In this case, CBA applied for summary judgment against a borrower and a guarantor of corporate debtor who sought to defend the matter by raising certain defences including breach of implied terms, estoppel, misleading and deceptive conduct and unconscionability. The judicial officer stated, taking the defendant's version of the facts and without deciding the matter, that there was some room to argue these defences so dismissed the application for summary judgment. Since that decision, additional pleadings have been filed by both parties including a reply by CBA, and a preliminary trial of certain issues (not the claims for misleading or deceptive conduct, or unconscionability) has occurred with judgment reserved.

FOS matters

39. The following summary has been prepared in order to provide the Commission with details of complaints that concern SME lending that were made to FOS which were closed at the "preliminary view" or "determination" stage (which are the two stages of the FOS process in which a complaint can be closed as a result of a view or decision of FOS (noting that prior to July 2015 "preliminary views" were referred to as a "recommendations")) (**FOS Cases**). For a complaint to be closed by FOS at the "preliminary view" stage both parties to the dispute must agree with the FOS view. If either party to a dispute does not agree to a preliminary view issued by FOS, the dispute proceeds to a determination and this decision is binding on CBA but not the applicant.

40. The summary includes cases classified by FOS as "Business Finance", together with additional cases that CBA has identified as potentially relating to SME lending issues. Since 2010, there have been 196 FOS Cases. Of those cases, 110 had a FOS view in favour of CBA while in 86 cases FOS had a view adverse to CBA. Those 86 cases can be categorised in to the following types of claims. CBA notes that the categories are provided to the

Commission on an indicative basis and do not exhaustively capture all issues relevant to each FOS Case. Similarly, where a FOS Case is relevant to more than one category, CBA has not duplicated the FOS Case entry:

- (a) Decision made by CBA – 27 of the FOS Cases relate to matters in which a customer has made a complaint in relation to a decision that CBA has made. An example of these types of complaints is a complaint made by a customer in relation to CBA's decision to cancel a customer's overdraft or approve a loan;
- (b) Issues arising with instructions provided by customers to CBA – seven of the FOS Cases relate to matters in which a customer has made a complaint in relation to instructions that have been provided to CBA. An example of these types of complaints is a complaint made by a customer that CBA failed to process a loan discharge request in accordance with instructions;
- (c) Privacy and confidentiality – four of the FOS Cases relate to matters in which a customer made a complaint in relation to mis-use of customer information. An example of these types of complaints is a complaint made in relation to credit reporting;
- (d) Service – one of the FOS Cases relates to a matter in which a customer made a complaint in respect of CBA's delay in handling a request;
- (e) Transactions – four of the FOS Cases relate to matters in which a customer made a complaint about the unauthorised transaction made by CBA. For example, a customer disputing transactions on a business account;
- (f) Financial difficulty – 24 of the FOS Cases relate to matters in which a customer experienced financial difficulty. An example of these the types of complaints made by customers is in relation to CBA's decision to decline a request for dispensation due to financial difficulty;
- (g) Charges – 10 of the FOS Cases relate to matters in which a customer made a complaint about a fee or interest charge. An example of the types of complaints made by customers is in relation to CBA's interest rates;
- (h) Disclosure – eight of the FOS Cases relate to matters in which a customer made a complaint about the CBA's disclosure of product or service information. An example of the types of complaints made by customers is in relation to the disclosure of a particular fee or charge; and
- (i) Advice – one of the FOS Cases relates to a matter in which a customer made a complaint in relation to advice to obtain a loan.

41. Given that FOS formed a view adverse to CBA in these cases, CBA accepts that its conduct fell below community standards and expectations.

Customer complaints

42. In order to provide the Commission with insight into the types of customer complaints that CBA receives in relation to SME lending, CBA has conducted a review of its customer complaint database (that was introduced in 2010) and makes the following observations in relation to those complaints:

- (a) Amongst business customers, the majority of complaints received by CBA are classified as 'Quick Resolve'. This means that CBA staff are able to address and resolve the complaint in the first instance, without escalation to further internal or external dispute resolution mechanisms;

- (b) 13% of business complaints about business lending were escalated to CBA's internal dispute resolution team, Group Customer Relations. A small proportion of those complaints were escalated to external dispute resolution through FOS;
- (c) Amongst these complaints, the most common causes of complaints recorded by CBA staff (in order of prevalence) are:
 - (i) Staff Responsiveness;
 - (ii) Fees and Charges;
 - (iii) CBA Policy;
 - (iv) Delay in Service;
 - (v) Collections/ Financial Assistance;
 - (vi) Staff Error; and
 - (vii) Credit Decisions;
- (d) The most common causes of complaints recorded by Bankwest staff are:
 - (i) Product-related process issues;
 - (ii) Staff Service;
 - (iii) Errors;
 - (iv) Fees and Charges; and
 - (v) Delays.