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CONFIDENTIAL

Response of Westpac Banking Corporation

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

13 February 2018

200 | Westpac GROUP

Westpac provides the following response to the Commission's letter dated 2 February 2018 (the **Second Request**).

The Second Request can be divided into parts:

1. the request for more specific identification of instances of misconduct in tabular form (**Part A**); and
2. the request for more detailed information on the specific matters identified in the annexure to the Commission's letter (**Part B**).

Part A

Westpac's response to Part A of the Request is set out in the attached schedules (the **Schedules**). The following matters should be noted in relation to the information contained in the Schedules:

1. Relevantly to the Second Request, Westpac's management systems are designed to identify issues, incidents, risks, potential customer and compliance impacts as well as reportable breaches. Westpac's systems do not necessarily characterise conduct issues in a manner that corresponds with the definition of Misconduct contained in the Commission's terms of reference. Accordingly, identifying with certainty if an identified issue or incident was or was not Misconduct in the 5 year period (as distinct from whether some action should be taken) would often require substantial additional investigation and legal advice.

2. Given those constraints, the limited time available and Westpac's desire to assist the Commission to gain an understanding of the conduct issues affecting Westpac's business, Westpac's response sets out the potential Misconduct it has identified in the relevant period by applying the methodology in paragraph 3 below.

3. Westpac has sought to do this by seeking to identify potential Misconduct by reference to specific information sources within Westpac. As a result, Westpac is providing a list of issues identified through its breach reporting processes and other relevant source documents, as well as a broader set of material captured by Juno, its incident management system. Further information about Juno is set out below. Westpac has taken this approach in order to provide the most comprehensive response possible, noting the points in paragraph 1 above and that it has not been possible for Westpac to look at all documents or sources of documents across the Group. While Westpac has directed its searches to uncovering the most significant and highest number of instances of potential misconduct, it is not possible to say with certainty that the process has identified all potential Misconduct during the period.

4. While Westpac has worked hard to provide as substantive a response as possible to the request from the Commission in the time available, there are a number of sources of information and instances of potential misconduct that it is still reviewing[1]. While this response represents the majority of the information we anticipate providing to the Commission in response to the request, Westpac will submit a further response identifying additional potential Misconduct in the coming week. Westpac acknowledges the importance and urgency of the Commission's work and will seek to ensure that any additional information is provided as soon as possible.

The Juno incident management platform

5. One particular data source we have referenced in preparing our response is our Operational Risk and Compliance management platform 'Juno'. The Juno platform is the Westpac Group's 'incident' recording system used since around April 2017 to manage Operational or Compliance Risk events. The predecessors of Juno were Accord and Radar which were used to capture operational risk and compliance information respectively. Records from those systems were migrated into Juno.

[1] Westpac has not sought to respond on behalf of Westpac-related entities in offshore jurisdictions who are not the subject of a notice, or offshore branches in relation to offshore conduct, given the terms of reference places emphasis on the Australian banking system and its impacts on Australians. If the Commission would like Westpac to respond by reference to its offshore related entities or branches please advise. Westpac has also not sought to respond on behalf of affiliated companies in respect of which it does not currently have a majority shareholding.

6. To help provide a full response to the Commission, in addition to including information from our breach registers and other documents, we have reviewed and sought to identify potential Misconduct from the Juno platform. Given the nature of that system we have left the descriptions of incidents obtained from the Juno system intact so the Commission obtains a clear view of how the relevant issue was first recorded.

7. Juno is designed to facilitate the ready recording of incidents by all Westpac staff members to ensure potential conduct issues affecting the business are identified in a timely manner and then considered as part of our risk and compliance management processes. The records in Juno represent a record of the incident as it was understood at the time of entry by the person who makes it.

8. Once captured, the incidents recorded in Juno are triaged to determine cause, impacted parties, compliance impacts, incident ownership, rectification and remediation as required. Monitoring of the adherence to policy regarding timeframes is part of regular Business Unit, Divisional and Group level Risk Committees.

9. The records and descriptions of incidents in Juno thus reflect the early recording of incidents by many different users across the Group, often before all the relevant facts and circumstances are known. The entries are not always easy to understand without broader context. Importantly, it cannot be assumed that the records obtained from the Juno system are an accurate, complete or up to date record of the relevant issue identified. The Juno system does not usually record the manner in which issues were ultimately handled and is not routinely updated as other facts emerge or change. Where appropriate, these tasks are undertaken by other aspects of Westpac's management systems, such as breach reporting and voluntary disclosures to regulators, and management and Board reporting processes.

10. The Juno system does not record information for all of the specific particulars requested by the Commission. In particular, specific and final details of compensation amounts paid is not uniformly recorded in that system and it has been necessary to attempt to locate that information from other information sources. The information recorded for compensation amounts represents the position to the best of our knowledge at the time of preparing the response.

11. The Schedules indicate which information is extracted directly from Juno. The Juno information used for the purposes of this response was extracted from the Juno system on 24 January 2018.

12. There may also be some duplication of issues between the Juno records in the Schedules and the other references. The duplication between the records identified from Juno and the subsequent identification can sometimes illustrate how an incident can evolve from the manner it is first logged to how it is ultimately understood following investigation. There are a small number of privileged entries which have been reframed to avoid disclosing privileged information.

13. Further information on Westpac's processes for dealing with issues and incidents logged on Juno can be provided on request.

Part B - Response to Annexure Questions

A. General Information

Question A1.

What are the functions, powers and resources of the Customer Advocate, which is referred to on p 3?

Westpac is committed to continuing to improve the way it manages and resolves customer complaints. The Customer Advocate, while employed by Westpac, is intended to act as an independent voice within Westpac to assist customers and improve the customer experience in connection with complaints. Westpac's Customer Advocate, Mr Adrian Ahern, a former chairman and senior partner of law firm Norton Rose Fulbright, was appointed by the Westpac Group in late 2016.[2] The Westpac Group Customer Advocate's functions are set out in the Terms of Reference for the role, which were approved by the Group senior executive team in March 2017 and updated in October 2017. The role covers all individual and small business customers in Australia across Group brands (Westpac, St George, BOM, BankSA, RAMS and BT) and was established in response to the ABA Six Point Plan published in April 2016.[3]

Importantly:

- the Customer Advocate does not report to or through a Westpac Group business unit or the compliance or legal function within the Westpac Group. The Customer Advocate reports to the Group Executive Human Resources, Corporate Affairs and Sustainability, who in turn reports to the Westpac Group CEO, Mr Brian Hartzer:
- the Customer Advocate also meets the Westpac Group CEO every second month to discuss the Customer Advocate function and the Customer Advocate's observations about the conduct of complaints and related issues. The Westpac Group CEO is also available as and when requested by the Customer Advocate to discuss any issues: and
- the Customer Advocate attends meetings with Westpac Group executives and the Westpac Group Board from time to time to provide insights and themes arising from the Customer Advocate's work.

The Westpac Group Customer Advocate has five primary functions:

(a) Escalation of complaints from dissatisfied customers:

The Customer Advocate is available as a point of review and decision for any retail or small business customer dissatisfied with how their complaint has been managed by the Westpac Group. If dissatisfied with the outcome of a complaint, a customer may escalate their complaint directly to the Financial Ombudsman Service (**FOS**) or choose to go first to the Customer Advocate (and then if still dissatisfied they can go to FOS). The two processes can also proceed in parallel.

Customers of the Consumer Bank and Business Bank are advised of the availability of the Customer Advocate by way of the letter they receive from the internal dispute function in the Westpac Group if their complaint is declined. The same notification process is presently being rolled out across BT. Once approached by a customer, the Customer Advocate deals with the customer directly. Further, each Westpac Group website also makes clear that the Customer Advocate is available to assist retail and small business customers.

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[2] See: www.westpac.com.au/contact-us/your-customer-advocate

[3] See: www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust.

The Customer Advocate has unfettered access to all Westpac Group information and personnel. Subject matter experts are also available across the Westpac Group as a point of contact for the Customer Advocate to obtain a briefing on technical issues.

(b) Ad hoc review of complaints:

The Customer Advocate also reviews customer complaints referred to him by any senior executive or dispute resolution function within the Westpac Group where a complaint is particularly complex or the customer is suffering a vulnerability, no matter the stage the complaint is at (i.e. early stage complaint review through to a matter before the courts).

This aspect of the Customer Advocate function includes the Customer Advocate's review of all long-standing unresolved customer complaints across the Westpac Group. In the final four months of 2017, approximately 180 matters were reviewed and decisions made about how best to progress each matter to a close. This is an ongoing process.

(c) External stakeholders:

The Customer Advocate liaises with customer and consumer support organisations to listen to and act on feedback about the Westpac Group, including the Westpac Group's products, policies and processes. The Advocate also engages with other stakeholders as appropriate, such as the Australian Bankers Association (**ABA**).

As part of this, two Customer Councils have now been established by the Customer Advocate, one consisting of external stakeholders representing the interests of vulnerable customers, the first meeting of which took place in October 2017, and the other for small business representatives, the first meeting of which is scheduled for April 2018.

The purpose of each Council is to have a constructive dialogue with key stakeholders regarding current issues and what the Westpac Group can be doing better, and to "road test" proposed Westpac Group initiatives.

(d) Internal stakeholders:

The Customer Advocate maintains working relationships with relevant teams across the Westpac Group, including customer facing staff, and attends Westpac Group internal team meetings as appropriate. The Customer Advocate may have a role, for example, in participating in committees having oversight of or coordinating customer remediation projects.

(e) Recommendations:

The Customer Advocate makes recommendations to identify root cause issues which give rise to complaints to help identify and eliminate those issues within Westpac so as to seek to improve the Group's customer experience. Thus far the Customer Advocate has published a number of recommendations on a number of themes, including improved complaint resolution processes, customer communications, and support for vulnerable customers.

In addition to these specific functions, after his appointment, the Customer Advocate spent 90 days listening to internal and external stakeholders, and mapping out how the function of the Customer Advocate could be best implemented within the Westpac Group, based on that input and on the general guidelines published by the ABA.[4]

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[4] See: www.bankers.asn.au/images/uploads/ArticleDocuments/149/ABA-Customer%20Advocate%20Guiding%20Principles-FINAL.pdf.

Powers

The Customer Advocate has the power to amend or reverse an Internal Dispute Resolution decision made within the Westpac Group in relation to any retail or small business customer who is dissatisfied with the outcome of their complaint. The Customer Advocate can make a decision in such cases which is binding on the Westpac Group in matters involving relief (whether by payment or write off) of an amount up to and including $1 million. For matters involving amounts over $1 million, the Customer Advocate will review the matter and make a recommendation to the Westpac Group CEO.

Resources

The Customer Advocate function within the Westpac Group consists of the Customer Advocate, the Customer Advocate program director (full time dedicated position), and four full time dedicated review managers.

The Customer Advocate's remuneration is fixed for the period he is with the Westpac Group. He is not entitled to any short or long term incentive or bonus payment or benefit of any kind relating to his role. All Customer Advocate team members are on fixed remuneration for the period they are with the Customer Advocate team.

Question A2.

2.1. What are the remuneration and recognition practices referred to on p 10?

The Westpac Group Remuneration Policy (**the policy**) sets out the mandatory requirements reflected in the design and management of remuneration arrangements across Westpac. Employees are remunerated based on a total reward framework which is designed to:

- align remuneration with customer and shareholder interests;
- support an appropriate risk culture and employee conduct;
- differentiate pay for behaviour and performance in line with our strategy and vision;
- provide market competitive and fair remuneration;
- enable recruitment and retention of talented employees;
- provide the ability to risk adjust remuneration; and
- be simple, flexible and transparent.

Westpac's remuneration arrangements are intended to support the interests of Westpac, its employees, and its customers. Westpac aims to design and manage individual remuneration packages to support the attraction and retention of talented employees while delivering an appropriate mix of fixed pay and variable reward (**VR**).

VR is awarded on a discretionary basis to permanent ongoing or maximum term employees. Westpac's VR policy is designed to:

- encourage employee conduct aligned to customer interests;
- support Westpac's long term financial soundness and risk management framework;
- allow for adjustments to reflect the outcomes of business activities, the risks related to business activities and the time necessary for outcomes to be reliably measured; and
- reflect Australian and international regulatory requirements.

The policy is supported by plans and processes that are designed to produce appropriate remuneration decision making across all levels (for example, Westpac's individual VR plan rules include the requirements for remuneration decisions to be approved by the employee's direct manager and the next level up manager) and a governance structure (the Remuneration Oversight Committee, the Risk Adjustment Oversight Committee and the Divisional Remuneration Oversight Committees).

Westpac also operates a series of frameworks to support sound risk management and influence the risk-taking behaviours of individuals:

- VR 'gate-openers': Employees must satisfy expected minimum requirements (gates) to be considered for VR. Employees who fail to satisfy expected minimum performance, risk, compliance (including accreditation for the role) and behaviour requirements are excluded from participating in VR and may also be subject to disciplinary action and/or termination of employment;
- Risk-adjusted VR: Westpac's Group Risk Adjusted Reward Framework supports the identification of material behaviour based risk and compliance matters and consequential recommendations of positive and negative VR adjustments. It facilitates the adjustment of VR prior to award for matters impacting our reputation, financials, customers or other stakeholders;
- Deferral requirements: Westpac's Group Variable Reward Deferral Framework sets out the minimum deferral requirements for VR across the Group. By deferring a portion of VR, deferred awards support alignment with the interests of shareholders as the ultimate value of the deferred portion is tied to the share price at the end of the restriction period. Deferral also provides a portion of award at risk over time and is subject to malus (see below); and
- Malus: The Board has the discretion to reduce an unvested VR, including to zero, if having regard to circumstances or information identified after its grant, all or part of the initial award was not justified.

In addition, Westpac also operates a number of recognition programs. These programs apply at a Group level and in the business divisions and functions and are used to recognise individuals and teams for high performance and/or excellence in customer service.

The CEO Awards, Westpac's overarching group wide recognition program, have been in operation for approximately 10 years with the purpose of recognising individuals and teams across the Westpac Group for their exceptional contribution. In addition to high performance (contribution to business results), the program is used to recognise employees and teams in other categories including exemplifying living Westpac's values, recognising extraordinary customer service and contribution to the community and environment. Winners from the divisional and functional recognition programs are considered finalists in specific categories.

Westpac operates minimum behaviour and individual performance criteria across its recognition programs, with employees excluded from participation should these not be met. For example, being a recipient of a Business or Consumer Bank award requires all individuals and teams to be assessed against:

- All behaviours being rated as exemplary;
- Modelling the Living all the Westpac Values;
- Meeting all risk and compliance requirements; and
- Meeting a high level of performance inclusive of all of the above.

Outside of remuneration and recognition arrangements, Westpac continues to review the design and management of leaderboards, sales campaigns and competitions to support its service based strategy and culture. In the Consumer Bank, these practices are governed by the Rewards and Scorecards Committee who operate in line with a set of guiding principles to ensure alignment with the objectives of the Sedgwick recommendations and Our Service Promise.

2.2. What are the improvements that have been made to the design and implementation of these practices, referred to on p 10?

Westpac is committed to continual improvement of its remuneration arrangements, in line with strategic objectives, market practice and stakeholder expectations. Recent programs of work focused on improving the design and implementation of remuneration practices at a Group level include:

- In 2016, the Board approved updates to the policy to align with emerging best practice and stakeholder expectations. They included expanding Westpac's remuneration principles to focus on customer interests;
- VR plan documentation and associated governance frameworks have been harmonised across the Group to support governance, monitoring and control activity. The updated plans highlight the focus on customer interests in line with Our Service Promise and Westpac's Code of Conduct;
- Although deferral requirements for VR have been in place for a number of years, in 2016 the Westpac Group Variable Reward Deferral Framework was developed to consolidate deferral requirements across VR plans;
- In 2016, the Group Risk Adjusted Reward Framework was updated to improve consistency in the application of downward VR adjustments and support the identification of relevant matters for upward VR adjustment; and
- Westpac is rolling out a new approach to performance management (Motivate) across the Group which has an increased emphasis on behaviours in performance assessment. Motivate seeks to embed a focus on behaviours, conduct risk, real time and ongoing performance feedback, and helping people deliver higher performance. As at February 2018, around 70% of employees across the Group are on the Motivate framework. Our Service Promise also continues to be well embedded in the operating rhythm, demonstrating a strong commitment to doing what is right for Westpac's customers and the link to appropriate conduct.

Within the Consumer Bank, performance and incentive scorecards in the retail business have evolved to a set of measures which are balanced and product agnostic. The changes supported a shift from a focus on the quantity of sales to the delivery of advice and the provision of service to customers. Specifically:

- Since 1 October 2016, Westpac has not had any product quotas or financial gate-openers in incentive arrangements for front line branch roles (Tellers, Personal Bankers, Home Finance Managers, Bank Managers);
- Since 1 October 2017, Personal Bankers are remunerated based on 50% customer / 50% financial measures. 80% of their scorecard measures are team (branch) based to encourage strong teamwork in providing great service to our customers and the incentive can be further enhanced for bankers who are strong role models of Our Service Promise (generally circa +20% to +30%);
- From 1 October 2016, we were also the first major bank to have Teller incentives linked 100% to customer satisfaction (using the Net Promoter Score or NPS). This is fully aligned to the Sedgwick recommendations[5]; and
- For Home Finance Managers, given the specialist nature of these roles, their reward scorecards focus on the value of loans provided (based on what customers draw down), other customer needs met and customer NPS. A modifier around mortgage quality also applies and can reduce their incentive relating to loans provided by up to 100% where mortgage application documentation is below expected standards. VR arrangements for Home Finance Managers do not include any accelerators, namely a higher rate of payment earned in line with higher levels of performance, based on the volume of lending written. The scorecards are currently being reviewed to support a move away from a commission structure and ensure a balanced scorecard approach aligned to the Sedgwick recommendations. Incentive arrangements for Home Finance Managers will be fully compliant by 2020.

These changes form part of Westpac's ongoing program to ensure bankers focus on having quality conversations with customers to meet their needs.

[5] Stephen Sedgwick AO, Retail Banking Remuneration Review, 19 April 2017.

Question A3.

What is Westpac's understanding as to the influence remuneration has on culture and behaviours, referred to on p10?

Westpac's understanding is that culture and behaviours are influenced by a range of factors including:

- behavioural mechanisms, such as leadership and team dynamics; and
- structural mechanisms, such as consequence management and remuneration.

In more colloquial language at Westpac, these factors are known as 'soft wiring' and 'hard wiring', respectively. Westpac recognises that these mechanisms can have both positive and negative effects on behaviours and culture, noting the relationship between these elements is complex and requires careful consideration. Measuring the influence of these factors is also challenging, and involves the exercise of considerable judgement by management.

Westpac recognises its responsibility to design and operate an overall business system that supports its desired culture and behaviours, and this includes the behavioural and structural elements mentioned above. Remuneration arrangements are an important element of this overall system. A brief overview of these remuneration arrangements is set out in A2.1.

Changes to Westpac's remuneration arrangements have been made over time, and continue to be made. Examples of this are set out in A2.2. Westpac continues to strengthen its remuneration governance including in order to more directly assess the influence of remuneration and other tools such as consequence management on culture and behaviours. In doing so, Westpac is mindful to reinforce the need for an open, a safe to speak up culture and therefore seeks to design both the behavioural and structural elements in order to promote the identification and ownership of risks. An example of this is the recent increased focus on positive remuneration adjustments to recognise strong risk management behaviours.

The performance metrics, targets and weightings in employee scorecards also represent an important signal to our people about what we value and are calibrated with a focus on conduct, culture and customer outcomes. We recognise the importance of making phased and targeted improvements to our scorecard arrangements to encourage appropriate behaviours, avoid potential or perceived conflicts of interest, support our risk and compliance settings and good customer outcomes.

Other tools are also used to seek to influence culture and behaviours. An important example of this is Westpac's performance management system, where Westpac is moving to a new approach called Motivate, where leaders make a holistic assessment of performance by reference to a range of criteria including role expectations, performance against goals, broader contribution to the business and behaviours in line with Westpac's values. This assessment informs the employee's VR outcome along with factors outside of personal performance e.g. business performance and available funding.

Westpac recognises the importance of continued focus on the influence that remuneration and other factors have on culture and behaviours. As part of this, Westpac has committed to implementing the recommendations from the recent Sedgwick Review in full and will continue its ongoing review of the design, operation, staff perception and effectiveness of its remuneration practices, both in design and implementation..

B. Consumer lending

Question B1.

Did Westpac remediate any "customer affected by financial difficulty", as referred to on page 11? If so, what was the methodology and timing of such remediation?

Of 6,612 customers potentially impacted, 3,401 were remediated following an examination of their circumstances. The remediation was completed in February 2017. Westpac consulted with ASIC in relation to the remediation methodology which is summarised below.

Identification of impacted customers

Westpac adopted the following steps to identify impacted customers:

- All customers who received a bank-initiated Credit Limit Increase (**CLI**) in the period from 12 September 2012 (the date of ASIC's letter to industry) to 17 December 2014 (the date the issuing of bank-initiated CLI invitations was paused) were identified;
- Of this population, Westpac identified those customers who had been classified as requiring No Further Credit Assessment (**'Non-FCA'**) due to eligibility criteria which were based on the customer's prior dealings with Westpac and the information Westpac already held on the customer;
- Of this population, we identified the potentially impacted customers as:
  - all those customers who subsequently contacted our "Assist" hardship services where the cause was related to their bank-initiated CLI;
  - all those customers who had been 60+ days in arrears at any time in the 12 months from when their bank-initiated CLI was approved; or
  - all those customers who had been 30+ days in arrears on more than one occasion in the 12 months from when their bank-initiated CLI was approved.
- Of those potentially impacted customers, the following groups were excluded as not requiring remediation as a result of Westpac's conduct:
  - where the hardship was unrelated to the bank-initiated CLI (i.e. due to an intervening event such as unemployment) or where it arose more than 12 months after the bank-initiated CLI was provided;
  - where Westpac made inquiries into a customer's financial situation during the subsequent 3 months from the approval of the bank-initiated CLI and they demonstrated capacity to service additional Westpac Group consumer lending products;
  - if a customer's circumstances had previously been considered and accepted on the basis of hardship or been reviewed in a related FOS dispute; and
  - where the customer did not utilise the additional credit limit.

For customers requiring remediation, their case was assessed on a case by case basis through a team dedicated to the remediation. Measures applied included partial debt waivers and / or card limit decreases for amounts down to and including the pre-CLI limit, including any fee and interest reversals. Any issues for the customers as a result of credit reporting was also addressed.

After ASIC accepted the proposed approach in December 2015, Westpac undertook a pilot and then commenced customer engagements from June 2016. Independent assurance was obtained on the implementation of the program, and once completed, was shared with ASIC.

Under the process adopted, the 3,401 customers who were remediated received $11.3 million in remediation (in the form of refunded fees and balance reductions).

Question B2.

What is the methodology of the "proposed remediation plan" referred to on page 14?

The proposed remediation methodology has been informed by the approach adopted and agreed with ASIC in December 2015 for the 2015 CLI matter (noted above) and is summarised as follows.

Identification of impacted customers

Westpac adopted the following steps to identify impacted customers:

- all customers who were provided with their Credit Card or CLI via the Credit Card Cross Sell functionality in conjunction with the assessment of their home loan during the relevant period from 15 November 2004 to 31 December 2015 were identified;
- of this population, Westpac identified:
  - any customers who may have been assigned a limit higher than the residual surplus from the mortgage application would have allowed; or
  - any customers where the serviceability assessment may have relied upon information which was more than 90 days old; and
- of those customers, Westpac identified any customers who potentially faced financial difficulty in connection with the approved limit on the basis that they had either been:
  - 60+ days in arrears at any time in the 12 months from when their cross sold credit card or CLI was approved; or
  - 30+ days in arrears on more than one occasion in the 12 months from when their cross sold credit card or CLI was approved.

That process identified 414 potentially impacted customers.

What the remediation will involve

For each of the 414 impacted customers identified through that process, Westpac will undertake the following approach to address the customer impact:

- refunding associated interest and fees accrued. The minimum remediation that impacted consumers will receive is a refund of the interest and fees charged to their account from the date the account was opened, to the date of the assessment for the purpose of remediation (Life to Date (**LTD**) interest and fees);
- allowing customers to continue to have a credit facility if there is evidence that they can afford to service the agreed credit limit, or a lower limit that is established through serviceability assessment, and writing-off debt which the customer cannot service:
  - Whether a consumer needs to pay off any remaining debt will depend upon whether they wish to retain the card and if so, whether they can service their current credit limit. Westpac will conduct a serviceability assessment based on the consumer's statement of financial position and offer each consumer a credit limit that they can service (if any).
  - If a customer does not wish to retain their card, or declines to participate in a new serviceability assessment, the card will be cancelled and Westpac will write-off the outstanding balance.
  - Consumers who opt to retain the card will need to service that credit limit from the date that Westpac issues the notice of variation.
  - Any consumer who cannot service the minimum allowed limit ($1,000) on the credit card will have their account closed and the outstanding balance written-off (after the refund of LTD interest and fees).
  - Any consumer who opts to retain their card and who cannot service their current limit but can service a reduced limit, will have their limit reduced to the serviceable limit. In these circumstances, if the outstanding balance as at the date of the assessment after the refund of LTD interest and fees exceeds the new credit card limit, Westpac will write off the balance exceeding the new credit card limit.

  - o The amount of any write-offs will not be known until we have completed the consumer engagement process and conducted serviceability assessments for any consumers who wish to retain their credit card;
- Additional ex gratia payments. Customers who may be left in immediate, short-term hardship or financial distress as a result of their account's closure or credit limit reduction will be managed on a case-by-case basis. Westpac may consider making ex gratia payments.

The remediation process is currently on hold at ASIC's request pending their review and response on Westpac planned customer communications as outlined below.

Customer contact strategy

Westpac is consulting with ASIC on the communications to impacted customers. Informed by the CLI approach discussed above, Westpac's proposed process involves:

- A series of mechanisms to contact impacted customers, including letters, telephone calls, SMS' and communications on the customers' online banking. The approach defines the sequence and number of attempts to contact the customer through each method supported by associated templates and call scripts; and
- Monitoring of customer accounts.

Question B3.

What are the preventative controls that Westpac has implemented to reduce the risk of financing of inappropriate add-on insurance, referred to on p 20?

Dealers are intermediaries who provide car loans without an Australian Credit Licence (**ACL**) to retail customers under the 'point of sale' exemption in the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**).

Westpac does not manufacture add-on insurance for distribution to dealers. Westpac undertakes a process of approving all add-on insurance products manufactured by a third party before the products may be financed as part of a car loan. Westpac undertakes a review to ensure the add-on insurance policy offered is by a reliable and licensed insurer and appears to offer value for appropriate customers. For the period of the request, this has been undertaken in the form of a PDS review by Westpac's external legal advisors based on Westpac criteria. This control does not determine the suitability of the product for individual customers but rather the suitability of the product for financing by Westpac as part of a car loan.

Westpac has made the following improvement to its PDS review process. In July 2016, Westpac amended the PDS review template for add-on insurance products manufactured by third parties before they are eligible to be financed by the Westpac Group. The amendments introduced the following requirements (a) comment on key policy exclusions, (b) comment on how the policy could interact with other policies typically sold at point of sale (to address duplication of policies or customers being 'over insured' for the same type of risk), (c) CCI subcategories for unemployment, TPD and life risk, and (d) enhance the description of the product and comment on the real prospect of benefit the policy may provide to an insured at various premium amounts (depending on the type of policy).

The origination of car loans occurs under the Auto Finance Credit Policy. The Auto Finance Credit Policy contains:

- key elements that are required to be considered or measured against during the origination or review of customer exposures by bank staff;
- guidelines relevant to a specific policy that are required to be considered during the origination or review of customer exposures. Guidelines are not policy and therefore non- compliance is not a policy exception;

- procedures relevant to the application of policy and the origination or review of customer exposures; and
- additional useful information relevant to a specific policy or procedure that may assist users in understanding or completing tasks. This may include: user guides, checklists, links to relevant Intranet or Internet sites.

In August 2016, Westpac implemented improvements to the controls relating to add-on insurance within the Auto Finance Credit Policy including:

- No longer financing Consumer Credit Insurance which included a Life Insurance component
- Restricting the Lending Value Ratio (**LVR**) for financing of Gapcover Policies to not less than 75%, that is Westpac would not finance Gapcover insurance if the amount of the finance was less than 75% of the value of the car. Gapcover Policies provide cover for any loss between the amount paid by the comprehensive insurer in the event of theft, fire or accident and the amount required to pay out the related loan balance; and
- Introducing a maximum amount of add-on insurance premiums that could be financed with car purchase to 25% of the value of the car before non-taxable items.

Policy changes were communicated to dealers and monitored as part of the review process. At the same time, Westpac commenced working with an external technology provider to implement these policy changes into the Westpac origination system to prevent dealers from being able to process loans with these characteristics for retail customers.

As a result of these changes the number of add-on insurance policies financed by Westpac per year (tyre & rim, Gapcover, CCI, Life and Mechanical) had fallen from 8,063 in January 2016 to 3,357 in December 2017. For example, the number of tyre and rim policies fell from 992 in January 2016 to 80 in December 2017.

Question B4.

How does Westpac process and monitor loans written by or through motor dealers (as referred to on page 20)? What are the payments, commissions, rewards or non-monetary benefits paid to dealers who arrange such loans under the POS exemption, including where such loans relate to add-on insurance?

Process

Dealer loans are originated by business managers (**Business Managers**) working for the dealer. Business Managers undergo Westpac Training and Accreditation modules (on an ongoing basis) prior to being granted access to Westpac's origination platform. These modules are updated following changes to Westpac policy, process or guideline and most recently in October 2017. Once granted access, the Business Managers are able to process auto loan applications for submission to Westpac via this platform.

When a customer applies for a loan, the relevant Business Manager working for the dealer will enter the following information into Westpac's origination platform:

(a) asset (car) details;
(b) requested loan details (value, term etc.);
(c) customer's personal and employment details;
(d) customer identification requirements (for the purpose of satisfying requirements imposed under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth)); and
(e) record of financial situation (including income, assets, liabilities, expenses (for the purpose of satisfying requirements of the NCCP Act).

The information entered in the system is validated by the Business Manager, verbally with the customer and, where appropriate, by Westpac with supplied documentation such as driver's licence and proof of income, and is then submitted.

Once submitted, the application will either be approved or declined (decisioned) automatically using the Westpac Credit Decision Engine or, where further assessment may be required, it will be referred to the Credit Decisioning Team (part of the second line Risk function). The Credit Decisioning Team will review the reason for the referral (examples would include stability of employment / residence and credit bureau outcomes) and apply judgment to the application operating within the Auto Finance Credit Policy. The Credit Decisioning Team may seek additional information. Should the application be approved, the dealer will be advised and the customer will then execute the loan documentation. If the application is declined due to information from Credit Reporting Bodies, then customers are advised in writing. If the application is otherwise declined, the customer will be advised by the Business Manager of the outcome.

For loans approved automatically or approved by the Credit Decisioning Team, the executed documents are then forwarded to Westpac Group Settlements Team. This team performs compliance checks on the application (including, but not limited to, confirming the finance application matches the system entries, a privacy consent is signed, a copy of the driver's licence of the borrower if included together with proof of address and proof of income). If these checks are satisfactory, the application proceeds to settlement. In the event of irregularities, it is returned to the dealer.

Monitoring

Monitoring is regularly undertaken on the portfolio. Some forms of monitoring (including interest rate and insurance) are undertaken on the entire portfolio of settled loans, while others are undertaken on a sample. The reviews numbered 3 to 5 below represent cumulatively approximately 5% of settled loans.

The monitoring of the portfolio is outlined as follows:

1. System-wide weekly interest rate reports identifying for remediation any loans written with an interest rate above 16% (to monitor compliance with Westpac 16% cap policy);
2. System-wide monthly insurance report confirming compliance with Auto Finance Credit Policy Insurance rules. Relevantly, the rules require: Consumer Credit Insurance (**CCI**) does not include a Life Insurance; that if a Gapcover Policy is financed, the LVR is not less than 75%; and the maximum amount of add-on insurance financed is not greater than 25% of the value of the car before non-taxable items:
3. Approximately 300 file reviews per month of the sales practices of dealers are undertaken by the Auto Finance Quality Assurance Team, focussing on higher risk categories as follows:
    - (a) borrowers with casual employment status;
    - (b) borrowers less than 21 years of age;
    - (c) loans with balloon payment amounts greater than 40%;
    - (d) loans with LVR above 150%;
    - (e) low capacity borrowers (commitment cover ratio less than 1.10x);
    - (f) self-employed; and
    - (g) receipt of Centrelink benefits.
4. 50 Mystery Shopping calls a month are undertaken by an external provider, surveying customers on the Sales Practices of the dealers. These are then reviewed by the Auto Finance Quality Assurance Team;
5. Approximately 100 file reviews a month are undertaken by the Credit Quality & Assurance Team focussing on the Credit Risk practices of dealers, including customer servicing capacity, customer requirements and objectives, financial situation and quality of credit assessment;
6. Quality Assurance reviews are undertaken within the Westpac Group Settlements Team on the Compliance Checks undertaken prior to settlement. A minimum of 3% of applications settled are subject to this review each month;
7. Approximately 75 fraud alerts a week are reviewed by the Risk & Fraud Operations team through the Equifax Fraud Check and Lorica Fraud detection platforms;
8. Weekly review of complaints is undertaken by the Complaints Working Group and any required or outstanding actions for Auto Business;

9. Monthly Credit Portfolio Review by Credit Quality & Assurance showing performance of portfolio by State, Applicant Age, Residential Status, Loan Amount, Asset Type, Credit Decision Engine score, Balloon Payment, LVR Band and Decision (Auto or Manual); and
10. Approximately 20-30 reviews per month of the suitability of loans financed which include CCI premiums, review focuses on criteria typically associated with exclusions in CCI policies including (a) age of customers (b) customers in casual employment or apprenticeships/traineeships (c) customers with short term employment or (d) customers with part time employment or low income (indicative of not meeting minimum hours of work under a CCI policy).

The outcomes from monitoring activities are reported and escalated to the Auto Finance Management Team and Auto Finance Risk and Compliance Committee. Issues identified from monitoring are actioned in accordance with the Auto Finance Consequence Management Framework and Westpac's Issue Management Policies and Procedures.

Payments, commissions, rewards or non-monetary benefits

Payment arrangements for dealers can be grouped into key categories, some of which are payable to all dealers (under a standard commission offering) while others are bespoke arrangements negotiated individually in addition to (or in replacement of elements of) a standard commission offering. Some commission calculations are undertaken based on a later aggregation process. Because of this, the commission arrangements are considered 'unascertainable' for the purpose of the NCCP and not visible to customers as part of their loan documentation

No commission or other payment is made to dealers by Westpac for the sale of add-on insurance products. The dealers as representatives of the insurers receive any commission from the insurers.

As set out in Westpac's response to the Commission dated 29 January 2018 (**Westpac's January Response**), within the auto finance industry lenders use a form of commission known as 'flex commissions'. Flex commissions refer to an arrangement where the dealer who arranges the loan for a customer receives a larger commission from the lender the higher the contract annual percentage rate is above the benchmark or base interest rate. As a lender, the Westpac Group pays dealers using flex commissions for loans written (noting that Westpac has introduced a 16% cap on the annual percentage rate that a customer can be charged). This form of commission will be prohibited from November 2018 under changes announced by ASIC in March 2017. Westpac is currently working with dealers to support implementation of the new rules by 1 November 2018. A small number of dealers are not paid on a flex commission basis, instead being paid as a percentage of the value of the applications approved and settled from a dealer.

In addition to flex commissions which are paid on individual loans, all dealers who submit applications to Westpac receive commissions with a Volume Based Incentive (**VBI**). VBI is a commission payment to the dealer in a given period based on the total amount of loans written by the dealer for the period (traditionally monthly). The VBI arrangements are tiered, with the dealer receiving a higher commission for higher volumes of loans written with Westpac. Another form of VBI payable to a small number of dealers is an interest rate offset to their Wholesale Borrowing Costs (Floorplan Financing). The percentage of VBI a dealer receives is negotiated between dealers and Westpac.

Dealers are also incentivised by Westpac to establish loans where customers have agreed to repay the loan using Direct Debits. This incentive is payable to all dealers in the form of a dollar amount per contract (within a range per contract, typically between $10 or $20).

Bespoke arrangements exist for some dealers including Marketing Fund Payments made to the dealer, which are payable in the form of an actual dollar amount or as a percentage of the amount financed, and Contract Bonuses which are payable based on the number of loans written.

On occasion dealers will be rewarded for campaigns which can include fixed commissions per loan written. VBI and or direct debit bonus will also be payable in respect of these loans.

Westpac continually reviews commission arrangements, in line with strategic objectives, market practice and stakeholder expectations.

Dealers will on occasion be provided with gifts or hospitality by Westpac. These are undertaken in accordance with the Westpac Gifts & Hospitality Policy and recorded in the Auto section of the Gifts & Hospitality Register.

Question B5.

What are the specific policy and process changes in relation to interest-only loans referred to in the second last paragraph on page 23?

The Westpac Group has made a number of changes progressively to the policies and processes which apply in respect of interest-only home loans.

These included changes targeted at enhancing both the information that Westpac makes available to prospective home loan applicants and the information provided to existing home loan customers to assist them in understanding how interest only loans work and the risks and benefits involved with this feature.

Changes adopted in 2017 include:

- The online calculators on Westpac Group websites have been redeveloped and updated to display both the principal and interest, and interest-only repayment schedules side by side. The total interest saved under the principal and interest option is also displayed.
- The online explainer relating to interest-only loans has been revised. The 'Understanding repayment types' content on Westpac Group websites has been updated to detail the advantages and disadvantages of each repayment type;
- This information is replicated within a brochure to assist with in-branch conversations; and
- An annual statement insert is issued to all Westpac, St.George and RAMS customers who have an interest-only owner occupier home loan, providing information to assist them in understanding their home loan repayments, including highlighting that their repayments will increase once the interest only term ends. For RAMS customers the online banking portal (myRAMS) was updated to include interest only term expiration date.

Over the last year, changes have also been made to existing systems, and new banker tools have been developed, to better capture the customer's requirements and objectives. Lenders are prompted by the system to ask specific questions and capture customer preferences and rationale in respect of the product type and features being considered. The system does not allow lenders to progress the application if the required fields are not completed.

Hindsight processes have been strengthened with the introduction of a pre settlement 'day 2' sales quality team who conduct a targeted sample-based review of information captured for the product being provided. The review process commenced in December 2017 and is being progressively embedded to cover more than 20% of all mortgage applications.

The process by which home loans are switched from interest-only repayments to principal and interest repayments at the end of the interest-only term has been automated, ensuring the change to repayments is made at the correct time.

Changes have also been made to the credit policy in relation to the assessment of interest only mortgages. Changes to the serviceability assessment of interest only loans include using the higher of the customer's declared living expenses or the benchmark figure (the Household Expenditure Measure) and calculating the repayment figure of the proposed liability on the amortising term, rather than the total loan term.

The maximum interest-only period for owner occupier loan products has also been reduced to five years.

Question B6.

What is the work that Westpac is doing to address areas of improvement for complying with responsible lending obligations in relation to consumer lending products other than home loans, referred to in the fifth paragraph on page 23?

Westpac recognises that judgements need to be made in applying responsible lending principles and is committed to reviewing and seeking to continue to enhance its credit practices and control environment and improve its record keeping practices. This includes having regard to regulatory feedback, evolving industry and community requirements and expectations and technological capability.

In addition to the changes referred to in Westpac's January Response (such as in relation to credit card limit increases and auto finance), work undertaken to date includes:

- Development of a single, unified statement of responsible lending standards across the Westpac Group through the Group Responsible Lending Policy, taking into account revised regulatory guidance and the desired customer experience. This Policy, together with the Responsible Policy Manual, sets out the expected standards for reasonable inquiries regarding customer requirements and objectives and financial situation, financial situation verification and the not unsuitable assessment process;
- Recognising that customers' income may vary for legitimate reasons, prior to October 2015, where the income shown in documents provided by a customer to support a personal loan or credit card was within 10% of the income declared by the customer in their loan application, Westpac adopted the income declared by the customer. That policy was changed in October 2015 so that where the income shown in the supporting documents provided by the customer is lower than the income declared by the customer in their loan application (even if those amounts are within 10%), the lower figure is adopted in assessing serviceability.
- Historically, Westpac allowed certain existing customers who met eligibility requirements to obtain personal loans and credit cards based on income information declared by the customer and information held by the bank and their credit history without the need to provide supplementary material to verify that income. That practice has been progressively discontinued so that from February 2018 it will only remain for a narrow category of joint borrower personal loans in the Westpac brand where system complexities will require additional time to remove the practice.
- Westpac is currently testing approaches to make it easier for customers to supply information to verify their income in support of an application for a credit card or personal loan where the customer makes the application online or through a mobile device. For example, these approaches will allow customers to electronically submit documents to verify their income. They will also enable customers to authorise Westpac to electronically obtain financial information such as salary credits into transactional accounts at other financial institutions.
- Westpac has commenced a project to implement Comprehensive Credit Reporting to assist in the identification of pre-existing customer liabilities. This will enhance credit assessments as the Comprehensive Credit Reporting regime becomes more widely used across the industry.
- Westpac has conducted an assessment of the effectiveness of controls in place to manage responsible lending obligations for credit cards and personal loans, which is helping to inform the credit practices, controls and record keeping practices requiring further improvement.

Specific steps have also been taken in the area of auto finance to implement improvements in responsible lending practices. These steps include changes to the origination process as well as enhanced review processes to monitor compliance.

The origination process was changed to expand the income and expense details required to be provided by the borrower and to introduce minimum benchmarks on expenses. Payment calculations were improved to include balloon and structured repayments within the assessment.

The enhanced monitoring framework involves reviewing approximately 5% of loan files each month to assess the Sales Practices of the dealers.

Westpac recognises that there will always be more work required in relation to these areas to continue to evolve its lending practices and enhance its control environment and is committed to doing so.

Question B7.

What is the work that Westpac has done to address the issues identified in its review of its mortgage portfolio covering controls used to ensure completeness and accuracy of borrower financial information for the assessment of serviceability for residential mortgages, referred to in the second paragraph on page 24?

Westpac management acknowledge their responsibility for designing and implementing a robust control environment. In that context, the results of the review referred to in Westpac's January Response are disappointing and management are committed to addressing them. To co-ordinate those activities, management established a dedicated Responsible Lending Program which is amongst other things co-ordinating the implementation of the recommendations from the APRA Targeted Review. The following work which has been or is being undertaken as part of the program relates to controls used to ensure completeness and accuracy of borrower financial information for the assessment of serviceability for residential mortgages:

- Westpac's credit and responsible lending policies have been updated to revise the supporting information required to verify key elements of financial position and require more granular financial information. Under the revised policies, prospective borrowers will be requested to break down their expenses into thirteen different categories and will be required to provide supporting documents to verify the amount spent on rent and on child maintenance where applicable. These policy updates are in the process of being implemented across the business;
- The presentation of mortgage files is being revised to provide greater consistency in collation and presentation of financial information. There will be a consistent format and description in all mortgage files of the thirteen categories of expenses;
- An additional customer confirmation of financial information is being introduced at the end of the assessment process, with the customer required to reconfirm their financial information at the time of signing of the loan offer document;
- The adoption of broad based review processes to assess mortgage applications through a dedicated team, reviewing whether the file contains the required information and supporting documentation and adheres to responsible lending policy standards. Any issues identified in this review which are assessed as substantive are required to be addressed prior to the drawdown of funds under the mortgage. The process commenced in December 2017 and is being progressively embedded and will cover more than 20% of mortgage applications;
- Strengthening IT security protocols and user access controls for serviceability calculators and enhancements to the override reporting capability; and
- Improved staff training in relation to responsible lending and associated processes.

C. Wealth Management

Question C1.

What are the control environment improvements and reform referred to on pages 32 and 33?

Outline

The Commission has requested that Westpac identify the control environment improvements and reforms referred to on pages 32 and 33 of Westpac's January Response. Those changes were summarised in Westpac's January Response and further detail is provided below in respect of each of those improvements and additional enhancements (including implementation of additional controls) that have been made.

By way of background, BTFG's financial advice control environment has a number of aspects that have been improved, enhanced or added to, including:

- preventative controls such as policy, training standards, paraplanning and pre-vetting functions; and
- detective controls including analysis of key risk indicators and audit of advice files for compliance.

Additionally, an annual control self-assessment process is undertaken by BTFG to review the control environment and assess the design and operating effectiveness of the current controls.

BTFG recognises that detecting certain types of misconduct may be complex and that it has more to do to improve its control measures. For example, detecting and identifying inappropriate advice is difficult given advice is tailored to the individual needs, circumstances, and preferences of a client. As a result, BTFG recognises that it needs to make regular enhancements to its control environment as it learns about poor practices through both its compliance reviews and control processes and through regulatory reviews and guidance. BTFG continues to make improvements where it identifies opportunities to do so. This is consistent with Westpac's approach to investigating why things go wrong and then responding in a way that reflects Westpac's vision and values.

A. THREE LINES OF DEFENCE

To assist in reviewing this response, we set out below a short explanation of the various roles and responsibilities involved in the relevant aspects of the BT Advice business. BTFG employs a 'Three Lines of Defence' compliance model in accordance with Westpac's Compliance Management Framework as outlined on page 3 of Westpac's January Response.

- The 'First Line of Defence' is the responsibility of BT Advice and includes responsibility for identifying, evaluating and managing the operational risks within approved risk appetite and policies. BT Advice strengthened the first line capability in 2016 establishing a team of risk and compliance specialists in its Capability and Conduct function to provide greater focus on developing and testing controls and improved standardisation in resolving issues, and to promote a strong risk and compliance culture.
- The 'Second Line of Defence' is a structurally separate team reporting to the BTFG Chief Risk Officer. It is a separate risk and compliance advisory, control, assurance and monitoring function, which establishes frameworks, policies, limits and processes for the management, monitoring and reporting of risk.
- The 'Third Line of Defence' is performed by Westpac's Group Audit function. Group Audit is an independent assurance function that evaluates and considers the adequacy and effectiveness of both first and second Line risk management approaches and tracks remediation progress, with the aim of providing Westpac with information as to the operation of the Group's governance, risk management and internal controls.

B. MONITORING OF ADVISERS

BTFG has made a number of improvements to its control environment in the way that it monitors its advisers. These improvements relate to both Westpac employed financial advisers and also to persons who are authorised to provide advice under Australian Financial Services Licences (**AFSL**) operated by two Westpac subsidiaries (**authorised representatives**). Authorised representatives are not employees of Westpac and are usually owners or employees or small businesses. Given that BTFG has a greater control over and access to information in respect of the activities of Westpac employed financial advisers as compared to authorised representatives, the monitoring it conducts for Westpac employed financial advisers is different to the monitoring it conducts of authorised representatives.

Planner Risk Insights

One of BTFG's detective controls is Planner Risk Insights (**PRI**), a proprietary data analytics system developed by BTFG which is used to analyse a range of key risk indicators (**KRIs**) to identify potential issues in relation to the advice provided by Westpac employed financial advisers and authorised representatives. Since its introduction in October 2013, BTFG has allocated resources to developing and embedding this system in its control environment.

PRI has access to a number of data sets extracted from product systems, payment systems, customer data and monitoring systems across a full range of BT Advice's customer interactions. On a quarterly basis, PRI analyses this data against predefined metrics to identify outlier behaviour in areas where BTFG has assessed there is a potential for higher risk of problematic behaviour.

Once the PRI tool identifies a potential outlier, it is referred to a triage analyst who is responsible for manually reviewing the file(s) flagged to assess whether the matter requires escalation and investigation for any compliance concerns. If it is required, an action plan is prepared.

The action plan may include, for example:

- Priority action by the adviser's supervising manager in BT Advice to undertake further questioning with the adviser to address potential issues detected. This may also involve communication with the customer;
- Referral to the monitoring and supervision team within the Capability and Conduct function of BT Advice. The monitoring and supervision team conducts compliance audits including either a targeted review or carries out pre-profiling activities before conducting a scheduled review; and
- Immediate referral to the Advice Investigations team within the Capability and Conduct function of BT Advice. The Advice Investigations team conducts priority and scoping assessments and formal investigations.

The PRI tool has been continually refined and improved since its adoption in October 2013 to enhance its effectiveness in detecting possible issues. After initial testing, the system was configured to interrogate 11 KRIs for BTFG's employed financial advisers, including fees charged to vulnerable customer groups such as the elderly, insurance claw-backs and gearing. The PRI tool now interrogates 26 KRIs for Westpac's employed financial advisers. For authorised representatives, the PRI tool interrogates 13 KRIs reflecting the data available to BTFG in relation to these non-employed advisers. BTFG has also worked on improving the integrity of data which is analysed by the PRI tool to improve its capabilities.

PRI was prominent in *The ACP and Related Reviews* as outlined on page 29 of Westpac's January Response. BTFG has demonstrated PRI to ASIC and has applied the PRI tool against historic financial adviser cases to test its efficacy. This process demonstrated that PRI is a useful detection tool. The review has also informed further enhancements to PRI.

Compliance Audits of Customer Files

BTFG has in place a compliance audit program, which is conducted by the Monitoring and Supervision team within the Capability and Conduct function of BT Advice. This program assesses selected adviser files against a compliance checklist (which include both regulatory and business requirements). This is now scheduled to occur at least annually for each adviser. The checklist is reviewed and updated periodically to ensure that it reflects any updated regulation or guidance and is designed to ensure financial advisers comply with regulatory obligations. Most recently, in November 2017, this was updated in light of feedback from ASIC and its regulatory guidance in Report 515 entitled “Financial advice: Review of how large licensees oversee their advisers” released March 2017.

Monitoring of provision of advice under ongoing advice service arrangements

As outlined on page 29 of Westpac’s January Response, BTFG commenced an Ongoing Advice Services (**OAS**) Review program in 2016, in conjunction with ASIC’s industry-wide review of OAS (ASIC refers to this as the ‘Fee for No Service’ review) in financial planning. BTFG’s OAS Review is focused on identifying retail clients who have been charged fees for OAS, where those clients have not received service, or where evidence of such service being provided cannot be located in BTFG’s records.

Concurrent with this process, a number of enhancements have been made to BTFG’s processes over the last two years.

For example in BTFG’s employed financial adviser channel, where a consistent service package is defined, some of the enhancements implemented by BTFG include:

- Enhancements to the Opt In process including introduction of Renewal Notice templates, strengthening of Opt In reporting and monitoring from December 2016;
- Development of an automated process for generation and central delivery of Fee Disclosure Statement (**FDS**s) from July 2014 and Renewal Notices to enhance accuracy and timeliness of delivery; and
- Introduction of additional monitoring, exception reporting and reconciliation processes to support accurate FDS delivery – this has been continuously improved since July 2014 with enhancements during 2017 to FDS validation reporting for business management.

Enhanced Regional Manager Supervision

Westpac employed financial advisers are supervised by BT Advice Regional Managers who report through to State General Managers. This has included a requirement that Regional Managers make a prescribed number of customer care calls per quarter per adviser in order to gain a clear understanding of the customers’ experience and their understanding of the advice provided. Regional Managers identify customers to be called having regard to risk factors such as complex products, higher risk strategies, execution only business and high fees, amongst other things. In October 2014, BTFG implemented enhancements to its existing Regional Manager supervisory processes. The enhancement included increasing the number of calls per quarter where an adviser is subject to increased supervision. Since April 2015, the customer calls have been conducted in accordance with a prescribed set of questions. From December 2017, the responsibility for conducting customer calls was moved from the adviser’s direct Regional Manager to a different Regional Manager, in order to reduce the risk of potential or perceived conflict or unconscious bias in the process.

Quality Assurance - Pre-vet function

BTFG has improved its monitoring of the activities of authorised representatives by the introduction of pre-vet processes. Authorised representatives are typically employed by independent small businesses. Since June 2015, new authorised representatives (and at times Westpac employed advisers and authorised representatives who are subject to a review or investigation) have been required to submit their draft advice documents to the “Pre-vet” function in BT Advice (reporting to the Capability and Conduct Function within BT Advice). The Pre-vet function then reviews the advice for consistency with BTFG’s standards and requires them to resubmit the advice where it does not meet those standards. Once a particular authorised representative demonstrates that it consistently meets BTFG’s standards they are no longer required to submit their draft advice to the Pre-vet team. This process facilitates quality assurance for advice issued by authorised representatives.

Quality Assurance - Paraplanning

As a preventative control, since January 2015, BTFG has mandated that all Westpac employed financial advisers have advice documents for complex advice situations[6] prepared by a dedicated team referred to as the paraplanning team. This process facilitates quality assurance for complex advice issued by Westpac employed financial advisers.

Requests and documentation submitted to paraplanning are assessed against a number of criteria and if those criteria are not met, and are not able to be adequately resolved, the request will be rejected. The relevant financial adviser's supervising manager is notified of any rejected paraplanning request and repeated rejections may result in further action being taken against the financial adviser.

This mandatory use of the paraplanning function and the quality controls over it makes it much more difficult for advisers to give advice without taking the necessary steps to ensure they have all the relevant information and that advisers are taking all the steps to be in a position to advise the client properly.

Enhanced customer file record keeping

BTFG has improved its monitoring of financial advisers through its enhancements to record keeping practices. Since September 2013 BTFG has required all employed financial adviser client files to be stored electronically. Electronic access to files provides BTFG with immediate access to underlying documents for compliance audits or investigations without notice to the financial adviser. Financial advisers who do not adhere to the record keeping requirements have consequence "demerit" points applied (as discussed below).

BTFG has also commenced a program to migrate authorised representative practices onto a common software platform that will afford similar access to these financial adviser files.

Adviser View online feedback register

Adviser View is an online register detailing financial adviser qualifications, experience and areas of expertise, with the ability for clients to provide feedback and to rate their advice experience. Potential clients are be able to search information on financial advisers via Westpac's website (**BT's Adviser View**) and if engaged, clients have the opportunity to provide feedback on their advice experience using a 5 star rating format, which includes whether they would recommend their financial adviser to others. A further free text field is also available for clients to make any comments regarding their experience.

Launched in October 2014, BTFG has published approximately 13,700 ratings on the website, including many comments from clients.

Consequence Management

Westpac's employed financial advisers are subject to BT Advice's consequence management policy. This policy seeks to guide and influence the financial adviser's behaviour in relation to their compliance with regulatory obligations and to establish a clear set of consequences in the event of non-compliant behaviour.

For Westpac employed financial advisers, this policy establishes a system of "demerit" points which are applied in circumstances such as failed file audits and substantiated complaints against the financial adviser. A range of consequences can be applied based on the number of "demerit" points accrued by the adviser, including additional oversight, reduction in the variable component of their remuneration and dismissal. Changes were implemented in April 2017 to increase the demerit points for a range of indicators or behaviours in relation to demonstrating best interests and failures in recording keeping.

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[6] Non-complex advice is subject to quality assurance processes.

As authorised representatives are not subject to BTFG employee policies, the primary consequences for a failure to meet compliance standards is a requirement to submit their advice to the pre-vetting function. In the case of serious misconduct, their authorisation is terminated.

C. ADVISER SELECTION AND TRAINING

BTFG has made a number of improvements to the way in which it selects and authorises individual financial advisers and financial adviser practices, and also the way in which it trains its financial advisers.

Employee onboarding - enhanced reference checking

BTFG conducts reference checks for new Westpac employed financial advisers and also in the event of particular role changes or promotions. BTFG has continued to strengthen its reference checking processes. The reference checks include, for example, police checks, credit checks, individual references and training compliance checks. In March 2017, BTFG's reference checking process was enhanced with the introduction of the Australian Banking Association's Industry Reference Checking standards for financial advisers which now covers a range of employment detail that may be shared between prospective employers, in addition to standard police and other checks. Westpac advocated for and was involved in initiating these standards.

Authorised representative onboarding - due diligence

In addition to individual reference checks as noted above, since late 2014, BTFG has also conducted due diligence on practices of authorised representatives before a practice is authorised to operate under the AFSL of Securitor or Magnitude. This process assesses advice files, the practice's operating processes, complaints and regulatory history and also the profile of the practice in relation to advice complexity and the approved product list. Practices that fail to meet the required standard are not authorised.

Training

BTFG has implemented a number of modifications to its financial adviser training over the years to assist in the prevention of conduct issues that arise. For example, Financial Adviser training was completed to support the introduction of 'Future of Financial Advice' reforms (**FOFA**) on 1 July 2013. As part of this process, BTFG updated adviser policies, developed tools, conducted training for advisers and updated monitoring processes to support FOFA.

Over recent years, BTFG has progressively uplifted the minimum annual ongoing training requirements for financial advisers from the minimum 30 hours prescribed by the Financial Planning Association to 40 hours per year.

In October 2017, BTFG implemented an enhanced structured training program consisting of face to face training, masterclass and eLearning modules with assessment requirements for financial advisers in respect of updated 'best interest' and record keeping policies. BTFG anticipates all Westpac employed financial advisers and authorised representatives will have completed the training, and follow-up workshop if necessary, by the end of March 2018. In addition, BTFG completed targeted training for compliance audit employees in October 2017.

BTFG also engaged the Ethics Centre to develop ethics training for its advisers and employees. This program focused specifically on ethics and providing participants with an ethical framework to assist in day to day decision making. During 2017, in excess of 500 BTFG representatives including Westpac employed financial advisers, authorised representatives and management staff completed that program. Ethics training is a mandatory component of financial adviser training programs.

D. AREAS OF FUTURE FOCUS

BTFG acknowledges that more can be done to strengthen its advice control environment. BTFG continues to identify opportunities to do so, including to enhance those controls, particularly in the context of an environment of evolving regulatory standards. Examples of BTFG's particular areas of focus at present include:

1. **Stronger controls to prevent inappropriate advice being provided to clients** – BTFG is reviewing its paraplanning compliance check lists and is also taking steps to ensure that the checklist is used consistently;

2. **Ensuring the records kept in client files are comprehensive and of sufficient quality to unambiguously support the advice provided** - BTFG has recently updated its record keeping policy and issued the updated policy to its financial advisers. Westpac has also updated its compliance check list and strengthened the consequences of non-compliance with those policies. BTFG has also implemented a training program targeted at the best interest duty and record keeping. Additionally, BTFG is updating its guidance to financial advisers to better demonstrate compliance with the best interest duty; and

3. **Reducing errors associated with the implementation of advice for clients** – BTFG has commenced a program of work directed to simplifying its operating environment and processes to reduce the likelihood of error in its advice business. This program of work is being conducted by BTFG's Advice Implementation Team with support from an independent consultant. It includes removing duplication, redesigning support function processes and simplifying administrative processes.

Question C2.

What are the internal policies and procedures for reporting in compliance with s 912D of the Corporations Act 2001 (Cth)? If those policies and procedures have changed over time, identify what changes were made and when they were made.

Outline

Westpac recognises that notifying ASIC about significant breaches in compliance with s912D commences with effective incident identification and management policies and procedures.

Westpac has an Operational Risk Incident Management (**IM**) Procedures & Guidance, which forms part of the Group's Operational Risk Management Policy and outlines the minimum requirements for managing incidents across the Westpac Group. The IM Procedures & Guidance is applicable to all employees and, in accordance with that policy, all staff have a responsibility to identify and record incidents. The Group's IM Procedures & Guidance complements, and should be read in conjunction with, the Operational Risk Management Policy by providing detailed guidance and processes with practical examples.

As a supplement to the IM Procedures & Guidance and the Operational Risk Management Policy, Westpac has developed and implemented a process for identifying, assessing, escalating and reporting Australian Financial Services Licence (**AFSL**) breaches (or likely breaches). The process is designed to promote consistency and transparency in Westpac's processes for complying with its reporting obligations, and is regularly reviewed. The process has been the subject of substantial enhancements, discussed below, to further strengthen Westpac's breach reporting procedures.

To support compliance with s912D, Westpac has established a breach reporting process that is governed by the Westpac AFSL Breach Policy (an element of Westpac's AFSL Framework) and operates in conjunction with the Operational Risk Management Policy. The AFSL Breach Policy was designed to provide an overarching policy framework to underpin a consistent approach to Breach reporting across the Westpac Group. Further guidance is contained in:

- the Compliance Assessment Standard Operating Procedure & Guidance - which supports our Compliance team in reviewing compliance incidents;
- the Voluntary Disclosure and Client Legal Privilege Policy – which establishes a framework for voluntarily disclosing information to our regulators; and
- the Westpac Group Code of Conduct.

Breach reporting process

Westpac's Breach reporting process can be summarised in the following phases:

A brief overview of each phase of the Breach reporting process is set out below. Westpac notes that investigation into the incident might occur at, or across, various phases in the process as appropriate.

Incident identification

The first stage is the identification of incidents. Westpac is committed to supporting its employees to speak up about any issues of concern they may have, including in relation to possible incidents or Breaches. This is reflected in:

- Westpac's commitment to further strengthening its risk culture, including through a number of organisational initiatives designed to enhance and embed capabilities and desired behaviours that support such a culture (including, among other things, the Motivate program and the Doing the Right Thing training); and
- Westpac's Whistleblower Protection Program, which includes our Whistleblower Protection Policy and the dedicated role of Whistleblower Protection Officer.

The IM Procedures & Guidance defines an incident as an 'operational risk event' which *'arise[s] from inadequate or failed internal processes, people and systems or from external events'* (see the definition of Operational Risk Incident). All such incidents across the Group are captured and managed through a single risk and compliance platform, JUNO. JUNO was implemented in April 2017, and replaced Westpac's previous platform, ACCORD.

Key aspects of this phase include:

- Logging data in JUNO: All incidents are required to be logged. A logged incident is to be flagged as having a potential compliance impact if it is a potential 'compliance incident'. A compliance incident is defined in the IM Procedures & Guidance as an actual, likely or imminent contravention or breach of:
    - a Compliance obligation of any applicable law or regulation;
    - an industry standard or code, such as the ASX Market Rules; or
    - a material contravention of a Compliance policy (ie 'material contravention' – not following the main intent of the policy).
- Incidents are to be logged by the employee that identifies the incident (although they can also be logged by others where necessary). All employees are responsible for identifying and recording incidents.
- Incident verification: Each business division designates one or more employees as an 'Incident Verifier'. Incident Verifiers are generally First Line Risk and/or business representatives, with oversight and support provided by Second Line Risk teams. The role of the Incident Verifier is to ensure the integrity of data in JUNO by:
    - ensuring the incident meets the Westpac Group classification requirements for an incident;

   - validating the incident data inputs; and
   - ensuring that the incident is communicated to key internal stakeholders.
- Depending on the nature of the possible incident and the information logged in JUNO by the incident identifier, the Incident Verifier may perform further investigations to validate whether an incident has in fact occurred.
- Accountability: An 'Incident Owner' is assigned by the Incident Verifier to be responsible for the incident, including managing and overseeing rectification. The Incident Owner is generally from the business unit where the incident originated.

Compliance assessment

If an incident is flagged in JUNO as having a potential compliance impact, it is escalated via JUNO for a compliance assessment. The compliance assessment is used to determine whether the incident should be escalated to the Breach Determination Forum. The compliance assessment is performed by a second line Compliance Assessor and can involve engaging with other teams including the business, operational areas, Legal and Regulatory Response.

Compliance Assessors assess the non-compliance (or potential non-compliance) in line with the Compliance Assessment Standard Operating Procedure, which is designed to establish consistency in the assessment of incidents with a potential compliance impact across the Westpac Group.

Breach Determination Forum

The AFSL Breach Policy outlines how Westpac satisfies its notification obligations under section 912D. That Policy describes the roles and responsibilities of various teams within Westpac, including the Business Owners.

The Chief Compliance Officer (**Group CCO**) is responsible for determining whether an incident is to be reported to ASIC under s912D. The Group CCO delegates that responsibility to the Chief Compliance Officer – Enterprise Compliance (**CCO – EC**), together with a senior representative from the relevant business division, as follows:

- for BTFG, the Chief Compliance Officer, WIB & Group Functions or the Head of WIB Compliance (Australia); or
- for BTFG, the Chief Risk Officer; or
- for remaining divisions, the Chief Compliance Officer, Australian Banking and Regulatory Change and Implementation,

(each a **Decision Maker**).

A decision to report must be made by both the CCO – EC and the other relevant Decision Maker.

The Decision Makers meet to discuss incidents in the Breach Determination Forum. The Breach Determination Forum (**BDF**) was established in March 2015 to support effective implementation of the AFSL Breach Policy.

The BDF is governed by defined terms of reference, introduced in May 2017. It provides a formal structure for consideration of whether Westpac's breach reporting obligation is triggered.

The Decision Makers review completed Compliance Assessments and any supporting information. Where required, they request further information or advice from relevant stakeholders.

The BDF considers Westpac's reporting obligations on a holistic basis, having regard both to whether a Breach has occurred, or is likely to occur, and the significance of the possible breach. Consistent with Westpac's commitment to proactive, transparent and timely reporting, the BDF may recommend that a disclosure is to be made to ASIC voluntarily in circumstances where it has not definitively concluded that a Breach, or Significant Breach, has occurred or is likely to occur.

Reporting to ASIC

Once the BDF has determined a breach or likely breach must be notified to ASIC, this triggers the 10 business day notification period.

Westpac has set out below, by way of explanation, some commentary on the way in which its voluntary disclosure process operates.

Westpac works to establish a relationship-based approach for managing regulatory interactions and promoting a culture of positive and productive regulatory engagements.

Consistent with that approach, Westpac has adopted a Voluntary Disclosure and Client Legal Privilege Policy pursuant to which matters are disclosed to ASIC in circumstances where a statutory reporting obligation does not arise. That Policy concerns disclosure of "Significant Information" (eg information that is subject to confidentiality obligations, information that if disclosed to a third party could have an adverse impact on Westpac if disclosed to a regulator or third party or if the information is out of the ordinary). Such a voluntary disclosure may be made in response to a request by ASIC for voluntary disclosure or it may be a matter that Westpac determines should be disclosed on a voluntary basis. Examples of matters that may be considered for voluntary disclosure to ASIC include:

- matters of significance at an industry level which ASIC may have an interest in;
- matters being notified to other regulators;
- matters which may be an early warning sign of a wide-reaching issue or similar to matters previously notified to ASIC; and
- matters where there is a customer or remediation impact that Westpac believes is appropriate to bring to ASIC's attention.

For matters that do not trigger the 'Significant Information' definition, in the ordinary course of Westpac's engagement with its regulators Westpac also makes voluntary disclosures to regulators. These disclosures are assessed and determined at a Division or business unit level with guidance from the Regulatory Response team and in accordance with a policy entitled Managing our Regulatory Relationships Policy (Dec 2017).

Recording and internal reporting of Breach determinations

Westpac records and internally reports determinations to notify ASIC under s912D.

In addition, Enterprise Compliance provides weekly reporting of determination outcomes to, among others:

- Group Executive, Compliance, Legal & Secretariat;
- Chief Compliance Officer;
- the General Manager, Regulatory & Governance, Enterprise & Risk;
- relevant Compliance Assessors (to finalise incidents in JUNO); and
- relevant responsible manager(s).

All matters notified or voluntarily disclosed to ASIC are reported by Divisional Compliance teams to the relevant Divisional level Risk and Compliance Committees (chaired by the relevant Group Executive) and by Enterprise Compliance to the Group level Risk and Compliance Committee (**RISKCO**) (chaired by the Group Chief Risk Officer, with attendees including the Chief Executive Officer and all Group Executives).

1.1 Earlier process

The process described above is the result of a series of enhancements following comprehensive review of Westpac's breach reporting policies and procedures (including as described in further detail below). Westpac's breach reporting practices were significantly revised in 2014, with the AFSL Breach Policy and AFSL Framework introduced in December 2014. The Voluntary Disclosure and Client Legal Privilege Policy was also developed in 2015. The BDF was established in March 2015. JUNO was introduced in April 2017. More information about these changes is set out below.

Before those reforms:

- incidents were primarily managed through the ACCORD platform (data from ACCORD was migrated into JUNO);
- breach assessment, escalation and decisions around reporting were ordinarily conducted on a Divisional basis; and
- the Regulatory Response team maintained, and continues to maintain, a tracker that captures breach reporting and voluntary disclosures.

Changes to breach reporting policies and procedures

Westpac's breach reporting policies and procedures have been the subject of enhancements over time.

In 2014 Westpac's strengthened its Breach reporting processes and procedures. These reforms were based primarily on an internal assessment of its existing incident management and breach reporting procedures, including taking into account a review in early 2014 by Group Audit. That preceded the revised ASIC Regulatory Guide 78 and Public Statements, although it took these into account when they were released.

The review resulted in of enhancements to Westpac's breach reporting processes. Taking a Group-wide view and drawing on, and learning from, existing practices at a Divisional level, the changes further strengthened Westpac's procedures for identifying, assessing and (if appropriate) reporting breaches or possible breaches.

In summary the key reforms introduced following this review included:

- the introduction of the Westpac AFSL Breach Policy in December 2014, although policy and incident management procedures were already in place prior to its introduction, the AFSL Breach Policy represented a significant reform to our breach reporting practices and articulated our specific approach to managing possible AFSL breaches);
- to further operationalise our new Policy and to support a more consistent approach to breach reporting across the Group, the establishment of the BDF in March 2015. The BDF centralised the escalation and assessment of potential AFSL breaches, and the decision-making process around reporting to ASIC;
- the development in early 2015 of our Voluntary Disclosure and Client Legal Privilege Policy to govern voluntary disclosure of Significant Information to regulators (where a matter has been determined as not reportable to ASIC on a mandatory basis) and applies when considering any request for privileged documents, or a proposal to invoke or waive privilege or otherwise not disclose privileged documents);
- the initiation in early 2015 of a Compliance Hindsight Review to measure targeted aspects of compliance with AFSL Breach Policy requirements and provide Compliance Leadership with data and insights regarding identifiable trends in the application of the AFSL Breach Policy across the Group. Lessons learned are fed back into the process, which also provides the basis for dialogue between Enterprise Compliance and divisional Compliance teams over the resolution of issues identified by the review. Since its inception, this quarterly review has evolved to encompass a focus on two primary objectives:
    - evaluation of compliance with the AFSL Breach Policy and the Compliance Assessment Standard Operating Procedure (SOP), including (among other things) incident accountability, compliance assessment minimum standards, the escalation process to the BDF and reporting to ASIC; and
- identification of compliance incidents that may have been misclassified and not escalated for compliance assessment; and
- the implementation in April 2017 of a new risk and compliance platform (JUNO) (which strengthened the initial identification and verification phases of the breach reporting process, and provides a single point of reference for recording incidents and potential Breaches).

In addition:

- Group Audit conducts an annual audit of the effectiveness of controls in place to support compliance with key licence obligations (including the identification, reporting and resolution of licence breaches). Group Audit also conducts periodic reviews of Westpac's Operational Risk Framework, which includes incident management.

- the policy is updated from time to time to reflect any relevant legal or regulatory changes, as necessary;
- JUNO is also the subject of a quarterly reconciliation process; and
- as set out in the IM Procedures & Guidance, one of the roles and responsibilities of Divisional Operational Risk & Compliance is ensuring that incident information is recorded accurately in JUNO, coordinating the investigation of unreconciled items and providing quarterly Internal Loss Data attestation.

These reforms were also accompanied by the expansion of our training programs around incident management and breach reporting for all Westpac employees. These initiatives were part of a Group-wide push to escalate issues and ensure that all potential compliance issues are appropriately identified.

The review of Westpac's breach reporting and incident management policies and procedures remains an ongoing process. Westpac's continue to refresh, update and improve its practices on a regular basis. This includes considering guidance from ASIC, addressing specific feedback received from ASIC and assessing areas for possible law reform and improvement, including the current review undertaken by Commonwealth Treasury (which may result in an amended significance test, apply a reporting obligation for potential breaches and expand the mandatory notification regime to include consumer credit) and ASIC's Breach Reporting Project . This includes identifying opportunities to increase the speed with which matters are identified, investigated and reported.