ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

CLOSING SUBMISSIONS

Personal Overdrafts, Processing Errors, Car Loans and Credit Cards

CBA PERSONAL OVERDRAFTS

Background

1. The sixth case study involved a programming error in the automated serviceability calculator used by CBA to assess certain applications for personal overdrafts, which resulted in breaches of CBA's responsible lending obligations. The Commission heard evidence in this case study from Mr Clive van Horen, the Executive General Manager for Retail Products, within the Retail Banking Services Business Unit of CBA.

2. The evidence established that, in July 2011, CBA commenced using an automated decision-making tool for serviceability and risk, as part of its assessment of long-form personal overdraft applications.

3. Between July 2011 and September 2015, CBA's automated serviceability calculator did not have regard to rental amount figures included in customers' long-form applications. Although the customers' housing expenses were included in applications, the automated decision-making tool excluded that amount from the assessment, replacing it with a "nil" amount for housing expenses. Further, rather than using a customer's declared expenses, the automated process adopted a benchmark. This led to the approval of certain applications for personal overdraft limits which would otherwise have been declined.

4. CBA identified the programming error in September 2015. It notified ASIC of the programming error on 5 November 2015.

5. Infringement notices were issued to the CBA for amounts totalling $180,000. CBA also remediated 9,161 customers, including by way of writing off overdraft balances, reducing limits and waiving outstanding amounts. The total amount of remediation was approximately $2.5 million.

Available findings of misconduct

6. On the evidence, it is open to the Commissioner to make the following findings of misconduct against CBA:

    a. CBA breached its statutory obligations under s 912A(1)(a) of the Corporations Act and s 47(1)(a) of the National Credit Act to do all things necessary to ensure that the financial services covered by its financial services licence and the credit activities authorised by its credit licence were engaged in efficiently.

    b. CBA breached the prohibition in section 133 of the National Credit Act on entering into credit contracts with consumers in circumstances where the contract was unsuitable.

    c. CBA failed to comply with the obligation in clause 27 of the Banking Code of Practice to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in forming an opinion about the customer's ability to repay the credit facility.

Governance practices

7. On the evidence, it is open to the Commissioner to find that a cause of the misconduct was inadequate governance of data management at CBA. This may be reasonably inferred from the time taken to detect the programming issue, which first arose in July 2011 and was not detected until September 2015.

Questions for written submissions in response

8. CBA is invited to provide written submissions addressing each of the findings that have been identified to be open to the Commissioner, as well as any other findings that it regards as available on the evidence.

9. All parties with leave to appear will be permitted to provide written submissions addressing the following question, which arises from this case study:

    > In circumstances where banks rely on automated serviceability calculators, are their automated processes adequate to ensure that they comply with their obligation under s 133 of the National Credit Act to only provide a customer with a credit contract that is not unsuitable for the customer?

ANZ PRE-APPROVED OVERDRAFTS

Background

10. The seventh case study involved a series of mail-outs by ANZ to 330,000 existing customers holding transaction accounts. Evidence in this case study was given by Ms Heang Forbes, Pricing Operations Chapter Lead at ANZ.

11. The mail outs were unsolicited and offered the customers an overdraft facility with a limit of $500 or $1000. ANZ did not inquire into the customers' requirements and objectives before sending the mail outs or give them an opportunity to elect a different overdraft amount.

12. The overdraft facility was an 'arranged' overdraft, a credit facility attached to a bank, building society or credit account, which a person applies for or which may be given to a person as part of the account. Once the customer began to use the overdraft, interest began accruing. The interest rate at the time was approximately 17%. An annual fee, to be paid in monthly instalments of $5.00, also applied.

13. Of the 330,000 offers to customers, 2,992 offers were taken up.

14. In February 2016, ASIC issued five infringement notices to ANZ totalling $212,500, alleging that the overdraft offers breached the responsible lending obligations in the National Credit Act. ASIC alleged that ANZ had failed to comply with the obligation to make inquiries about the customer's objectives and requirements, as required by s 130(1), including the maximum credit limit desired (if any) by the customer in respect of pre-approved offers. The infringement notices identified contraventions of ss 128 and 130 of the National Credit Act and reg 289 of the National Credit Regulations. ANZ paid the penalty amounts.

Available findings of misconduct

15. On the evidence, it is open to the Commissioner to make the following findings of misconduct:

    a. ANZ breached its statutory obligation under section 47(1)(a) of the National Credit Act to do all things necessary to ensure that its credit activities were engaged in efficiently, honestly and fairly.

b. ANZ breached the prohibitions in section 128(a) on entering into a credit contract and section 128(aa) of the National Credit Act on making an unconditional representation to customers that ANZ considered the customers to be eligible to enter a credit contract with ANZ, in circumstances where:

    (i) it had not made reasonable inquiries about the customers' requirements and objectives in relation to the credit contract in accordance with s 130(a) of the National Credit Act;

    (ii) it had not made reasonable enquiries about the customers' financial situation in accordance with s 130(1)(b) of the National Credit Act;

    (iii) it had not taken reasonable steps to verify the customers' financial position in accordance with s 130(1)(c) of the National Credit Act; and

    (iv) it had not made reasonable enquiries about the maximum credit limit that the customers required in accordance with s 130(1)(d) and regulation 28JA of the National Credit Regulations 2010; and

    (v) it had not made an assessment about whether the credit contract would not be 'unsuitable' for the customers.

c. ANZ failed to comply with Regulatory Guide 209: "Credit licensing: Responsible Lending Conduct", which constitute a recognised and widely accepted benchmark for meeting the responsible lending obligations in the National Credit Act.

d. ANZ breached its obligations under clause 3.2 and clause 27 of the Banking Code of Practice, which, oblige it to act fairly and reasonably towards its customers in a consistent and ethical manner and to exercise the care and skill of a diligent and prudent banker in selecting and applying its credit assessment methods and in forming its opinion about its ability to repay the credit facility.

Available findings of conduct falling below community standards and expectations

16. On the evidence, it is also open to the Commissioner to make findings that ANZ engaged in conduct that fell below community standards and expectations in connection with its failure to remediate customers.

17. The evidence establishes that on 14 April 2016, ASIC expressed concerns that ANZ's processes did not comply with the responsible lending obligations, and had it complied,

ANZ might have found the overdraft product unsuitable for some customers or provided them with a lower limit. ASIC informed ANZ that it considered it appropriate for ANZ to review the facilities provided in order to remediate customers in either situation. ANZ told ASIC that it did not consider that remediation was necessary.

18. It may be inferred from the evidence that:

    a. ANZ has not communicated with the customers affected by the misconduct to attempt to identify those that may have been subject to hardship, arrears or default due to ANZ's failure to make necessary enquiries about their suitability for the overdraft;

    b. ANZ has not communicated with the customers whose pre-approved overdrafts were the subject of the infringement notices issued to ANZ; and

    c. ANZ has not provided any customer with any remediation in respect of the misconduct.

Inadequacy of ANZ's internal systems

19. On the evidence, it is open to the Commissioner to find that a cause of the misconduct was the inadequacy of ANZ's internal systems to ensure that its overdraft offers complied with its responsible lending obligations.

Effectiveness of mechanisms for redress

20. On the evidence, it is open to the Commissioner to find that ANZ has not responded effectively to any potential detriment suffered by ANZ's customers as a result of the misconduct.

Questions for written submissions in response

21. ANZ is invited to provide written submissions addressing each of the findings that we have identified to be open to the Commissioner, as well as any other findings that it regards as available on the evidence.

22. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from this case study:

    a. Do banks have adequate policies to ensure that they comply with their obligations under s 128 of the National Credit Act before offering overdrafts to consumers,

including by making reasonable inquiries of customers about their financial situation?

b. Is it acceptable for a bank to decline a request by a regulator to identify and remediate customers who obtained an overdraft facility in circumstances where the lender had not complied with its responsible lending obligations?

ANZ PROCESSING ERRORS

Background

23. The eighth case study involved a number of processing errors made by ANZ in connection with home loans during the period from 2003 to the present. The Commission heard evidence in this case study from Ms Sarah Stubbings, ANZ's Head of Home Loan Product, Australia and New Zealand.

24. The evidence established multiple processing errors by ANZ in connection with its home loan products since 2003:

a. In the period from 2003 to July 2013, some offset accounts were not properly linked to home loans, resulting in customers being charged excess interest;

b. In the period from 2006 until July 2013, some ANZ customers were charged an interest rate higher than they should have been according to the terms and conditions of their accounts;

c. In the period from July 2013 to July 2017, certain customers who had selected a particular home loan package after drawdown or had linked an existing home loan to a new home loan package were not given the benefit of being linked to an offset account. This resulted in these customers paying excess interest, and occurred because the fixes implemented to the two previous issues did not incorporate this issue;

d. In the period from June to December 2016, certain customers did not receive the correct interest rate margin discount on their home loan;

e. Between December 2012 and February 2016, approximately 4,800 offset accounts were not adequately linked to an eligible retail home loan, resulting in the customer failing to obtain the benefit of the offset; and

f. Prior to May 2015, a further processing error resulted in customers with certain home loan and commercial lending accounts failing to receive the full benefit of offset arrangements.

25. ANZ designed and implemented a remediation program to remediate the first two of these errors, which were the most significant in terms of quantum. That program identified approximately 400,000 affected accounts. Affected customers were paid approximately $69.3 million in remediation. ANZ completed the remediation program in April 2014, which also involved fixes to the ANZ systems. Other remediation programs followed and are on-going.

Available findings of misconduct

26. On the evidence, it is open to the Commissioner to make the following findings of misconduct against ANZ:

a. ANZ breached its statutory obligations under s 912A(1)(a) of the Corporations Act and s 47(1)(a) of the National Credit Act to do all things necessary to ensure that the financial services covered by its financial services licence and the credit activities authorised by its credit licence were engaged in efficiently, honestly and fairly.

b. ANZ failed to comply with its obligations under s 912D of the Corporations Act to provide a written report to ASIC within 10 business days of becoming aware of the errors, which constituted significant breaches of its obligation to do all things necessary to ensure that the financial services covered by its licence were engaged in efficiently, fairly and honestly. The errors constituted significant breaches by reason of:

(i) the actual or potential loss to ANZ's customers arising from errors;

(ii) the number and frequency of the errors, which were of a similar nature; and

(iii) the impact of the errors on ANZ's ability to provide the financial services covered by its licence.

c. ANZ failed to comply with the expectations of ASIC in relation to breach reporting by Australian Financial Services licensees, as set out in Regulatory Guide 78: "Breach Reporting by AFS licensees", which constitute a recognised and widely

accepted benchmark for meeting the breach reporting obligations in s 912D of the Corporations Act.

d. ANZ breached its obligations under cl 3.2 of the Banking Code of Practice, which obliged it to act fairly and reasonably towards its customers in a consistent and ethical manner.

Available findings of conduct falling below community standards and expectations

27. On the evidence, it is open to the Commissioner to make findings that ANZ engaged in conduct that fell below community standards and expectations in connection with the detection, reporting and remediation of the processing errors. In particular:

    a. ANZ took too long to appreciate that what it considered "ad hoc" errors were in fact instances of systemic processing issues;

    b. the fixes put in place in response to these errors were not adequate to ensure that similar errors did not occur in the future; and

    c. the remediation processes undertaken by ANZ did not place primary emphasis on the need for customers to be compensated in a timely manner.

Inadequacy of internal systems

28. It is open to the Commissioner to find that ANZ's misconduct resulted from:

    a. inadequate systems to ensure that customers received their entitlements under their home loan package, including the application of the correct interest rate, the application of interest rate discounts and the benefits of a linked offset account;

    b. inadequate processes for identifying and resolving processing errors;

    c. reliance on manual processes by disparate and separate people within the bank, without overarching controls;

    d. a failure to invest sufficient resources in the proper resolution of the errors.

Effectiveness of mechanisms for redress

29. As to the effectiveness of ANZ's mechanisms for redress for consumers who suffered detriment as a result of the misconduct, it is open to the Commissioner to find that ANZ did not have adequate mechanisms to provide such redress in a timely manner.

a. ANZ failed to identify the initial errors as systemic until 2010 and adopted an 'ad hoc' response to customer complaints in the years before doing so.

b. Although a steering committee was put in place in 2010 to deal with the initial remediation program, remediation was not complete until 2014. The project had on-doing delays and the engagement of PwC in 2012 was the only means by which remediation was able to be completed in 2014.

Questions for written submissions in response

30. ANZ is invited to provide written submissions addressing each of the findings we have identified to be open to the Commissioner, as well as any other findings that it regards as available on the evidence.

31. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from this case study:

a. Are banks' internal systems and procedures adequate to detect processing errors that result in customers failing to receive their entitlements under the terms and conditions of their accounts?

b. Are banks' internal systems adequate to provide timely and full remediation to customers who have suffered detriment as a result of failing to receive their entitlements under the terms and conditions of their accounts?

c. Are banks' remediation and review processes adequate to prevent a repeat of identified processing errors and to ensure that structural, as opposed to interim, changes are made in response?

d. Are banks' processes adequate for assessing whether an error such as a processing error (or a series of such errors) is of a systemic nature and meets the criteria for a significant breach that must be the subject of a written report to ASIC within 10 days?

WESTPAC CAR LOANS

Background

32. The ninth case study involves car loans approved by the Westpac auto finance business through dealer intermediaries. Evidence in this case study was given by Ms Nalini Thiruvangadam, a consumer who obtained a car loan from Westpac and Mr Phillip Godkin, the General Manager, Specialist Finance Business Bank at Westpac.

33. The evidence establishes that the loans provided by Westpac auto finance are currently originated through either St George or Bank of Melbourne. Westpac acknowledged that "very much the overwhelming majority" of car loans on issue by Westpac were initiated by dealers and that the number of those car loans was "well into multiple hundreds of thousands". The number of car loans on issue by Westpac was in the multiple billions of dollars. Westpac is typically number one or number two in the market for auto finance through dealer intermediaries.

34. The Commission heard evidence from Ms Nalini Thiruvangadam. Ms Thiruvangadam entered into a car loan with Westpac in July 2012. Ms Thiruvangadam tried to arrange finance from a number of major banks, including Westpac, and other sources such as car dealers. All of them denied her application, apparently on the basis of her credit. However, Ms Thiruvangadam eventually found a dealer who approved her application. The loan was financed by the Bank of Melbourne.

35. At the time that the car loan was approved, Ms Thiruvangadam's fortnightly repayments for her car loan totalled just under 30% of her income. Ms Thiruvangadam subsequently became unable to work as a result of an injury, and suffered financial hardship as she continued to attempt to make loan repayments. In around November 2017, Bank of Melbourne acknowledged that Ms Thiruvangadam's loan "should not have been approved". The Commission heard evidence that Westpac acknowledged that the processes in relation to the approval of Ms Thiruvangadam's loan were deficient.

36. The Commission also heard evidence about a number of other aspects of the car loans offered by Westpac. Specifically, the Commission heard:

    a. The standard Westpac auto finance policy permits a maximum loan-to-value ratio of 180%. Westpac acknowledged that to get a vehicle "out of the showroom will quite often take it above 100%". Westpac's policies allow it to finance the purchase of a number of insurance products, and the payment of origination fees.

b. In relation to flex commissions, until August 2016, Westpac did not impose any maximum cap upon the amount of flex commission that could be charged to a customer. Westpac continues to allow its dealers to impose flex commissions, and expects that it will not cease this practice until the date fixed by ASIC as the date by which the practice must cease.

c. Add-on insurance, including consumer credit insurance, tyre and rim insurance and gap insurance, among others, have represented an important source of income for dealers. Westpac recognises the imbalance of outcomes for consumers and dealers in this respect but remains "heavily committed to" this model.

d. Westpac monitors dealers' compliance with the interest rate cap on flex commissions and their behaviour in relation to add-on insurance, in recognition that the conflict of interest arising out of these structures could have detrimental effects on customers.

Available findings of misconduct

37. On the evidence, it is open to the Commissioner to make the following findings of misconduct:

a. Westpac breached its statutory obligations under section 47(1)(a) of the National Credit Act and section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that its credit activities in relation to Ms Thiruvangadam and the financial services provided to Ms Thiruvangadam, covered by its Australian Financial Services Licence, were engaged in efficiently, honestly and fairly.

b. Westpac breached the prohibition in section 128(a) of the National Credit Act on entering into a credit contract with Ms Thiruvangadam in circumstances where it had not made reasonable enquiries about her financial situation, as required by section 130(1)(b).

c. Westpac breached the prohibition in section 128(a) of the National Credit Act on entering into a credit contract with Ms Thiruvangadam in circumstances where it had not taken reasonable steps to verify her financial situation, as required by section 130(1)(c).

d. Westpac breached the prohibition in s 133 of the National Credit Act by providing to Ms Thiruvangadam a loan that was unsuitable for her, insofar as she could not comply with the terms of her loan without substantial hardship.

e. Westpac failed to comply with the Banking Code of Practice in respect of Ms Thiruvangadam's car loan. In particular, Westpac failed to comply with the obligation in clause 27 of the Code to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and forming an opinion about Ms Thiruvangadam's ability to repay her car loan.

Available findings of conduct falling below community standards and expectations

38. On the evidence, it is open to the Commissioner to make findings that, more generally, Westpac has engaged in misconduct and conduct that fell below community standards and expectations in relation to the following:

    a. By allowing flex commissions to be charged, Westpac gives its car dealer intermediaries a discretion to set the interest rate charged to a customer up to a certain cap. The dealer receives a percentage of the margin charged. It is open to the Commissioner to find that in doing so, Westpac permits the existence of a conflict of interest between the dealer intermediaries and its customers.

    b. According to Westpac's evidence, consumers are not generally aware of car dealers' remuneration structures and their potential effect of placing dealers and consumers in conflict as to the amount of interest a consumer pays on their loan.

Effectiveness of mechanisms for redress

39. The evidence supports a finding that Westpac did not effectively and adequately respond to the detriment suffered by Mr Thiruvangadam. Ms Thiruvangadam was granted a six week period of hardship on her repayments. Her further requests for hardship were declined. Ms Thiruvangadam was not released from the contract and remediated until after she engaged legal assistance, five years after the loan.

Questions for written submissions in response

40. Westpac is invited to provide written submissions addressing each of the findings that have been identified as being open to the Commissioner, as well as any other findings that it regards as available on the evidence.

41. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from the Westpac case study:

a. Are the structural arrangements between banks and car dealers for the provision of car loans to consumers likely to result in the contraventions of the banks' responsible lending obligations under the National Credit Act?

b. Do remuneration and incentive structures that reward car dealers for increasing the volume of their sales of cars or insurance policies, or the interest to be charged to the customer, create an unacceptable risk that:

    (i) dealers will prefer their own interests to the interests of customers; and

    (ii) as a result, customers will suffer detriment?

ANZ CAR LOANS

Background

42. The tenth case study involves the provision of car finance to customers under the Esanda Dealer Finance portfolio. Evidence in this case study was given by Mr Guy Mendelson, ANZ's General Manager, Small Business Bank.

43. Until April 2016, Esanda was owned by ANZ. The evidence before the Commission established that while under ANZ's ownership, Esanda engaged in a number of misconduct or conduct falling short of community standards and expectations.

44. Mr Mendelson gave evidence of a number of instances of misconduct, including in respect of loan applications submitted by car finance brokers in the name of an individual who did not own or have possession of the vehicle, but who agreed to guarantee the loan. ANZ accepted that the systems it had in place at the time were ineffective to detect this behaviour.

45. In February 2018, ASIC secured penalties of $5 million in respect of ANZ's breaches of the National Credit Act. The underlying conduct related to ANZ's failure to verify borrowers' pay slips when providing loans to twelve (representative) applicants who were introduced to ANZ by three third party intermediaries, in circumstances where Esanda had reason to doubt the reliability of that information. ANZ expects to remediate approximately 320 customers in respect of similar conduct by the relevant third party intermediaries from 2013 to 2015, amounting to approximately $5 million. So far, ANZ has paid remediation of $100,000. In its evidence before the Commission, ANZ accepted that its fraud detection processes were "deficient".

46. In relation to its broader responsible lending practices, ANZ acknowledged that it had sold add-on products, such as insurance or warranties, to some borrowers without their knowledge or consent. Esanda acknowledged that the premiums inflated the amount that the borrowers had borrowed, thus increasing the overall amount of interest paid by borrowers.

47. Mr Mendelson also explained the remuneration structures within the auto finance industry and those of which were used by ANZ, both when it owned the Esanda business and now. In relation to flex commissions, ANZ's evidence was that it determined to cease offering flex commissions in December 2017. ANZ accepted that for the period that it permitted its intermediaries to charge flex commissions, the intermediary had a conflict of interest.

48. Further, ANZ gave evidence to the effect that it undertook a full review of its insurance product offerings after the sale of the Esanda business. As a result of that review, it withdrew from selling all but two add-on insurance products from April 2016, being comprehensive car insurance and loan protection insurance. ANZ made that decision because it took the view that the "claim rates on the remaining insurance products … were nowhere near an acceptable level or an industry level", in that premiums paid were larger than claims paid out.

49. Finally, Mr Mendelson explained that, only last Friday, ANZ announced an intention to suspend providing new secured asset finance loans for retail customers in Australia as of 30 April 2018. In the accompanying media release, ANZ states that the suspension will be in place "while it undertakes a detailed review of its business". It was put to Mr Mendelson that the documents produced to the Commission indicated that sales were being suspended due to concerns about the compatibility of the Esanda Lending System with responding lending obligations. Mr Mendelson rejected that characterisation.

Available findings of misconduct

50. On the evidence, it is open to the Commissioner to make the following findings of misconduct:

    a. ANZ breached its statutory obligations under section 47(1)(a) of the National Credit Act and section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that its credit activities, and the financial services covered by its Australian Financial Services Licence, were engaged in efficiently, honestly and fairly.

b. ANZ breached its statutory obligation under s 47(1)(b) of the National Credit Act to have in place adequate arrangements for the management of conflicts of interest that may arise wholly or partly in relation to the credit activities undertaken by Esanda, in particular in respect of flex commissions paid to brokers.

c. ANZ breached the prohibition in s 128(d) of the National Credit Act, read with s 130(1)(c), by failing to take reasonable steps to verify the financial situation of the approximately 320 customers who were subject to similar conduct by the relevant third party intermediaries as that considered in the *Esanda* proceeding.

Available findings of conduct falling below community standards and expectations

51. On the evidence, it is open to the Commissioner to find that that ANZ engaged in conduct that fell below community standards and expectations by, for a period of time, offering to consumers insurance products with claim rates that "were nowhere near an acceptable level or an industry standard".

Remuneration practices and adequacy of internal systems

52. On the evidence, it is open to the Commissioner to find that a cause of the misconduct was the remuneration and incentive structure in respect of Esanda car loan intermediaries.

53. It is also open to the Commissioner to find that ANZ had inadequate systems in place to enable it to comply with its responsible lending obligations when assessing whether to approve a car loan.

Questions for written submissions in response

54. ANZ is invited to provide written submissions addressing each of the findings that we have identified to be open to the Commissioner, as well as any other findings that it regards as available on the evidence.

55. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from this case study:

a. Are the arrangements between banks and car dealers for the provision of car loans to consumers likely to result in the contraventions of the banks' responsible lending obligations under the National Credit Act?

b. Do remuneration and incentive structures that reward car dealers for increasing the volume of their sales of cars or insurance policies, or the interest to be charged to the customer, create an unacceptable risk that:

(i) dealers will prefer their own interests to the interests of customers; and

(ii) as a result, customers will suffer detriment?

CBA CREDIT CARDS

Background

56. The eleventh case study involved CBA's responsible lending practices with respect to credit cards and credit card limit increases. Evidence in this case study was given by Mr David Harris, who had provided a public submission to the Commission, as well as Mr Clive van Horen, the Executive General Manager, Retail Products within the Retail Banking Services Business Unit of CBA.

57. Mr van Horen gave evidence about CBA's credit card application processes and procedures, including in respect of the information obtained by CBA from customers as part of the application process.

58. A customer would be eligible for a short form application if (amongst other things) their salary was deposited into a CBA account and passed CBA's credit card pre-servicing assessment. Mr van Horen's evidence was that CBA prepopulated the customer's income based on the information in their CBA account, and would confirm that the customer was not aware of any future changes to their circumstances. The customer would then declare their expenses, liabilities, number of dependents, and be required to pass an external credit check. Mr Van Horen's evidence was that CBA did not take any steps to verify the customer's living expenses.

59. The "short-form" serviceability assessment was an automated process, which took into account the customer's financial position and the customer's servicing surplus. For serviceability purposes, the customer's stated living expenses were compared against an internal CBA benchmark (namely, the income-based HEM), and the higher was used in the serviceability assessment.

60. Mr van Horen explained that in CBA's terms, the "servicing surplus" was generated by deducting expenses from income. CBA's minimum serviceability requirement was that a customer have a "surplus" which was the higher of 2.5% of their credit card limit or $25. In

Mr van Horen's view, it was reasonable for CBA to assess a customer's suitability for a credit card or credit card limit increase on the basis that the customer has at least a $25 servicing surplus in their account each month. Mr van Horen said that CBA was meeting its requirement to ensure that a credit contract would not occasion substantial hardship if CBA was satisfied that a customer had $25 or more available to them by way of "servicing surplus" each month.

61. In relation to credit card limit increases, Mr van Horen gave evidence that, amongst other things:

    a. CBA pre-assessed customers to be eligible for the credit limit increase in advance of the customer applying for the credit (that is, it was not something the customer initiated); and

    b. in order to be eligible for the credit limit increase, CBA would assess whether the customer's average repayments in the last 6 months were equal to or greater than 2% of the potential new credit limit.

62. Mr Harris obtained his first credit card from CBA towards the end of 2014. Not long after obtaining that credit card, he began to gamble beyond his means, including by obtaining cash advances on his credit card, transferring that money to a CBA debit account, and then using that money for gambling purposes.

63. In early 2016, Mr Harris consolidated the three credit cards into one card, with a credit limit of $27,100. It was in April of that year that Mr Harris first incurred direct gambling-related expenses on his credit card with CBA.

64. In October 2016, during a call to CBA about an unrelated matter, a CBA staff member informed Mr Harris that he was conditionally approved for a credit limit increase. Mr Harris informed the bank of his gambling problem. Mr van Horen admitted that the information CBA received from Mr Harris about his gambling problem was not in any way passed though the credit decisioning systems at CBA.

65. Ten days later, CBA sent Mr Harris a letter inviting him to increase his credit limit. Another similar letter was sent soon after. In early 2017, Mr Harris applied for, and was offered, a credit limit increase of $8,000 to $35,100. Mr van Horen's evidence was that $8,000 was the maximum credit limit increase offered by CBA. He acknowledged that CBA should not have approved this credit limit increase.

Available findings of misconduct

66. It is open to the Commissioner to make the following findings of misconduct:

    a. CBA breached its statutory obligations under section 47(1)(a) of the National Credit Act and section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that its credit activities in relation to Mr Harris, and the financial services provided to Mr Harris covered by its Australian Financial Services Licence, were engaged in efficiently, honestly and fairly.

    b. CBA breached the prohibition in section 128(b) of the National Credit Act on increasing the credit limit of a credit contract with Mr Harris in circumstances where it had not made reasonable enquiries about Mr Harris' financial situation and take reasonable steps to verify his financial situation, as required by sections 130(1)(b) and 130(1)(c).

    c. CBA failed to comply with Regulatory Guide 209: "Credit licensing: Responsible Lending Conduct", which constitutes a recognised and widely accepted benchmark for meeting the responsible lending obligations in the National Credit Act.

    d. CBA failed to comply with the Banking Code of Practice. In particular, CBA failed to comply with the obligation in clause 27 of the Code to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and forming an opinion about Mr Harris' ability to repay his credit card.

Available findings of conduct falling below community standards and expectations

67. CBA failed to take into account that Mr Harris was using his CBA consolidated credit card for gambling, at the point in time that it offered a credit limit increase to Mr Harris. At that point, CBA was aware of Mr Harris' gambling problem.

Inadequacy of internal systems

68. The evidence establishes a number of inadequacies in CBA's internal systems. CBA required Mr Harris to follow complex and contradictory processes in order to close his account. Mr Harris's disclosure to CBA of his gambling problems was not captured by CBA's systems. Further deficiencies in CBA's systems were demonstrated by the fact that Mr Harris was sent a letter declining his hardship request for some months *after* Mr Harris had already entered into a payment arrangement with CBA.

Questions for written submissions in response

69. CBA is invited to provide written submissions addressing each of the findings that have been identified as being open to the Commission, as well as any other findings that it regards as available on the evidence.

70. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from this case study:

    a. Do credit providers have adequate policies to ensure that they comply with their responsible lending obligations under the National Credit Act when offering credit cards and credit card limit increases to consumers, insofar as those policies require them to:

        (i) make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract;

        (ii) make reasonable inquiries about the consumer's financial situation; and

        (iii) take reasonable steps to verify the consumer's financial situation?

    b. More specifically:

        (i) what policies might be appropriate to ensure that reasonable inquiries are made into consumers' discretionary expenditure (including in relation to the categories identified in [209.33] of ASIC's Regulatory Guide 209)?

        (ii) in circumstances where a bank has access to information about a customer's spending, by reason of the fact that that customer has other accounts with the bank, is it necessary for bank to inquire into the expenses incurred in respect of those accounts to comply with its responsible lending obligations under the National Credit Act?

WESTPAC CREDIT CARD LIMIT INCREASES

Background

71. The twelfth case study involved the approval by Westpac of 183,143 credit limit increases, without making reasonable inquiries about the customer's financial position or taking

reasonable steps to verify the customer's financial situation. Evidence in this case study was given by Mr William David Malcolm, General Manager, Credit, at Westpac.

72. In the period from September 2012 to December 2014, Westpac relied on an automated process to perform the assessment as to whether the credit limit increase was not unsuitable for the customer. Westpac did not seek further information from customers as to their employment status, income or non-Westpac debts.

73. In September 2012, ASIC had told lenders, including Westpac, that it expected them to undertake inquiries in respect of employment and income when making an offer to increase a customer's credit card limit. In its evidence, Westpac acknowledged that ASIC had made such recommendations and recognised in hindsight that its approach to the regulator's guidance was inappropriate.

74. In December 2014, Westpac temporarily suspended credit limit increase invitations until it had implemented changes to its processes. It also engaged in negotiations with ASIC that led to a remediation program including refunds and write-offs of around $11 million and a $1 million contribution over four years to support financial counselling and literacy. The evidence is that some of the offers that were made in 2012 and 2013 were only remediated in 2016.

Available findings of misconduct

75. On the evidence, it is open to the Commissioner to make the following findings of misconduct:

    a. Westpac breached the prohibition in section 128(b) of the National Credit Act on increasing the credit limit of a credit contract with consumers in circumstances where it had not made reasonable enquiries about the consumers' financial situation, as required by section 130(1)(b).

    b. Westpac breached the prohibition in section 128(b) of the National Credit Act on increasing the credit limit of a credit contract with consumers in circumstances where it had not taken reasonable steps to verify their financial situation, as required by section 130(1)(c).

    c. Westpac breached the prohibition in section 133(1)(b) of the National Credit Act on increasing the credit limit of a credit contract with a consumer where the contract is unsuitable for the consumer.

    d. Westpac failed to comply with Regulatory Guide 209: "Credit licensing: Responsible Lending Conduct", which constitutes a recognised and widely

accepted benchmark for meeting the responsible lending obligations in the National Credit Act.

Available findings of conduct falling below community standards and expectations

76. On the evidence, it is also open to the Commissioner to make findings that Westpac engaged in conduct that fell below community standards and expectations.

    a. The evidence establishes that despite being aware from September 2012 that ASIC expected banks, including Westpac, to make inquiries about employment status and current income as a minimum before offering a credit limit increase, Westpac chose to ignore ASIC's guidance until late 2014.

    b. The evidence establishes that despite being aware from September 2012 that ASIC expected banks, including Westpac, to make inquiries about a customer's employment status and current income before offering them a credit limit increase, Westpac maintained its prior position in respect of non-FCA customers.

    c. Westpac relied on an automated process to assess suitability of credit card limit increases for customers, including in circumstances where it was aware, or ought to have been aware, that such a process may not take into account the customer's current employment status, current income or current debts.

    d. Westpac made no attempt to assess whether credit card limit increases met the needs of the customers.

    e. Westpac did not commence remediation in respect of the customers who may have been affected by the misconduct that occurred during the period from 2012 to 2014, until January 2016.

Culture, governance and remuneration practices

77. On the evidence, it is open to the Commissioner to find that there were a number of causes of the misconduct or conduct falling below community standards and expectations, which are attributable to the culture and governance practices at Westpac.

    a. It is open to the Commissioner to find that a significant cause of the misconduct was Westpac's prioritisation of profitability over the recommendations of the regulatory and compliance team.

    b. It is open to the Commissioner to find that another cause of the misconduct was the inadequacy of Westpac's policies and its automated procedures to ensure that credit card limit offers were made in compliance with Westpac's responsible lending obligations.

c. It is open to the Commissioner to find that a further cause of the misconduct was Westpac's remuneration and incentives scheme, which rewarded bankers for the volume of credit card limit increases that they achieved in a given period.

Questions for written submissions in response

78. Westpac is invited to provide written submissions addressing each of the findings that we have identified as open to the Commissioner, as well as any other findings that it regards as available on the evidence.

79. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from the Westpac case study:

    a. How should a bank assess the unsuitability of a revolving credit card facility, in particular whether it will meet the customer's requirements or objectives?

    b. How should a bank assess the unsuitability of credit card limit increases, in particular what is the appropriate level and period of repayment that ought to be taken into account, including having regard to the legislative reforms that are to take effect from 1 January 2019?

    c. Can a bank utilise an automated system for determining eligibility and suitability of credit card limit increases in order to comply with their responsible lending obligations under the National Credit Act?

    d. How should banks respond when ASIC issues guidance to entities by way of correspondence or a Regulatory Guide?

CITI INTERNATIONAL TRANSACTION FEES CASE STUDY

Background

80. The final case study involved Citi's failure to adequately disclose to customers that International Transaction Fees would be imposed for Australian dollar transactions on their Citi-branded and partner-branded credit cards where the merchant was located overseas or where the merchant used a foreign bank or entity to process the transaction. Citi's partner-branded cards included Bank of Queensland and Virgin Money credit cards.

81. The Commission received evidence in the form of two witness statements in this case study, each of which was made by Citi's Consumer Business Manager, Mr Alan Machet.

82. Prior to early 2016, Citi only charged its credit card customers international transaction fees on transactions denominated in a foreign currency. In December 2015, Citi sent to its credit card customers a Variation Notice which informed them that international transaction fees may be payable on any transaction made in foreign currency or with an overseas merchant.

83. However, Citi did not explicitly inform customers that it would charge international transaction fees for transactions with an offshore merchant in circumstances where the website operated by the offshore merchant:

    a. quoted prices in Australian dollars;

    b. used an Australian web address; and

    c. otherwise contained no information to indicate that the merchant was located offshore.

84. In addition, Citi did not explicitly inform customers that they could be charged an International Transaction Fee in circumstances where the merchant was located in Australia but the payment was processed by the merchant overseas.

85. The evidence establishes that Citi began to charge customers such fees from January 2016 in relation to its Citi-branded cards and from March 2016 in relation to its partner-branded cards.

86. ASIC contacted Citi about the circumstances in which it was charging International Transaction Fees in August 2016.

87. ASIC and Citi agreed on a program to remediate customers who had paid International Fees in the circumstances we have described.

88. Remediation payments were made to 229,936 customers in February and March 2017, totalling approximately $5 million.

Available findings of misconduct

89. On the evidence, it is open to the Commissioner to make the following findings of misconduct against Citi:

    a. Citi breached its statutory obligations under s 912A(1)(a) of the Corporations Act and under s 47(1)(a) of the National Credit Act to do all things necessary to ensure that the financial services covered by its financial services licence and the credit activities authorised by its credit licence, were engaged in efficiently, honestly and fairly.

    b. Citi failed to comply with clause 3.2 of the Banking Code of Practice.

Available findings of conduct falling below community standards and expectations

90. On the evidence, it is also open to the Commissioner to find that Citi engaged in conduct that fell below community standards and expectations, in that it failed to clearly articulate to customers the nature of, and basis for, the imposition of international transaction fees.

Inadequacy of internal systems

91. On the evidence, it is open to the Commissioner to find that the misconduct can be attributed to Citi's failure to have adequate processes to ensure that the disclosure to customers of the circumstances in which International Transaction Fees would be charged were disclosed to customers.

Questions for written submissions in response

92. Citi is invited to provide written submissions addressing each of the findings that we have identified to be open to the Commissioner, as well as any other findings that it regards as available on the evidence.

93. All parties with leave to appear will be permitted to provide written submissions addressing the following questions, which arise from this case study:

a. Are the terms and conditions provided to consumers in respect of credit cards specifically, and credit products generally, too complex for consumers to understand the circumstances in which they will be liable to pay fees?

b. What steps could, and should, banks take to ensure more transparency in respect of the circumstances in which customers are charged fees in connection with credit products?