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

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

Round 1 Hearing - Consumer Lending Closing Submissions

3 April 2018

Part A: Proposed Findings

1. Counsel Assisting has made submissions that it is open to the Commissioner to make a number of findings of "misconduct" (as that term is defined in the Letters Patent) and conduct falling below community standards and expectations. The proposed findings range from alleged breaches of the *National Consumer Credit Act 2009* (Cth) (**NCCP Act**) and provisions of the *Corporations Act 2001* (Cth) (**Corporations Act**) to breaches of the Code of Banking Practice and relevant ASIC Regulatory Guides. This section of the submission sets out CBA's response to those submissions.

Case Study 2: CBA's Arrangements with Mortgage Brokers

2. This case study relates to the commission structure that CBA has in place for mortgage brokers, including how that commission structure is disclosed or explained to customers of CBA. CBA submits that the Commission should not make a finding that the mere existence of the commission structure for mortgage brokers amounts to inadequate arrangements to manage conflicts of interest. CBA accepts that improvements could be made to the disclosure of remuneration, including that CBA could have disclosed the upfront commission and the rate of the trailing commission payable to Head Groups.

3. The case study also concerns CBA's monitoring and supervision of Head Groups and mortgage brokers, including CBA's decision to revoke the accreditation of inactive brokers in 2017. For the reasons outlined below, CBA submits that the Commission should not make a finding that the manner in which it monitored the activities of Head Groups breached its obligations under s 47(1)(a) of the NCCP Act and / or the Corporations Act.

Factual Findings Alleged by Counsel Assisting

4. CBA accepts that the evidence supports the factual findings set out at T977.11 – 980.22 subject to the comments in paragraphs (a) to (f) below:

   (a) Only mortgage brokers accredited by CBA were authorised to submit home loan applications to CBA on behalf of a customer.[1] That is, it is not the case that all mortgage brokers can submit loans to CBA through its "third party distribution" channel.

   (b) The evidence does not establish that CBA regarded an accredited broker as acting as its agent.[2] The scope of the Head Group's authority was set out in Schedule B of the agreement between CBA and the Head Group.[3] That agreement described the Head Group as "our agent" only in relation to the Head Group's completion and collection of: customer identification, tax file number disclosure, privacy protection of information forms, and any bank account opening application.[4] The agreement provided that "Our arrangement is one of principal and agent only in respect of you acting in accordance with Schedule B clause 1.14 and is not to be construed as

[1] Witness statement of Daniel Huggins dated 2 March 2018 - Exhibit 1.27 (**First Huggins Statement**) at [58].
[2] cf T977.39-41.
[3] Template Head Group Agreement (CBA.0001.0028.0344) (Exhibit DH-4 to the First Huggins Statement) (**THG Agreement**).
[4] Clause 1.14 THG Agreement; T237.30-41.

implying you are our agent in respect of any other part of this Agreement."[5] In examination, Mr Huggins was taken to the former, but not the latter provision. The evidence of Mr Huggins was that in the business he would not use the term "agent" to describe brokers.[6]

(c) CBA expected its accredited brokers to put CBA products to customers if the product was suitable for the customer's needs.[7]

(d) Mr Huggins acknowledged that as the broker commission structure is linked to the size of the loan, the larger the loan the larger the upfront commission and the longer the loan takes to pay off. This in turn also leads to a larger trailing commission. This commission structure can lead to a conflict between the customer's interest and the broker's interest since the broker can maximise their income by getting the largest loan possible approved extending over the longest period of time.[8]

(e) Mr Huggins considered that any move away from commissions needed to be industry wide. Mr Huggins' evidence was that if CBA were to change its practice of paying commissions without a uniform change across the industry, a bias would be created for brokers to prefer to promote commission-based products over other products. In addition, brokers would direct customers to competitor lenders and CBA would lose a lot of volume.[9] In the absence of industry wide change, outcomes for customers would not necessarily be improved (which is described in greater detail in paragraph 121 to 142 below).

(f) If a loan application is approved, customers are provided with loan documentation, including a Consumer Credit Contract Schedule.[10] Item J of that document states "Commission we pay in relation to the Loan Contract" and identifies the Head Group to which the commission will be paid. The amount of commission is described as "Not ascertainable". Customers are also provided with a Credit Assessment Summary which requires the customer to "acknowledge that the Bank may pay a Broker or other intermediary acting in relation to this enquiry for finance, commission or other benefits in connection with the enquiry and that any commission is disclosed in the Consumer Credit Contract Schedule".[11]

Conclusions on Conduct

First Alleged Misconduct Finding

5. CBA submits that it is not open to the Commission to find that CBA's remuneration arrangements with brokers and Head Groups breached its statutory obligations under s 47(1)(b) of the NCCP Act and/or s 912A(1)(aa) of the Corporations Act.

6. Section 912A(1)(aa) of the Corporations Act requires CBA to have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by it or its representative in the provision of financial services as part of the financial services business of CBA or the representative. The legislative separation between the provision of financial products and services, and credit facilities, reflected in the enactment of the NCCP Act and the complementary exclusion of credit

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[5] Schedule B Part 5 clause 5.3 THG Agreement.
[6] T237.22-25.
[7] T238.1-4.
[8] T239.19-26.
[9] T242.1-12.
[10] Template home loan documentation (CBA0507.0003.0448) (Exhibit DH-8 to the First Huggins Statement) (**THL Documentation**).
[11] Credit Assessment Summary (CBA 0507.0004.1654) (Exhibit DH-9 to the First Huggins Statement).

facilities from Chapter 7 of the Corporations Act, means that s 912A(1)(aa) can only ever have a limited operation in the context of home loans.[12]

7. Section 47(1)(b) of the NCCP Act requires CBA to have in place adequate arrangements to ensure that clients of CBA are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by CBA or its representatives.

8. It is necessary at the outset to identify the conflicts of interest with which s 47(1)(b) is concerned. The explanatory memorandum to the *National Consumer Credit Protection Bill* 2009 which introduced s 47(1)(b), describes the conflicts of interest to which that section refers as being "*conflicts of interest that arise by operation of law*".

9. Customers choose to engage mortgage brokers because they value the service that brokers provide.[13] That consumer demand has arisen from lawful competitive forces of recent decades. Customers can deal with CBA directly, without involving brokers.[14] The evidence was that in terms of CBA's commission arrangements with brokers, *"there is a conflict in the commission structure…in that the commission structure is linked to the size of the loan and therefore…- the larger the loan, the larger the upfront commission and…the longer a loan takes to pay off - and the larger* [the loan] *is…the larger the trailing commission and that can lead to a conflict…between the customer…and…the broker…and that's how* [the broker] *would maximise their income"*[15]. That is, the impugned conflict of interest that arises by operation of law was between the interests of brokers and the interests of customers. That conflict arises in relation to activities undertaken by brokers. No conflict in law arises between the interests of CBA and its customers. Remuneration arrangements with brokers that contain upfront and trail commissions are standard across the broking industry.[16]

10. An assessment of compliance with CBA's obligations under the NCCP Act does not permit the merger of the activities of the brokers with the activities of CBA. In considering the relevant conflict of interest, the following features of the relevant legal relationships must be considered.

11. First, accredited mortgage brokers do not act as the agent of CBA[17]. They are authorised by CBA to submit application forms to CBA on behalf of customers who choose to apply for a CBA product. When the broker submits the loan application to the lender which the customer has chosen, the broker is acting as the agent of the customer, not as agent of the lender.

12. Intermediate appellate authority has recognised this feature of the legal relationship since mortgage broking became an established feature of the industry: see eg *Morlend Finance Corporation (Vic) Pty Ltd v Westendorp*;[18] *Tonto Home Loans Australia Pty Ltd v Tavares*;[19] *Micarone v Perpetual Trustees Australia Ltd*.[20] Schedule B of the THG Agreement recognises the traditional characterisation. That characterisation has been extended to promote harmony with other areas of the law, so that it has been held that the broker is liable to the lender for misleading or deceptive conduct when submitting false loan application documents, because by submitting the documents to the lender, the broker "…*would reasonably be understood to have been representing the truth of those matters, they being fundamental to the existence of the relationship of lender and borrower that the mortgage broker was proposing be created*": *Perpetual Trustee Company v Milanex Pty Ltd (in liq)* (**Milanex**).[21]

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[12] An example of where Ch 7 of the Corporations Act may apply to a home loan is where a broker arranges for a transacting account for the home loan.
[13] T235.6-10.
[14] T233.41-43.
[15] T239.22-30.
[16] ASIC Report 516 *"Review of mortgage broker remuneration"* at [26].
[17] See [4(b)] above.
[18] [1993] 2 VR 284 at 308 (per Fullagar J, with whom Brooking and Tadgell JJ agreed.
[19] [2011] NSWCA 389 at [191] per Allsop P, with whom Bathurst CJ and Campbell JA agreed.
[20] (1999) 75 SASR 1 at 123-125 per Debelle and Wicks JJ.
[21] [2011] NSWCA 367 at [48].

13. Second, mortgage brokers must hold their own Australian Credit Licence (**ACL**) or be a credit representative of a mortgage aggregator/franchisor/Head Group that holds an ACL. The holders of the ACL have their own obligations imposed by s 47(1)(b) of the NCCP Act.

14. Properly construed, the obligation imposed by s 47(1)(b) in this instance is an obligation on the broker (or Head Group) to adopt adequate arrangements to ensure that customers are not disadvantaged by the possible conflict of interest between the interests of the broker and the interests of the customer. This is consistent with the views expressed by ASIC in Regulatory Guide 205[22] where ASIC raised no concerns about a possible breach of s 47(1)(b) by lenders by reason of the existence of commission arrangements.

15. The obligation imposed upon CBA pursuant to s 47(1)(b) is an obligation to have adequate arrangements in place to ensure clients are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by CBA or its representatives.

16. As brokers are not agents of CBA with respect to the relevant conflict, they are not representatives of CBA, as defined in s 5 of the NCCP Act. Consequently, the obligations under s 47(1)(b) do not apply to broker's activities, as there is no relevant conflict that arises in relation to credit activities engaged in by CBA or its representatives; only in respect of separate and distinct credit activities engaged in by brokers.

17. Even if, despite the legal relationships, there was a relevant conflict of interest, CBA did not fail to have adequate arrangements to manage that conflict of interest:

    (a) What constitutes adequate management will depend on the scale, nature and complexity of the business. Effective management will involve a combination of controlling, avoiding or disclosing the conflict of interest: *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd.*[23]

    (b) The remuneration arrangements CBA had with brokers were consistent with industry standards,[24] and the proportion of CBA's business coming through the broker channel is between 10 and 20 percent lower than other major lenders.[25] In this context, it is insufficient to identify the mere existence of standard remuneration arrangements constitutes "inadequate" arrangements to manage that conflict of interest.

    (c) CBA subjected loan applications initiated by brokers to the same lending policy assessment as loans initiated through proprietary channels.[26] The same lending standards were applied in evaluating the loan applications.[27] CBA does not differentiate between the broker or proprietary channel as to the fees or charges, or interest rate that a customer pays.[28] Every loan submitted through the broker channel was reviewed by CBA employees to ensure that it was not unsuitable for the customer.[29]

    (d) CBA discloses the conflict of interest to the customer but acknowledges that the conflict could be better explained to customers. CBA has committed to updating the disclosure to make this clearer for customers.[30]

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[22] RG 205.82-205.83.
[23] (No 4) (2007) 160 FCR 35.
[24] ASIC Report 516 *"Review of mortgage broker remuneration"* at para 26.
[25] T306.39-T307.1-3.
[26] First Huggins Statement at [63(a)].
[27] First Huggins Statement at [63(a)].
[28] First Huggins Statement at [49] and [52].
[29] First Huggins Statement at [63(a)].
[30] Credit Assessment Summary acknowledgment by customer (CBA 0507.0004.1654) (Exhibit DH-9 to the First Huggins Statement).

Second Alleged Misconduct Finding – Inadequate Monitoring of Head Groups

18. CBA submits that it is not open to the Commission to find that CBA breached its obligations under s 47(1)(a) of the NCCP Act and/ or s 912A(1)(a)[31] of the Corporations Act by failing to monitor adequately the activities of Head Groups. The legislative separation between the provision of financial products and services, and credit facilities means that only s 47(1)(a) of the NCCP Act is of relevance in the context of home loans.

19. First**,** "credit activity" is a defined term (see s 6) and the credit activity provided by brokers is a "credit service" which in turn means providing credit assistance or acting as an intermediary (both terms further defined in the NCCP Act). The term "authorised" is also defined in s 35(2) as activities authorised under the ACL. The credit activities of brokers are not authorised under CBA's ACL. When brokers provide credit assistance or act as an intermediary they are acting under their own licence and CBA has no obligation under s 47(1)(a) to monitor that brokers are operating efficiently, honestly and fairly in the relevant respect.

20. Second, the controls CBA have in place to ensure compliance by the Head Groups and its accredited mortgage brokers with CBA's Mortgage Broker Code of Conduct are set out in the First Huggins Statement.[32] In particular, one of those controls was the Head Group Assurance Program. This involves CBA auditing the processes and procedures of the Head Group.[33] This process was commenced in about May 2017 and three audits have been completed.[34] The chain of a file review process, targeted file review, Head Group Assurance Program and Broker Governance Committee more than adequately satisfied CBA's legislative and industry obligations.

21. In August 2017, Group Audit and Assurance internal audit found that CBA could do more to monitor the activities of the Head Groups and the mortgage brokers who sit under those Head Groups.[35] The report covered the period May 2015 to May 2017[36] and thus preceded the commencement of the Head Group Assurance Program. Counsel Assisting's submission that there was a failure to monitor adequately the activities of Head Groups is based on the findings of the internal audit report. The audit found (amongst other things) that CBA management needed to assess and determine whether aggregators and brokers were complying with the relevant group policies in accordance with their contractual obligations.[37] It is crucial that the nature of audit documents not be misunderstood. Audit documents are prepared based on a specific set of objectives (an audit scope), which define the key risks and processes to be considered within the confines of the audit. The findings from the audit are rated in accordance with the Group risk management framework which outlines the importance of individual findings based on a risk assessment. As Mr Huggins noted in his evidence, audit documents are prepared in a particular context, where even if there are multiple layers of internal controls, an audit is designed to expose a problem in isolation, divorced from the other, overlapping internal controls. In this way audit isolate specific parts of the business that can be improved, and focus on those.[38] Contrary to Counsel Assisting's submission, it does not follow that observations in audit documents amount to contraventions of s 47(1)(a) of the NCCP Act and/ or s 912A(1)(a) of the Corporations Act.

22. Further, the financial services and credit activities provided by CBA must be distinguished from the credit activities or financial services provided by the Head Groups and their brokers (which could be employees or credit representatives of the Head Group). As noted above, the Head Group did not conduct its credit activities as an agent for CBA. The activities of the Head Groups and brokers cannot simply be merged with the activities of CBA. Head Groups provide

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[31] For the reasons explained in connection with s 912A(aa), s 912A(1)(a) of the Corporations Act will only apply insofar as the facilities under consideration are not credit facilities.
[32] at [63].
[33] T289.29.
[34] T289.42.
[35] CBA.0508.0001.0029; T291.33-34.
[36] T291.1-4.
[37] CBA.0508.0001.0029 at 0029.
[38] T292.34-35.

a different form of credit activities from the credit activities of CBA. Head Groups are subject to their own compliance and legal obligations.

23. While CBA was relying on Head Groups to comply with the Head Group's obligations, it did not (and does not) seek to rely upon Head Groups in meeting CBA's own obligations to make loans that were appropriate to customers' needs.[39]

24. The activities of brokers are not undertaken under CBA's licence; they are undertaken under the authorisation of the broker's own ACL, or where brokers are operating as a credit representative of a Head Group, the ACL of the Head Group.

25. Any consideration of whether monitoring of Head Groups by CBA is adequate, needs to be considered in the context that it is only the extent to which those activities have a bearing or impact on CBA's own credit activities (which is most relevantly, being the credit provider under the credit contract entered into with the customer) that they could be relevant.

26. This is recognised in Regulatory Guide 209[40] which states that credit providers can rely upon information provided by third parties, such as brokers, provided they have in place processes to ensure the reliability of any information provided, and is consistent with the decision of the Court of Appeal of the Supreme Court of New South Wales in *Milanex* permitting lenders to sue brokers for misleading or deceptive conduct in relation to the information provided.

27. CBA's obligation is to ensure that the credit activities authorised by its credit licence are engaged in efficiently, honestly and fairly. There is nothing to suggest that any inadequacies in the process by which CBA monitored the activities of Head Groups (including those identified in the internal audit report) resulted in the loans made by CBA being provided in a manner that was not efficient, honest and fair. Loan applications were assessed and verified in accordance with CBA's own processes and procedures, not those of the Head Group. It is the processes and procedures used by CBA to evaluate loan applications which determines whether the loans it made are efficient, honest and fair.

Third Alleged Misconduct Finding

28. CBA submits that the Commission should not find that CBA breached its obligations under s 47(1)(a) of the NCCP Act or s 912A(1)(a) of the Corporations Act by failing to disclose the commissions paid to Head Groups. Simply put, this is because brokers had the legal obligation to make these disclosures, while CBA had no such obligation.

29. The issue is whether the failure to disclose the basis on which commissions were paid to brokers resulted in financial services covered by CBA's financial services licence and credit activities authorised by CBA's ACL being provided in a manner that was not efficient, honest and fair. The test of "*efficiently, honestly and fairly*" has been interpreted broadly as encompassing conduct that "*is morally wrong in the commercial sense*": *R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA)*[41] or "*falls short of the reasonable standard of performance that the public is entitled to expect*": *Story v National Companies and Securities Commission*.[42]

30. It is conceded that CBA could have disclosed the upfront commission[43] and the rate at which trailing commission will be applied.[44] CBA could have disclosed, also, any amounts of commission payable for referrals of related products.[45] However, to the extent that brokers are complying with their obligations outlined above, CBA's disclosure is redundant in terms of ensuring customers are adequately informed and additionally, as the disclosure is provided

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[39] T293.33-45.
[40] At paragraphs 54 to 56.
[41] (1989) 1 ACSR 93 at 110.
[42] (1988) 6 ACLC 560 at 576.
[43] T259.31.
[44] T259.36-37.
[45] T260.1-4.

well after the customer has received and relied upon advice from the broker (evidenced by the customer having applied and been approved for a home loan with CBA), of limited value to a customer at that late stage. CBA accepts that improvements can nonetheless be made to its disclosures.[46] But the failure to make that disclosure in the overall context set out above does not constitute misconduct as defined by the Terms of Reference.

31. Consideration of this suggested finding of misconduct requires a close examination of the legislative context. This invites the comparison between disclosure of the *amount* of the commission and of the total interest payable on the loan. Section 17(6) of the National Credit Code (Schedule 1 to the NCCP Act) requires disclosure of the total amount of interest charges payable only if the contract would, on the assumptions, be paid out within seven years. A series of assumptions is then given in the NCCP Act about, for example, the length of loan and interest rate changes (see s 180(2) and Reg 108) which permit calculation of an estimate of the interest to be paid. Like with the commission, the actual amount of the total interest to be paid is not ascertainable, but statutory assumptions compel the disclosure of an estimate if the loan is expected to be paid out in less than seven years. Two points are to be noted. First, there is no such regime for commissions and, second, CBA already adopts a higher standard on interest by using the assumptions to calculate and disclose interest for loans of greater than seven years, as inaccurate as that may be.[47]

32. CBA disclosed to customers whose loan applications originated with a broker that commissions were payable to the Head Group in the schedule to a Consumer Credit Contracts Schedule.[48] This schedule was provided once a loan had been approved. Individual customers are also provided with a credit assessment summary when they are provided with their loan contract[49] (which is not a document that CBA is required by law to provide, but which it does provide in order for customers to better understand the information CBA will be relying upon). Because the summary is provided in respect of all loans and not just broker-initiated loans, the language used is "may be paid". That document contains an acknowledgement from the customer that a commission may be paid. The document does not disclose the quantum of commission. The customer is referred to the Consumer Credit Contracts Schedule.

33. The disclosure given to customers about the quantum of commissions was accurate. CBA could not know the amount of commission that would be paid to Head Groups over the life of the loan because the amount of commission would depend upon matters unknown at the time the loan was approved, such as how the loan was paid down. CBA could not know the amount of commission that would be paid to brokers because that depended on the terms of the contract between the Head Group and the broker.[50] CBA's conduct must be understood in the context of a statutory regime that obliges brokers to disclose their commissions to their customers and where CBA and the Head Groups had agreed that the Head Group would disclose commissions to customers. CBA was not the primary source of disclosure of commissions to customers.

34. It is important to consider CBA's disclosure of commissions paid to brokers in the context of the broader legislative regime put in place by the Federal Parliament. Credit assistance providers such as mortgage brokers are required to provide additional documents to customers over and above those required for credit providers.

35. This relevantly includes a requirement to provide a credit proposal disclosure document at the same time as providing credit assistance to the customer. The document must contain a reasonable estimate of the total amount of any commissions that the licensee (the Head Group), or an employee or credit representative (the broker) is likely to receive in relation to the credit contract and the method used for working out that amount (s 121(2)(b) of the NCCP Act). Regulation 28G of the NCCP Regulations 2010 prescribes significant detail that must be

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[46] T260.10-11
[47] See Item D of Consumer Credit Schedule in the THL Documentation.
[48] THL Documentation.
[49] Credit Assessment Summary (CBA 0507.0004.1654) (Exhibit DH-9 to the First Huggins Statement).
[50] T259.18-20

disclosed in meeting this obligation, as well as providing assumptions that the mortgage broker may rely upon to determine a reasonable estimate (which can be distinguished from the commission disclosure obligations for CBA in its credit contract, where no such assumptions have been provided for).

36. This represents a decision by the legislature and executive that disclosure of the commission and benefits received by brokers is most appropriately given by brokers (who as noted above have the relevant conflict) at the time that the brokers are providing their services to customers. This is consistent with a policy of enabling customers to consider the benefits received by brokers and the potential conflict at the time the advice is provided by the brokers.

37. While CBA could have disclosed the upfront commission and trailing commission rate, as well as amounts of commission paid for referrals of related products,[51] that is not misconduct as defined by the Terms of Reference.

38. It is convenient at this juncture to highlight the distinction between misconduct, as defined by the Terms of Reference, and conduct falling below community standards and expectations. Merging these two concepts is potentially invited by a definition of misconduct that includes "breaches a professional standard or widely accepted benchmark for conduct" but where the Terms of Reference also require this Commission to assess community standards and expectations. That merger has typically been avoided in common law countries, by dealing with a departure from professional standards by employing the ordinary dictionary meaning, as being a deliberate departure from accepted standards or serious negligence reflecting indifference or an abuse of privileges.[52] If the test of misconduct is looser, then a well-drawn separation between misconduct and conduct falling below community standards and expectations becomes crucial.

39. Conduct falling below community standards and expectations conveys a breach of some general moral duty, arising from a moral claim that the community has on a financial institution to behave in a certain manner, or even a departure from an expectation of "the community", not reflected in any legal or professional norm. Courts, in many areas, may be forced to confront the intersection of legal and moral claims. A useful analysis of such a confrontation is disclosed by the way in which the High Court in *Vigolo v Bostin*[53] discussed the distinction between legal and moral duties. The differences expressed in that case as to the applicability of a moral test to the legislation at issue there are presently irrelevant as the Terms of Reference call for moral judgments to be made as part of a Chapter II inquiry.

40. In *Vigolo v Bostin*, Gleeson CJ[54] adopted the rubric to legal and moral claims given by McLachlin J in *Tataryn v Tataryn*[55] as the distinction between those which the law imposes and those that arise from society's reasonable expectations of what a judicious person would do in the circumstances, by reference to contemporary community standards. Legal tests such as "honestly, efficiently and fairly" can be seen to potentially traverse both grounds. It is important, therefore, in distinguishing between misconduct and conduct that falls below community standards to bear in mind the injunction offered by Gummow and Hayne JJ at 214 [60] by reference to Windeyer J in *Stott v Cook*:

> *Questions of duty, when not determinable by the fixed criteria of law, become questions of casuistry. Standards and principles may be stated. But their application to a particular case can seldom be beyond all debate even when all the facts are known.*

41. In cases of misconduct, although the Commission is a Chapter II body in which the rules of evidence do not apply, it is generally accepted that it should have regard to the principles

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[51] T260.10-11.
[52] see eg *Pillai v Messiter [No 2]* (1989) 16 NSWLR 197.
[53] (2005) 221 CLR 191.
[54] at 202-202 [19].
[55] [1994] 2 SCR 807.

expressed in *Briginshaw v Briginshaw*[56] before making findings about conduct of the kind which the law recognises that natural or corporate persons do not ordinarily take part in.

42. On questions of conduct falling below community standards and expectations where reasonable minds may differ even when all the facts are certain, the need those standards and expectations to be well-defined, and for a state of comfortable satisfaction to be reached by the Commission before finding a breach is also important. This is so because of the public, moral opprobrium that follows from those finding being made in a forum such as the Commission. The perceptive observation of Windeyer J on casuistry recognises that there are often a range of matters to consider (that in the present circumstances will involve, *inter alia*, the interests of the community in strong banks and a strong banking system both directly through their financial holdings, and indirectly through the strength of the economy and the financial system).

43. Finally, to the extent a passing reference was made in closing, CBA also submits that it is not open to the Commission to find that its failure to disclose to customers the commissions payable amounted to misleading or deceptive conduct. Whether conduct is misleading or deceptive is a question of fact in each case. The characterisation of the conduct is a task that generally requires consideration of whether the impugned conduct viewed as a whole has a tendency to lead a person into error. In circumstances where the broker complied with his or her duty to disclose commissions, and in circumstances where the broker was in the direct relationship with the customer, no inference can be drawn that any customer was misled by CBA, and, especially, no general conclusion can be drawn that customers as a class were so misled.

Fourth Alleged Misconduct Finding

44. For the reasons outlined above in respect of the First and Third Alleged Misconduct Finding, CBA submits that the Commission should not find that CBA's broker remuneration arrangements or its failure to disclose the total amount of commissions to customers breach clause 3.2 of the Code of Banking Practice. Clause 3.2 of the Code of Banking Practice requires CBA to act fairly and reasonably towards its customers in a consistent and ethical manner.

45. CBA's broker remuneration arrangements take the form of an upfront commission and a trailing commission. They are no different to the broker remuneration arrangements of other banks. They have developed over decades because prospective borrowers value advice from brokers about the comparative costs and features of products and services from different lenders.[57] Given their conforming to standard industry practice, CBA's broker commission arrangements cannot be said to be in breach of the Code of Banking Practice. Furthermore, CBA's broker commission arrangements are applied by CBA consistently to all broker initiated customer loans.

46. The solution to the conflict of interest is not for an individual lender (a first mover) to stop paying commissions. That would disadvantage customers because it would give an incentive to brokers to prefer commission-paying lenders even if the non-commission-paying lender offered the product best suited to the customer's needs.

47. This is discussed further in Part B of these submissions.

First Alleged Below Community Standards and Expectations Finding

48. CBA submits that the Commission should not find that CBA's conduct fell below community standards and expectations by continuing to pay commission to brokers. CBA repeats its submissions above in relation to the First and Fourth Allegations of Misconduct.

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[56] (1938) 60 CLR 336 at 361-362. See Final Report of the Royal Commission into Trade Union Governance and Corruption at [124].
[57] see for example T243.20-27.

Second Alleged Below Community Standards and Expectations Finding

49. CBA submits that the Commission should not find, as alleged by Counsel Assisting, that CBA engaged in conduct that fell below community standards and expectations by revoking the accreditation of hundreds of brokers on the basis of inactivity with immediate effect and without first providing brokers with an opportunity to satisfy CBA of the quality of their activities.

50. CBA does not accept that there is a community expectation that brokers will be able to "recommend a full suite of potentially suitable loan products to a customer" from every lender in the market as alleged by Counsel Assisting.[58] The community does not expect that a broker will have access to all lenders. The reality is that Head Groups do not have access to all lenders, but rather have access to a sufficiently broad spectrum of lenders to ensure that they can meet their customer needs. There is nothing wrong with a lender like CBA determining which brokers should be authorised (and de-authorised) to submit loan applications on behalf of customers. Indeed, it cannot be suggested that every broker who would like to be accredited by CBA has a right to be accredited, or not de-accredited.

51. The evidence in respect of the de-accreditation program in question is that CBA's view was, and is, that active brokers generally were more familiar with, and understood CBA's product offering better, than inactive brokers.[59] CBA considers that this aligns with community standards and expectations, in that the community will expect that if a broker is authorised by CBA to apply for its products, that the broker will have meaningful knowledge and understanding of the CBA products and processes. This is particularly true in circumstances where brokers use their CBA accreditation, and so the CBA brand, to promote their services. Mr Huggins gave evidence that a consistent pattern of activity from brokers is the only reliable method CBA has of ensuring compliance by brokers with CBA procedures.[60]

52. A review of loan applications from low activity brokers disclosed lower conversion rates, that there were more errors and that there was higher arrears. This supported a conclusion that brokers who had less activity did not understand the CBA processes and policies as well as brokers who were submitting more loan applications.[61] De-accreditation was intended to raise the standards of brokers accredited by CBA.[62] The Commission's witness, Mr Mark Harris, showed a 50% failure rate in the CBA applications he had submitted over the prior two years. CBA did consider the interests of brokers, which is why it instructed the relationship managers of the brokers to inform them of the appeal process (109 brokers appealed[63]). Also, customers could still access CBA products through the proprietary channel or through another CBA accredited broker. Further, it cannot be said that customers were disadvantaged by the de-accreditation activities. Those brokers had not been actively applying for CBA loans, which means that they were meeting the needs of their customers without utilising the CBA product offering, and would continue to be able to do so without their CBA accreditation.

53. The fact that notice was not given to the de-accredited brokers was a consequence of the use of inactivity as a proxy for assessing broker quality. CBA did not want to incentivise brokers to recommend a customer a CBA product that they would otherwise not have recommended, merely to retain their CBA accreditation.

54. CBA accepts that using activity levels alone as a basis for assessing broker knowledge of products was not an ideal approach. As a result of further consultation with the industry, CBA now requires brokers with low activity to undergo further training to retain their accreditation[64] to address the matters which were of concern to CBA at the time it de-accredited the brokers in question.

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[58] T981.44-45.
[59] First Huggins Statement at [75]; T272.10-15.
[60] First Huggins Statement at [76].
[61] T272.10-15.
[62] T272.21-32; T275.5-11.
[63] T275.27-28.
[64] T274.18-45; T 275.40-276.5.

Case Study 5: CBA'S CCP and LPP Products

55. This case study relates to the sale by CBA of credit card plus (**CCP**) and loan protection product (**LPP**) insurance policies to customers who did not meet the employment eligibility criteria for making claims in respect of certain benefits under those policies at a time when CBA did not give additional disclosure to customers (that is, disclosure beyond that contained in Product Disclosure Statements (**PDS**)) of the employment eligibility criteria applicable to certain of the CCP and LPP benefits.[65]

56. CBA has to date paid around $9.9 million in remediation to approximately 64,000 CCP customers and is currently in the process of finalising a remediation program which will involve communicating with approximately 140,000 LPP customers.

57. CBA identified the CCP issue in April 2015. In May 2015 CBA notified ASIC of the issue[66] and introduced changes to its assisted sales channels, directing staff not to offer the product to customers who did not meet the employment eligibility criteria. In October 2015 CBA wrote to open policyholders who may not have met the CCP employment eligibility criteria, explaining the employment eligibility criteria and identifying the benefits that would not be available under their policy if the employment eligibility criteria were not met. CBA was of the view at that time that it had effectively addressed the CCP issue. CBA now accepts that there were errors in that assessment and that it took too long to arrive at the remediation outcome it ultimately implemented.

58. CBA approached the LPP issue as a follow up to the CCP issue in 2017, rather than as a distinct problem that required a concurrent investigation. CBA acknowledges that its identification of the extent of the LPP problem was too slow and that, as a consequence, CBA did not engage with ASIC and implement a remediation program as early as would otherwise have been the case.

59. In March 2018, CBA announced its decision to cease offering CCP insurance and LPP insurance in relation to personal loans by 30 June 2018.

Factual Findings alleged by Counsel Assisting

60. CBA accepts Counsel Assisting's summary of the factual background to the CCP matter at T 993.18-T994.19 subject to the following matters:

    (a) It was Mr van Horen's evidence that CBA provided ASIC with a 'good governance' notification of the CCP issue on 15 May 2015[67] in accordance with a practice that CBA had at the time to inform ASIC of an issue when it was not clear to CBA exactly how material the breach was.[68] In February 2017, CBA was of the view that the CCP matter did not involve a breach of its legal obligations.[69]

    (b) That view was held by CBA at the time based on the following considerations:

        (i) CBA had advised customers of all eligibility requirements including the employment criteria in the PDS which was provided to customers at the time of sale.[70] Further, the existence of waiting periods, exclusions was

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[65] As noted in Mr van Horen's witness statement dated 9 March 2018 (**van Horen 9 March CCP/LPP statement**), Colonial Mutual Life Assurance Society Limited (CMLA), which is a subsidiary of CBA, was the manufacturer of these CCP and LPP products. For simplicity in the remainder of this document, we refer to CBA unless a distinction is required between CMLA and CBA.
[66] CBA.0001.0024.0118_R.
[67] CBA.0001.0024.0118_R.
[68] T516.20-27.
[69] Letter from CBA to ASIC, 21.02.17, CBA.0001.0024.0224.
[70] T510.23-47 and van Horen 9 March CCP/LPP statement at [27(a)].

expressly raised to customers' attention in the version sales material used prior to the identification of an issue in 2015;[71]

(ii) CBA was offering customers CCP on a general advice basis, and in line with the Corporations Act requirements for the provision of general advice, CBA did not take into consideration customers' specific circumstances. Customers were provided with the required warning that customers should consider the content of the PDS to determine whether the policy met their needs;[72] and

(iii) CBA considered that the bundled nature of the CCP policy meant that, even where customers did not meet the employment eligibility criteria, there was value obtained by customers in respect of other forms of benefits under the CCP policy.[73]

(c) Mr van Horen conceded that, in retrospect, the sale of the CCP product to customers who did not meet the employment criteria for certain benefits, taking into account all the considerations was, on balance, a breach of CBA's obligation to do all things necessary to ensure that the CCP product was provided efficiently, honestly and fairly.[74]

(d) In giving evidence concerning CBA's dealings with ASIC on this matter, Mr van Horen refuted the proposition that CBA did all that it could to minimise the CCP issue in its communications with ASIC.[75] Mr van Horen's evidence was that there was nothing in the material he has seen that suggests any intent on the part of CBA to provide ASIC with a different account of the CCP problem to that which was provided to CBA's internal governance structures (including the Board).[76] That evidence ought to be accepted, particularly having regard to Mr van Horen's willingness to promptly and unequivocally concede the errors on CBA's part in connection with this matter.

61. CBA accepts Counsel Assisting's summary of the factual background to the LPP matter subject to the following matters:

(a) The employment eligibility criteria for the LPP products were similar to those for the CCP products, but as the LPP products could be unbundled, it was customers who did not meet employment eligibility criteria and who had selected Loan Repayment Cover (as opposed to Loan Cover) who may be adversely affected by a sale to them of the product in circumstances where sales scripts did not refer to the employment eligibility criteria;[77]

(b) CBA knew that eligibility issues might have arisen for the LPP products in the same way as for the CCP products, but did not know that many customers would be affected.[78] The problem was not investigated at that time and it is accepted by CBA that the investigation of the LPP issue ought to have occurred much earlier than it did.[79] It was Mr van Horen's evidence that there was no deliberate choice within CBA not to investigate the LPP issue.[80] It was Mr van Horen's evidence that CBA's

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[71] See example section of digital application forms prior to May 2015 exhibit CVH-6B to the van Horen 9 March CCP/LPP statement (CBA.0507.0021.0229 at 0232): "The PDF contains important information on benefits, terms and exclusions, including waiting periods and pre-existing conditions".
[72] Example section of digital application forms prior to May 2015 amendments, exhibit CVH-6B to the van Horen 9 March CCP/LPP statement (CBA.0507.0021.0229 at 0232).
[73] T516.25-26 and T519.1-4.
[74] T516.26-27; T519.7-11.
[75] T517.23-29.
[76] T518.3-5.
[77] van Horen 9 March CCP/LPP statement at [107] and [108].
[78] T543.19-21.
[79] T544.13-16.
[80] T544.20-24.

understanding of the LPP issue was based on misplaced assumptions about the number of impacted customers and that its understanding developed too slowly, with the consequence that CBA did not engage with the regulator as early as would otherwise have been the case.[81]

Conclusions on Conduct

First Alleged Misconduct Finding

62. The First Misconduct Allegation advanced by Counsel Assisting in respect of the CCP and LPP products is that CBA and CMLA breached their statutory obligations under s 912A(1)(a) of the Corporations Act to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly.

63. CBA accepts that CCP and LPP products were sold to customers who did not, at the time of their application, meet the employment eligibility criteria applicable to those products at a time when CBA's assisted sales scripts did not sufficiently highlight to those customers that they may be ineligible for certain benefits under those policies if they continued not to meet the employment eligibility criteria. While CBA met the legal obligation to disclose exclusions (including those arising by reason of the employment eligibility criteria) in the PDSs, the existence of employment eligibility exclusions were not explicitly called out in CBA's assisted sales scripts, in the manner recommended by ASIC after it released its report concerning the sale of Consumer Credit Insurance (**CCI**) (**Report 256**) in October 2011. CBA now accepts that, in failing to implement scripts that specifically called out the employment eligibility exclusions as recommended in Report 256, and in circumstances where it subsequently became known to CBA that products had been sold to customers who did not meet the employment eligibility criteria applicable to those products, it breached its obligation under s 912A(1)(a) of the Corporations Act to do all things necessary to ensure that it provided the CCP and LPP products efficiently, honestly and fairly in respect of those customers.

Second Alleged Misconduct Finding

64. CBA submits that the Commissioner should not make a finding that it contravened s 912D of the Corporations Act by failing to provide a written report to ASIC within the prescribed time period in connection with the CCP and LPP products. CBA submits that in considering whether such a finding ought to be made, the *Briginshaw* standard ought to be applied to the material before the Commission for the reasons set out at paragraph 41 of these submissions.

65. In considering whether there has been a contravention of s 912D, regard is to be had to the terms of the licensee's obligation to lodge a written report with ASIC:

> *The financial services licensee must, as soon as practicable and in any case within 10 business days after becoming aware of the breach or likely breach mentioned in subsection (1), lodge a written report on the matter with ASIC.*[82] (emphasis added)

66. It must be the case, whether a contravention of s 912D(1B) of the Corporations Act is alleged by reference to a failure to give notice *"after becoming aware"* of a breach or by reference to a failure to give notice "*as soon as practicable"*, that a contravention is to be determined by reference to a finding that the contravener had actual knowledge both of a breach or likely breach and that that breach or likely breach was significant and, despite that knowledge, the contravener failed to give notice to ASIC in accordance with s 912D(1B) of the Corporations Act.

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[81] van Horen 9 March CCP/LPP statement at [124].

[82] S.912D(1C) of the Corporations Act. It is important to note in this regard that "likely" breach has the very specific definition in s.912D(1A) that "a financial services licensee is likely to breach an obligation referred to in that subsection if, and only if, the person is no longer able to comply with the obligation". In other words it is limited to a future breach that has not yet occurred.

67. The material before the Commission does not establish that to be the case in respect of the CCP/LPP matters. Rather, the evidence demonstrates that CBA did not appreciate that what had occurred was a significant breach of s 912A(1)(a) sufficiently quickly.

68. The CCP and LPP issues required analysis by CBA before it could determine whether a significant breach or likely breach of s 912A(1)(a) had occurred. That assessment required CBA to consider whether the particular conduct concerned involved CBA deviating from the obligation to do all things necessary to ensure the products were provided in a manner that was honest, efficient and fair, and to have deviated from that obligation in a way that was significant for the purposes of s 912D. Such an assessment requires a greater element of judgment compared to other assessments of contravention of law or regulation that are more readily ascertainable. Further, in the context of the CCP/LPP issues, assessment of the significance of the breach, or likely breach, required careful consideration given that:

    (a) The bundled nature of the CCP product did not allow ready ascertainment as to whether a customer obtained all, some or no potential benefit in connection with the product;

    (b) Determining the size and composition of the cohort of potentially affected customers was not a straightforward exercise; and

    (c) Ascertainment of the impact of a failure to meet ASIC's "best practice" guideline, in circumstances where customers had received a PDS that did disclose the employment eligibility criteria, was also a matter requiring careful analysis.

69. Understood in that context, CBA's conduct ought to be seen as a consequence of its failure to quickly and accurately assess the issues that arose out of the CCP/LPP problem. This is not a case in which the evidence establishes any intent on the part of CBA to mislead or fail to report a significant breach, or likely significant breach, to the regulator. There is no evidence, in the case of either the CCP or the LPP issue, that CBA was of the view at the time that what had occurred was a significant breach of s 912A(1)(a) and that, despite that awareness, CBA then failed to report those matters to the regulator in the time prescribed. On the contrary, CBA notified ASIC of the CCP issue despite having formed the view that it did not constitute a breach of legislation.

70. Accordingly, there should not be a finding that CBA contravened s 912D of the Corporations Act in relation to the CCP/LPP products.

Third Alleged Misconduct Finding

71. CBA submits that the Commission should not find that misleading or deceptive conduct has occurred in connection with the sale of CCP/LPP products, including in connection with the sale to Ms Savidis of the CCP product.

72. Whether any customer was misled or deceived, or likely to be misled or deceived, must turn on a number of circumstances particular to any given case including:

    (a) that customer's own knowledge and ability to determine for themselves the suitability of the CCP/LPP product in their particular circumstances;

    (b) the discussion that took place between the customer and any CBA representative at the time;

    (c) the customer's regard to the terms of the PDS; and

    (d) the materiality to particular customers of the information omitted from the sales script, which must be found to have given rise to a reasonable expectation that specific exclusions would be called out otherwise than by the general reference to

exclusion and the full terms and conditions contained in the PDS, and thereby rendered the script misleading or deceptive.[83]

73. Although the sales scripts for the CCP and LPP products prior to May and October 2015 (respectively) did not contain a "knockout" question on employment, those scripts both referred to the existence of "terms and conditions… including waiting periods, exclusions and benefit limits" and to the combined PDS and policy document for full details around the policy and required that customers be provided with the PDS.[84] Customers were also provided with a warning that any advice was general and not specific to their circumstances.[85] The PDSs for the CCP and LPP products at all relevant times explicitly and accurately disclosed the applicable eligibility criteria, including a disclosure to the effect that CBA would pay on the policies in the event that the customer was employed and "became involuntarily unemployed" during the period of cover. Each PDS provided a definition of what constituted employment for the purposes of the relevant policy.[86] In those circumstances, a general finding of misleading or deceptive conduct, or conduct likely to mislead or deceive, on the basis of non-disclosure or misrepresentation is not available.

74. CBA submits that the Commission should not find that Ms Savidis was misled or deceived by reason of the sale to her of CCP insurance. Ms Savidis' evidence was "*[t]he staff member told me … that if anything happened to me in the future and I had to stop working, the insurance would help me. I told the staff member that I was not working at the time … the staff member said that I could still get other benefits under the policy*".[87] "Other benefits" must be viewed as a reference to the cover of the customer's credit card balance in the case of death, permanent disability or terminal illness, rather than to the policy benefits for which employment was a pre-condition. The statement as to "other benefits" was not misleading or deceptive. While CBA has rectified its processes such that, upon being informed of Ms Savidis' unemployment, the CCP insurance offer would now cease,[88] the evidence does not demonstrate that CBA engaged in misleading or deceptive conduct in the sale of the product to Ms Savidis in October 2014.

Fourth Alleged Misconduct Finding

75. Counsel Assisting contends that it is open to the Commission to find that CBA failed to comply with its obligation in clause 3.2 of the Code of Banking Practice. For the reasons outlined in the First Alleged Misconduct Finding, CBA accepts that it failed to adhere to cl 3.2 of the Code of Banking Practice.

First Alleged Below Community Standards and Expectations Finding

76. The First Below Community Standards and Expectations Finding advanced by Counsel Assisting is that having become aware that CCP and LPP was being sold to customers who did not meet the employment eligibility criterion, CBA failed to introduce a knock-out question to the online credit card application form to prevent the sale of the product online to people who did not meet the employment eligibility criterion for approximately two years.

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[83] *Fraser v NRMA Holdings* (1995) 13 ACLC 132 at 132-133: "*In the circumstances the Court should not be quick to conclude that a contravention of s 52 has occurred because other information could have been provided that was not. The need for the applicants to establish the materiality of errors and omissions is an important step in the proof of their claims*." See also *Kimberley NZI Finance Ltd v Torero Pty Ltd* [1989] ATPR (Digest) 53,193 at 53,195 per French J (and agreed with by Gummow J in Demagogue Pty Ltd v Ramensky (1992) 39 FCR 31 at 41): *"[U]nless the circumstances are such as to give rise to the reasonable expectation that if some relevant fact exists it would be disclosed, it is difficult to see how mere silence could support the inference that the fact does not exist.*"

[84] van Horen 9 March CCP/LPP statement at [27(c)] and [90(c)].

[85] Example section of digital application forms prior to May 2015 amendments, exhibit CVH-6B to the van Horen 9 March CCP/LPP statement (CBA.0507.0021.0229).

[86] van Horen 9 March CCP/LPP statement at [27(c)] and [90(c)].

[87] Witness statement of Irene Savidis, dated 9 March 2018, Exhibit 1.92 (WIT.0001.0004.0001) at [11].

[88] Witness statement of Clive Richard Van Horen in relation to Ms Savidis, dated 9 March 2018, Exhibit 1.96, at [21] (CBA.9005.0001.0001 at 0003).

77. CBA acknowledges that it should have amended the application form in the digital channel concurrently with the amendments to the assisted sales channel.[89] As Mr van Horen said in his evidence, the delay in introducing the change to the digital channel resulted from CBA prioritising the assisted channel to ensure that concerns about ineligible customers who were having interactions with CBA staff during the purchase of these products, notwithstanding their ineligibility for certain benefits, were addressed promptly following the CCP issue being identified by internal audit in April 2015.[90] CBA formed the view that the risk of ineligible customers being sold the product in the digital channel was lower because customers would read the application in their own time and not in the context of a sales related discussion with a staff member. It is likely that similar considerations informed ASIC's decision to suggest in Report 256 that best practice in selling CCI involved additional disclosure in assisted sales channels only. CBA has now exceeded the Report 256 guidelines by implementing changes in the digital channel. Mr van Horen acknowledged that, in hindsight, the delay in implementing changes to the digital process was an error and, in recognition of that error, CBA has remediated customers who applied for the products through the digital channel up until August 2017.[91]

Second Alleged Below Community Standards and Expectations Finding

78. The Second Below Community Standards and Expectations Finding advanced by Counsel Assisting is that having become aware that the LPP product was being sold to people who did not meet the employment eligibility criterion in 2015, CBA failed to notify ASIC until ASIC approached CBA with a customer complaint.

79. CBA accepts that its notification to ASIC of the LPP issue fell below community standards and expectations. The reasons for CBA's failure to recognise the need to notify ASIC of the LPP issue sooner than it did were two-fold. First, CBA deferred the investigation of the LPP issue until it had concluded its CCP investigation, rather than as a distinct problem requiring a concurrent investigation.[92] Secondly, CBA was working from the assumption, subsequently exposed as flawed, that consumers approved for a home loan or personal loan were more likely to be employed, and the significance of the problem would be substantially less.[93] CBA accepts that those views were mistaken and resulted in CBA not commencing its investigation earlier, and consequently not engaging with ASIC, or formulating and implementing a remediation program as early as it could have done.

80. CBA's delay in notifying ASIC from the point at which the LPP investigation commenced in May 2017 arose from that investigation being more complex than was the case for CCP.[94] As the LPP product was unbundled in respect of home loans (and personal loans until November 2015), with only one cover type requiring customers to satisfy employment related eligibility criteria,[95] additional analysis was required to identify the cohort of LPP policyholders who could be adversely impacted.[96] Also, home and personal loans could be issued to joint borrowers, and thus the circumstances of each of the borrowers required separate consideration.[97] CBA pursued an analysis of these issues in order to ascertain the significance of the problem and, as a result, did not notify ASIC quickly enough of the LPP issue. Consequently, CBA's conduct fell short of community standards and expectations.

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[89] T522.2-17. In this regard CBA points out that ASIC Report 265 recommends disclosures of exclusions so that the changes made to the assisted scripts in 2015 by introducing knock out questions go beyond these recommendations and the changes to the digital application process in 2017 which involve specific disclosures of these exclusions, are consistent with these recommendations.
[90] T.522.2-41.
[91] van Horen 9 March CCP/LPP statement at [54] (CBA.9006.0001.0001 at 0010).
[92] T544.12-13 and T546.15-21.
[93] T546.24-29.
[94] van Horen 9 March CPP/LPP statement at [106] (CBA.9006.0001.0001 at 0019).
[95] van Horen 9 March CPP/LPP statement at [107] (CBA.9006.0001.0001 at 0019).
[96] van Horen 9 March CPP/LPP statement at [108] (CBA.9006.0001.0001 at 0019).
[97] van Horen 9 March CPP/LPP statement at [109] (CBA.9006.0001.0001 at 0019).

Third Alleged Below Community Standards and Expectations Finding

81. The Third Below Community Standards and Expectations Finding advanced by Counsel Assisting is that CBA took over a year to agree to implement a remediation program that was acceptable to ASIC.

82. CBA accepts that the time taken to implement a remediation program that was acceptable to ASIC to compensate customers who had been sold CCP insurance when they did not meet the employment eligibility criteria fell below community standards and expectations. CBA has conceded that its approach to developing a remediation program for CCP customers was "incremental" and that this was one of its errors.[98] Ultimately, CBA has paid approximately $9.9 million to customers under the remediation program.[99] The delay in the remediation of customers affected by the CCP issue was in part attributable to the number of affected customers identified as being entitled to remediation fluctuating as CBA's investigation progressed and as more information about the individual circumstances of customers became known.[100] Consequently, to adopt Counsel Assisting's three limbs of community expectation:[101] CBA fixed the problem in its sales processes and CBA compensated customers for any detriment they have experienced in connection with CCP, but CBA failed to do so in a timely fashion.

Fourth Alleged Below Community Standards and Expectations Finding

83. CBA submits that the Commission should not find that by inviting staff members to overcome objections by a customer up to two times before ceasing offer of a product CBA's conduct fell below community standards and expectations.

84. ASIC Report 256 provides in recommendation 1(h) that *"there should be clear instructions for staff to end any attempted telephone sale if a consumer indicates once, or at the most twice, that they* do *not want to purchase the product "*.[102] CBA submits that in considering what reflects community standards and expectations ASIC Report 256 is a relevant consideration and CBA's processes fall within the standards set out in that report.

Alleged findings as to CBA's culture and processes

85. The Commission should not accept the submission of Counsel Assisting that the CCP and LPP conduct can be attributed to a culture and processes in CBA that permitted the conduct to occur. While CBA has acknowledged that the failure to specifically draw the employment eligibility criterion to customers' attention was a deficiency in its process, there is no evidence before the Commission warranting a conclusion of a failure of broader processes or of culture within CBA in relation to the sale of the CCP and LLP products.

86. It is also important that a specific process failure be distinguished from culture. There is no evidence before the Commission concerning CBA's culture in relation to the sale of CCP and LPP that could be said to be causative of the conduct identified. Evidence has been adduced concerning the remuneration of CBA sales staff.[103] Mr van Horen's evidence was to the effect that the proportion of a CBA employee's remuneration attributable to their sales performance in a particular product category, such as CCP, was *de minimis*[104] and that sales staff were not incentivised to push particular products on to customers, or incentivised to pressure customers

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[98] T524.40-44.
[99] T534.46.
[100] This was a proposition that Counsel Assisting appeared to accept during the examination of Mr van Horen: T517.18-20.
[101] T998.37-40.
[102] ASIC Report 256 at [95].
[103] See van Horen 9 March CPP/LPP statement, at [29] - [32] in relation to CCP and at [94] - [97] in relation to LPP (CBA.9006.0001.0001 at 0007 & 0017).
[104] "*A very tiny fraction of 1 per cent of a person's remuneration … would be determined by their sales performance on one category [of product]*": T.506.34-36.

into acquiring those products specifically.[105] That evidence was not contradicted and should be accepted.

87. Counsel Assisting has, in the context of discussing CBA's culture, pointed to CBA requiring staff to sell CCP and LPP products without adequate disclosure of employment eligibility criteria. CBA has acknowledged a deficiency in its process but there is nothing to suggest that it resulted from any failure within CBA's culture.

88. CBA accepts that it should have been more proactive in devising and implementing a remediation program for customers affected by the CCP issue.

89. Similarly, CBA accepts that it erred in its decision to defer its consideration of LPP until it had dealt with the CCP product. The proper conclusion to follow from the evidence adduced is that these were errors of judgment that resulted in CBA acting too slowly, rather than CBA intentionally acting to avoid responding to the issue or denying wronged customers remediation.

Case Study 6: Personal Overdrafts

90. This case study relates to a programming error within CBA's automated decision-making system (for assessing long form personal overdraft applications), which resulted in some data specified in a customer's application not being included in the serviceability calculations. That error affected 10,593 overdrafts, 9,465 of which would have been declined but for the error, and 1,128 of which were approved at a higher overdraft limit than that for which the customers were eligible. CBA accepts that the programming error adversely affected the impacted customers. Those customers were remediated. CBA further accepts that, notwithstanding the checks and controls it had in place, the error regrettably remained undetected for over 4 years.

Factual Findings Alleged by Counsel Assisting

91. CBA accepts Counsel Assisting's summary of the factual background to Case Study 6 subject to one clarification. In relation to the failure to properly map a customer's declared living expenses, the programming error in the automated process was not that it adopted a benchmark rather than using a customer's declared expenses; instead, the error was that the serviceability calculator was coded to reference the "living expense" variable from the incorrect data field which did not include all the underlying values.[106]

Conclusions on Conduct

92. Counsel Assisting contends that it is open to the Commissioner to find that:

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

(b) CBA breached the prohibition in section 133 of the NCCP Act on entering into credit contracts with consumers in circumstances where the contract was unsuitable;

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

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[105] T.505.04 – T.508.09, including Mr van Horen's response to propositions put by Counsel Assisting in relation to Exhibit 1.98, 'KPI direct banking financial year '16' (CBA.001.0049.1198, in particular at .1235 and .1237).
[106] Witness statement of Clive Richard van Horen, dated 9 March 2018, Exhibit 1.113, CBA. 9000.0002.0001 (**van Horen 9 March PODs statement**) at [21(b)].

93. CBA accepts that a finding of misconduct pursuant to a breach of s 133 of the NCCP Act is available, but only in respect of those customers who were affected and where the loans were, in fact, unsuitable for the borrowers concerned. CBA submits that the Commission should not find a breach of s 47(1)(a) of the NCCP Act or cl 27 of the Code of Banking Practice, in circumstances where the programming error affected a relatively small number of applications and where, but for the programming error, the systems in place were reasonable given the scale of the business. Further, there should not be a finding of misconduct arising from a breach of s 912A(1)(a) of the Corporations Act as that provision does not apply to CBA's personal overdraft facilities, which are credit facilities.[107]

94. The conduct under consideration arose from a computer programming error, in that the correct inquiries were made in accordance with responsible lending obligations, but the information obtained from those inquiries was not correctly handled by the computer system so as to include the information in the calculations when decisions were made. Obviously, the mistake in writing the program should not have been made, and it should have been picked up earlier. But no human activity is perfect. A realistic standard is that mistakes should be reduced to the absolute minimum, that they should be rectified as quickly as possible and that any customers who are adversely affected should receive full remediation.

95. In circumstances where a relatively small number of personal overdraft applications were affected, and where the issues that arose did not result from a failure in diligence in making inquiries,[108] generalised findings of misconduct in the terms suggested are wholly inappropriate. Counsel Assisting did not particularise matters that would permit a general finding beyond those customers who were prudently identified by CBA, separated into the six relevant categories.[109] No part of Mr van Horen's statement was challenged in his examination by Counsel Assisting.

96. CBA samples a proportion of every consumer credit decision to *"determine whether the* [credit decision] *was the right or wrong decision or whether there were any technical or documentation errors in that decision"*.[110] The sampling process failed to identify the error prior to 2015 as only a small proportion of overall overdraft customers were affected.[111] CBA also monitors customer complaints to identify any systemic reason behind those complaints. That monitoring process did not identify the error prior to 2015,[112] but that was understandable in the circumstances given the nature of the error. Once identified, the error in the existing system was corrected within two and a half weeks, by 18 September 2015.[113]

97. In all the circumstances, it cannot be said that CBA did not take steps to ensure its systems were operating in line with its obligations to provide services efficiently, honestly or fairly or that it did not exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods. Problems such as this are impossible to eradicate absolutely and will, on any reasonable view, arise in all businesses despite all efficiency and diligence. Indeed, when it is properly understood that the controls in place failed to take into account a computer coding error, precisely because the instance of the occurrence was statistically low, the disputed allegations of misconduct must be rejected.

Case Study 11: CBA Credit Cards

98. This case study relates to Mr Harris, a customer of CBA, to whom CBA offered three credit cards and two credit limit increases (**CLIs**) during the period November 2014 to January 2017. The second CLI was offered to Mr Harris after he had disclosed his gambling problem to a staff member of CBA in October 2016. CBA regrets, and has apologised to Mr Harris for granting him a CLI after he had informed CBA of his gambling problem.

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[107] s.765A of the Corporations Act specifically excludes credit facilities from the definition of the financial products that are regulated by Chapter 7 of that Act.
[108] van Horen 9 March PODs statement at [14] (CBA.9000.0002.0001 at 0003).
[109] van Horen 9 March PODs statement at [28] (CBA.9000.0002.0001 at 0006).
[110] T597.42-45.
[111] T598.23-28.
[112] T598.15-19.
[113] T590.43-44.

Factual Findings Alleged by Counsel Assisting

99. CBA accepts Counsel Assisting's summary of the factual background to the 11th case study, subject to the following matters:

(a) To be eligible to complete a Short Form application for a credit card, CBA customers had to meet all of the criteria set out in Mr van Horen's statement at [13(a) - (f)],[114] each of which was aimed at ensuring that the applicant was likely to be a relatively low risk applicant for a credit card in respect of whom CBA had some transacting history;

(b) It was not Mr van Horen's evidence that CBA did not take any steps to verify the customer's living expenses. It was Mr van Horen's evidence that CBA compared the customer's declared living expenses against an internal (HEM-based) benchmark, the higher of which was used in CBA's assessment of serviceability. CBA did not verify the particulars of each of the disclosed expenses provided by the customer;[115]

(c) So far as CLIs were concerned, they were offered to customers who had opted in to receive CLI invitations and who were then pre-assessed to be eligible for a CLI.[116] An application for a CLI could also be initiated by a customer through either digital or assisted sales channels;[117]

(d) To be eligible to apply for a CLI by way of short form application, in addition to other criteria, a CBA customer's monthly credit card repayments over the last 6 monthly statement cycles had to be equal to or greater than 2% of the proposed new limit[118] and in the course of the Short Form application process customers were required to confirm that they had a monthly serviceability surplus of 3% of the proposed new limit;[119] and

(e) Mr Harris' evidence is that it was about 6 months after he obtained his first CBA credit card that he began to gamble beyond his means using the CBA credit card to transfer cash to another CBA transaction account to facilitate the gambling.[120]

100. Additionally, the following matters are material to consideration of the issues raised by the 11th case study:

(a) CBA has approximately 3,000,000 CBA branded credit cards on issue to individuals who hold a personal credit card or a business card with individual liability.[121] It receives upwards of 40,000 applications per month for credit cards and another 20,000 applications per month for CLIs;[122]

(b) At the time that Mr Harris disclosed his gambling problem to CBA in October 2016, the CBA employee speaking with Mr Harris on the telephone stated that she (the employee) would decline the offer to apply for a CLI on Mr Harris' behalf, but did not do so based on Mr Harris' request not to decline it because he would take advantage of the offer to apply for a CLI but "I want to sort my gambling stuff out first";

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[114] Witness statement of Clive Richard van Horen, dated 22 March 2018, Exhibit 1.161, CBA.9007.0001.0001 (**van Horen 22 March statement**), at 0002-0003.
[115] van Horen 22 March statement at [25(g)] (CBA. 9007.0001.0001 at 0004) and T874.19-36-T876.02.
[116] van Horen 22 March statement at [29] (CBA.9007.0001.0001 at 0006) and T886.7-14.
[117] van Horen 22 March statement at [31] (CBA.9007.0001.0001 at 0006).
[118] van Horen 22 March statement at [33(d)] (CBA. 9007.0001.0001 at 0007).
[119] van Horen 22 March statement at [33(d)] (CBA. 9007.0001.0001 at 0007).
[120] Witness statement of David James Harris, dated 18 March 2018, Exhibit 1.161 (**Harris 18 March Statement**), at [10].
[121] van Horen 9 March CPP/LPP statement at [14(a)] (CBA.9006.0001.0001 at 0003).
[122] T878.33-39.

(c) CBA has put in place a financial hardship arrangement for Mr Harris whereby CBA has:

(i) Reduced the balance owing on Mr Harris' credit card;

(ii) Ceased charging fees and interest on the balance owing; and

(iii) Reduced the payment amounts to be made by Mr Harris;

(d) CBA has now implemented a range of additional measures designed to prevent credit card customers who exhibit signs of problem gambling from receiving CLI offers and signs of problem gambling will be taken into account in assessing any new credit card, CLI or personal loan application made by a customer. Additionally, CBA has developed tools to facilitate customers managing their credit card expenditure such as spending caps, credit limit decreases and online closure of credit cards.

Conclusions on Conduct

First Alleged Misconduct Finding

101. CBA submits that there should not be a finding that it breached s 47(1)(a) of the NCCP Act or the s 912(1)(a) of the Corporations Act general conduct requirement to do all things necessary to ensure that credit activities were engaged in, and financial services were provided, by it efficiently, honestly and fairly.

102. CBA submits that s 47(1)(a) of the NCCP Act is the provision applicable to credit cards and credit card limit increases rather than s 912A of the Corporations Act. That is because s 765A of the Corporations Act specifically excludes credit facilities from the definition of financial products.[123]

103. CBA has acknowledged, and continues to acknowledge, the significant issues that arose in Mr Harris' case (as discussed in more detail below). However, the particular circumstance of Mr Harris' case, are not of themselves sufficient to warrant a finding that CBA has not met its general conduct obligation to do all things necessary to ensure that the credit activities authorised by its licence, in this case the provision of credit card facilities and CLIs, are engaged in efficiently, honestly and fairly. CBA submits that when regard is had to the number of customers to whom CBA provides credit card facilities and the number of credit card applications and CLI applications received per month, a failing by CBA at any particular point in time in relation to any individual customer's experience does not, of itself, indicate the type of systemic failure to which s 47(1)(a) is directed.[124] Further, there is nothing in the evidence before the Commission concerning CBA's general conduct in providing credit card facilities and CLIs that is identified by Counsel Assisting as not being efficient, honest or fair.

104. Consequently, in response to the first allegation of misconduct, CBA submits that a finding of:

(a) breach of s 912A(1)(a) of the Corporations Act should not be made because the provision does not apply; and

(b) breach of s 47(1)(a) of the NCCP Act is not warranted on the available evidence.

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[123] See s.765A(h) of the Corporations Act and r.7.1.06 of the Corporations Regulations 2001.

[124] Those cases in which breaches of s.47 are considered look to systemic breaches, rather than failings in a particular case, to determine whether a breach has occurred (see, for example, *Good To Go Loans Pty Ltd v Australian Securities and Investments Commission* [2015] FCA 1350 and *Dimitropoulos and Australian Securities and Investments Commission* [2017] AATA 1513).

Second Alleged Misconduct Finding

105. The Second Misconduct Allegation advanced by Counsel Assisting is that CBA breached s 128(b) of the NCCP Act because it had not made reasonable inquiries about Mr Harris' financial situation and had not taken reasonable steps to verify his financial situation as required by s 130(1)(b) and s 130(1)(c) of the NCCP Act. This allegation applies to the increase in Mr Harris' credit limit to $35,000 after he disclosed his gambling problem to an employee of CBA.

106. Before it offered that CLI to Mr Harris, CBA confirmed that Mr Harris was able to meet his credit card obligations in relation to the increased limit if the CLI were to be granted to him. CBA made a range of relevant inquiries by asking Mr Harris to respond to questions regarding employment, disposable income and changes to his circumstances. CBA reviewed Mr Harris' repayments patterns to ascertain that Mr Harris was already making sufficient payments on his credit cards to meet the repayment requirements for the increased limit. This confirmation would have been sufficient to discharge the obligations contained in ss 130(1)(b) and (c) of the NCCP Act, but for Mr Harris' disclosure of his gambling problem.

107. However, CBA accepts that given the circumstances in which Mr Harris informed CBA of his gambling problems and his stated intention to take up the CLI when he had his gambling under control, CBA ought to have taken further steps to use this information before determining whether to offer further credit to Mr Harris.

108. Consequently, CBA accepts that following the particular circumstances of Mr Harris' disclosure of his gambling problem to CBA, CBA breached its obligation under s 128(b) of the NCCP Act in relation to Mr Harris. CBA regrets and has apologised to Mr Harris for granting him the CLI after he disclosed his gambling problem to CBA. CBA has remedied that breach by entering into a hardship agreement with Mr Harris which involves both a debt write-off by CBA and CBA ceasing to charge interest and fees on the balance outstanding.

Third Alleged Misconduct Finding

109. The Third Misconduct Finding advanced by Counsel Assisting is that CBA failed to comply with Regulatory Guide 209: "Credit licensing: Responsible Lending Conduct", which constitutes a recognised and widely accepted benchmark for meeting the responsible lending obligations in the NCCP Act.

110. CBA accepts that in Mr Harris' case it did not comply with ASIC Regulatory Guide 209.[125]

111. CBA accepts that it ought to have used the information provided by Mr Harris about his gambling problem and his intention to take up the CLI when he had his gambling under control, when of assessing whether a CLI was unsuitable for him. In not doing so, CBA failed to comply with RG 209.90 in the particular circumstances of Mr Harris' case.

Fourth Alleged Misconduct Finding

112. The Fourth Misconduct Finding advanced by Counsel Assisting is that CBA failed to comply with the clause 27 of the Code of Banking Practice in selecting and applying credit assessment methods and forming an opinion about Mr Harris' ability to repay his credit card.

113. For the reasons outlined above, CBA submits that in assessing the suitability of the increase in Mr Harris' credit limit, CBA acted with appropriate care, skill and prudence except in granting the CLI after Mr Harris disclosed his gambling problem to CBA.

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[125] Particulars have not been provided by Counsel Assisting as to the aspects of CBA's conduct that are said to have been non-compliant with RG 209. If other matters are identified as being non-compliant CBA requests that it be permitted to make submissions in response to those matters

Allegation that CBA's conduct fell below community standards and expectations

114. CBA accepts that in inviting Mr Harris to apply for, and subsequently providing Mr Harris with, a CLI after he had disclosed his gambling problem to CBA, its conduct fell below community standards and expectations.

115. However, CBA submits that community standards and expectations do not require it not to offer a CLI to any customer who has used his or her credit card to gamble. Gambling is a legal activity on which adults are entitled to spend their money, and many Australians do. To take Mr van Horen's example, a customer who places a bet on the Melbourne Cup on their credit card may properly be offered a CLI. Community standards and expectations do not require otherwise and the exact standard is difficult to define.

Allegations as to inadequacies in CBA's internal systems

116. Three inadequacies in CBA's internal systems are alleged by Counsel Assisting.

117. First, it is said that CBA required Mr Harris to follow complex and contradictory processes in order to close his credit card facility. CBA does not accept that its processes for closing credit card facilities were complex or contradictory at the time that Mr Harris sought to close his credit card account. Mr Harris' account of his conversations with CBA staff members is, understandably given the effluxion of time and without criticism of Mr Harris, lacking in detail sufficient to enable such a finding to be made. At the time that Mr Harris sought to close his account, necessarily there was a short time period which needed to elapse to permit the final payment to be processed and any pending transactions to be finalised, before a credit card account could be closed.

118. Transcripts of Mr Harris' telephone conversations with CBA at the time he wanted to close his credit card account in February 2017 indicate that he was advised by the CBA staff members of the process required to do so. This involved obtaining the final balance owing from the credit card team in CBA's contact centre, paying that amount at a branch and, importantly, subsequently calling the credit card contact centre team to implement the closure. The last CBA staff member Mr Harris spoke to, also offered to follow up with Mr Harris to ensure the account was closed, but Mr Harris indicated he would call back. CBA's records indicate that Mr Harris never did take the final step to close his credit card and, in fact, used his card to pay for online transactions the very next day.

119. Second, Counsel Assisting points to CBA's failure to capture Mr Harris' disclosure of his gambling problem in its systems as an inadequacy in CBA's internal systems. To use Mr van Horen's language, CBA's internal systems do not "flag" a self-disclosure of a gambling problem and do not operate to automatically factor such information into CBA's credit models. This is something that Mr van Horen acknowledged CBA needs to continue to work on.[126]

120. Third, Counsel Assisting has pointed to deficiencies in CBA's internal systems which resulted in CBA sending correspondence to Mr Harris in error, indicating that a hardship agreement had not been reached, when in fact a hardship arrangement was in place for the customer. As Mr van Horen explained, the question of why mistaken correspondence issued from CBA remains under investigation, but CBA accepts that its collections systems have not been state of the art and are, as a result, currently the subject of a major upgrade due to be completed in the middle of 2019.[127]

[126] T896.1-23.
[127] T897.41-T898.2.

Part B: Questions arising from the case studies

Mortgage Broker Arrangements

Does the use of upfront and trailing commissions for remuneration of head groups and the brokers who submit loans through head groups lead to poor customer outcomes?

121. CBA acknowledges that the use of upfront and trailing commissions linked to loan size for third-parties can potentially lead to poor customer outcomes (see CBA submission to Mr Sedgwick (Exhibit 1.37)).

122. At present, both upfront and trailing commissions are linked to loan size at the start of the loan and (for trail only) in subsequent years. The potential for poor customer outcomes arises due to a conflict which exists between the broker's interest and the customer's interest as the broker can maximise their income by securing larger loans which pay down more slowly, which may not be in the customer's interest.

123. CBA's submission to the Sedgwick Review noted that:

> *As the Reviewer identified, the use of upfront and trailing commissions linked to volume can potentially lead to poor customer outcomes. Our analysis of loans applied for through the proprietary versus broker channel shows that:*
>
> *(i) "broker loans are reliably associated with higher leverage. This finding is robust after allowing for all major descriptors of borrower circumstances, not only channel but, first home buyer status; owner occupier status; fixed or variable loan choice and major demographic factors of location, age and income;*
>
> *(ii) Even for customers with an identical estimate of ex-ante risk, loans through the broker channel have higher leverage;*
>
> *(iii) Loans written through the broker channel have a higher incidence of interest only repayments, meaning customers pay-down their loans more slowly."*

124. This analysis is consistent with ASIC Report 516 - Review of Broker Remuneration. ASIC found that:

(a) *"Even after controlling for differences, compared to consumers going directly to lenders, we found that consumers going through broker channels obtained: (a) loans with higher LVRs (typically between 1 and 4%, depending on the lender); and (b) larger loans in dollar terms.*

(b) *These findings take into account many of the differences in characteristics of consumers who use brokers and those who go directly to lenders. Based on the raw data alone, the broker channel produces even higher LVRs (average of 12.7% higher across lenders in 2012, and 7.1% higher in 2015), and even higher loan amounts (9.4% higher in 2012, 7.4% higher in 2015).*

(c) *Even after controlling for differences, compared to consumers going directly to lenders, we found that consumers going through broker channels obtained significantly more interest-only loans: for all eight lenders reviewed, brokers arranged at least 50% more interest-only loans, and up to four times as many interest-only loans in the case of one lender."*

125. ASIC also noted that:

> *All other things being equal, loans with higher amounts, and/or interest-only terms will cost the consumer more in interest and may take longer to pay down. Whether*

or not this is a poor consumer outcome depends on whether the loan met the consumers requirements and objectives and did not result in the customer experiencing financial hardship. For example, if a consumer is placed in a larger loan than they needed, this is clearly a poor consumer outcome (and may also breach responsible lending laws.)

Should upfront and trailing commissions be replaced with an upfront flat fee payment?

126. CBA has expressed the view that there could be merit in discontinuing the practice of volume-based commissions, but care needs to be taken to implement any change in a way that does not adversely impact customers, or legitimate business interests.

127. As outlined in the Sedgwick Review submission, CBA believes that differences in proprietary and broker loans *"are consistent with the hypothesis that differences in remuneration between the channels are driving different customer outcomes and lends some support to the case for discontinuing the practice of volume-based commissions for third parties."*

128. In the same submission, CBA outlined that it does not believe it is breaching responsible lending laws by offering broker commissions. It is important to note that CBA loan applications, agnostic of the channel through which they arise, are subject to CBA's own processes and procedures for evaluation of loan applications and credit assessment purposes. For all broker originated loans this involves a manual review process, and additionally CBA customers are required to acknowledge, through the credit assessment summary document, supplied to them prior to the loan funding, that CBA is providing them with the loan amount that they have sought.

129. While replacing upfront and trail commissions with an upfront flat fee de-linked to loan size can address identified areas of conflict, any changes should be carefully designed to:

(a) Avoid creating new conflicts. A per-loan account fee, for example, could encourage unnecessary loan splitting (i.e. to generate more accounts per customer and greater fees). If a flat fee was paid by lenders, and differences emerged between the fees offered by different lenders, then a conflict over lender choice could be created (i.e. a broker could favour a lender with higher fees, even if this is not optimal for the customer). Likewise, a fixed fee with steps related to size or complexity could encourage loans to be constructed just over individual step thresholds;

(b) Avoid reducing the availability of service to key customer segments. A flat fee payment has the potential to incentivise brokers to focus on simpler loans rather than serve customers with more complex needs or customers who are less familiar with the mortgage market or processes, such as first home buyers;

(c) Ensure the sustainability of the broker channel including by appropriately grandfathering existing arrangements; and

(d) Be applied uniformly. Any unilateral change away from the current arrangements, to which brokers are accustomed and appear to prefer relative to available alternatives, would result in a shift of business towards lenders who supported the status quo. The volume benefits associated with maintaining the status quo would incentivise remaining lenders to retain existing commission structures. Status-quo lenders would experience increased volume at the expense of the first mover, and would learn (from the impact on the first mover) that moving away from the status-quo would significantly impact their businesses. Given this, other lenders would not follow the first-mover, instead rationally choosing to take volume from the first mover, and, as most customers would remain under the current commission structure, concerns about commission structures would remain unaddressed.

130. CBA's submission to the Sedgwick Report noted that:

(a) *"A move to a flat-fee payment would enable brokers to be agnostic towards loan size and leverage."*

(b) *"A move to flat-fee could also consider the removal of 'trail commission's' which can encourage brokers to suggest slower paydown strategies (e.g. interest only) that maximise broker trail commission income."*

(c) *"We would support elevated controls and measures on incentives related to mortgages that are consistent with their importance and the nature of the guidance that is provided. For example, de-linking of incentives from the value of the loan across the industry; and the potential extension of regulations such as Future of Financial Advice (FOFA) to mortgages in retail banking."*

Is the first mover issue identified in CBA's evidence a genuine commercial impediment to change in respect of the structure of broker remuneration? If so, what can and should be done to overcome that impediment?

131. The first mover issue identified in CBA's evidence is a genuine commercial impediment to change in respect of the structure of broker remuneration.

132. The structure of broker commissions have evolved to their current form over many years and the evolution has had benefits for lenders, brokers and customers.

133. For brokers, this evolution has made broking more attractive, particularly in an environment where property prices have increased leading to higher broker incomes. The increase in the attractiveness of broker businesses is reflected in the large increase in the number of brokers in the industry.

134. At present, CBA's broker commissions are typical of the industry in both structure and level. That is, the payment of an upfront commission, linked to loan size, and the payment of an ongoing trailing commission, is also linked to loan size. The level of upfront commission (37.5 to 50bps for CBA Standard Plan) is typically higher than the trail commission (15bps for the first 3 years, and 20bps from year 4 for CBA Standard Plan).

135. CBA believes most brokers are satisfied with the current commission arrangements. CBA offers two commission structures. Both offer upfront and trail commission but in different proportions.

136. Of the two commission structures offered to brokers by CBA, more than 99.5% of brokers choose the one closest to the industry standard (outlined in paragraph 134 above). Few brokers prefer the offered alternative which features, in essence, higher ongoing trail commissions and lower up-front payments.

137. ASIC's review of mortgage broker remuneration also found that this standard commission model is almost universal:

> *Our review identified significant variability and complexity in remuneration structures between industry participants. The common element across all remuneration structures for brokers, however, was a standard commission model made up of an upfront and a trail commission.*

138. The home lending market is very competitive. Many home loan customers will find a number of products suitable for their needs. For example, basic principal and interest loans frequently match up very closely against a range of basic features including, for example, access to a single offset account.

139. Under these circumstances, it is likely that customers will take into account a number of 'extra' features (such as product flexibility, service offerings, locality of branch network, online or phone banking offerings), including the preference of their broker.

140. As similar products are often available, brokers can seek higher commissions while achieving similar customer outcomes. Given this, should a lender move to a lower or less structurally attractive commission structure, brokers could be expected to direct business elsewhere while still meeting their obligations to customers.

141. The likely impact of unilateral action would be for brokers to favour current commission structures and direct their business accordingly, with little impact on customer outcomes. Brokers would redirect customers to lenders who maintain current commissions. The level and nature of broker incomes would remain unchanged and the prevalence of conflicts of interest would remain. In addition, the commercial impact on the first mover would be such that there would be little prospect of action by other lenders.

142. These circumstances mean uniform change is needed for effective commission reform. This could mean, for example, regulation similar to that needed to drive the *Future of Financial Advice* reforms.

Will the programme of reforms in the mortgage broking industry, announced by the Combined Industry Forum in 2017, ameliorate the conflicts of interest or any other issues that have been referred to in this case study?

143. Reforms announced by the Combined Industry Forum (**CIF**) will ameliorate some of the issues referred to in this case study.

144. The CIF has recognised *"the risk of poor customer outcomes as a result of financial incentives that may encourage customers to borrow more than they need."* The CIF has also recognised "*Lender choice conflict: when a broker is incentivised to recommend a loan from a particular lender over another*."

145. This recognition is an important step in industry reform, because it represents the alignment of the major lender and broking industry bodies about the need to reform current incentive structures.

146. The CIF proposes to ensure that commission payments are made on the basis of funds that have been drawn down, rather than funds available to a customer. This change is designed to reduce incentives for brokers to recommend loans with higher limits than are strictly required initially, and will partially but not completely remove the current conflict between brokers and customer interests. The CIF also required the removal of volume-based bonus commissions, campaign-based commissions and volume based bonus payments to brokers, together with the limitation of 'soft-dollar' incentives to $350 per broker, per event.

147. CBA supports the CIF's approach to implementing its reforms, initially through contractual arrangements and internal frameworks before moving to industry-based enforcement mechanisms.

148. However, CBA acknowledges that the CIFs scope of action is limited by the mechanisms through which it can work. In particular, the CIFs ability to coordinate an industry-wide response is limited by regulatory and competition law limitations.

149. As uniform change is key to the effectiveness of reforms, in CBA's view, legal or regulatory changes will be needed to bring about some important changes.

Who does a mortgage broker act for: in law; in fact. Who does the customer think the broker acts for? Who does the lender think the broker is acting for, are there varying or varied answers at various steps? If there are, what are they?

150. In addition to the perspectives incorporated in section A which address CBA's understanding in law and in fact of who the broker is acting as an agent for, specifically that the broker is acting as an agent for the customer except in relation to the Head Group's completion and collection of: customer identification, tax file number disclosure, privacy protection of information forms and any bank account opening application. CBA also offers the following additional observations.

151. Customers believe that brokers are their agents. MFAA research *"Customer Experiences of Using Mortgage Brokers – October 2016",* Deloitte prepared on behalf of MFAA identified that customers choose brokers to help protect their interests. Excluding customers with an existing relationship with a broker, or a personal recommendation, approximately half of the customers choose to use a broker to help provide advice and guidance, as well as price negotiation. The remaining half indicate that they choose brokers to access a safe and secure lender, access the best product range, or for other reasons. It appears reasonable to assume that those customers with a prior relationship with a broker, or a recommendation to a broker, have similar reasons for valuing a brokers' services.

152. Customers assess satisfaction with their brokers as if they are their agents. This is supported by the MFAA research which suggests that 82% of customers evaluate broker actions as being in their interests all or some of the time.

153. Broker firm marketing materials also position brokers as customers' agents. The MFAA website, for example, states: *"The advantage of working with a finance broker is that they have knowledge of a broad spread of products from multiple lenders. Finance brokers endeavour to recommend products that suit the client's needs and objectives."*

154. Similarly, as an example, the Head Group AFG states on its website under the section *"Why use a broker"* the following: "*We work for you and not the bank. We get to know you personally to understand your unique circumstances. From our experience, we know which lenders will have the product that will meet your needs. And we negotiate for what's right for you, not what's right for one particular lender*".

Credit insurance in connection with home loans, personal loans and credit card

Are the processes that financial services licensees have in place for the sale of add-on insurance sufficient to ensure that those entities comply with their obligations under section 912A(1)(a) of the Corporations Act, the obligation to do all things necessary to ensure efficiently, honestly and fairly.

155. CBA's process for the sale of add-on insurance have been strengthened considerably in recent years, and are sufficient to ensure that it complies with its legal obligations. However, this submission in Part A (and in particular, at paragraph 63) acknowledges the specific circumstances in which CBA accepts that it did not comply with its obligations under s 912A(1)(a) of the Corporations Act.

156. It may be useful to provide some further background and context about the sale of CCI products and the regulatory regime which governs such sales.

157. In October 2011, ASIC issued Report 256 "Consumer credit insurance: A review of sales practices by authorised deposit-taking institutions" (Report 256). Report 256 examined in detail the sales practices of 15 ADIs and provided 10 recommendations to industry specifically in relation to the sale of CCI products.

158. The recommendations were premised on an understanding and acknowledgement by ASIC that CCI products are often proactively offered and/or cross sold to consumers when they apply for credit products, and that the sale of CCI products is conducted on a general advice basis which does not include a detailed fact find about consumers. At paragraph 32 of Report 256, ASIC stated that its recommendations reflect best practice.

159. Where ADIs have introduced processes that address ASIC's 10 recommendations in Report 256, CBA considers that those ADIs meet the best practice standards in Report 256 and would therefore be compliant with their obligation to provide financial services in relation to CCI products efficiently, honestly and fairly under s 912A(1)(a) of the Corporations Act.

160. CBA has taken steps to implement ASIC's 10 recommendations in Report 256. CBA's previous omission was in relation to Recommendation 1 that when CCI is sold over the telephone, distributors should have formal scripts in place for their sales staff and these sales scripts should meet 10 specified requirements. One of these 10 requirements is that scripts should include a clear explanation of the main exclusions that apply to the CCI policy (or that apply to each component of the policy where CCI is sold as a packaged product).

161. For CCI sales made in branches, ASIC did not include any specific recommendations, but encouraged distributors to adopt an approach based on Recommendation 1. In implementing the recommendations in Report 256, CBA applied substantially the same processes in branches as were applied to telephone based sales and in CBA's view, this is appropriate to ensure it complies with s 912A(1)(a).

162. There were no recommendations in Report 256 about sales of CCI through digital channels. As consumers increasingly interact with banks online and through other digital means, CBA considers that ASIC's recommendations should be applied (to the extent they are relevant) in relation to those channels.

163. There is no recommendation in Report 256 that sales scripts include a "knock-out question" of the type CBA introduced into its scripting for assisted channels in 2015 and its digital sales channels in 2017. CBA considers the inclusion of a knock-out question is over and above the best practice approach defined by ASIC and is not required in order to meet the obligation in 912A(1)(a) of the Corporations Act to provide financial services efficiently, honestly and fairly.

164. The more recent work undertaken by ASIC that affects CCI sales processes is set out in Reports 470, 471 and 492, all issued in 2016. These reports focus specifically on the sale of insurance through car dealers. While Report 492 states (at para 33) that many of the findings have a broader application to add-on insurance products sold through other channels, the recommendations that relate to sales processes (as opposed to product features) have not

substantively advanced the position in relation to the sale practices of ADIs since ASIC's Report 256.

Are existing legal mechanisms considered in light of the regulatory changes which are anticipated to come into effect under the deferred sales model sufficient to address the issues associated with the sale of add-on insurance to customers identified by ASIC in its report 256

165. In its review of sales practices in Report 256, ASIC identified the following risks:

(a) consumers not being aware that they have purchased CCI or that CCI is optional;

(b) consumers not being asked whether or not they wish to purchase CCI;

(c) consumers not being eligible to claim on all components of the CCI policy they have purchased;

(d) the potential for consumers to be pressured or harassed by sales staff; and

(e) consumers not understanding the cost or the duration of the CCI policy.

166. As part of the review of the Australian Banking Association (**ABA**) Code of Banking Practice currently underway, and following consultation with ASIC and relevant consumer groups, a number of measures are proposed for inclusion in the Code to further improve consumer outcomes.

167. These include the:

(a) adoption of a deferred sales period of four days for the sale of CCI on credit cards in branch or over the telephone; and

(b) separation of application processes for CCI for credit cards and loans sold in digital channels so that:

(i) the availability of CCI will only be referenced after the completion of a digital application for the credit card or loan; and

(ii) enhanced disclosure to make it clear that the purchase of CCI has no bearing on the approval of the credit card or loan and to enable customers to better understand the insurance prior to purchase.

168. CBA supports the introduction of the above measures and believes they will further strengthen sales processes to address the issues identified in Report 256. Indeed CBA believes that these measures should apply to the finance industry generally and not just banks which are subject to the Code of Banking Practice. However, CBA does not consider that these measures are necessary to meet the statutory obligation in s 912A(1)(a) to provide financial services efficiently, honestly and fairly.

169. CBA proposes that the deferred sales period should also apply to CCI on personal loans. The application and approval process for both credit cards and personal loans generally involves a relatively short timeframe from application to approval and funding, so a deferred sales period for these CCI offers will help to ensure consumers have sufficient time to consider if the product is appropriate for their needs. This will further address the issues identified by ASIC in Report 256.

170. CBA does not consider that this measure needs to be extended to CCI on home loans given the application, approval and funding of home loans generally occurs over a more extended period and involves a number of interactions between lenders and consumers thereby giving consumers ample opportunity to review any offers of insurance.

171. CBA also proposes that the measures in relation to the separation of application processes for all CCI products in digital channels should apply to all channels including branch and telephone. While CBA's scripting is already explicit on these points, the separation will further help consumers to understand that CCI is ancillary to the loan application and that approval of the loan is not conditional in any way on the purchase of CCI.

How do financial services licensees ensure that they comply with their obligation under section 912D of the Corporations Act in relation to reporting significant breaches.

172. CBA Group has established systems, policies and procedures to identify, record and manage compliance incidents and to determine whether these should be reported to ASIC under s 912D of the Corporations Act. These have been provided to ASIC in 2017 and produced to the Commission in response to NP-008.

173. Generally, the process in place within CBA is that:

(a) Any compliance "incident" is required to be promptly recorded by the Line 1 business in RiskInsite (CBA's risk management platform), generally within five days of identification;

(b) An assessment of whether the incident constitutes a "breach" of financial services law is then undertaken by Line 2 Compliance. This may require further investigation of the incident to ascertain the facts needed to determine whether a breach has occurred;

(c) Legal advice is sought where necessary, to determine whether a breach of financial services law (as defined in the Corporations Act) has occurred. Legal advice is generally required where the potential breaches identified relate to conduct (such as breaches of the ASIC Act or breaches of licensee obligations in s 912A of the Corporations Act) as the legislation does not define or otherwise clearly articulate concepts such as "efficiently, honestly and fairly" or "misleading or deceptive" and the interpretation of these terms is assisted by an understanding of the relevant case law;

(d) A further assessment is then made to determine whether the breach is "significant" as defined in s 912D and subject to reporting under s 912D of the Corporations Act. Further investigation may be required to complete this assessment to determine whether a substantial number of customers may be impacted or the impact on customers is material and a review of RiskInsite is undertaken to ascertain whether similar breaches had occurred in the past; and

(e) The report to ASIC is made within 10 business days of a determination that a "significant breach" has occurred.

174. Investigation to ascertain the facts required to understand the impacts of an incident and to determine whether this impact is significant can be complex and time consuming. The investigation frequently requires the assessment of data held in multiple systems or in legacy systems and the analysis can require bespoke programming, testing and verification. This can lead to a significant period elapsing between the time an incident is first identified and a determination that a significant breach has occurred. CBA does not pursue this investigation to determine the exact volume of impacted customers or the exact amount of funds affected and will report the breach to ASIC as soon as it assesses that the impact is significant, in line with ASIC's guidance in RG 78. While a determination of a significant breach may sometimes take a long time, and CBA has acknowledged this was the case with the LPP matter, once a determination is made by CBA that a significant breach has occurred, CBA will report this to ASIC within 10 days.

175. Compliance incidents that are not reportable to ASIC under s 912D of the Corporations Act may still be notified by CBA to ASIC as a matter of "good governance". This may occur where:

(a) CBA has identified a material breach of a law or Code administered by ASIC but which is not a "financial services law" and therefore not subject to reporting obligations under s 912D of the Corporations Act, such as a breach of the NCCP Act;

(b) CBA has identified a breach of a financial service law that it does not consider to be significant in light of the meaning of that term in the Corporations Act, but is of the view that breach raises concerns which warrant notifying ASIC regardless; or

(c) CBA has not been able to form a view on whether a breach of financial services has occurred (eg where required data is unavailable), but is of the view that the matter warrants notifying ASIC regardless.

176. CBA's policies and procedures are supported by training and communications to staff regarding the importance of raising incidents and publication and training on policies such as The Group Values Guidelines, The Group Whistleblower Policy and the "Can We? Should We?" decision-making framework.

177. In addition, CBA supports staff members raising concerns by the provision of:

(a) The Group Security Fraud Hotline: to assist staff to report fraud or suspected fraud directly to the appropriate investigations team; and

(b) The SpeakUp hotline: an external telephone and email service for CBA staff to raise issues they do not wish to raise through normal reporting lines.

Personal Overdrafts

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

178. CBA relies on automated serviceability calculators, coupled with processes that identify sensitive or high risk applications (such as those from customers living in remote locations) that are subject to additional manual checking once they pass the automated tests of serviceability. CBA considers that these measures are adequate to ensure that it complies with its obligations under s 133 of the NCCP Act.

179. Except in a limited way, the NCCP Act does not prescribe the process that lenders should use to determine whether the credit contract being provided to the customer is unsuitable. The limited prescription is provided in:

(a) subsection 133(4) which requires the assessment to be based on the information obtained from the reasonable inquiries undertaken by the lender and which information the lender has reason to believe to be true (or would have had reason to believe was true if the lender had made the inquiries or verification); and

(b) other subsections that establish presumptions of unsuitability that apply in certain specific circumstances.

180. In RG 209.102, ASIC provides guidance that it expects lenders to develop appropriate systems and processes to identify whether a proposed credit contract is likely to cause substantial hardship to a consumer. ASIC specifically acknowledges that different licensees are likely to take different approaches, depending on the nature of their business and their range of customers. RG209 is technology agnostic but there is an expectation that where lenders rely on automated processes, those lenders should monitor their systems to ensure they are, and remain, fit for purpose.[128]

181. CBA considers that in the context of a bank which deals with a substantial volume of credit applications each month, it is appropriate that the majority of applications (particularly those for relatively small amounts of credit) are processed using automated processes. Automation is not only efficient in delivering a fast turn-around for customers at a reasonable level of cost, but it ensures consistency and quality in decision-making. Moreover, with advances in technology (such as the development of artificial intelligence), and regulatory changes (for example the introduction of mandatory comprehensive credit reporting) automation is likely to enhance the decision making process and regulatory compliance.

182. Unfortunately, errors can occur in both automated and manual processes. Generally, CBA considers manual processes to be more susceptible to human error and less likely to ensure a consistent outcome.

183. The error that caused CBA to incorrectly assess applications for personal overdrafts, at its core, was caused by human error, not the failure of CBA's system. In particular, the developer made an error when writing the code used to program CBA's serviceability calculator for personal overdrafts. The system then correctly delivered outcomes in accordance with the coding that was programmed by the developer.

[128] See paragraph [93] above for an overview of CBA's systems and processes.

Credit Cards

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

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

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

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

184. CBA considers that it does have adequate policies to ensure it complies with its responsible lending obligations under the NCCP Act.

185. The NCCP Act and ASIC's RG 209 are not prescriptive about the nature of inquiries or verification that must be undertaken by lenders. RG 209.19 explicitly recognises that these obligations are "scalable", meaning the extent of inquiries and verification may vary depending on the circumstances. ASIC has provided guidance in RG 209 on the factors relevant to scalability, which include the potential impact on consumers of entering into an unsuitable credit contract, the complexity of that contract, the capacity of a consumer to understand the contract and whether a consumer is an existing customer or a new customer.

186. In line with this guidance, CBA has applied different standards for inquiries and verification in the following circumstances:

(a) Where providing unsecured, relatively low value and well understood credit products such as credit cards, CBA undertakes fewer inquries and takes fewer verification steps compared with home lending (which typically involves large sums and long terms and where an unsuitable loan can result in the loss of a borrower's home);

(b) CBA will conduct a more limited range of inquiries and verification steps when offering credit cards to existing CBA customers or when increasing credit limits for existing credit card customers. Instead, CBA may rely on information that is already known to CBA. For new credit cards, CBA may use information it holds about customers' income, existing CBA loans and customers' repayment history in its assessment. For CLIs, CBA will consider customers' repayment history on their existing credit card to determine their capacity to service a higher limit as well as confirmations by the customer that they are still employed, and their level of disposable income; and

(c) Conversely, where the required information is not known about existing customers, or where available information suggests that customers may be more vulnerable if they obtain an unsuitable contract (for example, where customers have previously defaulted on repayment of other credit products or already have significant unsecured debt), CBA may make more inquiries and conduct additional checks.

187. In relation to inquiries concerning the customer's requirements and objectives, the Explanatory Memorandum to the NCCP Act states that as credit cards do not have any particular purpose, there is a limited requirement to understand the customer's requirements and objectives[129]. ASIC has stated in RG 209.37 that it expects lenders to make inquiries about the limit the customer requires on their credit card.

188. In addition to inquiries relating to the customer's desired credit limit, CBA staff discuss with customers the features of different credit card products (eg fees and interest, reward programs

[129] Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 – Example 3.5 given to paragraph 3.139.

and other benefits). Different credit cards may be offered to customers depending on whether customers expect to be "transactors" or "revolvers" ie whether they will be paying off the full balance outstanding within each monthly statement period or paying off a smaller amount and carrying the balance over to the next period.

189. Increasingly, customers are applying for credit cards through digital channels and banks have developed online content and tools such as CBA's Card Selector Tool to assist consumers to select a product that best meets their requirements and objectives.

190. CBA continually assesses its policies and processes in light of changing regulatory and community expectations. Currently, CBA obtains credit bureau checks as a standard inquiry for credit card applications. In due course, CBA will be incorporating the use of improved comprehensive credit reporting bureau information, which will provide further useful information regarding a customer's financial circumstances, including their repayment history on loans with other financial institutions. CBA believes this will go further in helping strengthen the industry as a whole, with regards to responsible lending practices.

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

191. ASIC's RG 209 specifies (consistently with the decision in *ASIC v The Cash Store (in liquidation)* [2014] FCA 926) that reasonable inquiries about a consumer's financial situation will generally include:

(a) the consumer's amount and source of income;

(b) fixed expenses such as rent and repayment of debts; and

(c) variable expenses such as food and utilities (basic expenses) and drivers of these expenses, such as dependents and any unusual circumstances.

192. In relation to discretionary expenses, such as entertainment, take away food and alcohol, ASIC guidance as specified in RG 209.33 is that these may be included in reasonable inquiries depending on the circumstances of the consumer and the kind of credit contract involved, but this is not mandated.

193. "Reasonable inquiry" about expenses has generally been satisfied by asking customers about all their expenses, including basic and discretionary living expenses, and applying a minimum floor for living expenses based on an appropriate index.

194. The index is used to take account of the tendency of customers to underestimate their living expenses in credit applications, even when questions about expenses are broken down into multiple categories. To assist its customers monitor expenditure, CBA has developed new digital tools, such as Spend Tracker. Spend Tracker categorises CBA customers' debit and credit card transactions into different spending categories (such as groceries, health, entertainment) to help them understand their expenditure patterns.

195. CBA does not have visibility of customers' transactions made on accounts with other financial institutions which is a constraint on the ability to use this information for responsible lending purposes. In the meantime, CBA uses the customer's estimate of their living expenses in its calculations only when customers advise CBA of living expenses that are above the index.

196. The index currently used by CBA is Income scaled HEM, which is comprised of the 50th percentile (or median) expenditure on basic expenses and the 25th percentile discretionary expenditure of 100,000 consumers periodically surveyed by the Melbourne Institute, scaled against income levels and published on a quarterly basis.

197. Our understanding is that the industry has historically used other benchmarks such as the Henderson Poverty Index. The Income scaled HEM currently used by CBA sets a floor on

living expenses that is modest, but above the level of "substantial hardship" as it includes some discretionary expenditure, which consumers would generally be able to give up if required.

198. When considering policies and procedures for ensuring that reasonable inquiries are made into customer's discretionary expenditure, it is important to bear in mind the standard for determining that a product is not unsuitable for the consumer. The current legislative standard is that the customer must be able to service the loan "without substantial hardship". It is reasonable to expect that a customer experiencing substantial hardship would cease most, if not all, discretionary expenditure and concentrate on basic spending for items such as groceries, utilities, transport, etc.

199. A different examination of discretionary expenditure would need to be considered in the context of whether the current "without substantial hardship" standard is appropriate or whether a higher standard such as, for example, "without having to materially reduce current expenditure" or "without having to reduce current standard of living" would be more appropriate.

200. It is not clear that this would be a better standard for consumers, as many consumers are able to modify their discretionary spending and are motivated to do so when applying for credit. Any raising of the standard would have a significant impact on the availability of credit and while this may benefit some consumers, it will negatively impact others. The macro effect on the economy of the overall reduction in the availability of credit would also need to be taken into consideration.

201. CBA believes it is appropriate to utilise an independent benchmark as a floor for customers' living expenses. We also note that it is appropriate to have asymmetry between inquiries and verification requirements for income versus expenses. This is because customers cannot easily adjust their income but are able to adjust their expenses more readily.

202. APRA is currently working, together with the banks, to determine if benchmarks should be raised to a level above the current standard of determining a financial position which is "without substantial hardship". Current benchmarks have been designed to satisfy this standard. These benchmarks could be adjustable by APRA, and could become a prudential and monetary policy lever to be able to slow lending without adjusting headline interest rates and impacting business lending.

203. CBA also supports the position set out in RG 209.100 that credit providers be able to have conversations with applicants about cutting back on non-essential expenditure (i.e. discretionary expenses) in order to be able to afford a loan.[130]

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

204. For the reasons outline below, CBA does not consider that it is necessary, or that it would be effective, for it to inquire into the expenses incurred by a customer on accounts held with CBA, in order to comply with its responsible lending obligations under the NCCP Act.

205. While banks have some of this data about existing customers, it will rarely have a complete picture of expenditure for a customer, which risks an underestimation of expenditure being made by the bank. CBA considers that outgoings from a CBA transaction account and/or a CBA credit card are often a poor starting point for estimating expenses. This is particularly the case where customers bank with multiple financial institutions and therefore any one institution

[130] RG 209.100 states: *In addition, you may wish to take into account any other conversations that you have had with the consumer about how the credit contract or consumer lease will affect their living standards. For example, a consumer may be willing to make reasonable changes to their lifestyle to enable them to afford a loan without substantial hardship (such as cutting back on non-essential expenses).*

does not have a complete view of a customer's transaction activity. While this will improve with the introduction of Comprehensive Credit Reporting and Open Banking by enabling customers and financial institutions to share more information, it will take some time for systems and tools to be developed to create holistic views of customers' financial information across institutions.

206. In particular, it is at this point in time challenging to correctly distinguish basic spending from discretionary spending by looking at a customer's transaction history. This is because:

(a) It is difficult to work out the nature of goods and services delivered by different merchants since this information is often not captured in transaction descriptions;

(b) Cash withdrawals may be used for either basic or discretionary expenditure; and

(c) Purchases in many general stores or online outlets can be for either basic or discretionary spending.

207. Even if transaction history on existing accounts was a good starting point, there is the potential for unintended outcomes, for example incentivising customers who would like to borrow to either conceal expenses from their accounts, driving up the cash economy, or approaching lenders who know least about the customer for credit. Neither are good outcomes for customers.

208. CBA is innovating to help customers manage their spending and save more with tools such as Spend Tracker. Customers who most need to manage their spending will have a disincentive to use these tools if they perceive the information will be used to limit their access to credit.

3 April 2018