

**Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry**
**ANZ'S SUBMISSION ON FINDINGS AND QUESTIONS
ARISING FROM CASE STUDIES INVOLVING ANZ**

1. INTRODUCTION

- 1.1 These submissions concern the following four case studies directly involving Australia and New Zealand Banking Group Limited and its associated entities (**ANZ**) that were examined in the course of the hearings of the Royal Commission held between 13–23 March 2018: (a) ANZ Responsible Lending Home Loans (Robert Emmett Regan): section 2; (b) ANZ Pre-Approved Overdrafts: section 3; (c) ANZ Processing Errors: section 4; and (d) ANZ Car Loans: section 5.
- 1.2 In respect of each case study, ANZ has: (a) set out a summary of the facts which, in its submission, the Commissioner ought to find, having regard to the evidence heard and tendered in the course of the hearing; (b) addressed each of the findings said by Counsel Assisting to be open; and (c) addressed each of the questions posed by the Commissioner and Counsel Assisting (**Questions**).
- 1.3 In addressing the Questions, ANZ has confined its submissions to its own conduct, practices and policies, and has not sought to make submissions in respect of other banks, intermediaries or the banking industry generally. That is because ANZ has not examined the conduct, practices or policies of its competitors or intermediaries to the extent necessary to enable it to address submissions in respect of those matters.

2. ANZ RESPONSIBLE LENDING HOME LOANS CASE STUDY (ROBERT EMMETT REGAN)

SUMMARY OF FACTS

- 2.1 On 7 March 2017, ANZ received a \$50,000 home loan application from Robert Regan.¹ The application, together with supporting documents, was submitted on Mr Regan's behalf by his mortgage broker.² At the time of his application, Mr Regan owned his own home in [REDACTED] Victoria, which was estimated to be worth at least \$530,400.³ He had no dependents, was single, and a retiree.⁴
- 2.2 Mr Regan intended to use the \$50,000 loan to assist in securing the release of gold bullion which had been purportedly seized by Customs at Heathrow Airport.⁵ There is no evidence that Mr Regan disclosed this intention to his broker, or to ANZ. ANZ was informed by Mr Regan's broker that the money was intended for "minor non-structural renovations".⁶
- 2.3 Mr Regan's loan application included, among other documents, a personal statement of financial position. Mr Regan read the statement before he signed it, and declared that the details in his statement were true and correct.⁷ Mr Regan declared that his average monthly living expenses were \$1,140, and his monthly income was \$2,663.⁸

¹ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3018, ANZ.800.141.3031, ANZ.800.141.3046.

² Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3018, ANZ.800.141.3046.

³ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3018 at .3020. A recent valuation is said to have suggested that the property was worth \$575,000: exhibit RER-3 to Regan statement (WIT.0001.0006.0001, ex. 1.82), at RCD.0014.0001.0044, Appendix A [1.14].

⁴ Regan statement (WIT.0001.0006.0001, ex 1.82), at [3].

⁵ T435.33-46. Exhibit WAR-12 to Ranken Statement (ex 1.86) at: ANZ.800.141.3166.

⁶ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3046.

⁷ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3020; T447.17-41.

⁸ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3018 at .3020.

- 2.4 Mr Regan's bank statements with Credit Union Australia for February 2017 were provided to ANZ as part of Mr Regan's loan application.⁹ Those statements were used by ANZ to verify Mr Regan's income, but not his expenses.¹⁰
- 2.5 ANZ conducted a serviceability assessment in respect of Mr Regan's loan application. As part of that assessment, ANZ:¹¹ (a) increased Mr Regan's stated monthly living expenses of \$1,140 to \$1,189 (in line with the applicable income-linked Household Expenditure Measure (**HEM**) for March 2017); (b) allowed \$341.09 for monthly repayments on the proposed home loan (sensitised at 7.25% to provide a buffer for potential interest rate fluctuations); and (c) assumed monthly repayments of \$300 for Mr Regan's overdraft (based on 3% minimum monthly repayments on the total limit of the CUA overdraft).¹²
- 2.6 ANZ approved Mr Regan's loan application,¹³ which Mr Regan then accepted.¹⁴ On 4 April 2017, the proceeds of the loan were fully drawn down.¹⁵ On 7 April 2017, Mr Regan visited an ANZ branch and requested that the Australian dollar equivalent of £20,000 be transferred to an account with Halifax plc in London in the name of Samuel Regan.¹⁶ Mr Regan was not asked to explain the purpose of the transfer.¹⁷ The balance of the ANZ loan (\$15,073) was later spent by Mr Regan on a trip to London, including flights, accommodation and meals.¹⁸ On that trip, Mr Regan discovered he was the victim of a scam: there was no gold held by Customs at Heathrow Airport.¹⁹ Mr Regan was unable to recover the £20,000 he had transferred on 7 April 2017.²⁰
- 2.7 On 10 May 2017, Mr Regan wrote to ANZ about what had occurred.²¹ The following day, ANZ sent him a hardship application form.²² The form was completed during a phone call with ANZ on 7 June 2017.²³ Mr Regan's hardship application was assessed incorrectly by ANZ.²⁴ If assessed correctly, by taking into account an additional amount for overdraft repayments, it would have shown that Mr Regan had negative uncommitted monthly income (**UMI**). On 20 June 2017, ANZ informed Mr Regan that his application had been declined.²⁵
- 2.8 In late January and February 2018, two organisations contacted ANZ on Mr Regan's behalf: FMC Mediation and Counselling (**FMC**), and the Consumer Action Law Centre (**CALC**).²⁶ By letter dated 5 February 2018, FMC informed ANZ that Mr Regan did not dispute his debt to ANZ, but sought that it be forgiven.²⁷ CALC's letter to ANZ dated 21 February 2018 sought (among other things) a three month moratorium on

⁹ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3066. Other documents submitted are listed in the Regan statement (ex 1.82): WIT.0001.0006.0001 at [13].

¹⁰ T482.29-30.

¹¹ Exhibit 1.84 (RCD.0014.0002.0002).

¹² Ranken Statement (ANZ.800.327.0001 at .0010 [59(b)(ii)], ex 1.86); Exhibit WAR-6 to Ranken Statement (ex 1.86) at: ANZ.800.141. 134.

¹³ Exhibit WAR-7 to Ranken Statement (ex 1.86) at: ANZ.800.141.3041.

¹⁴ Exhibit WAR-10 to Ranken Statement (ex 1.86) at: ANZ.800.141.3232 at .3238. See also exhibit RER-3 to Regan Statement (WIT.0001.0006.0001, ex 1.82), ApplyOnline application summary: "Loan Term: 30 years".

¹⁵ Exhibit WAR-11 to Ranken Statement (ex 1.86) at: ANZ.800.314.0252.

¹⁶ Exhibit WAR-12 to Ranken Statement (ex 1.86) at: ANZ.800.141.3166. See also exhibit RER-6 to Regan Statement (WIT.0001.0006.0001, ex 1.82).

¹⁷ T443.36-37.

¹⁸ Regan Statement (WIT.0001.0006.0001, ex 1.82), at [29]. Exhibit WAR-12 to Ranken Statement (ex 1.86) at: ANZ.800.141.3166.

¹⁹ Regan Statement (WIT.0001.0006.0001, ex 1.82), at [29].

²⁰ Exhibit WAR-12 to Ranken Statement (ex 1.86) at: ANZ.800.141.3166.

²¹ Exhibit WAR-12 to Ranken Statement (ex 1.86) at: ANZ.800.141.3166.

²² Ranken Statement (ANZ.800.327.0001 at .0012 [61(b)], ex 1.86).

²³ Ranken Statement (ANZ.800.327.0001 at .0012 [61(c)], ex 1.86).

²⁴ Ranken Statement (ANZ.800.327.0001 at .0012 [61(c)], ex 1.86).

²⁵ Ranken Statement (ANZ.800.327.0001 at .0012 [61(d)], ex 1.86).

²⁶ Ranken Statement (ANZ.800.327.0001 at .0012-.0013 [61(g)-(k)], ex 1.86).

²⁷ Exhibit WAR-19 to Ranken Statement (ex 1.86) at: ANZ.800.333.0001.

repayments, and a waiver of Mr Regan's debt. CALC requested a response by 16 March 2018.²⁸ On 9 March 2018, ANZ informed CALC that a three month moratorium would be provided, and that ANZ would provide a further written response by 16 March 2018.²⁹ On 15 March 2018, ANZ wrote to CALC,³⁰ offering to resolve the matter with Mr Regan on terms that: (a) ANZ would reverse all fees and interest applied to the loan since drawdown; (b) ANZ would stop the accrual of all future fees and interest on the loan; (c) ANZ would apply a goodwill credit of \$1,500 to the loan balance; and (d) from June 2018, Mr Regan would make minimum monthly repayments of at least \$150 until the principal was paid in full. In his evidence to the Commission, Mr Regan rejected ANZ's offer.³¹

CONDUCT FINDINGS

- 2.9 ANZ acknowledges the challenges Mr Regan now faces in consequence of the events of 2017. ANZ accepts that in incorrectly assessing Mr Regan's hardship application on 7 June 2017 and, on that basis, refusing his hardship application at that time, its conduct fell below community standards and expectations (**CSEs**).
- 2.10 Counsel Assisting submitted that other findings of misconduct, or conduct falling below CSEs, are open on the evidence. ANZ submits that such findings should not be made.
- 2.11 The principal cause of Mr Regan's loss was the calculated and fraudulent deception of which Mr Regan was the victim in relation to non-existent gold bullion in the United Kingdom. ANZ played no part in that deception, and had no knowledge of it. Those involved have been arrested and convicted.³² In succumbing to the fraud, Mr Regan sought assistance from a broker. The broker met with Mr Regan on a number of occasions, identified various options, and facilitated his loan application. When acting for Mr Regan, the broker was required to meet a variety of statutory and general law obligations. The evidence given by Mr Regan suggests that the broker may not have discharged those obligations. The broker, however, did not give evidence before the Commission, and no statement was filed on his behalf.³³ Finally, and regrettably, Mr Regan decided to transfer money to a foreign bank account controlled by persons he had never met and did not know. In connection with that decision, Mr Regan spent additional sums travelling to and staying in London in May 2017.

Mr Regan's loan application

- 2.12 ANZ made reasonable inquiries about Mr Regan's requirements and objectives in relation to the loan and his financial position by requiring a completed application form and signed statement of financial position. The forms were completed and submitted on Mr Regan's behalf by his broker. ANZ's Broker Operations Manual required Mr Regan's broker to conduct a loan interview with Mr Regan.³⁴
- 2.13 Subject to its reasonable verification obligation, ANZ was entitled to rely, and did rely, on Mr Regan's signed declaration of financial position in assessing his application. Section 154(1) of the National Credit Code imposes upfront obligations on any party to a credit transaction,³⁵ including consumers, not to make false or misleading representations in

²⁸ Exhibit WAR-20 to Ranken Statement (ex 1.86) at: ANZ.800.282.0600.

²⁹ Exhibit 1.83 (RCD.0014.0002.0001).

³⁰ Exhibit 1.84 (RCD.0014.0002.0002).

³¹ T446.12.

³² T444.5-8; Exhibit WAR-12 to Ranken Statement (ex 1.86) at: ANZ.800.141.3166.

³³ In these circumstances, the Commission should not make findings, including findings of fact, in relation to what was said (or not said) in conversations between Mr Regan and his broker, and what steps (if any) the broker took to verify the purpose of the loan and Mr Regan's living expenses.

³⁴ Exhibit WAR-2 to Ranken Statement (ex 1.86) at: ANZ.800.314.0073, p 71.

³⁵ Revised Explanatory Memorandum for the National Consumer Credit Protection Bill 2009 (Cth) at [3.143] (**Revised NCCP EM**).

relation to matters that are material to entering into a credit contract. Mr Regan's stated monthly living expenses did not reflect his true expenses.³⁶

- 2.14 ANZ took reasonable steps to verify Mr Regan's financial position by obtaining documentation to verify his income and comparing his living expenses to the HEM benchmark. ANZ refers to paragraphs [2.28]–[2.33] below regarding the use of HEM.
- 2.15 ANZ submits that it was not required, in order to discharge its responsible lending obligations, to compare the contents of Mr Regan's February 2017 CUA bank statement with the information provided in Mr Regan's signed statement of financial position. ANZ was entitled to rely on Mr Regan's declared expenses, calibrated against the HEM benchmark. A single month's bank statements do not provide a reliable account of a customer's recurrent or typical monthly expenses. Discretionary expenditures incurred in one month may not reflect a customer's average living expenses over a twelve month (or longer) period, and annual expenses may be paid, in full, in a single month. In any event, the transfers in the February 2017 CUA bank statement which were identified by Mr Regan as being payments in connection with the scam do not evidence commitments in the nature of recurrent non-discretionary living expenses which are relevant to an assessment of suitability.
- 2.16 After making the inquiries and taking the verification steps referred to above, ANZ conducted an unsuitability assessment for Mr Regan's loan. On the information provided by Mr Regan, ANZ's serviceability assessment concluded that Mr Regan had a positive UMI of \$831. Having regard to the adjustment made by reference to the HEM benchmark, and the additional buffer provided for potential interest rate fluctuations over the life of the loan, ANZ was entitled to conclude that Mr Regan was able to service the loan. Given that Mr Regan's future income was assured, his age was not a reason for determining that a loan to him was unsuitable.
- 2.17 In undertaking the steps that it did, based on the information provided to it, ANZ submits that it did not: (a) fail to act efficiently, honestly and fairly in conformity with s 47(1)(a) of the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**);³⁷ (b) fail to make reasonable inquiries about Mr Regan's financial situation pursuant to s 130(1)(b) of the NCCP Act; (c) fail to take reasonable steps to verify Mr Regan's financial situation pursuant to s 130(1)(c) of the NCCP Act; (d) enter into an unsuitable credit contract with Mr Regan under s 133 of the NCCP Act; or (e) fail to act fairly and reasonably toward Mr Regan in a consistent and ethical manner, and exercise the care and skill of a diligent and prudent banker in selecting and applying its credit assessment methods and forming its opinion about Mr Regan's ability to repay his loan, as required by cl 3.2 and 27 of the Code of Banking Practice.
- 2.18 In Counsel Assisting's closing address, reliance was placed on s 912A(1)(a) of the *Corporations Act 2001* (Cth) (**Corporations Act**) in submitting that it was open for the Commission to conclude that ANZ failed to act efficiently, honestly and fairly. For the reasons outlined above, that submission should not be accepted. Further, ANZ observes that, in any event, s 912A(1)(a) is not engaged in this case because, in granting a loan to Mr Regan, ANZ did not provide him with a "financial service" within the meaning of s 766A of the Corporations Act. Counsel Assisting also submitted that it was open for the Commission to find that ANZ failed to comply with ASIC RG 209.³⁸ The particular respects

³⁶ It is not suggested that Mr Regan contravened s 154(1) of the National Credit Code or would not, in any event, have available a defence provided by s 154(2). ANZ considers that there should be "truth in lending" obligations for all parties to a credit transaction, including consumers, and there should be consequences for non-compliance. However, ANZ questions whether the current criminal penalties are appropriate for consumers who breach the section. ANZ would welcome discussion with the Commission regarding reform of s 154.

³⁷ See further paragraphs [4.23]–[4.24] below in connection with the meaning of the phrase "efficiently, honestly, and fairly".

³⁸ While ANZ accepts that conduct falling short of RG 209 might support a finding of misconduct as defined in the Commission's terms of reference, this will depend on the circumstances and the particular parts of the guide relied

in which it is said that ANZ did not comply with RG 209 were not identified in closing submissions, but insofar as the finding is said to rest on a contravention of the NCCP Act, that should not be accepted for the reasons already provided.

Mr Regan's draw down and use of the loan

- 2.19 Having approved Mr Regan's request for a \$50,000 loan, Mr Regan was entitled to draw down and use the money. The implicit suggestion during Counsel Assisting's closing address that the ANZ branch officer ought to have questioned Mr Regan's request to transfer his own funds should not be accepted. No question was put to ANZ's witness, Mr Ranken, about ANZ's policies concerning, or the issues which may be involved or would need to be considered in dictating or controlling, how a customer may later use funds provided under a credit contract. In the circumstances, no misconduct, or conduct falling below CSEs, has been established in ANZ acting on Mr Regan's instructions to transfer £20,000 to a London bank account for the benefit of Samuel Regan.

ANZ's response to CALC and offer to Mr Regan

- 2.20 Counsel Assisting submitted that ANZ failed to consider and respond in a timely and appropriate manner to CALC's request by letter dated 21 February 2018 to waive Mr Regan's home loan. That submission, too, should be rejected. On 9 March 2018, ANZ informed CALC that a three month moratorium would be provided and, the following week, wrote to CALC with an offer to resolve the matter on a fair and reasonable basis. The Commission should not conclude that the offer to Mr Regan fell below CSEs. The offer involved a genuine compromise of the amount payable by Mr Regan in respect of the loan for which he applied and in support of which he signed a declaration of financial position.³⁹
- 2.21 The Commission should also not conclude that the timing of the offer to Mr Regan supports a finding of conduct that falls below CSEs. ANZ responded to CALC within a reasonable time and made its offer on the day before the deadline nominated by CALC. For the Commission to assess whether the timing of ANZ's response fell below CSEs, further facts would be required as to: (a) the processes at ANZ in considering hardship applications; (b) the time involved in reviewing such applications and obtaining approvals to make an offer; (c) whether the time taken to respond in Mr Regan's case was consistent with the timing of responses to other hardship applications; and (d) whether there are industry standards or norms in connection with such matters. Questions of this kind were not directed to Mr Ranken in the course of his evidence, and nor was information or explanation sought from ANZ.

ANZ culture and use of HEM benchmark

- 2.22 Having regard to ANZ's primary submission that no finding of misconduct should be made against it in connection with Mr Regan's home loan, it is submitted that there should be no attribution of any particular culture within the bank as contributing to such conduct. Even if a misconduct finding were made, the Commission should not conclude that it was attributable to an approach by ANZ in this case, or a culture within the bank generally, which favours administrative convenience over strict adherence to the law. ANZ takes its legal obligations seriously. Its approach towards compliance is highly developed, led from the top, and regularly revised and refined.⁴⁰ Even if the Commission were to come to a different view about what was required by ANZ in this case, it should be accepted that ANZ considered that its conduct in relation to Mr Regan complied with its responsible lending obligations. ANZ further submits that its use of the income-linked HEM benchmark

on. ASIC recognises in RG 209 that the guide does not constitute legal advice, and the examples provided in it are purely for illustration, are not exhaustive, and are not intended to impose or imply particular rules or requirements.

³⁹ See further: Revised NCCP EM at [4.92] and Example 4.3; Exhibit WAR-2 to Ranken Statement (ex 1.86) at ANZ.800.314.0073, p 71.

⁴⁰ See, in particular, ANZ's 29 January submission at [4.17]-[4.22], [6.100] and 13 February submission at [1.8]-[1.12], [1.30]-[1.41], [2.9]-[2.19], [3.21]-[3.51].

in testing the reliability of information provided by customers, and in establishing a floor in assessing loan suitability, does not fall below CSEs. It refers further to paragraphs [2.28]–[2.33] below.

QUESTIONS

- 2.23 Australia's responsible lending obligations require credit providers to make "reasonable" inquiries about a customer's requirements, objectives and financial situation, and take "reasonable" steps to verify the customer's financial situation. In relation to verification steps, the credit provider must make such efforts to verify the information as would normally be undertaken by a reasonable and prudent lender in the circumstances and is not expected to take action going beyond prudent business practice.⁴¹ What constitutes prudent business practice in this context may be informed by a number of factors, such as cases involving the application of legal principle to different factual circumstances, regulator guidance, community expectations, impact on customers, industry practice, cost and expense, and available technology. These factors may evolve over time, leading to changes in what constitutes reasonable verification steps.⁴²

Do credit providers have adequate policies to ensure they comply with their obligations under the NCCP Act when offering broker-originated home loans to customers, insofar as those policies require them to make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract, to make reasonable inquiries about the consumer's financial situation, and to take reasonable steps to verify the consumer's financial situation?

- 2.24 ANZ has adequate and appropriate policies and procedures to ensure it complies with its obligations under the NCCP Act when offering broker-originated home loans.⁴³ ANZ's policies and procedures are directed at ensuring that ANZ: (a) makes reasonable inquiries about customers' requirements and objectives in relation to credit contracts; (b) makes reasonable inquiries about customers' financial situations; and (c) takes reasonable steps to verify customers' financial situations.
- 2.25 ANZ's policies and procedures are reviewed and updated to reflect changes in the availability of data, new technology, and engagement with industry regulators and participants. ANZ's projects include: (a) facilitation of the introduction of comprehensive credit reporting requirements which will assist in identifying and verifying a customer's stated liabilities; (b) new ANZ systems for making loan decisions (known as the "Common Decision Platform") and the move from three to one home loan origination system (known as "RLS"); (c) automated analysis of a customer's account transactions to identify and calculate aspects of the customer's financial information such as income, categories of basic living and other expenses and repayments to outstanding credit facilities (known as the "Transaction Income and Expense Data" (TriEx) work stream); and (d) an initiative to facilitate the exchange of bank statements with other ADIs (Statement Exchange Project).
- 2.26 Many Australians seeking home loans rely on assistance from brokers.⁴⁴ Recognising this, and without derogating from its own obligations under the NCCP Act, ANZ is committed to improving customer outcomes by requiring brokers to comply with the standards and procedures set out in its Broker Operations Manual.⁴⁵ Ongoing ANZ initiatives include the development of an industry home loan interview guide and the introduction of additional training requirements for brokers in relation to responsible lending. Reviews of broker files are also being undertaken to assess when investigation of a broker's conduct is required.

⁴¹ Revised NCCP EM at [3.146]; ASIC RG 209 – Table 4, Note 3.

⁴² ASIC RG 209 – Table No 4, Note 2.

⁴³ These include: ANZ's Mortgage Credit Requirement Policy, Guiding Principles document issued to brokers, Statement of Position toolkit, Broker Interview Guide, and Mortgage Assessment Guide.

⁴⁴ Ranken Statement (ANZ.800.327.0001 at 0006 [42]–[43], ex 1.86).

⁴⁵ Exhibit WAR-2 to Ranken Statement (ex 1.86) at: ANZ.800.314.0003.

- 2.27 Brokers are generally the agent of the borrower and not the lender. This conclusion is not altered by the fact that the broker is authorised in relevant respects by, or may receive a commission from, the lender.⁴⁶

Benchmarks: Is the use of any benchmark suitable? Particularly where customers are not very good at providing accurate information, should home loans be assessed on a measure of UMI? Is use of the HEM benchmark an appropriate way to deal with the difficulties associated with securing an accurate assessment of living expenses from a customer? Is use of the HEM benchmark appropriate in assessing whether a loan is unsuitable for a customer? Is the HEM benchmark too conservative a measure of a customer's living expenses?

- 2.28 These are important and welcome questions. Based on current levels of access to data, ANZ considers that independent benchmarks, such as HEM, if statistically robust and regularly reviewed, can be suitable for testing the reliability of information provided by customers, and in establishing a floor in assessing loan suitability. HEM is currently the recognised industry-standard method for reasonably verifying customers' living expenses. In combination with inquiries, the use of benchmarks has been identified by ASIC as a method for verifying customers' living expenses, and by APRA as an acceptable part of a serviceability assessment.⁴⁷ One of the reasons the use of HEM is reasonable is because of the difficulties for customers and credit providers in verifying living expenses, having regard to the number and variety of expenses customers may incur, when and how they are incurred, and whether they are one-off or regular. Income, by contrast, is generally more predictable and consistent. Whether HEM remains a reasonable method for verifying customer living expenses may change in an open data environment.
- 2.29 Whilst ANZ considers the HEM benchmark is a reasonable and not overly conservative measure for verifying customers' living expenses, ANZ is supportive of the work APRA is doing to confirm that HEM continues to reflect a reasonable level of living expenses. ANZ is also supportive of industry initiatives which would improve inquiries into and verification of customer expenses. ANZ would welcome the opportunity for further engagement with the Commission about the use of the HEM benchmark.
- 2.30 That said, HEM is not a replacement for making genuine inquiries of the customer about their living expenses, and ANZ does not use HEM as a replacement for making those inquiries.
- 2.31 ANZ recognises that customers can have difficulty in accurately recalling and calculating their expenses. ANZ is looking at further measures to assist customers in identifying and recording living expenses. For example, ANZ is introducing a more detailed breakdown of living expense categories in the statement of financial position that customers complete for home loans, with further roll-outs and enhancements scheduled for its other consumer credit products. These expanded expense fields include narrative explanations of the information the customer is being asked to provide.
- 2.32 As data availability and technology processes develop, it may be possible for credit providers to rely less on benchmarks such as HEM in verifying living expenses. ANZ is working towards using individual customer data to generate personalised income and expense estimates that can be used in inquiry and verification processes. While data and technology changes are being progressed, however, it would be neither appropriate nor practical to replace the use of the HEM benchmark with a process of manually assessing

⁴⁶ See, for example: *Permanent Mortgages Pty Ltd v Vandenbergh* [2009] NSWSC 902 at [336]-[341]; *Permanent Trustee Co Ltd v O'Donnell* [2009] NSWSC 902 at [342]; *Perpetual Trustees Victoria Ltd v Burns* [2015] WASC 234 at [140]-[144].

⁴⁷ RG 209.49 and RG 209.104; *ASIC Report 516: Review of mortgage broker remuneration* (March 2017) at [59]-[64] and [865]-[885]; APRA Prudential Practice Guide APG 223 – Residential Mortgage Lending (February 2017) at [44]. NB ASIC and APRA have expressed concern about the prevalence of use, and potential for misuse, of HEM.

transaction account data (which may or may not be available). The manual assessment of transaction data would involve significant operational complexity, requiring comprehensive analysis of large volumes of transaction level data, with potential implications for the cost and availability of credit. There is no evidence before the Commission which indicates that a manual assessment, even if it were undertaken, would lead to better customer outcomes.

Does the widely-known use of the HEM benchmark as a default for customers' living expenses create an unacceptable risk that brokers will fail to make reasonable inquiries about a customer's financial situation, instead opting to declare an amount of living expenses for the customer that is known by the broker to be in the vicinity of the relevant HEM benchmark?

- 2.33 Knowledge of the use of the HEM benchmark may lead unethical brokers to declare an amount of living expenses at or around the HEM benchmark in place of satisfying their obligation to make reasonable inquiries about a customer's financial situation. The possibility, however, of brokers defaulting to the HEM benchmark does not mean there is an unacceptable risk that it will occur. There are measures in place to address this risk. *First*, such conduct may place brokers in breach of their obligations under the NCCP Act. *Second*, it may also place brokers at risk of breach of their obligations to ANZ. In both cases, there are significant consequences for brokers found to be in breach. *Third*, ANZ takes steps to address this risk, such as by directing brokers to collect information in relation to living expenses. *Finally*, ANZ monitors for brokers whose applications default to HEM to a disproportionate degree.

3. ANZ PRE-APPROVED OVERDRAFTS CASE STUDY

SUMMARY OF FACTS

- 3.1 ANZ Assured is a small overdraft facility with a credit limit of either \$500 or \$1,000.⁴⁸ The product is intended to operate as a "safety net" to cover customers' small and temporary cash shortfalls, such as the normal consequences of an account being temporarily overdrawn due to, for example, a bounced cheque or dishonour fee.⁴⁹
- 3.2 In 2014, ANZ sent 330,762 pre-approved offers for ANZ Assured to eligible customers.⁵⁰ Between November 2014 and January 2015 (the **Relevant Period**), approximately 2,992 ANZ Assured facilities were activated. It is likely that most if not all of those activations were in response to the receipt of pre-approved offers.⁵¹ The hard-copy pre-approved offers stated that the customer had been "pre-selected" for eligibility,⁵² and that they could activate the facility by communicating their acceptance to ANZ.⁵³ The Activation Authority form, included in the hardcopy pre-approved offers, stated that by accepting the offer the customer confirmed that they had read the offer and the accompanying terms and conditions and ANZ Credit Guide,⁵⁴ and that they could repay the facility limit without substantial hardship.⁵⁵ It also stated that if the customer's personal circumstances had recently changed or would likely soon change in a manner that could adversely affect their financial position, they ought not to accept the pre-approved offer but contact ANZ instead.⁵⁶

⁴⁸ Forbes Statement (ANZ.999.001.0025 at 0027 [14], ex 1.122).

⁴⁹ Forbes Statement (ANZ.999.001.0025 at 0027 [17], ex 1.122); T625.33-39.

⁵⁰ T627.18-20, T638.41-45.

⁵¹ Forbes Statement (ANZ.999.001.0025 at 0034 [68], ex 1.122); T627.25-29, T639.10-44.

⁵² Exhibit HF2 to Forbes Statement (ex 1.122) at ANZ.800.255.7837; T631.27-31.

⁵³ Forbes Statement (ANZ.999.001.0025 at 0028 [26]-[27], ex 1.122); Exhibit HF2 to Forbes Statement (ex 1.122) at ANZ.800.255.7837.

⁵⁴ Exhibit HF2 to Forbes Statement (ex 1.122) at ANZ.800.255.7837.

⁵⁵ Exhibit HF2 to Forbes Statement (ex 1.122) at ANZ.800.255.7837; T632.24-42.

⁵⁶ Exhibit HF2 to Forbes Statement (ex 1.122) at ANZ.800.255.7837; T632.24-42.

- 3.3 Not all ANZ customers were eligible to receive pre-approved offers for ANZ Assured.⁵⁷ The product could only be linked to certain ANZ accounts.⁵⁸ It could not be linked to, for example, the ANZ Access Basic account, held by customers holding a concession card or receiving certain government benefits,⁵⁹ and was not available to ANZ customers participating in the Saver Plus program (which supported lower income earners to develop savings habits).⁶⁰ ANZ also used "eligibility criteria" to identify those customers to whom pre-approved offers would be sent.⁶¹ During the Relevant Period, those criteria stated that, to receive a pre-approved offer, a customer had to:⁶² (a) be aged between 18 and 64; (b) have been an ANZ customer for at least six months; and (c) meet ANZ's inquiries and verification criteria,⁶³ which excluded customers who had, among other things, received certain Centrelink benefits into an ANZ account or previously demonstrated delinquency, default or arrears in respect of, or on, ANZ accounts. The criteria also required ANZ to review up to six months of deposits made into a customer's eligible ANZ account for the purpose of identifying receipt of deposits of at least double the amount of the ANZ Assured credit limit proposed to be offered.⁶⁴ Further, ANZ Assured was not activated on a customer's account if, at the time of purported acceptance, the offer had expired or a hardship "flag" had been imposed on the customer's account.⁶⁵
- 3.4 The eligibility criteria were intended to exclude from the pool of potentially eligible customers persons who, based on the information available to ANZ, were at risk of carrying an overdraft balance over an extended period of time, contrary to the intended purpose of the product.⁶⁶ ANZ carried out its unsuitability assessments under the NCCP Act on the basis of the information referred to in the previous paragraph. ANZ did not, during the Relevant Period, ask customers about their required credit limit. The pre-approved offers did not enable customers to request a credit limit different from what they had been offered.⁶⁷
- 3.5 ANZ stopped sending pre-approved offers for ANZ Assured in early 2015, after being contacted by ASIC in December 2014.⁶⁸ ANZ Assured is now only available to customers upon application, and following a full credit assessment.⁶⁹
- 3.6 ANZ's failure to inquire expressly about pre-approved customers' required credit limits was the subject of five infringement notices issued by ASIC in February 2016. ANZ paid the infringement notices, which totalled \$212,500, in February 2016.⁷⁰ By letter dated 10 January 2017 (**ASIC January 2017 letter**), ASIC requested that "ANZ provide remediation on a case by case basis" to any ANZ Assured customers suffering hardship, arrears or default.⁷¹ ANZ has not identified any customers affected by the conduct that

⁵⁷ Forbes Statement (ANZ.999.001.0025 at 0027 [18], ex 1.122).

⁵⁸ Forbes Statement (ANZ.999.001.0025 at 0027 [18]-[19], ex 1.122); T-625.30-31.

⁵⁹ Forbes Statement (ANZ.999.001.0025 at 0027 [19], ex 1.122).

⁶⁰ Forbes Statement (ANZ.999.001.0025 at 0027 [19], ex 1.122).

⁶¹ Forbes Statement (ANZ.999.001.0025 at 0029 [35]-[37], ex 1.122); Exhibit HF3 to Forbes Statement (ex 1.122) ANZ.800.276.0241 at 0244-0247).

⁶² Forbes Statement (ANZ.999.001.0025 at 0029 [37], ex 1.122).

⁶³ Forbes Statement (ANZ.999.001.0025 at 0029 [38], ex 1.122).

⁶⁴ Forbes Statement (ANZ.999.001.0025 at 0029 [38], ex 1.122); T633.40-42.

⁶⁵ Forbes Statement (ANZ.999.001.0025 at 0031 [45], ex 1.122); T635.1-21.

⁶⁶ Forbes Statement (ANZ.999.001.0025 at 0029 [37], ex 1.122).

⁶⁷ Forbes Statement (ANZ.999.001.0025 at 0031 [46], ex 1.122).

⁶⁸ Forbes Statement (ANZ.999.001.0025 at 0028 [22], 0032 [53], 0033 [55], 0035 [70], ex 1.122).

⁶⁹ Forbes Statement (ANZ.999.001.0025 at 0035 [71], ex 1.122).

⁷⁰ Forbes Statement (ANZ.999.001.0025 at 0033 [59], 0034 [63], ex 1.122).

⁷¹ Exhibit HF1 to Forbes Statement (ex 1.122), ANZ.800.255.8807; T-642.38-46-T-643.1-9. Receipt of the ASIC January 2017 Letter and, specifically, ASIC's remediation request as expressed in that letter, was acknowledged by ANZ by return email: Exhibit 1.124 at ASIC.0012.0003.1696; T645.31-46.

was the subject of the infringement notices such as would require remediation as requested by ASIC.⁷²

CONDUCT FINDINGS

- 3.7 Sections 128 to 130 of the NCCP Act require that "reasonable inquiries" be made about customers' requirements, objectives and financial situations for the purpose of determining the suitability of a credit contract. RG 209 relevantly states that the obligations to make reasonable inquiries, and to take reasonable steps to verify information, necessarily vary according to the circumstances in question.⁷³
- 3.8 Having regard to: (a) the nature and intended purpose of ANZ Assured (see [3.1]); (b) the size of the credit limits involved (\$500 and \$1,000); (c) the terms of the pre-approved offer letters and Activation Authority form (see [3.2]); (d) the factors set out in [3.3], including ANZ's eligibility criteria which were intended to exclude potentially unsuitable customers from receipt of pre-approved offers; and (e) the absence of evidence of customers in fact suffering hardship, default or arrears (see [3.6]), at the time the matter was raised with it by ASIC, ANZ considered that its inquiries during the Relevant Period were reasonable, and that its conduct complied with its responsible lending obligations. It was for those reasons that ANZ did not admit breaches at the time it paid the infringement notices issued by ASIC. In those circumstances, ANZ submits that the Commission should not find that ANZ breached its statutory obligation to act efficiently, honestly and fairly under s 47(1)(a) of the NCCP Act, or its obligations under cl 3.2 and 27 of the Banking Code of Practice 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 forming its opinion about ability to repay the credit facility. Nor should the Commission find that ANZ "failed to comply" with RG 209. ANZ explained its genuinely held understanding of the responsible lending obligations applicable to pre-approved offers for ANZ Assured to ASIC in correspondence, including by express reference to RG 209, which contemplates that inquiries may, at times and in certain circumstances, be scalable.⁷⁴
- 3.9 Having had the opportunity to further consider the matter, however, including in the course of preparing for this case study and as a result of the examination of the case study at the Commission's hearings, and in light of evolving mores since the introduction of responsible lending obligations, ANZ has come to the view, and accepts, that its previous position, while genuinely held at the time, is not consistent with contemporary standards. In particular, in respect of ANZ Assured and the circumstances in which it was offered to customers, ANZ would not (and does not)⁷⁵ today issue this product: (a) without making express inquiries of customers' required credit limits; and (b) without seeking adequate and current information for the purpose of assessing customers' financial positions. ANZ accepts that it did not meet its responsible lending obligations under reg 28JA of the Credit Regulations and, therefore, s 130(2) of the NCCP Act, in respect of the pre-approved offers made and accepted by customers during the Relevant Period. This was "misconduct" as defined in the Commission's terms of reference.
- 3.10 ANZ submits that the Commission ought not find that ANZ's conduct fell below CSEs in connection with the remediation of customers. ANZ did not tell ASIC that it considered remediation was unnecessary.⁷⁶ It sought clarification of what ASIC considered such remediation ought to involve,⁷⁷ which was provided in the ASIC January 2017 letter. The ASIC January 2017 letter did not request that ANZ review each ANZ Assured facility

⁷² Forbes Statement (ANZ.999.001.0025 at 0034 [67], ex 1.122); T639.20-22; T643.41-47-T644.1-19, T645.44-46.

⁷³ See, for example, RG 209 at p 11.

⁷⁴ Exhibit HF1 to Forbes Statement (ex 1.122) at ANZ.800.255.7833 and ANZ.800.255.9420.

⁷⁵ Forbes Statement (ANZ.999.001.0025 at 0035 [71], ex 1.122). See also [3.13] below.

⁷⁶ Contra Counsel Assisting's closing submissions at RCD.9999.0003.0001 at .0005 [17].

⁷⁷ ANZ letter to ASIC dated 2 May 2016 at Exhibit HF1 to Forbes Statement (ex 1.122), ANZ.800.077.0172.

issued to pre-approved customers during the Relevant Period. Rather, it requested that ANZ remediate affected customers on "a case by case basis" in response to "any hardship, arrears or default".⁷⁸ As noted in [3.6], ANZ has not identified any customers affected by the conduct that was the subject of the infringement notices such as would require remediation as requested by ASIC. ANZ did not ignore a direction by ASIC. Having come to the view that its conduct was not consistent with contemporary responsible lending obligations, ANZ has also come to the view that it ought to revisit whether any customers may have been potentially affected by the conduct the subject of this case study so as to require remediation. ANZ will develop a methodology, consistent with its remediation principles, for doing so, and will seek to engage ASIC in this process.

- 3.11 ANZ submits that the Commission should not find that a cause of its misconduct was any inadequacy in its internal systems to ensure that the pre-approved offers complied with responsible lending obligations. In its engagement with ASIC, ANZ adopted a genuinely held interpretation of its responsible lending obligations. As explained at [3.9], ANZ has come to the view, as a result of further consideration, that that interpretation is not consistent with contemporary standards of responsible lending. It does not follow, however, that ANZ's previous position was the result of any inadequacy in ANZ's internal systems.
- 3.12 Nor should the Commission find that ANZ has not responded effectively to any potential detriment suffered by ANZ's customers. No customer detriment has yet been identified (see [3.6], [3.10]). Further, detriment may be expected to be unlikely, having regard to: (a) the nature and intended purpose of ANZ Assured (see [3.1]); (b) the credit limits involved (\$500 and \$1,000); (c) the terms of the pre-approved offer letters and Activation Authority form (see [3.2]); and (d) the eligibility criteria (see [3.3]), which were intended to exclude unsuitable customers from accessing the product via pre-approved offer. That said, as noted in [3.10], ANZ is committed to revisiting the question of remediation.

QUESTIONS

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?

- 3.13 ANZ's current policies for offering the ANZ Assured product comply with s 128 of the NCCP Act ANZ now inquires into customers' requirements and objectives for ANZ Assured overdrafts, by asking them to confirm that their intended use of the facility is consistent with the intended purpose of the product (namely, to provide cover against temporary expenses which may lead to an account being overdrawn). ANZ now asks customers to confirm their preferred credit limit. Further, inquiries into customers' financial situations are now made by collecting a signed statement of financial position, outlining income, liabilities and living expenses (including dependents). Reasonable steps to verify customers' financial situations are now taken by applying the verification policies and processes that apply to other forms of consumer credit, including comparison against documentary evidence such as payslips and/or review of salary credits into a transaction account. In light of these changes to its processes for ANZ Assured, ASIC was satisfied in early 2017 that further inquiries were not warranted.⁷⁹

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?

⁷⁸ Exhibit HF1 to Forbes Statement (ex 1.122), ANZ.800.255.8807; T642.38-46–T643.1-9. Receipt of the ASIC January 2017 Letter and, specifically, ASIC's remediation request as expressed in that letter, was acknowledged by ANZ by return email: ASIC.0012.0003.1696; T-645.31-46.

⁷⁹ Exhibit HF1 to Forbes Statement (ex 1.122), ANZ.800.255.8807.

- 3.14 ANZ has committed to compensation as a remediation principle (see ANZ's January submission, [4.17]). There can, however, be breaches which do not result in loss to the customer (for example, due to a technical breach). Where there is no demonstrable loss, it does not necessarily follow that the lender is required to compensate customers.
- 3.15 ANZ is entitled to, and should, form its own, independent view on how best to meet its legal and regulatory obligations in all of the circumstances. In doing so, it seeks to cooperate with and be guided by requests or recommendations by regulators. In the context of the ANZ Assured case study, ASIC correctly noted that ANZ had cooperated with its inquiries.⁸⁰

4. ANZ PROCESSING ERRORS CASE STUDY

SUMMARY OF FACTS

Mortgage Breakfree Home Loan Accounts (137 Issues)

- 4.1 The 137 Issues comprised two key components: the incorrect application of interest rate discounts to home loans attached to a Breakfree package, and a failure to link offset accounts to home loans so that customers could take the benefit of offsetting deposits held by ANZ against an eligible home loan account.
- 4.2 The Breakfree package was introduced in February 2003.⁸¹ It was an offering that provided customers with, among other things, a range of interest rate discounts dependent on the aggregate of the customer's eligible home lending, relevant eligibility criteria, and the interest rate discount offered at the time.⁸² The application of Breakfree interest rate discounts were substantially manual processes with limited system automation.
- 4.3 ANZ's failure to link certain offset accounts to eligible home loans was the result of a combination of factors, including manual processes at both inception and at the point of a home loan renewal, the fact that the linkage of the offset account was generally independent of the home loan drawdown,⁸³ and defective system and process controls.⁸⁴
- 4.4 While ANZ accepts that the 137 Issues represented a failure on its part, it was not a failure that arose from a lack of customer concern, avarice or dishonesty.
- 4.5 The 137 Issues were reported to ASIC on 17 June 2010.⁸⁵ ANZ then undertook the difficult task of remediating customers, which involved analysing billions of lines of data and reconstructing each customer's home loan for each day of the period in question in order to determine customer detriment. The remediation program was known internally as the Mortgages Breakfree and Offset Remediation Program (**MBORP**).⁸⁶ In an effort to ensure that an appropriate approach was adopted and the matter progressed more quickly, PwC was engaged in August 2012 to conduct a review of the project's approach to remediation. PwC was then involved in reviewing aspects of MBORP as it progressed. A pilot for customer remediation payments commenced in January 2014.⁸⁷ The repayment

⁸⁰ Forbes Statement (ANZ.999.001.0025 at 0032 [53], ex 1.122); Letter from ASIC to ANZ dated 15 April 2015 at Exhibit HF1 to Forbes Statement (ex 1.122), ANZ.800.255.9453; Exhibit HF4 to Forbes Statement (ex 1.122), ANZ.800.317.0001 (media release dated 7 March 2016, in which ASIC stated "ANZ has co-operated with ASIC's investigation").

⁸¹ Stubbings Statement (ANZ.999.0001.0001 at 0004 [12], ex 1.126).

⁸² Stubbings Statement (ANZ.999.0001.0001 at 0004 [12], ex 1.126).

⁸³ Linking generally could not occur until the customer drew down the home loan account, which could be between 1 day and up to approximately six months following the home loan approval: Stubbings Statement (ANZ.999.0001.0001 at 0006 [22], ex 1.126).

⁸⁴ Stubbings Statement (ANZ.999.0001.0001 at 0006 [21]-[23], ex 1.126).

⁸⁵ Stubbings Statement (ANZ.999.0001.0001 at 0006 [25], ex 1.126).

⁸⁶ Stubbings Statement (ANZ.999.0001.0001 at 0008 [38], ex 1.126).

⁸⁷ Stubbings Statement (ANZ.999.0001.0001 at 0008 [39], ex 1.126).

process was completed by April 2014.⁸⁸ A total of over \$69 million was paid to customers.⁸⁹ The remediation program was thorough and comprehensive.⁹⁰

- 4.6 MBORP was ANZ's first major customer remediation. ANZ was concerned to ensure that the lessons learned during MBORP were incorporated and applied to future remediations.⁹¹
- 4.7 The system fixes and enhancements that were introduced under MBORP did not entirely resolve processing errors associated with the Breakfree package or with offset linkages.⁹² When considering further issues, however, it is important to recognise the unique features of each, the complexity of the systems involved, and the difficulty in anticipating problems that may seem foreseeable in hindsight.

Issues with the application of interest rate discount and fees

- 4.8 In March and July 2017 respectively, ANZ identified that approximately 1,450 accounts had attracted fees that ought to have been waived as part of the Breakfree package, and that around 1,400 home loan accounts attached to the Breakfree package had not received the correct interest rate discount (**138 Issues**).⁹³ The 138 Issues had not been picked up earlier because the controls and fixes put in place as part of MBORP had not addressed existing home loans which had not previously been attached to a Breakfree package and customers who "opted in" to the package after drawing down a home loan.⁹⁴
- 4.9 In September 2017, meetings of a Stakeholder Group were held to discuss these issues and ANZ's reporting obligations under s 912D. It was determined that the incident was significant and should be reported to ASIC by 5 October 2017.⁹⁵ ASIC was given written notification of the incident on 5 October 2017.⁹⁶ In February 2018, ANZ introduced two new exception reports to stop the recurrence of these issues. ANZ estimated that approximately 2,900 accounts were affected and the total remediation is likely to be in the order of \$3 million.⁹⁷
- 4.10 There was a further, confined, issue, whereby negotiated interest rate discounts were not applied to existing home loan accounts between June and December 2016 (**135 Issue**).⁹⁸ Human processing and supervisory failures caused particular requests to be overlooked and not detected by ANZ's systems in a timely way.⁹⁹
- 4.11 ANZ responded to the 135 Issue quickly.¹⁰⁰ First, ANZ took steps to ensure that from January 2017 customers submitting new interest rate discount requests relating to existing home loan accounts were not affected by the 135 Issue. Then, between February

⁸⁸ Stubbings Statement (ANZ.999.0001.0001 at 0008 [39], ex 1.126).

⁸⁹ \$21 million in relation to the offset linkage issue and approximately \$48 million for the Breakfree issue: Stubbings Statement (ANZ.999.0001.0001 at 0008 [41], ex 1.126); see also Exhibit SMS-5 to Stubbings Statement (ex 1.126) at ANZ.800.316.0157.

⁹⁰ Exhibit SMS-6 to Stubbings Statement (ex 1.126) at ANZ.800.223.1917, MBORP ANZ Post Implementation Review.

⁹¹ Exhibit SMS-6 to Stubbings Statement (ex 1.126) at ANZ.800.223.1917, noting that "In the latter stages, the program team themselves also documented their learnings from the overall experience" (at ANZ.800.223.1919).

⁹² T708.44-T709.14.

⁹³ Stubbings Statement (ANZ.999.0001.0001 at 0010 [52], ex 1.126) and T681.12-24.

⁹⁴ Stubbings Statement (ANZ.999.0001.0001 at 0010 [54]-[55], ex 1.126); Exhibit SMS-8 to Stubbings Statement (ex 1.126) at ANZ.800.223.3649; T682.15-37.

⁹⁵ Stubbings Statement (ANZ.999.0001.0001 at 0010 [53], ex 1.126); Exhibit SMS-8 to Stubbings Statement (ex 1.126) at ANZ.800.223.3660-3662.

⁹⁶ Stubbings Statement (ANZ.999.0001.0001 at 0010 [53], ex 1.126); Exhibit SMS-9 to Stubbings Statement (ex 1.126) at ANZ.800.223.1555.

⁹⁷ Stubbings Statement (ANZ.999.0001.0001 at 0011 [59], ex 1.126); Exhibit SMS-12 to Stubbings Statement (ex 1.126) at ANZ.800.316.0158.

⁹⁸ Stubbings Statement (ANZ.999.0001.0001 at 0013 [71]-[74], ex 1.126).

⁹⁹ This practice was a response to a 50% increase in the number of requests for interest rate discounts received from May 2016. The team decided not to actively mark cases as completed/closed in the relevant workflow tool as a time-saving measure: Stubbings Statement (ANZ.999.0001.0001 at 0013 [73(a)], ex 1.126); T696.28-41.

¹⁰⁰ T698.29-37.

and September 2017, ANZ worked to identify approximately 1,860 affected accounts and took steps to apply the correct interest rate to them. Remediation payments totalling \$980,000 have been made to the majority of affected customers.¹⁰¹ ANZ has also introduced clearer processes and reconciliations and is introducing a new workflow tool to streamline the process whereby interest rate discounts are applied to existing home loans and improve its supervisory processes.¹⁰²

- 4.12 ANZ concluded that the 135 Issue was not significant for the purposes of s 912D and as such was not reported to ASIC. In reaching this conclusion, ANZ considered the duration of the error, the number of affected customers and the dollar impact of the issue.¹⁰³ The conclusion was revisited in July 2017 and confirmed.¹⁰⁴
- 4.13 While there is superficial similarity between the 135 and 137 Issues (in that both involved a failure to apply correct interest rate discounts), the 135 Issue was distinct and isolated.¹⁰⁵

Issues with unlinked offset accounts

- 4.14 There are three further instances of ANZ identifying systems issues involving offset accounts not being linked with home loan accounts.
- 4.15 *First*, in September or October 2015, ANZ identified that about 700 customers had offset accounts that were not linked to an eligible home loan account. Following investigation, it identified approximately 4,800 open offset accounts in this category over the period January 2013 to January 2016 (**134 Issue**).¹⁰⁶ The problem generally arose where a customer had more than one eligible home loan to which the offset account might be linked.¹⁰⁷ ANZ has taken measures to avoid a repeat of the issue. In February 2016, it centralised responsibility for determining which eligible home loan an offset account should be linked to and introduced a hierarchy of rules (intended to operate in the customer's favour) to support the centralised process.¹⁰⁸ In March and April 2016, the coding instructions for the relevant macro were amended. Between February and March 2016, ANZ linked the 4,800 accounts to an eligible home loan.¹⁰⁹ By September 2016, ANZ had paid approximately \$3.9 million in remediation to customers.¹¹⁰
- 4.16 Once ANZ had a sense of the number of affected accounts, the 134 Issue was reported to the Australia Division Risk Committee in April 2016.¹¹¹ ASIC was informed of the issue by ANZ's Head of Regulatory Compliance Australia Division in May 2016.¹¹²
- 4.17 *Second*, Ms Stubbings gave evidence about an issue with unlinked offset accounts between January 2016 and March 2017.¹¹³ Affected accounts were linked within a period of months. ANZ is building a new reporting tool to identify offset linkage issues and is gathering data on affected accounts so that remediation can commence. Based on the

¹⁰¹ Stubbings Statement (ANZ.999.0001.0001 at 0014 [76], [78], 0015 [83], 0016 [88], ex 1.126). As Ms Stubbings identified at [86] of her statement, investigations are ongoing in relation to a residual cohort of affected accounts. ANZ expects to complete investigation in respect of this cohort by May 2018.

¹⁰² Stubbings Statement (ANZ.999.0001.0001 at 0014-0015 [81]-[82], ex 1.126).

¹⁰³ Stubbings Statement (ANZ.999.0001.0001 at 0014 [77], [80], ex 1.126); and T699.3-15.

¹⁰⁴ Stubbings Statement (ANZ.999.0001.0001 at 0014 [80], ex 1.126).

¹⁰⁵ T699.9-15.

¹⁰⁶ Stubbings Statement (ANZ.999.0001.0001 at 0016 [89]-[90], ex 1.126).

¹⁰⁷ Stubbings Statement (ANZ.999.0001.0001 at 0016-0017 [91]-[93], ex 1.126); and T700.22-32.

¹⁰⁸ Stubbings Statement (ANZ.999.0001.0001 at 0017 [94]-[95], ex 1.126).

¹⁰⁹ Stubbings Statement (ANZ.999.0001.0001 at 0017 [96], ex 1.126).

¹¹⁰ Stubbings Statement (ANZ.999.0001.0001 at 0018 [102], ex 1.126).

¹¹¹ Stubbings Statement (ANZ.999.0001.0001 at 0017 [97], ex 1.126); Exhibit SMS-16 to Stubbings Statement (ex 1.126) at ANZ.800.316.0411; and T700.37-44 and T701.3-6.

¹¹² Stubbings Statement (ANZ.999.0001.0001 at 0017 [100], ex 1.126).

¹¹³ This is reported at Item 139 of the table annexed to ANZ's 13 February 2018 response to the Commission.

data, approximately 2,800 accounts were affected and remediation will be in the order of \$1.5 million. It is intended that customers will be remediated by December 2018.¹¹⁴

- 4.18 *Third*, during the process of preparing Ms Stubbings' witness statement, ANZ identified that remediation undertaken to date had overlooked offset accounts that may have been closed and unlinked, or temporarily unlinked, in the period between January 2013 and January 2016. These accounts should have been identified and included in the original remediation. Investigation to determine customer detriment in respect of these accounts is underway.¹¹⁵

Sub-system issues

- 4.19 These issues arose from differences in the way that loan and offset subsystems calculate interest and involve what Ms Stubbings described as "backdated transactions" and "rejected transactions" (collectively, **151 Issues**). In certain scenarios, customers did not receive an offset interest reduction for which they were eligible.¹¹⁶
- 4.20 Although these problems do not represent a recurrence of the principal 137 Issue relating to incorrect interest rate discounts and offset linkages, during oral evidence Ms Stubbings was asked questions about whether the possibility of backdated transactions was identified as part of MBORP. Ms Stubbings resisted the suggestion that backdated transactions were identified as an "issue" in 2011 or 2013.¹¹⁷ ANZ submits that her evidence should be accepted. While the existence of the subsystem differences was known, there is no evidence to suggest that ANZ appreciated that those differences had given rise to the 151 Issues or, indeed, any other compliance issues.
- 4.21 The backdated transactions issue was identified in September 2014 and referred externally for legal advice and investigation. That investigation concluded in May 2016 and was followed by further internal ANZ investigations to understand the types of transactions and scenarios involved and the likely customer detriment. This process took some time. ASIC was notified of the 151 Issues on 16 October 2017.¹¹⁸
- 4.22 System fixes were introduced to address the two rejected transaction issues in 2015 and a backdated transactions fix is being prepared.¹¹⁹ ANZ has not yet identified the number of accounts affected, however initial estimates suggest that remediation will be in the order of \$13 to \$15 million. Subject to data availability, ANZ hopes to conclude remediation by December 2018 for the two rejected transaction issues which make up the majority of the \$13 to \$15 million. Remediation for the backdated transaction issue will occur once the system fix is implemented.¹²⁰

CONDUCT FINDINGS

Did ANZ provide financial services efficiently, honestly and fairly?

- 4.23 Counsel Assisting have submitted that it is open to the Commission to conclude that ANZ breached various obligations which have at their core the obligation to do all things necessary to ensure that the credit activities undertaken by ANZ are engaged in

¹¹⁴ T694.21-696.2 and Exhibit 1.136 at ANZ.800.223.1859.

¹¹⁵ Stubbings Statement (ANZ.999.0001.0001 at 0018 [105], ex 1.126); and T702.5-22.

¹¹⁶ Stubbings Statement (ANZ.999.0001.0001 at 0019 [112], ex 1.126). As explained at [112(a)(ii)], in other cases, the backdated transactions result in customers receiving an offset interest benefit for which they are not in fact eligible.

¹¹⁷ T704.29-33.

¹¹⁸ Stubbings Statement (ANZ.999.0001.0001 at 0019 [109], ex 1.126); Exhibit SMS-19 to Stubbings Statement (ex 1.126) at ANZ.800.077.1180; and T704.35-705.21.

¹¹⁹ Stubbings Statement (ANZ.999.0001.0001 at 0021 [118]-[119], ex 1.126).

¹²⁰ T706.13-30.

efficiently, honestly and fairly.¹²¹ This standard is recognised as a single, composite concept, rather than three discrete behavioural norms.¹²² Accordingly, the Commission must consider whether ANZ went about its duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty.¹²³

- 4.24 The following considerations are material to this analysis. *First*, there is no suggestion that any of the ANZ processing errors arose because of dishonesty. This conclusion informs the analysis of efficiency and fairness in the context of s 912A. *Second*, none of the ANZ processing errors deliberately benefited or disadvantaged any identified group of customers or prospective customers. *Third*, while customer detriment arose, there is no evidence before the Commission of customer distress or significant disadvantage. *Fourth*, in its terms, s 912A looks to whether or not the steps taken by a licensee are *adequate*.
- 4.25 Having regard to these principles, while ANZ accepts (and has from the outset accepted)¹²⁴ that the various account administration errors ought not to have occurred, it submits that no finding of a breach of the obligation to act efficiently, honestly and fairly arises:¹²⁵
- (a) There was no dishonesty involved in the **137 Issues**. Nor, having regard to the complexity of the interaction of systems, system operations and human errors that caused those issues, should it be concluded that they were infected by relevant unfairness or inefficiency. Again, however, there was no dishonesty. ANZ is in the process of remediating its customers.
 - (b) There was no dishonesty involved in the **134 Issue**. The failure to link offset accounts with more than one eligible home loan should have been identified by the relevant macro but was not in all cases. ANZ submits that this alone is insufficient to justify a finding of a breach of s 912A.
 - (c) The **135 Issue** impacted around 2,000 customers for a period of six months. With the exception of a residual cohort, remediation was completed within 12 months of discovery of the error. Again, the error was not connected to dishonesty.
 - (d) The **151 Issues** arose because of an unexpected interaction between two subsystems of ANZ's IT system. There was no relevant failure to do the things necessary to provide the services efficiently, honestly or fairly.

The obligation to report to ASIC within 10 Business Days

- 4.26 Counsel Assisting have submitted that it is open to the Commission to conclude that ANZ failed to report significant breaches within 10 business days.¹²⁶ A finding in relation to this issue depends upon whether the Commission concludes that there was, as a matter of fact, a significant breach of a relevant provision, having regard to the analysis above.
- 4.27 RG 78 clarifies expectations of financial services licensees. A "likely breach" is a reference to a likely future act that *would* constitute a breach of an identified provision.¹²⁷ RG 78

¹²¹ Specifically, its statutory obligations under s 912A(1)(a), s 47(1)(a), and clause 3.2 of the Banking Code of Practice (which frames the obligation in slightly different terms).

¹²² *Australian Securities and Investments Commission v Avestra Asset Management Limited (In Liquidation)* [2017] FCA 497 at [191] per Beach J.

¹²³ *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at [126]; *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ACSR 206; [2012] FCA 414 at [69] and [70] per Foster J.

¹²⁴ January Submission, [6.5].

¹²⁵ The same conclusions follow in relation to clause 3.2 of the Banking Code. Further, it is likely that not all accounts affected by these administration errors were "financial products" captured by the s 912A(1)(a) obligation (or, therefore, the s 912D reporting obligation), for example where the error related to discounts on interest rates not being correctly applied to a loan account or to fee waivers relating to loan or credit card accounts: see also [2.18].

¹²⁶ This contention is made by reference to ASIC Regulatory Guide 78 (**RG78**) and s 912D.

¹²⁷ RG78.9, 78.10.

therefore has operation where the Bank apprehends that there *has been* a "significant breach" of a relevant provision, or that there is *likely to be* such a breach in future. It does not encompass the circumstance where the Bank has identified that an error *may be* a breach, or a breach *may be* significant, but has not reached a concluded view pending further investigation.

4.28 If an obligation to report arose, then:

- (a) The **137 Issues** were identified in about March 2010 and notified to ASIC on 17 June 2010.¹²⁸ At that time, ANZ believed that approximately 6,000 accounts had been affected and was in the process of collating relevant material to determine the scope of the issue.¹²⁹ ANZ submits that the report was thus made prior to any obligation under s 912D crystallising. In respect of the **138 Issues**, the Stakeholder Group resolved on 21 September 2017 that it was appropriate to report the matter to ASIC. A report to ASIC was made under s 912D on 5 October 2017.¹³⁰ The notification therefore took place on the 10th business day after 21 September 2017.
- (b) The **134 Issue** was identified as being a failure of one of the controls that had been put in place as part of the MBORP fixes, of which ASIC was aware.¹³¹ As a result, the notification to ASIC was, appropriately, verbal.
- (c) The **135 Issue** was not deemed significant by ANZ. It affected fewer than 2,000 customers requiring remediation payments of less than \$1 million. The fact that ANZ revisited (ultimately affirming) its decision not to report the 135 Issue to ASIC is evidence of ANZ taking its breach reporting obligations seriously.¹³²
- (d) ASIC was notified of the **151 Issues** on 16 October 2017,¹³³ following a Stakeholder Group decision on 27 September 2017.¹³⁴ The notification was thus given on the 12th business day after that decision,¹³⁵ rather than within 10 business days as required.

Identifying systemic processing issues

4.29 ANZ should have identified the 137 Issues earlier.¹³⁶ Its failure to do so fell short of CSEs.

Inadequate fixes

4.30 The 138 and 134 Issues arose from limitations or problems with the fixes introduced by MBORP. In this respect, ANZ fell short of CSEs.

Emphasis on customer compensation in a timely manner

4.31 ANZ accepts that certain remediation programs took too long to complete, and that the time involved was inconsistent with CSEs. However, ANZ submits that the Commission

¹²⁸ Stubbings Statement (ANZ.999.0001.0001 at 0006 [25], ex 1.126).

¹²⁹ Exhibit SMS-1 to Stubbings Statement (ex 1.126) at ANZ.800.223.0977

¹³⁰ Stubbings Statement (ANZ.999.0001.0001 at 0010 [53], ex 1.126); Exhibit SMS-9 to Stubbings Statement (ex 1.126) at ANZ.800.223.1555.

¹³¹ Stubbings Statement (ANZ.999.0001.0001 at 0017 [100], ex 1.126).

¹³² T699.21-31.

¹³³ Stubbings Statement (ANZ.999.0001.0001 at 0019 [109], ex 1.126); Exhibit SMS-19 to Stubbings Statement (ex 1.126) at ANZ.800.077.1180; T-704.35-T705.21.

¹³⁴ Australia Division Compliance, Compliance Incident Assessment dated 9 October 2017 (ANZ.800.259.0178 at 0189).

¹³⁵ 29 September 2017 was a public holiday in Victoria: see *Acts Interpretation Act 1901* (Cth) s 2B (definition of "business day").

¹³⁶ Stubbings Statement (ANZ.999.0001.0001 at 0006 [24], ex 1.126).

ought not conclude that the delays arose from a failure to place primary emphasis on the need to compensate customers in a timely manner. As the material before the Commission makes clear,¹³⁷ significant efforts were made to remediate customers. The complexity involved in identifying the customer cohorts to be remediated and calculating the amount of each customer's remediation led to delay. ANZ's engagement of PwC was an appropriate recognition of the difficulty involved. ANZ's recent creation of a Responsible Banking team (led by Ms Stubbings) demonstrates that it has learned from its experience and will have a strong focus on customer outcomes in future remediations.

- 4.32 On those occasions where remediation was less complex, ANZ remediated more quickly. For example, the remediation of the 134 Issue and the bulk of customers affected by the 135 Issue took place within 12 months of each issue being identified.¹³⁸ In respect of the 134 Issue, ANZ began remediating customers before the issue was able to be brought to the attention of the Australia Division Risk Committee, demonstrating ANZ's appreciation of the importance of providing timely remediation.¹³⁹

ANZ Systems

- 4.33 ANZ accepts that its systems proved to be ineffective in preventing the errors the subject of this case study from occurring. The errors the subject of this case study, however, were the result of the interaction of complex systems and system operations with human error. There is no evidentiary basis for a finding that ANZ failed to invest sufficient resources in the prevention or the proper resolution of the errors.

Remediation

- 4.34 MBORP represented a significant investment of time and money to design and implement an effective remediation program. ANZ had not conducted a remediation of this magnitude and complexity before, a fact that it recognised in 2012 with the engagement of PwC. After that time, the remediation progressed appropriately, and was completed in a reasonable time, having regard to the complexity of the tasks involved. The engagement of PwC demonstrates ANZ's commitment to ensuring that robust and independent processes are developed in response to customer detriment.

QUESTIONS

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?

- 4.35 ANZ's systems, policies and processes detected each of the processing errors summarised above.
- 4.36 Changes to ANZ's home lending systems and processes are being made to improve the timeliness of detection of processing errors. *First*, at the end of 2018, ANZ will transition its three home loan origination systems to a strategic platform, allowing further automation of Breakfree benefits and package set up, and offset linkages. *Second*, ANZ has introduced new exception reporting. *Third*, a new reporting tool is being introduced to identify issues with offset linkage. *Fourth*, ANZ has conducted reviews of its processes in relation to Breakfree benefits and offset linkages issues (see further below). ANZ is also

¹³⁷ See generally Exhibit SMS-5A to Stubbings Statement (ex 1.126) at ANZ.800.269.6722.

¹³⁸ Exhibits SMS-15 and SMS-18 to the Stubbings Statement (ex 1.126) at ANZ.800.316.0159 and ANZ.800.316.0160 respectively.

¹³⁹ T701.16-18. As Ms Stubbings explained at .3-14 of the same page, and also on T697.14-19, the Australia Division Risk Committee considers operational risk issues every second month, which can result in a short delay in matters being raised with the Committee once they have been identified by the business.

making and considering further changes to its event identification, recording and reporting systems.¹⁴⁰

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?

- 4.37 ANZ has acknowledged that, in some instances, it has not provided timely remediation and, therefore, has not met CSEs.¹⁴¹ Without seeking to detract from this acknowledgement, consideration of what is a reasonable timeframe to remediate needs to take into account operational requirements and project complexity. Remediation typically involves identifying and addressing all procedural or technical causes of a failure, assembling all relevant customer transaction and account records, and developing processes or technology to determine the required compensation. In relation to the 137 Issues,¹⁴² it was necessary, for example, to isolate and analyse billions of lines of data to reconstruct home loan information to determine customer entitlements.
- 4.38 ANZ has reviewed and made changes to the way its Australia Division runs and governs customer remediation projects,¹⁴³ taking into account ASIC remediation guidance in relation to financial advisers.¹⁴⁴ Further, ANZ has developed remediation principles, including a commitment to compensation, adequate resourcing of remediation activities and speedy action.¹⁴⁵

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?

- 4.39 In each instance where a processing error was detected, ANZ took steps to prevent recurrence, including through system automation, process changes and exception reporting. Because these steps were aimed at prevention, they are considered to be "structural" not "interim". Even with structural change, a residual risk of recurrence remains, for example where an error is repeated in a different way or for a different reason.
- 4.40 ANZ has undertaken reviews in relation to Breakfree benefits and offset linkages issues.¹⁴⁶ The aim of these reviews has been to understand why its processes failed and what needs to be done to address the failures and minimise further customer detriment. As discussed above, Breakfree and offset linkage issues occurred despite steps taken by ANZ in response to the 137 Issues. Acknowledging that it may not always be possible to eliminate the risk of processing errors, ANZ takes steps to ensure that repeat instances are detected. For example, ANZ introduced two new exception reports to prevent a recurrence of the 138 Issues.¹⁴⁷
- 4.41 The ANZ Operational Risk Measurement and Management Framework (**ORMMF**) requires each line of the business to identify the key risks that it is managing and key controls it has in place to reduce associated inherent risks (risks that exist in the absence of controls). These risks must be monitored on a regular basis and the key controls tested at least annually to ensure effectiveness. When residual risks (risks that remain despite the introduction of controls) are at elevated levels (High or Extreme), additional oversight is

¹⁴⁰ February submission [1.33]-[1.39].

¹⁴¹ January submission [6.39].

¹⁴² See also January submission at [6.10]-[6.15].

¹⁴³ January submission [4.17] and [6.42] and February submission [1.26]-[1.29].

¹⁴⁴ ASIC RG 256 Client Review and Remediation Conducted by Advice Licensees.

¹⁴⁵ January submission [4.17].

¹⁴⁶ See for example Exhibit SMS-2 to Stubbings Statement (ANZ.800.223.1961, The Breakfree Review) and Exhibit 1.136 (ANZ.800.223.1858, Offset Remediation Project Summary).

¹⁴⁷ Stubbings Statement (ANZ.999.0001.0001 at 0011 [59], ex 1.126).

provided by the relevant divisional Chief Risk Officer, with the divisional Risk Committee for High Risks, and the Operational Risk Executive Committee for Extreme Risks.

- 4.42 From April 2018, a Responsible Banking team with around 130 roles dedicated to customer remediation will operate in the Australia Division.¹⁴⁸ The team will focus on ensuring that, where ANZ makes mistakes that result in significant customer impact, it remediates customers, works with all relevant business units to deal with underlying causes, and shares the lessons learnt to reduce the likelihood of similar system, product or process mistakes recurring across the Division.¹⁴⁹

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?

- 4.43 ANZ has in place systems, policies and procedures that facilitate the identification, recording, investigation and, where appropriate, escalation and reporting of events.¹⁵⁰ The ORMMF, which is designed to identify and manage the risk of loss resulting from events (some of which would trigger the obligation to report a matter to ASIC under s 912D), has been strengthened to increase reporting on potential systemic issues. Systems and monitoring technologies have also been changed.¹⁵¹
- 4.44 ANZ has previously acknowledged its concern at the time it sometimes takes to investigate matters to determine whether they are reportable under s 912D.¹⁵² It is considering changes to event identification, recording and reporting of all incidents, including significant breaches.¹⁵³ These changes include clarifying internal requirements for reporting incidents, improving the timeliness of reporting, and making it easier to report incidents using the bank's operational risk system.¹⁵⁴ Engagement by the Commission with regulators and law reform bodies might assist in providing further clarity regarding breach reporting obligations, including with respect to timeliness.
- 4.45 Continuous improvement of risk management and compliance is required to reduce the risk of conduct that would constitute a significant breach.¹⁵⁵ ANZ has taken steps to improve its risk management and compliance systems and processes.¹⁵⁶ In addition, ANZ is looking to address the business complexities that can cause some processing failures.¹⁵⁷

5. ANZ CAR LOANS CASE STUDY

SUMMARY OF FACTS

- 5.1 Esanda is a brand name which was used by ANZ to market the sale of consumer motor vehicle asset finance. ANZ also sold consumer motor vehicle asset finance directly under the ANZ brand name.¹⁵⁸ In October 2015, ANZ sold its Esanda Dealer Finance portfolio to Macquarie Bank Ltd. As a result, most customers who had an ANZ contract arranged through a car dealership were transferred to Macquarie and ANZ ceased to accept contracts sold through car dealerships. Following the sale, customers who arranged their

¹⁴⁸ January submission [6.42 (c)] and [6.100(b)] and February submission [1.28].

¹⁴⁹ January submission [6.100(b)]; February submission [1.28].

¹⁵⁰ January submission [8.4].

¹⁵¹ January submission [4.21]; February submission [1.8]-[1.12].

¹⁵² January submission [8.5].

¹⁵³ January submission [8.8].

¹⁵⁴ January submission [8.10].

¹⁵⁵ February submission [1.11].

¹⁵⁶ February submission [1.12(c)].

¹⁵⁷ February submission [1.13]-[1.25].

¹⁵⁸ Mendelson Statement (ANZ.800.326.0025 at 0027 [10], ex 1.149).

contracts with ANZ directly, or through a broker, stayed with ANZ.¹⁵⁹ On 16 March 2018, ANZ announced the suspension of its consumer asset finance business in Australia, including car loans originated directly with customers and through brokers, while it undertakes a review.¹⁶⁰

- 5.2 On 18 January 2018, ASIC commenced a civil penalty proceeding in the Federal Court against ANZ for breaches of Chapter 3 of the NCCP Act in respect of the Esanda business (**Esanda ASIC proceeding**). ANZ and ASIC filed a Statement of Agreed Facts and Admissions, in which ANZ admitted that it had contravened sections 128 and 130(1)(c) of the NCCP Act by failing to take reasonable steps to verify the income figures stated in relation to 12 motor vehicle finance applications introduced to Esanda by three third party intermediaries, when it had reason to doubt the reliability of that information. The three intermediaries were involved in suspected fraud by the submission of falsified payslips.¹⁶¹
- 5.3 The Esanda ASIC proceeding was heard by Justice Middleton on 15 February 2018. Middleton J made declarations and orders on 15 February 2018 by consent including: (a) declarations pursuant to s 166 of the NCCP Act that ANZ had contravened ss 128 and 130(1)(c) of the NCCP Act on 24 occasions in respect of a total of 12 consumer credit contracts; (b) an order pursuant to s 167 of the NCCP Act that ANZ pay a pecuniary penalty in respect of the declared contraventions in a total amount of \$5 million; and (c) an order that ANZ pay ASIC's costs in the amount of \$120,000.¹⁶²
- 5.4 ANZ no longer accepts consumer credit applications from two of the three intermediaries or from the individual from the other intermediary who was involved in the suspected fraud the subject of the Esanda ASIC proceeding.¹⁶³ ANZ has also implemented a remediation program which was developed in consultation with ASIC to address consumer detriment caused by these frauds.¹⁶⁴ ANZ's remediation program covers approximately 320 car loan customers for loans taken out through the relevant intermediaries from 2013 to 2015.¹⁶⁵
- 5.5 In addition to the intermediary frauds outlined above, in 2013, ANZ detected misconduct in relation to loans introduced by another third party intermediary, [REDACTED]. The misconduct involved employees of [REDACTED] submitting loan applications in which a purported guarantor's information had been substituted for the information of the intended borrower who was to get the benefit of the car (referred to as "guarantor swap").¹⁶⁶ This occurred in circumstances where the intended borrower may not have met ANZ's serviceability requirements.¹⁶⁷ Following consultation with ASIC, ANZ agreed to compensate more than 70 customers for car loans provided by Esanda introduced by [REDACTED].¹⁶⁸ ASIC also investigated the circumstances of the [REDACTED] frauds and the provision of consumer credit by ANZ. No allegation of suspected breach by ANZ of its obligations in relation to the [REDACTED] frauds was alleged by ASIC in the Esanda ASIC proceeding.

¹⁵⁹ Mendelson Statement (ANZ.800.326.0025 at 0027 [12], ex 1.149); Exhibit 1.150 at RCD.0001.0035.0030 [6.46].

¹⁶⁰ Exhibit 1.152 at RCD.0021.0001.0003; T846.12-28.

¹⁶¹ Mendelson Statement (ANZ.800.326.0025 at 0045 [90], ex. 1.149); Exhibit 1.150 at RCD.0001.0035.0030 [6.47].

¹⁶² Mendelson Statement (ANZ.800.326.0025 at 0046 [95], ex 1.149).

¹⁶³ The relevant third party intermediaries are: [REDACTED] which was a sub-originator who had an agreement with [REDACTED] ANZ did not have an agreement with [REDACTED] but did permit [REDACTED] to submit loan application as a sub-originator of [REDACTED] Mendelson Statement (ANZ.800.326.0025 at 0032 [36]–[38], ex 1.149).

¹⁶⁴ Exhibit 1.150 at: RCD.0001.0035.0030–0031 [6.49].

¹⁶⁵ Exhibit 1.150 at RCD.0001.0035.0030–0031 [6.49].

¹⁶⁶ T831.41-832.5.

¹⁶⁷ T831.40-45.

¹⁶⁸ Mendelson Statement (ANZ.800.326.0025 at 0041 [72], ex 1.149); Exhibit 1.150 at RCD.0001.0035.0031 [6.51].

- 5.6 During the period in which the frauds the subject of the Esanda case study were perpetuated (the **relevant period**), ANZ received consumer motor vehicle asset finance applications from approximately 4,000 third party intermediaries.¹⁶⁹ The four third party intermediaries who engaged in suspected fraudulent behaviour therefore represent around 0.1% of the total number of intermediaries introducing loan applications to ANZ in the relevant period.
- 5.7 The prevention and detection of fraud is a major area of focus for ANZ.¹⁷⁰ It is a complex issue and includes conduct such as cyber fraud, payslip fraud, bank statement fraud, employment fraud and salary staging.¹⁷¹ ANZ had processes at the relevant time for investigating suspected fraud by third party intermediaries and banning them where such behaviour was identified. The primary activities undertaken by ANZ included: (a) the application of system rules within ANZ's fraud detection computer program known as "Hunter II"; (b) identification by ANZ assessment or settlement officers of applications which appeared to contain features which were consistent with suspected fraud; (c) notification by ANZ broker managers who had identified features of applications or loans which may be indicative of fraudulent behaviour; and (d) preparation of various fraud reports by divisions within ANZ such as the Collections team and Analytics team.¹⁷²
- 5.8 Since the relevant conduct occurred, ANZ has implemented a number of process changes in its asset finance business including: (a) the use of data analytics and monthly sample file reviews to audit broker compliance with ANZ's policies and procedures; (b) enhanced procedures regarding the suspension or heightened monitoring of brokers suspected of fraud; (c) the creation of a broker forum and clarification of ANZ's broker consequence management framework; (d) enhanced training for brokers, including on responsible lending; (e) a new Customer Interview Guide for use by brokers; (f) more and better training for relevant ANZ staff to increase fraud detection skills; and (g) enhanced guidelines for the Collections team regarding the referral of suspected frauds to the specialist fraud team.¹⁷³
- 5.9 Within the consumer motor vehicle asset finance area, in the financial year ended 30 September 2017, fraudulent conduct affected less than 0.2% of the total number of applications received.¹⁷⁴ Although ANZ is focussed upon continually enhancing its processes for the prevention and detection of fraud, it does not believe that it is possible to develop a system which will eliminate entirely the potential for fraud by third party intermediaries.¹⁷⁵
- 5.10 During the relevant period, third party intermediaries introducing motor vehicle asset finance to Esanda also sold add-on products, such as insurance and warranties. The insurances included tyre and rim, kerbside, gap and comprehensive car insurance.¹⁷⁶ During the relevant period, ANZ permitted consumers to finance the premiums paid in respect of these types of insurance up to a percentage limit of the total amount financed. Following the sale of the Esanda Dealer Portfolio, ANZ conducted a review of the insurance products it was willing to finance in relation to motor vehicle asset finance. That review found, among other things, that the claim rates on certain of the insurance products were less than the industry accepted levels.¹⁷⁷ As a result of the review, ANZ determined to

¹⁶⁹ T799.39-40.

¹⁷⁰ T803.38.

¹⁷¹ T803.28-38.

¹⁷² Mendelson Statement (ANZ.800.326.0025 at 0033-0034 [40], ex 1.149).

¹⁷³ Mendelson Statement (ANZ.800.326.0025 at 0036-0037 [48], ex 1.149).

¹⁷⁴ T803.46-T804.1.

¹⁷⁵ T803.33-35.

¹⁷⁶ T821.1-5.

¹⁷⁷ T822.3-6, T822.10-14.

reduce the number of insurance products it was willing to finance to two: comprehensive car insurance and loan protection insurance.¹⁷⁸

- 5.11 During the relevant period, ANZ paid to accredited third party intermediaries who introduced Esanda consumer motor vehicle asset finance applications remuneration which included commissions calculated by reference to the number and volume of loan applications introduced to ANZ. In some instances, the commission structure included a percentage of the revenue associated with the extent to which the loan contract was written at an interest rate in excess of ANZ's nominated base interest rate but less than the ANZ nominated cap (or maximum) interest rate (referred to as the "overs percentage" or "flex" commissions).¹⁷⁹ ANZ no longer offers the payment of overs percentage or flex commissions.¹⁸⁰

CONDUCT FINDINGS

- 5.12 ANZ's conduct the subject of the Esanda ASIC proceeding fell below CSEs and contravened ss 128 and 130(1)(c) of the NCCP Act. In the case of the 12 motor vehicle finance applications introduced to Esanda that were the subject of the Esanda ASIC proceeding, ANZ had reason to doubt the reliability of information it was receiving from the three third party intermediaries.¹⁸¹ ANZ ought to have taken steps to verify the stated income figures by reference to source documentation other than payslips alone, such as by requesting from the relevant consumers a bank statement showing the history of salary deposits into their bank accounts or (for existing ANZ customers) conducting a check of its customer account processing system to substantiate salary deposits.¹⁸²

- 5.13 However, ANZ submits that the Commission should not make any finding that:

- (a) ANZ's conduct the subject of the Esanda ASIC proceeding or otherwise referred to above was in breach of s 47(1)(a) of the NCCP Act or s 912A(1)(a) of the Corporations Act. ANZ's misconduct in the Esanda ASIC proceeding does not support a broader finding that ANZ's conduct was inefficient, dishonest or unfair in the provision of consumer motor vehicle asset finance. The dishonest conduct in respect of the Esanda ASIC proceeding and [REDACTED] was that of third party intermediaries. ANZ was not party to the frauds. Nor were any of its employees. ANZ's failure to detect the frauds does not evidence a failure by ANZ to act honestly, efficiently or fairly. ANZ had in place effective and sophisticated systems for the prevention and detection of fraud during the relevant period. However, ANZ cannot eliminate the risk of third party fraud. As Mr Mendelson explained in his evidence, the nature of fraud is dynamic and payslip fraud, in particular, is complicated.¹⁸³
- (b) ANZ's conduct was in breach of s 47(1)(b) of the NCCP Act, or that there was a conflict of interest or a failure by ANZ to manage such a conflict. ASIC did not contend in the Esanda ASIC proceeding that any such contraventions or conduct had occurred, and the evidence before the Commission does not support any such findings. The issues identified by ASIC in respect of the payment of flex commissions did not include fraudulent conduct by the intermediaries.¹⁸⁴

¹⁷⁸ T821.41-44.

¹⁷⁹ Mendelson Statement (ANZ.800.326.0025 at 0031 [29], ex 1.149). Third party intermediaries were also able to charge customers an origination fee, which was paid to the intermediary. The origination fee was able to be included in the total amount to be financed: Mendelson Statement (ANZ.800.326.0025 at 0031 [31(a)], ex 1.149).

¹⁸⁰ T815.39-43, T816.1-11.

¹⁸¹ Mendelson Statement (ANZ.800.326.0025 at 0034 [43], ex. 1.149).

¹⁸² Mendelson Statement (ANZ.800.326.0025 at 0046 [92], ex 1.149).

¹⁸³ T836.45 - T837.14.

¹⁸⁴ See Witness Statement of Michael Saadat dated 5 March 2018 (WIT.0001.0003.001, ex 1.158).

- (c) The dishonest conduct of the third party intermediaries was due to the remuneration and incentive structures for Esanda car loan intermediaries. The evidence before the Commission is not sufficient to support such a conclusion. It does not flow logically from the fraudulent nature of the conduct of the third party intermediaries. In each instance, the relevant individual who engaged in fraudulent conduct did not have an agreement directly with ANZ.¹⁸⁵ There is no evidence before the Commission as to the remuneration or incentive structures which applied to the individuals who engaged in the frauds. In those circumstances, there is insufficient evidence to support a finding that ANZ breached s 47(1)(b) of the NCCP Act.
- (d) ANZ's conduct in respect of the approximately 320 car loan customers, which are the subject of ANZ's remediation program, was in breach of ss 128 and 130(1)(c) of the NCCP Act. The evidence before the Commission does not enable any such conclusion to be reached. The Esanda ASIC proceeding did not include any allegations beyond the 12 customer loans identified by ASIC. While ANZ accepts that these loan files were the subject of suspected fraud, there is no evidence before the Commission to suggest that at the time each loan was entered, ANZ had reason to doubt the reliability of the payslips provided in support of these loans. Nor is there any evidence before the Commission to support a conclusion that the verification steps taken by ANZ in respect of these loans were otherwise unreasonable.
- (e) The failure by ANZ to detect the guarantor swap in the loan applications submitted by ██████████ was a breach of any of its obligations under the NCCP Act or CSEs. The guarantor swap was an unusual type of fraud.¹⁸⁶ There is no evidence to suggest that ANZ could, or ought to, have had in place a system which would have prevented this type of fraud from occurring.¹⁸⁷
- (f) The financing of the purchase of add-on insurance products sold by third party intermediaries was in breach of CSEs. ANZ was not asked to provide evidence to the Commission to explain the circumstances in which it financed the purchase of add-on insurance. The evidence before the Commission does not explore the terms of ANZ's relationships with car dealers or ANZ's willingness to finance the purchase of add-on insurance during the relevant period. There is no evidence before the Commission to support a finding that the financing of the purchase of add-on insurance by ANZ was inappropriate or otherwise in breach of CSEs.
- (g) ANZ had inadequate systems in place to enable it to comply with its responsible lending practices when assessing whether to approve car loans. This issue was not explored in any detail in the hearings. ANZ's misconduct in the Esanda ASIC proceeding does not provide a foundation for any such conclusion. The misconduct was limited to 12 customer loans in respect of which ANZ had reason to suspect that the third party intermediaries involved had engaged in fraudulent behaviour. ANZ had in place systems for detecting and preventing fraud. Fraud affected fewer than 0.2% of total consumer motor vehicle asset finance applications in the year to September 2017.

¹⁸⁵ In relation to the ██████████ and ██████████ frauds, the fraudulent behaviour was perpetrated by one or more employees of these entities. While the ██████████ fraud involved a director of ██████████, ANZ did not have an agreement with ██████████ as ██████████ was a sub-originator of ██████████

¹⁸⁶ T832.27-29.

¹⁸⁷ The removal of the ability to have in place a guarantor for an asset finance loan does not wholly eliminate the risk of guarantor swap fraud as a guarantor swap application is effected through the submission of an application in the name of a single borrower without a nominated guarantor.

QUESTIONS

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?

- 5.14 ANZ submits that the Commission should not make a finding that arrangements between banks (and other credit providers) and car dealers are, of themselves, likely to result in contraventions of credit providers' responsible lending obligations under the NCCP Act. The evidence is not sufficient to support such a conclusion. Credit providers utilise car dealers to introduce potential customers to them and to collect certain information and documents relating to potential loans. The obligation to comply with responsible lending obligations under the NCCP Act remains with credit providers. Credit providers who receive applications via car dealers are obliged to implement controls to ensure that information and documentation obtained from customers is sufficient to enable them to discharge their responsible lending obligations. In ANZ's case, this was done through: (a) contractual obligations on dealers; (b) monitoring of credit applications originating with dealers; and (c) providing training to dealers.
- 5.15 One regulatory response to the issue raised by Counsel Assisting might be to impose a direct obligation on car dealers under the NCCP Act by removing the point of sale exemption and requiring car dealers to hold an ACL.¹⁸⁸ Such a reform would place car dealers on an equivalent regulatory footing to brokers. The Commission does not, however, have the evidence before it to determine the commercial implications of any such reform.

Do remuneration and reward 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 dealers will prefer their own interests to the interests of customers and, as a result, customers will suffer detriment?

- 5.16 ANZ submits that the Commission does not have sufficient evidence before it to make a finding in respect of this question. Remuneration and reward structures for car dealers are not uniform. By way of illustration, ANZ did not have in place any arrangements directly with the individuals who engaged in the fraudulent behaviour the subject of the Esanda case study.

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¹⁸⁸ Regulation 23, National Consumer Credit Protection Regulations 2010 (Cth). Treasury reviewed the point of sale exemption in 2013: <<https://treasury.gov.au/consultation/regulation-of-point-of-sale-vendor-introducers/>>.