Confidential

Westpac Banking Corporation - General Submissions

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

3 April 2018

200 | Westpac GROUP

GENERAL SUBMISSIONS

WESTPAC BANKING CORPORATION

INTRODUCTION

1. This submission is provided by Westpac in response to the Commission's invitation following the Consumer Lending phase of the hearings, and accompanies our submissions in respect of the case studies on credit card limit increases and auto finance.

2. In general terms, Westpac recognises that the Commission is likely to identify that, in respect of the case studies and general information provided during the Consumer Lending phase, Westpac has made mistakes and that misconduct has occurred, in some cases with serious consequences for the customers involved. Westpac regrets these incidents and accepts that in many cases more could have been done to prevent them from occurring. At the same time, Westpac submits that it should also be found that Westpac has demonstrated over a number of years that it is committed to:

   a. identifying misconduct or mistakes where they occur;

   b. ensuring that the issues for the customer are remedied;

   c. identifying root causes and moving to modify systems and processes to prevent recurrence;

   d. working with regulators and industry bodies to address matters that stem from industry- or market-wide dynamics or structural issues that are difficult for one competitor to resolve on its own.

3. Westpac further assures the Commission that this commitment will continue.

4. More broadly, Westpac observes that the case studies that the Commission has examined have highlighted important matters of principle in the complex area of consumer lending, which the Commission may wish to consider in more detail as its work progresses. These issues, a number of which have been raised in Closing Submissions or through the hearing, include:

   a. how to ensure greater transparency for customers, particularly when dealing through intermediaries;

   b. the ongoing role and emphasis on disclosure in the regime governing the sale of financial products;

   c. the role and responsibility of the consumer in applying for credit, including the extent to which information they provide should be relied upon relative to benchmarks or other data held by the relevant bank;

   d. the extent to which regulation should extend to cover third parties, to ensure appropriate customer outcomes; and

   e. the impact of regulation, including responsible lending laws, on the availability and cost of finance for consumers.

5. Westpac looks forward to assisting the Commission to address these matters as its work progresses.

A. BROKERS

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

6. Mortgage brokers are typically remunerated through the payment of both upfront and trailing commissions. This system has developed in the home lending market over time as a way to compensate brokers for the work that they undertake and to support alignment between the interests of the customer, the broker, and the mortgage provider. Payment of an upfront commission compensates the broker for their work in originating the loan. Payment of a trailing commission is intended to promote an ongoing relationship between the broker and customer.

7. Broker fees are paid to the broker by the bank rather than directly by the customer. This spreads the broker cost to the customer over time, but also means that customers may not fully understand how the broker cost affects the total cost of their loan over its lifetime.

8. For brokers, different remuneration structures have the potential to lead to poor customer outcomes if they have the effect of encouraging brokers to recommend:

   a. a higher value loan than is appropriate for the customer (in order to maximise commission payments to the broker);

   b. a loan with a particular lender (because the broker will receive a higher commission rate from that particular lender); or

   c. a new loan (such as through refinancing) where the customer outcome is not improved, in order to trigger multiple commissions on essentially the same loan. (For example, a customer might be encouraged to refinance at a notionally lower interest rate, but not realise that this would involve extending the term of their loan or the amount of their borrowing.)

9. Westpac seeks to minimise these risks through a number of “claw back” mechanisms in its broker agreements. These mean that brokers have an incentive to understand a customer’s financial position and recommend loan products and amounts that are not unsuitable. These include:

   a. claw back of 100% of upfront commission if the loan is closed within 12 months, and 50% if the loan is closed within 12 to 24 months (outside of closure because of unforeseen events);

   b. cancelling trailing commission if the loan falls into arrears; and

   c. trailing commissions paid on the amount drawn down rather than the loan limit, net of offset amounts. Westpac also favours an industry move to claw back in the event of a default within 2 years that would be payable to the customer.

10. Westpac also no longer pays volume-based incentives, bonus commissions or bonus payments to brokers, which further reduces the possibility of brokers making inappropriate loan recommendations because of remuneration structures.

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

11. For the reasons set out above, Westpac does not consider that remuneration based on upfront and trailing commissions necessarily leads to poor customer outcomes, but considers the issue involves a slightly more complex interplay between the structure of the payment, the manner in which it is disclosed to the customer and the current mechanism of indirect payment by financiers to the broker instead of payment direct by the customer to the broker for their services.

12. There may be potential adverse customer outcomes associated with adopting an upfront flat fee under the existing payment structures in which the fee is absorbed by the financier as part of the overall mortgage costs. Some examples of potential adverse consequence of a change of that kind could include:

    a. customers would likely be charged higher upfront costs than today, which might make it more difficult for some customers to access finance;

    b. brokers may encourage customers to change lenders in circumstances where that is not in the customer's interests, in order to earn multiple upfront flat fee payments;

    c. absent trailing commissions, brokers may have less interest in ongoing customer service and ensuring that a customer continues to meet their ongoing obligations under the loan, potentially leading more customers to have difficulty servicing their loans;

    d. brokers may be discouraged from facilitating more complicated or time-consuming lending. This may have a particular impact on support for first home buyers, who typically require more upfront effort from brokers.

13. Many of those issues would be less pronounced if the 'upfront' fee was paid direct to brokers by the customers rather than indirectly through the financier.

Is the first mover issue 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?

14. If lenders were to implement different methodologies for remunerating brokers, any 'first mover' would be disadvantaged if the alternative methodology adopted resulted in brokers earning less remuneration in respect of that lender's products. What is more significant from a policy perspective is that brokers would be encouraged to favour products which generate a higher level of remuneration. That is to say, customers may see no improvement, but suffer adverse outcomes, due to increased incentives on brokers to sell other, not necessarily better, products.

15. Westpac has been an active participant in the Combined Industry Forum (**CIF**), which includes industry bodies, lenders, mortgage brokers, aggregators, introducers and consumer groups, since May 2017 and through that forum continues to seek to find mechanisms to address perceived payment structure issues in the market.

Will the program of reforms in the mortgage broking industry ameliorate the conflicts of interest or any other issue identified in the CBA case study?

16. Westpac supports current reform in the mortgage broker industry, and is committed to implementing each of the recommendations in the Retail Banking Remuneration Review prepared by Stephen Sedgwick AO (**Sedgwick Review**). In addition to changes to remuneration in banks, the ABA convened the CIF, bringing bank representatives together with representatives of the mortgage broking industry to address the recommendations of the Sedgwick Review and ASIC Report 516 review as they relate to mortgage broker remunerations. In December 2017, the CIF outlined a set of reforms including changes to remuneration and the introduction of a system of governance, monitoring and reporting to ensure that customer outcomes can be continuously assessed.

17. The latest McPhee report (January 2018) indicated that Westpac has made good progress on meeting the recommendations of the Sedgwick review and Westpac sees those as well aligned to its vision and culture.

18. Westpac recognises the potential for conflicts, however, it does not consider that current remuneration structures necessarily result in poor customer outcomes. It remains of the view that

implementation of the Sedgwick Review recommendations, and other industry reforms, is likely to reduce further the risk of conflicts involving brokers and rebuild trust in the industry.

19. Consistent with the Sedgwick Review, Westpac is in favour of greater transparency and clearer disclosure of the commissions and fees paid to brokers and the effect of those commissions and fees on the ultimate charge to the customer. The Commission may also consider whether brokers charging customers directly for their services might enhance transparency and competition for customers. Potential second order impacts of this type of structural change would need to be considered carefully.

Who does the mortgage broker act for?

20. Brokers are instructed by and act on behalf of the customers.

21. Westpac has direct contractual arrangements with aggregators. Those agreements make it clear that there is no relationship of agency between Westpac and those aggregators.

22. Westpac accredits brokers, but the aggregators that Westpac has a contractual relationship with are responsible for managing broker conduct and requirements.

Who does the customer think the broker is acting for?

23. Westpac considers it unlikely that customers would think that the broker acts for the lender, rather than for the customer or for themselves as an intermediary or arranger. The broker's independence from the lender is one of the things that customers value about brokers (for example, because they offer access to products from multiple lenders). To the extent that there is any customer confusion in this regard, such confusion is unlikely to disadvantage any customer. That is because the customer is likely to consider a broker's recommendation more carefully if they thought that the broker was acting on the lender's behalf.

Who does the lender think the broker is acting for?

24. Westpac's position is that the broker acts for the customer.

Do you give separate answers for each of the above at separate steps?

25. There is one exception to the position outlined above, where the broker acts on behalf of Westpac for the limited purpose of performing customer identification verification checks in the home loan application process in the St.George brand (for example, as required by anti-money laundering and counter-terrorism financing legislation).

26. Subject to that, Westpac considers that the position is clear and consistent throughout the process.

Whether credit providers have adequate policies to comply with responsible lending obligations in relation to broker-originated home loans[1]

Westpac Group Policies

27. Westpac's Australian Consumer Responsible Lending Policy[2] and the Responsible Lending Policy Manual (**Responsible Lending Manual**)[3] set out Westpac's minimum standards for responsible lending across the Group, including in the context of broker-originated home loans. This policy and manual have recently been adopted to provide Group-wide principles that complement the responsible lending obligations incorporated into divisional and product-specific policies, and Westpac is in the process of implementing them across the Group.

[1] In response to the question identified by Counsel Assisting at T991:44-T992:4.
[2] Ex. 1.141 (Witness Statement of Phillip Godkin dated 5 March 2018 Ex PG1-31) WBC.300.055.7113.
[3] Ex. 1.141 (Witness Statement of Phillip Godkin dated 5 March 2018, Confidential Ex PG1-C32) WBC.300.057.1013.

28. The Responsible Lending Manual sets out Westpac's approach to making inquiries about a customer's requirements and objectives and includes detailed provisions setting out the minimum inquiries that must be made in respect of applications for home loans; home loan credit limit increases; home loans with interest only periods and lines of credit secured over residential property; and low doc home loans. Where there are gaps in the minimum information required, Westpac requires further inquiries be made to ensure the responsible lending requirements are met.

29. The Responsible Lending Manual outlines Westpac's approach to making inquiries of a customer's financial situation. The minimum information requested includes: information about a customer's income; details of a customer's current employment arrangements; details of a customer's expenses and circumstances that drive those expenses; expected changes to the customer's financial circumstances; information about how the customer proposes to meet any balloon repayment or the repayment of an overdraft or line of credit; in respect of customers approaching retirement age, the arrangements they have in place for retirement; and information about the customer's assets and liabilities. Circumstances that warrant further inquiries about expenses are also identified.

30. The Responsible Lending Manual also sets out the minimum standard for verification of a customer's financial situation. A customer's income and employment status is required to be verified in accordance with the Income Verification Standard in Attachment C of the Manual.

31. Apart from obtaining signed declarations from customers, Westpac does not generally independently verify living expenses. Customer living expenses are inherently difficult to verify. In circumstances where a customer inadvertently or deliberately understates their expenses, it is not possible for the financier to identify with precision and confidence what the customer's true expenses are because the bank does not have access to the records necessary to establish the true position. While Westpac's policy is to check other Westpac accounts the customer has, the customer may have other bank accounts or cash expenses which might materially alter the position and there is no current source it can utilise to discover all of a customer's accounts. Westpac supports open banking reforms (discussed in more detail in section 6.1 of Westpac's submissions on its credit card limit increases case study), which will improve banks' ability to assess customer expenses.

32. Expenses also fluctuate significantly with the effect that a person's expenses in any particular period may not be a good indicator of what they may be in another period. Some customers may understate or overstate their expenses and some customers in need of finance may deliberately understate their expenses.

33. For all new credit contracts and credit limit increases in respect of existing credit contracts, in addition to obtaining the customer's estimated expenses and requiring that the customer declare that the estimate is accurate, Westpac benchmarks the customer's declared living expenses against the corresponding "Modified HEM" figure. Modified HEM is a modified version of the Household Expenditure Measure (**HEM**) developed by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne (**Melbourne Institute**). Modified HEM and its use by the Westpac Group is discussed in more detail below.

Intermediaries

34. Westpac deals with intermediaries in connection with proposed credit contracts and proposed credit limit increases. Westpac relies on information provided by customers to intermediaries to satisfy its responsible lending obligations. The *National Consumer Credit Protection Act 2009* (Cth) (the **National Credit Act**) does not require the "reasonable inquiries" to be made by the credit licensee directly of the consumer. ASIC has acknowledged that a credit provider can comply with its obligations by making inquiries of a third party intermediary who has made direct inquiries of the

consumer. When relying on information provided from the third party intermediary, a credit provider has an obligation to ensure that it has sufficient information from that third party to comply with its own obligations and that the information is reliable. Accordingly, the processes and controls in place to ensure the adequacy and reliability of the information provided are important.

35. Westpac has in place a number of policies, procedures and controls to ensure intermediaries make all relevant inquiries regarding the customer's financial circumstances and requirements and objectives, reliably record the results of those inquiries and convey the information obtained to Westpac. The controls include: induction and ongoing training programs; maintenance of training materials, schedules and requirements; monitoring of calls in the call centre; and due diligence as part of broker accreditation, including to ensure that brokers have robust compliance arrangements. Additional controls for all intermediary introduced deals include detailed requirements and objectives quality assurance checks carried out before settlement.

APRA's Targeted Review of the Westpac Group's controls

36. In May 2017, APRA delivered its Targeted Review of Westpac's controls to ensure completeness and accuracy of borrower financial information used in assessing serviceability of residential mortgages.[4] As a result of the Targeted Review, Westpac determined to make changes to its online origination system for home loans to enhance the controls used in the collection of customer declared expenses and liability commitments. Those controls are being progressively implemented across the Group, beginning in December 2017, with completion scheduled in July 2018. For example:

    a. questions relating to expenses were expanded from 6 categories to the following 13 categories: (i) childcare; (ii) clothing and personal care; (iii) education; (iv) groceries; (v) insurance; (vi) investment property utilities, rates and related costs; (vii) medical and health; (viii) owner occupied property utilities, rates and related costs; (ix) recreation and entertainment; (x) telephone, internet, pay TV and media streaming subscriptions; (xi) transport; (xii) rented property utilities and related costs; and (xiii) other;

    b. system prompts relating to expenses were introduced so that when (for example) certain assets are added to the system (including real property or motor vehicles), related expense fields are required to be completed, and when the number of dependents is added to the system, fields relating to education and childcare are required to be completed;

    c. some of the fields relating to expenses, including in respect of "groceries", "clothing and personal care", and "recreation and entertainment", were made mandatory so that where a value of "$0" is entered, an explanation or reason must also be provided to justify that estimate. That explanation or reason is reviewed by the hindsight quality assurance teams;

    d. for applicants who describe themselves as renting, boarding or living with their parents, minimum amounts were included for rental-outgoings and board-outgoings; and

    e. each household must have at least one Owner Occupied Property expense or Rented Property expense.

[4] Ex 1.190; WBC.300.005.0098. Note that he completeness and accuracy test used by APRA is a different test to the standard imposed by responsible lending obligations.

Conclusion

37. Westpac's policies and processes in relation to the inquiries into and verification of a customer's financial situation are, in all the circumstances, reasonable and fulfil the Westpac Group's obligations under s 128 of the National Credit Act. Further, having regard to the policies, processes and controls that Westpac has in place to ensure compliance with its responsible lending obligations, including in relation to the role of intermediaries, the Commission can be satisfied that Westpac has adequate policies in place to ensure compliance with its responsible lending obligations in the context of broker-originated loans.

B. HEM AND THE USE OF BENCHMARKS

38. This part of the submissions addresses questions relating to the use of expense benchmarks, in particular, Modified HEM. Westpac uses the Modified HEM benchmark as part of its overall suitability assessment process, as a method of checking expenditure figures declared by customers and to ensure that the figures used in that assessment are robust. As discussed below, in light of the inherent difficulties of identifying expenses (and estimating future expenses), Westpac considers that the use of the benchmark is appropriate, and supports ongoing work in the industry to ensure the benchmark operates effectively.

Introduction to HEM

39. HEM is an independent measure for the living expenses incurred by Australian households. HEM was constructed by the Melbourne Institute using data collected in the Australian Bureau of Statistics Household Expenditure Survey, which is conducted from time to time. HEM is calculated as the sum of: median expenditure on absolute basic expenditure items (such as food purchased in supermarkets); and, the 25th percentile of expenditure on "discretionary basic expenditure" (which includes, for example, restaurant meals and domestic holidays), but excludes "discretionary non-basic expenses".

40. The information is displayed in the form of a table. A specific measure is referrable to four main categories of information, being: (i) relationship status; (ii) dependents; (iii) income; and (iv) geographic location.

41. Westpac has made some modifications to the Melbourne Institute's HEM for use in lending decisions, all or some of which are applied to certain types of lending, including all secured lending. Those modifications include the following:

    a. HEM, as it is provided by the Melbourne Institute, includes two categories for a person's relationship status, being "single" or "couple". To allow for a borrowing structure that does not include both spouses as co-borrowers (that is, one spouse is the sole borrower for the loan, but they share household expenses with another), Westpac has created a HEM category based on borrower type and relationship status.

    b. HEM caters only for households of three dependents or fewer, and categorises dependents from 0-24 years of age. Westpac extrapolates the table to account for households with any number of dependents and dependents are categorised as between 0 - 18 years of age.

    c. HEM caters for income brackets, the last of which is "more than $200,000 per annum". The average expenditure under that income bracket is not in line with incremental increases observed between other income brackets. This is because the Melbourne Institute has used the results of the surveys from all income brackets above $200,000 and combined them, rather than continuing the incremental increase used for all pervious income brackets. To more accurately account for incomes above $200,000, Westpac has extrapolated the incremental steps, adding a further five income brackets up to a maximum income of HEM $530,002 per annum.

42. In these submissions, reference to “Modified HEM” is a reference to Westpac’s extrapolation of the measure provided by the Melbourne Institute as explained above.

Is the use of the HEM benchmark an appropriate way to deal with the difficulties associated with securing an accurate assessment of living expenses from a Customer?

43. For all applications for new credit contracts and credit limit increases for existing credit contracts, Westpac benchmarks the customer’s declared living expenses against the corresponding Modified HEM figure. The customer’s verified income is used in determining the appropriate Modified HEM income band. In undertaking this benchmarking, an allowance is made for customers living in a remote location. Except where the customer lives in a remote location, Westpac’s current practice is that it uses the higher of the customer’s declared living expenses (as adjusted as a result of any further inquiries made in accordance with the Responsible Lending Manual) and the corresponding Modified HEM figure. Where the customer lives in remote location, Westpac, in performing its serviceability assessment, uses the higher of the customer’s declared living expenses and the corresponding Modified HEM figure increased by a percentage set by the Credit Team to reflect the higher living expenses of persons living in remote locations.

44. Modified HEM is used as a check within the overall suitability assessment process, having regard to the particular difficulties involved in obtaining satisfactory evidence of a customer’s actual average living expenses. Westpac’s data indicates that around 81% of loans originated by Westpac in the 12 months to February 2018 had declared expenses that fell below the Modified HEM benchmark. Put another way, around 80% of customers estimate their actual expenses to be lower than the Modified HEM measure. Accordingly, Modified HEM provides an important objective standard. Where customers intend to reduce their expenses in order to afford a loan, Modified HEM can be used to assess whether those intentions are realistic.

45. Westpac submits that in the context of its expense inquiries and overall suitability assessment processes, the use of Modified HEM is appropriate to assist in obtaining an appropriate measure of a customer’s likely expenses. That is particularly so given that the suitability assessment involves an estimation of expenses, and, as discussed, there are inherent difficulties in obtaining accurate or complete information about a person’s actual living expenses, and, further, in determining which of those expenses are basic living expenses and which are discretionary).

Is use of the HEM benchmark appropriate in assessing whether a loan is unsuitable for a customer?

46. Westpac’s suitability assessment involves: (i) considering the ability of each customer to comply with his or her financial obligations under the relevant credit contract without substantial hardship (or likely substantial hardship); (ii) considering whether the credit contract will meet with the customer’s requirements and objectives; and (iii) determining whether, having regard to the customer’s financial situation, requirements and objectives and the maximum credit limit required, the credit contract is “not unsuitable” for the customer. The assessment is directed at determining whether the customer would be able to comply with their financial obligations without substantial hardship. In considering how HEM is used and what inquiries are made of customers’ expenses, it is important to recognise that the ‘without substantial hardship’ standard does not preclude taking into account that a customer may adjust discretionary spending if taking out a large loan, such as to purchase a house.

47. Modified HEM is just one factor taken into account in assessing whether a loan is not unsuitable for a particular customer. In addition to the Modified HEM figure (if applicable), Westpac's serviceability assessment takes into account other expense information, including: a nominal amount for rent or board; any HECS/HELP Debts; costs associated with particular income types (such as strata fees, maintenance costs, and managing agent's fees associated with rental income); amounts payable in relation to credit cards, overdrafts and lines of credit, loans with "no repayment" periods and structured repayments, margin loans, possible changes to the financial situation of the customer). In undertaking the serviceability assessment. Westpac also builds in buffers to the assumed monthly repayment obligations including to allow for possible future interest rate rises.

48. In addition, HEM is a median measure of non-discretionary expenditure after rent or loan repayments plus the 25th percentile of discretionary expenditure. By definition, 49 per cent of households will spend less than HEM allows on basic non-discretionary expenditure, and 24 per cent will spend less than HEM allows on discretionary expenditure.

49. Another measure which may act as a guide to the reasonableness of deploying a benchmark like HEM or Modified HEM as part of responsible lending practices is the measure of loan delinquencies. High loan stress could be an indicator that inquiries made in the serviceability assessment are not fulfilling their purpose. The data does not bear that out. The 90 days delinquency rate on home loans across the Westpac group is 0.7%. Lending is cyclical and one might expect delinquencies to increase if the economy was in more restricted circumstances, though, increased loan stress in a downturn would most be caused by reductions in income rather than increased expenses. The low level of delinquencies suggests that to the extent the use of expense benchmark measures like HEM or Modified HEM has impacted credit decisions, it has not done so adversely or is in fact functioning very well.

50. Westpac submits that the use of Modified HEM in conjunction with the other factors taken into account in the suitability assessment is appropriate in assessing whether a loan is "not unsuitable".

Is the HEM benchmark too conservative a measure of a customer's living expenses?

51. HEM as determined by the Melbourne Institute (which is the basis of Westpac's Modified HEM) is regularly updated by way of indexing to cost of living increases to keep pace with the cost of living during the intervals between the ABS surveys. For the reasons outlined above, Westpac thinks it is an appropriate measure that operates effectively within Westpac's assessment process.

52. While Westpac is of this view, it is also committed to continue to work with APRA to ensure that it is kept up to date and remains a reliable measure. In saying that, it must be borne in mind that given the importance of HEM in most banks' lending processes, alterations in the application of HEM can have significant impacts on the availability of finance to some members of the community. Small changes can have disproportionate impacts on total credit approvals and the pace of the economy more generally. For these reasons, Westpac believes that the appropriate way to consider and regulate the use of benchmarks such as HEM will be through discussions with APRA following detailed and considered economic evidence and lending data.

Whether there is a risk that use of HEM will lead to brokers failing to make reasonable inquiries[5]

53. Westpac accepts that brokers are generally aware that, as part of the suitability assessment for most finance applications, Westpac will apply a Modified HEM measure where that is higher than declared expenses. While that knowledge may influence the care with which the broker obtains expense information, Westpac has a number of policies and processes in place to train and monitor the

[5] [5] In response to the question identified by Counsel Assisting at T992:10-15.

performance of brokers against their responsible lending obligations (see paragraph 34 above), as well as the additional controls introduced to Westpac's online origination system (see paragraph 35) above, such that Westpac considers the risk to be low.

54. In particular, it is to be noted that home loan applicants are required to complete their own paper application form, which includes specific questions about the various categories of living expenses. That form is then provided to the mortgage broker, who inserts the information into the electronic origination system. The applicant's paper form is submitted with the supporting documentation and checked against the information inserted into the electronic origination system. For that reason, there is a lower risk that mortgage brokers will deliberately misstate an applicant's living expenses when entering information into the electronic system.

Practice of defaulting to the use of HEM when declared expenses are lower than HEM[6]

55. As explained above at paragraph 45, Westpac considers the use of Modified HEM to be a useful tool to assist in obtaining an appropriate measure of a customer's likely living expenses, as part of its customer inquiry and verification processes. In using Modified HEM, Westpac still makes reasonable inquiries of customers; Modified HEM is one part of the assessment process (having regard to the particular difficulties of verifying a customer's living expenses). It is notable that in RG209.49, ASIC specifically contemplates the use of expense benchmarks in this way.

56. The policies and processes in place to give effect to Westpac's obligations to take reasonable steps to verify a customer's financial situation are set out above at paragraphs 27 to 37, and in more detail in the Responsible Lending Manual. Modified HEM is a prudent check of a customer's declared expenses and a safety net where that estimate is below what Westpac calculates to be a safer estimate.

57. Westpac submits that the use of Modified HEM where declared expenses are lower than the corresponding Modified HEM figure is consistent with Westpac Group's statutory obligations.

Is the use of any benchmark suitable?

58. For the reasons set out above, Westpac submits that the use of a reasonable benchmark, as part of its overall assessment process, is appropriate and consistent with its statutory obligations. .

Judging home loans on a measure of UMI[7]

59. Westpac is of the view that the current approach, which essentially comprises a tailored estimate of expenses, benchmarked against national statistics, remains appropriate but should be kept under regular review.

60. Westpac is participating in an industry-led initiative to review options for the assessment of customer expenses. The review will be informed by independent review of individual bank data, analysis of potential customer impacts on outcomes and access to finance and consideration of the potential economic consequences. Westpac believes this will be the most appropriate process to inform options as to whether a more appropriate standard estimation of household expenses can be found and any impacts implementation of such options may have for customers, banks and the economy.

[6] In response to the question identified by Counsel Assisting at T976:43-46.
[7] In response to the question raised by the Commissioner at T992:17-26.

C. WAIVER OF RESPONSIBLE LENDING POLICY

Do banks too readily permit waivers of their policies in connection with assessment of home loan applications, including policies in relation to the assessment of serviceability of the loan?

Circumstances in which Westpac waives credit policy requirements

61. Westpac sees a need for a well-defined, controlled and monitored policy exception approval process. The existence of the discretion afforded to credit officers provides important flexibility to cater for the needs and objectives of customers, including through periods of change, such as when they start a family (in the case of parental leave exceptions), or need to refinance their existing loans, or when the customer's circumstances are unusual.

62. Westpac's credit officers have some discretion to override the serviceability assessment rules and other requirements in its responsible lending and credit policies in limited circumstances. The exercise of that discretion is governed by Westpac's Responsible Lending Policy Manual[8] and the applicable credit policy and guidelines.

63. The Responsible Lending Manual sets out the minimum standards for responsible lending applied across Westpac.

64. Pursuant to clause 8.5 of the Responsible Lending Manual, a credit officer may override the serviceability assessment rules set out at clauses 8.2, 8.3 and 8.4 of the Responsible Lending Manual where:

    a. exceptional circumstances exist which mean that the application of those rules produces a result which does not properly reflect the customer's ability to meet their proposed financial obligations;

    b. the detailed reasons for the override by the credit officer are recorded in the relevant credit file; and

    c. the effect of the override is not to remove or override the surplus requirements in paragraph 8.2.15 or any interest rate buffers and floor rates required to be applied by paragraph 8.4.6.

65. In addition, clause 5.2.2 of the Responsible Lending Manual provides that credit officers may waive certain verification rules in defined circumstances. Specifically, that clause provides that credit officers may approve:

    a. Types of income other than those set out in the Income Verification Standard being taken into account for a particular serviceability assessment (and the weighting to be applied to that income) provided the credit officer is reasonably satisfied the customer actually receives the income and records in the credit file the evidence (other than self-certification by the customer) taken into account in verifying that the customer actually receives the income;

    b. For a particular serviceability assessment, income verification by means other than those set out in the Income Verification Standard provided the credit officer is reasonably satisfied the customer actually receives the income and it records in the credit file the evidence (other than self-certification by the customer) taken into account in verifying that the customer actually receives the income; and

    c. An expected increase in income being taken into account for a particular serviceability assessment (and the weighting to be applied to that expected increase in income) provided

[8] Ex. 1.141 (Witness Statement of Phillip Godkin dated 5 March 2018, Confidential Ex PG1-C32) WBC.300.057.1013.

the credit officer is reasonably satisfied that customer's income will actually increase and it records in the credit file the evidence (other than self-certification by the customer) taken into account in verifying that the customer's income will actually increase at that time.

66. Credit officers are provided different levels of authority based on their levels of skills and experience. Only credit officers with higher levels of authority are able to approve certain types of exceptions.

67. More specifically, guidelines provide that the serviceability assessment rules may only be modified in specific situations, and only in accordance with the guidelines. The situations are:

a. Bridging loans and other loan applications where there is an upcoming change in the prospective debtor's financial circumstance, where the credit officer is reasonably satisfied that there will be a positive change in the debtor's financial circumstances (such as that resulting from the sale of assets and the associated release of funds);

b. Upcoming end to parental leave and other likely increases in income, where the credit officer is reasonably satisfied after making inquiries and conducting verification that the customer's income will actually increase;

c. Upcoming parental leave and other temporary reductions in income, where the credit officer is reasonably satisfied after conducting inquiries and verification that (among other things) the customer has a reasonable and feasible strategy for dealing with the repayment obligations;

d. Reconsidering an application following initial serviceability assessment by making further inquiries and conducting further verification in respect of a customer's financial situation, including in respect of a customer's discretionary expenses and any intention by the customer to reduce those expenses;

e. Indirect income from non-applicant spouses or partners or other family member not captured within original servicing calculation, and where the history of the relationship is such that it is reasonable to expect the spouse/partner/family member to assist with the repayments, inquiries and verification have been undertaken in respect of the spouse/partner/family member's financial situation, and the credit officer has been in direct contact with the spouse/partner/family member and obtained a statutory declaration regarding the nature of the relationship and their willingness to assist with repayments;

f. Product switches, re-financings and debt consolidations, where the customer is an existing customer, there is no increase in borrowed funds and the customer has been making the repayments on the current credit contract; and

g. Income verification documents do not meet the time requirements, provided that the documents are only slightly outside the specified time periods, and the credit officer has investigated and been provided with a satisfactory explanation as to why documents within the time period cannot be provided, and is reasonably satisfied that the documents provided reflect the current situation and that the income will continue over the term of the credit contract.

Reporting of policy waivers

68. Westpac has a percentage risk appetite tolerance limit for the percentage of loans which are approved by waivers of its policies. The percentage risk appetite tolerance changes from time to time and is monitored quarterly.

69. In addition to internal monitoring, Westpac also reports policy exceptions and overrides to APRA on a quarterly basis.

70. Relevantly:

    a. in 2016, Westpac approved loans with negative net income surplus overrides of under 2%; and

    b. in 2017, Westpac approved loans with negative or positive net surplus overrides of under 4%.

71. In light of the restricted circumstances in which credit officers may exercise their discretion to waive Westpac's credit and responsible lending policies and practices, and the measures Westpac has in place to monitor and report on such departures, Westpac submits that it does not readily waive its policies in connection with the assessment of home loans.

D. ADD-ON INSURANCE

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 912A(1)(a) of the Corporations Act, the obligation to do all things necessary to ensure efficiently, honestly and fairly?

72. Westpac's policies, procedures and processes in the sale of all add-on insurance are sufficient to ensure that it meets and complies with its obligations under section 912A(a) of the *Corporations Act 2001* (Cth) (**Corporations Act**).

73. Westpac refers to the outline of its risk and compliance management framework identified on pages 2 and 3 of its initial response to the Commission dated 29 January 2018.

74. Like all products, consumer credit insurance (**CCI**) and other add-on insurance need to be offered to customers in a responsible way.

75. Among the measures employed by Westpac to ensure that the financial services it provides in relation to CCI products are consistent with its s912A obligations are:

    a. now only offering CCI for sale in connection with credit cards and personal loans through Westpac's online channel, which requires customers to take an action on their own behalf to apply for CCI without the assistance of a staff member;

    b. only offering CCI as an optional product with credit cards and personal loans;

    c. post-sales processes to validate customer eligibility, such as employment status. Notably, employment is a necessary condition for eligibility for any Westpac CCI product;

    d. after purchase, providing customers with separate written confirmation of their purchase and informing them of the 30 day cooling off period;

    e. ensuring customers receive regular prompts through their credit card statements, personal loan statements and through annual reminders that they have CCI and can claim on it if needed, and how to cancel; and

    f. ongoing and regular review of pricing and benefits to ensure products continue to meet customer needs.

76. Westpac also has a Product & Services Lifecycle Review process which is used to periodically review its products (including CCI) to ensure that they continue to meet customers' needs. The reviews are holistic and have a strong focus on conduct, customer and any relevant external factors such as regulator focus.

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?

77. ASIC Report 256 identifies a number of concerns with CCI sales practices, in particular, "consumers not adequately understanding the products they are purchasing" and the use of "pressure tactics". Westpac's processes ensure that it offers CCI products consistently with the Recommendations in Report 256.

78. Westpac is a participant in ASIC's CCI Working Group, which is looking at a range of reforms, including a deferred-sales model for CCI sold with credit cards over the phone and in branches. The deferred sales model has been incorporated into the revised Banking Code of Practice and means that consumers cannot be issued with a CCI policy for their credit card until at least four days after they have applied for their credit card over the phone or in a branch. The deferred sales model is intended to further address some of the concerns raised by ASIC in Report 256, particularly those in regards to pressure selling.

79. While Westpac supports measures to help ensure greater customer understanding of CCI, Westpac is conscious of the need to balance a deferred sales model against the risk that the added administrative inconvenience (associated with making a separate application) for those who would like to and may benefit from a CCI product fail to acquire it.

80. Westpac is also frequently asked to fund CCI through the underlying loan which is a necessity for some customers, and in this context Westpac believes that any deferred sales model must consider how the credit process operates in the current regulatory environment, including the need to have a single assessment process and finance contract.

81. Issues over recent years have shown that the existing legal mechanisms may not be sufficient to address all issues related to the sale of add on insurance. Across the industry, it appears that there are customers who may have been offered and issued cover and who are unlikely to ever be able to claim key benefits. While Westpac seeks to ensure that our CCI products are only offered and issued to those customers who would be eligible to claim, Westpac agrees with the need for broader reform such as the introduction of design and distribution obligations (DDO) and a product intervention power (PIP) as recommended in the final report of the Financial System Inquiry, to ensure CCI products are designed for a target market and only offered to that target market.

Relevance of CBA's recent decision with respect to consumer credit insurance[9]

82. Westpac submits that CBA's recent decision to cease to offer its CCI product should be regarded as reflecting its own circumstances and does not show that CCI, with proper controls, cannot be sold in a responsible manner that is beneficial to customers. Westpac believes that CCI can be a valuable product for many customers and agrees that, like all products, it needs to be offered to customers in a responsible way. CCI products are designed to assist customers in making their credit card or loan payments (in the event of involuntary unemployment/sickness) or helping to ensure that their debts are repaid (in the event of death). Westpac believes that many customers would be disadvantaged if they were unable to purchase CCI relating to the credit products they acquire. It is important that customers have the opportunity to obtain insurance at this time and CCI can be an efficient and effective way to do this when it is designed and sold appropriately.

83. As a business enterprise we have a need to consider the commercial viability of all our products. Following the decision of the ABA to include a four day deferred sale process on CCI credit cards

[9] In response to question raised by Commissioner at T1000:6-18.

sold through branches and call centres, Westpac ceased sales of CCI through those channels in late 2017. Management will consider the business case to build a deferred sales model and any other changes to product design or regulation impacting CCI on its commercial terms, as well as the attractiveness and value to customers of CCI.

84. It is important for all product issuers and distributors to regularly review their offerings to ensure that they continue to meet consumer and commercial objectives. Westpac does so for all its products on a regular basis, and in particular for CCI has taken into account the issues raised by ASIC in its reports on add-on insurance, and as a consequence made changes to its CCI products and distribution processes. Westpac will continue to keep its products under review, including having regard to the testimony before and findings of the Commission, as well as other market developments.

E. SECTION 912D REPORTING

How do financial services licensees ensure they comply with obligations under s912D of the Corps Act to make a written report to ASIC of any significant breach of the obligations within s 912A of the Corporations Act within 10 days?

85. Westpac's policies and procedures for reporting under s 912D, including changes to strengthen these policies and procedures over time, are set out in its response dated 13 February 2018 to the Commission's letter dated 2 February 2018 (the **Westpac Reporting Framework**).[10]

86. The Westpac Reporting Framework assists in ensuring that the Group complies with its s912D reporting obligations. In essence, those policies and processes combine so that each 'compliance incident' identified in the business is the subject of appropriate and considered assessment, escalation through the business to appropriate areas to form a view on the conduct and whether the issue is a potential breach of any of the obligations set out in s 912D(1)(a) and, if so, if it is significant for reporting purposes. Most importantly, Westpac has firm policies and processes designed to ensure that potentially reportable matters are escalated to its Breach Determination Forum expeditiously. Where the process identifies a reportable breach, Westpac acts to ensure the written report required by s 912D(1B) is lodged within the prescribed time.

87. Westpac's processes are part of a broader context for communications with regulators. Westpac also engages regulators on a voluntary basis, in appropriate cases, about incidents not reportable under s 912D. Westpac's AFSL Breach Policy is currently under review, with a view to broadening the Breach Determination Forum's authority to determine disclosures to regulators beyond those required in accordance to s 912D.

88. Westpac supports ASIC's ongoing industry-wide review of the breach reporting obligations. As a potential area for reform, Westpac considers that greater clarity around the "significance" threshold for the purposes of s 912D(1)(b) would help to promote greater certainty and consistency in breach reporting practices.

[10] See pages 23 to 28 in Part B – response to Question 2C.

F. OVERDRAFTS

Policies to ensure compliance with s 128 of the National Credit Act before offering overdrafts[11]

89. Westpac offers personal overdrafts on transaction accounts offered by the Westpac brand, and brands under the St.George umbrella (St.George, BankSA and Bank of Melbourne).[12] Across all brands, there are approximately 13,000 active overdraft facilities with a combined outstanding balance of approximately $42.5 million.

90. An overdraft is initiated by a customer making an application. Westpac does not make bank-initiated overdraft offers (through any of its brands). Customers can apply for overdrafts through branch, telephone and online channels (though applications for the Westpac brand may only be made in a branch).

91. Overdrafts are governed by the Overdrafts Credit Policy (which is a subsection of the Group Consumer Credit Policy) and, like other lending products, are also subject to the Responsible Lending Policy and the Responsible Lending Policy Manual.

92. In accordance with those policies, customers are required to provide the following information when applying for an overdraft facility (by completing a form if the application is made in a branch or online, or in response to a series of questions if applying by telephone):

    a. predominant use for the overdraft (personal, household, domestic or investment) and purpose for which the funds will be used;

    b. current amount and source(s) of income;

    c. occupation, employment status (for example, part time, full time or self-employed) and employer details;

    d. fixed expenses. Customers are asked to provide details for multiple expense categories, including mortgage payments, car loans, credit card limits, store card limits, other loans and other liabilities;

    e. variable living expenses. For example, in the St.George online application, customers are specifically prompted to consider bills, groceries and transport; and

    f. number of dependents.

93. Westpac also performs a credit bureau check in respect of all applications (unless those applications are declined at an earlier stage in the process).

94. Information provided by customers is verified in accordance with the verification policies in the Group Unsecured Credit Policy. Among other things, for new-to-bank customers, the customer is required to provide primary documentation (two payslips, or a letter of employment and bank statements). For existing customers, verification can be made by identifying salary deposits in the transaction account. The policy also outlines the procedures for verifying income for self-employed and casual employees.

95. Westpac decides whether to approve the overdraft by performing a serviceability assessment, which involves deducting from the customer's monthly income a percentage of the proposed overdraft limit (1% for the Westpac brand or 3% for St.George) and their fixed and variable expenses. For applications in the St.George brand, that assessment is automated, and the higher of HEM or declared living expenses is used. For the Westpac brand, applications are currently manually

[11] In response to the question identified by Counsel Assisting in paragraph 22(a) of the written Closing Submissions (**CAS)**.
[12] Westpac also offers temporary overdraft facilities, which extend credit for up to 45 days. They are not addressed in these submissions, though the application process is similar as for a permanent personal overdraft facility.

reviewed, and the higher of HEM and declared living expenses is used (that recently replaced an approach of using the Henderson Poverty Index benchmark and other declared expenses). For the Westpac brand, the minimum overdraft limit is $250 and maximum is $25,000. For St.George, the minimum is $500 and maximum is $20,000.

96. Westpac submits that its policies for offering overdrafts to consumers are consistent with its obligations under section 128 of the National Credit Act. That is because before any overdraft is approved, Westpac makes detailed inquiries of a customer's financial situation, including their income, employment, fixed expenses and variable expenses, and of their purpose for the overdraft. Westpac considers that the steps taken to verify that information constitute reasonable steps in the circumstances, having regard to the modest size of an overdraft facility (and having regard to the "scalability" of obligations as set out in RG 209). As noted above, Westpac does not initiate overdraft offers. Overdraft facilities are only granted to customers who apply, so have already decided that they want an overdraft facility and that it would be of some use to them.

Response to regulator requests for remediation of overdraft facility customers[13]

97. Westpac takes its responsible lending obligations, and the views of its regulators, seriously. If Westpac identifies that it has failed to comply with its obligations, its policy is to take prompt steps to remedy the situation, which may include customer remediation in appropriate circumstances. Westpac considers that the appropriate response to a regulator's request will depend on all the circumstances and should be considered on a case by case basis, but that in all cases, the appropriate response will involve engaging with the regulator promptly and frankly (especially if there is a difference of opinion). That is Westpac's approach to its regulator relationships.

G. ACL STATUTORY OBLIGATIONS AND REPORTING REQUIREMENTS

Whether ACLs should be subject to reporting requirements broadly similar to those under s912D of the Corporations Act[14]

98. Australian credit licensees (**Credit Licensees**) are subject to general obligations under s47 of the National Credit Act. These obligations include:

    a. engaging in credit activities efficiently, honestly and fairly;

    b. complying with licence conditions and relevant laws;

    c. ensuring that clients are not disadvantaged by a conflict of interest;

    d. ensuring that representatives are adequately trained and competent; and

    e. taking reasonable steps to ensure that representatives comply with the credit legislation.

99. ASIC has recognised that the general conduct obligations for a Credit Licensee and Australian Financial Services licensee (**AFS Licensee**) are broadly similar and can generally be met through similar systems and processes.[15]

100. Credit Licensees are required to lodge an Annual Compliance Certificate with ASIC, confirming compliance with their obligations under the National Credit Act, however, they are not required to report breaches of their obligations to ASIC in the same way AFS Licensees are. The National Credit

[13] In response to the question identified by Counsel Assisting in paragraph 22(b) of the CAS.
[14] In response to the questions raised by the Commission at T987:5-21.
[15] http://asic.gov.au/for-finance-professionals/credit-licensees/your-ongoing-credit-licence-obligations/complying-with-your-obligations-if-both-credit-licensee-and-afs-licensee/

Act was introduced in 2010 and there was a deliberate decision made at the time to have an Annual Compliance Certificate regime instead of the self-reporting regime set out in s912D.

101. In April 2017 the ASIC Enforcement Review Taskforce released a position and consultation paper entitled 'S*elf-reporting of contraventions by financial services and credit licensees*' which supported reporting obligations for Credit Licensees aligned with s912D on the basis that the Annual Compliance Certification regime suffered the following deficiencies:

    a. The information in the certificate is high level, generalised information;

    b. ASIC is not able by reason of this to test the veracity of credit licensee responses in certificates without undertaking surveillance or issuing notices to obtain additional information;

    c. Credit licensees are not required to provide details of any negative response to enable ASIC to assess whether a breach has occurred, what it entails, whether it is significant or not, the effects (if any) on consumers or the adequacy of the licensee's remedial action, if any were taken. ASIC will often ask for this information once the Compliance Certificate is lodged;

    d. The lack of detail may encourage a "tick-box" approach to compliance, rather than focus credit licensees upon identifying systemic risks or issues; and

    e. There is no obligation to provide to ASIC information about breaches in a timely way as certificates are only required annually.

102. In its submissions to the ASIC Enforcement Review Taskforce, Westpac supported, and still supports, the proposal to establish a self-reporting regime aligned to the AFS reporting regime under s912D. In Westpac's view, implementation of such a reporting regime will not require reconsideration of the whole structure but requires adjustments to the existing systems and operations of Credit Licensees. Accordingly, industry consultation and a reasonable transition period would be required and any duplication with Annual Compliance Certification removed (or at least the requirements of such certificates should be less onerous).

103. Further, as noted above at section E of this submission in response to s912D reporting, further clarity should be given around the 'significance' threshold which would equally apply to any similar provisions for Credit Licensees.

H. ACCOUNT ADMINISTRATION

Introduction

104. While Westpac strives to create systems and processes which prevent errors occurring in account administration, given the volume of transactions annually (over 4.8 billion) and the number of accounts held with the bank (around 16 million), it is unrealistic to think that there will never be administrative or processing errors, and such errors do occasionally occur. Westpac takes all account administration errors seriously and its position with respect to the administration of accounts is that Westpac should 'get it right or put it right'.

105. It is critically important to Westpac that where errors do occur, that they are detected early, that customers are remediated promptly and fully, that steps are taken to identify the cause, that systems are put in place to prevent recurrence of the problem, and that any reporting obligations are met.

Relevant Law or Recognised Standard

106. In assessing whether its account administration systems are adequate, Westpac looks first to the key legal obligations it is required to meet, and the requirements of the Code of Banking Practice, including:

 a. s 912A(1)(a) of the Corporations Act: the entity must do all things necessary to ensure that the financial services covered by its financial services licence were engaged in efficiently, honestly and fairly.

 b. s 912D of the Corporations Act (and ASIC Regulatory Guide 78): the entity must provide a written report to ASIC within 10 business days of becoming aware of any significant breach or likely breach of its Australian Financial Services Licence obligation to do all things necessary to ensure that the financial services covered by its licence were engaged in 'efficiently, fairly and honestly'.

 c. s 47(1)(a) of the National Credit Act (and ASIC Regulatory Guide 205): the entity must, as an Australian Credit Licence holder, act efficiently, honestly and fairly in relation to its credit activities.

 d. cl 3.2 of the Code of Banking Practice: the obligation to act fairly and reasonably towards customers in a consistent and ethical manner.

107. In addition to these legal and self-regulatory obligations, Westpac strives to align its practices to community standards and expectations, including as captured in:

 a. the Westpac Group Code of Conduct: The Code describes the standards of conduct expected of Westpac's people and covers acting with honesty and integrity, complying with laws and Westpac policies, doing the right thing by customers, respecting confidentiality and not misusing information, valuing and maintaining professionalism, working as a team and managing conflicts of interest responsibly.

 b. the Westpac Group's Principles for Doing Business: The Principles set out the standards of behaviour, against which Westpac expects to be judged by customers, communities and Westpac's own people. Reflecting the stated values of one team, integrity, courage and achievement the Principles also set out Westpac's customer service promise (at 3.1), commit to responsible provision of products and services (at 3.4) and explain how Westpac addresses complaints and dispute resolution (at 3.9).

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

108. Westpac's Consumer Bank business has the following controls and monitoring designed to detect processing errors that result in customers failing to receive their entitlements under the terms and conditions of their accounts:

 a. <u>Data Exception Reports</u> – Reporting which monitors the customer's use (or lack of use) of product features. Where outliers are detected, targeted responses are undertaken (including contacting the customer for a product review). This form of reporting is maturing in terms of sophistication and breadth;

 b. <u>Interest Rate Calculation Reviews</u> – An annual operational and Sarbanes Oxley review of the accuracy of interest rate calculation (over and above the Product & Service Lifestyle (**PSL**) Framework);

c. Complaint monitoring – Monitoring and review of complaint data by the Product Governance Committee to identify themes and action as required. Product Managers are required to disclose any material issues to the Committee. Westpac's review of complaint data continues to evolve and mature; and

d. Control Testing – Assessment of Design Effectiveness and Operating Effectiveness by Control Owners of all key controls on an 'at least' annual basis. In addition, 2nd Line Assurance undertakes an independent review of key controls in accordance with the risk based assurance plan. 3rd Line Group Audit also reviews the effectiveness of the Group's risk management framework via their audits across 1st Line and 2nd Line.

109. Westpac is increasingly using data to flag anomalies. In the past, exception reports have detected matters that require further investigation and allowed Westpac to respond accordingly. For example, our analytics noted that a small percentage of customers were not fully utilising their offset accounts, and as a result we now write to these customers once a year to encourage them to use their offset account, and invite customers who thought they had an offset to have their case reviewed and any interest returned to them.

110. In addition to these monitoring measures, Westpac also has the following proactive measures in place, which are designed to prevent and minimise the risk of account administration errors:

a. Product & Services Lifecycle Framework – A framework which governs the management of products (including new, changed and existing bank accounts). Under the PSL Framework:

i. products are reviewed on a 3 year cycle;

ii. products are assessed against set criteria, including impact to the customer, to identify 'High risk' products. Additional management focus is applied to High Risk products;

iii. changes to products (including remediation changes) are subjected to IT change-management protocols, with pre-launch changes tested in a 'test environment' and post-launch changes confirmed through post-implementation reviews.

b. Removal of Grandfathered Products – An ongoing program of work to migrate customers from products, packages, services that are no longer for sale.

This reduces the risk of product administration error by migrating customers to better supported products, and by reducing the range of products that require ongoing monitoring by Westpac. However, for customers who remain on these products, Westpac ensures that the same levels of supports are available as there would be for current on-sale products.

c. Product Simplification Program – An ongoing program of work which aims to:

i. reduce the number and complexity of products;

ii. reduce the number of fee types; and

iii. simplify Terms & Conditions and other customer documents to make it easier for customers and staff to understand.

111. In addition to enhancing the customer experience, by simplifying the breadth and complexity of products, packages and services, the inherent risk of product administration failure is reduced.

112. In 2016, Westpac's Consumer Bank established a 1st Line Product Quality Team (with approximately 40 FTE staff). The Product Quality Team is responsible for proactively monitoring product related risk, including the risks associated with errors arising errors in account administration or processing, across the Consumer Bank product portfolio (such as through conducting the Annual Portfolio Risk

Assessment). As at March 2018, the team had also completed 51 'high risk' deep-dives and implemented 28 recommendations.

113. The Consumer Bank Product Governance Committee (PGC) has the role of facilitating and overseeing compliance with the PSL Framework.

114. Westpac's Consumer Bank business also has mandatory periodic product reviews of every product rated in the Annual Risk Assessment as 'high risk'. The purpose of these reviews is to:

a. undertake an in-depth end-to-end review of the product to identify any failure to meet any fairness or suitability principles;

b. identify any risks or issues;

c. identify any opportunities to improve the product or product processes; and

d. develop and implement an Action Plan to remedy any deficiencies and realise any opportunities for product.

These reviews are conducted by the Product Quality Team, and the minimum information to be included in the review is outlined in the Periodic Review Assessment Framework template.

115. At a Group level, Westpac's Group Audit function is the internal third line assurance function that provides the Board and Executive Management with independent and objective evaluation of the adequacy and effectiveness of management controls over risk. This is the ultimate escalation point for systemic errors. The role of Group Audit is to:

a. provide independent assurance over the adequacy of controls over key risks and whether those controls are operating effectively; and

b. provide independent reviews, evaluations and advice that will assist management in exercising its responsibility to develop, maintain, monitor, and continuously enhance control frameworks and systems.

In addition, Group Audit plays a role in promoting development of a strong, effective and enduring risk management culture across the Group.

116. In the performance of these functions, Group Audit has full and complete access to all the Westpac's activities, records, premises and personnel.

Whether banks' systems are adequate to provide timely and full remediation to affected customers[16]

117. Westpac's Consumer Bank business has in place a Remediation Framework which covers, among other situations, those where customers suffer detriment as a result of account administration errors or a failure to receive their entitlements under the terms and conditions of their accounts. The Remediation Framework is designed to ensure that customers are placed back into the position they would have been in but for the occurrence of the error. The Remediation Framework has a four step life cycle (discovery, planning, execution and maintenance) and sets out the requirements for the following areas of remediation strategy:

a. Issue identification;

b. Root cause analysis;

c. Data analysis;

d. Customer remediation;

[16] In response to the question identified by Counsel Assisting in paragraph 31(b) of the CAS.

e. Issue remediation;

f. Resourcing;

g. Reporting; and

h. Disclosure.

118. Westpac's Consumer Bank business' remediation of product administration errors is handled by the Consumer Bank Remediation Team, which has expanded in recent years to approximately 100 FTE staff. The team is, in addition to the operational responsibilities of existing staff, and sits across a range of business units reflecting considerable investment. Other teams are also put in place to remediate other issues or errors.

119. Having this workforce dedicated to remediation with consistency in functional roles (e.g. marketing, payments processing and data processing) and familiarity with the relevant products, processes and systems, increases the timeliness of the remediation Westpac is able to provide.

120. Westpac's position is that the remediation process should commence as soon as practicable, and the approach to remediation is to remediate as fully as possible based on the data available. Westpac also has a dedicated remediation data analytics team which allows Westpac to build the skills to interpret available data appropriately.

121. The ability to remediate some long-running or historical account administration errors is sometimes hampered by the fact that some systems only retain data for specified periods. Westpac also changes its data recording systems from time to time, which sometimes means it takes time to access and interrogate multiple sets of records to get an accurate and complete history for the customer. Westpac ensures that ASIC is aware of and understands Westpac's approach in respect of available data.

122. An example of this is the Dual Interest Rate issue for Credit Cards. Customers were offered a dual 0% promotion rate on purchases and balance transfers. The repayment methodologies held in our credit card platform prevented the 0% on purchases applying; as repayments are allocated to the plan established first where interest rates are the same. This was identified in November 2015 with a solution implemented in February 2016. The customer remediation program commenced in May 2016 with customer payments commencing in November 2016 which saw refunds of $593,000 and adjusted balance transfer limits of $3,400,000, to place customers back into the position they would have been in, had the repayments been allocated to the purchase plan initially.

123. In this case, the remediation approach was appropriate and adequate in the way it allowed:

a. the individualised calculation of money owed to customers in an efficient and accurate manner;

b. the large scale disbursement of funds to customers within a reasonable period.

124. Westpac's remediation payments for account administration errors include interest on the principal amount to be remediated, ensuring that the customer is not disadvantaged, but is properly placed back in the position they would have been in without the error occurring.

125. Westpac's systems for developing and delivering remediation ensure that Westpac is complying with its obligations under s 912A(1)(a) of the Corporations Act and s 47(1)(a) of the National Credit Act to provide financial and credit services efficiently and fairly. Further, Westpac's model meets the community expectation that in the provision of remediation to customers, Westpac's primary emphasis is on timeliness in 'putting things right', as well as clarity and quality in customer communication.

126. Westpac's practice has been to adopt a divisional approach to customer remediation. However, Westpac is also taking steps to supplement this to ensure consistency across the group in relation to the management of remediation activity, including through the development of a Group-wide Guidelines for Customer Remediation Activities, reflecting Westpac's continued commitment to remediation that adopts a customer-focused and consistent approach (eg through the use of the Customer Advocate) and which operates efficiently, honestly and fairly. The draft guidelines are informed by Westpac's existing remediation activities as well as ASIC's Regulatory Guide 256. Parts of the guidelines are already operational within the business units.

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

127. Westpac has a number of internal oversight bodies and committees within its business units who are notified of incident volumes, including the Consumer Bank Executive Risk & Compliance Committee, and the Product Governance Committee. These bodies and committees review material incidents and issues on at least a quarterly basis. They also determine any broader system changes which are necessary in order to prevent recurrence of the same or a similar error. With the advancement of technology, an increasing number of solutions involve investment in upgrades of systems in order to minimise use of manual human review in favour of system-wide reviews and controls. Technology-related incidents are managed in accordance with the Westpac Service Management Framework, which ensures root cause analysis is completed and root cause is addressed in a timely manner to avoid reoccurrence, and monitored until root cause is remediated. This is complemented by Westpac's incident management system which ensures account administration errors do not go un-investigated through a system of individual accountability which designates 'incident owners' to particular errors as they are reported. These incident owners:[17]

a. take accountability for the incident;

b. retain the ownership for the life of the incident;

c. manage and oversee the rectification of the incident until closure; and

d. take action to prevent recurrence.

128. Westpac's operational risk incident management framework endeavours to identify potential systemic issues by incorporating available information arising from incidents which do not result in actual customer loss. Utilising this information allows Westpac to build a better picture of potential areas where seemingly small issues may indicate systemic issues or potential significant control failures.[18]

129. Further, in line with the Group's 3 Lines of Defence risk management approach, Westpac runs post-implementation review processes for significant incidents to identify learnings that can be adopted to mitigate or minimise the risk of repeated error of a similar nature. This assists in reducing the risk that process failures or errors are not identified before they become systemic. 1st Line control owners are required to self-assess the design and operating effectiveness of their key controls on a minimum of an annual basis. 2nd Line Assurance independently tests the effectiveness of key controls in accordance with risk based plans, including testing of key controls introduced or changed by high risk rated controls within high rated projects. Moreover, 3rd Line Group Audit has authority to review any areas of the Bank, or activity, to assess the effectiveness of the Group's Risk Management Frameworks.

[17] Ex. 1.141 (Ex PG1-25 to the Statement of Phillip Godkin, 5 March 2018) WBC.100.118.8029 at p 8060.
[18] Ex. 1.141 (Ex PG1-25 to the Statement of Phillip Godkin, 5 March 2018) WBC.100.118.8029 at p 8035.

130. These measures support Westpac to engage in financial and credit activities efficiently, honestly and fairly, in accordance with its obligations under s 912A of the Corporations Act and s 47(1)(a) of the National Consumer Credit Protection Act. Further these measures ensure a level of responsiveness in the systems and processes so as to meet community standards and expectations surrounding the prevention of similar errors in the future.

131. Westpac is committed to continual improvement of its processes to minimise the occurrence and recurrence of process errors.

Whether banks' processes are adequate for assessing whether errors are reportable breaches[19]

132. Westpac's breach reporting process is summarised in above in section E in these submissions, and is set out in more detail Westpac's response dated 13 February 2018 to the Commission's letter dated 2 February 2018.[20]

133. Currently, under Westpac's Operational Risk Incident Management Procedures & Guidance (**IM Procedures and Guidance**), incidents that arise repeatedly or are of a similar nature assist in the identification of systemic issues, even in the absence of direct customer loss in every case. The IM Procedures and Guidance further makes clear that such systemic issues may indicate significant control failures.

134. When a processing error is identified, it is recorded in our incident management system, JUNO. If it has a potential compliance impact, the JUNO system triggers a compliance assessment to be completed by the second-line Compliance function. In performing compliance assessments, the second line Compliance Assessor uses the Compliance Assessment Standard Operating Procedure and Westpac Group AFSL Breach Policy to identify matters for escalation to the Breach Determination Forum, for consideration for reporting under s 912D of the Corporations Act. In completing this assessment, the second line Compliance Assessor may involve other teams including the business, operational areas, other second line of defence functions, and Legal and Regulatory Response. Critically, in assessing the significance of the incidence (in the context of potential reports to regulators), the Compliance Assessor considers, among other things, the frequency of similarly identified previous incidents, the extent to which the incident suggests compliance arrangement to be inadequate, and the timeliness of identification of the incident. Westpac has built these considerations into the Compliance Assessment Templates in order to better ensure that where similar account administration errors arise, they can be appropriately escalated for consideration and potential reporting.

135. Westpac's breach reporting system allows it to monitor and detect in a timely manner whether processing errors which initially seem disparate or ad-hoc are in fact systemic. This allows Westpac to meet community standards around the detection of systemic errors.

I. CREDIT TERMS AND CONDITIONS

Whether credit cards terms and conditions are too complex with respect to fees[21]

136. To Westpac's knowledge, credit cards terms and conditions are not too complex for consumers to understand when fees are payable. This has been assisted by recent reforms. Through amendments to the National Credit Act which came into force on 1 July 2012,[22] credit card providers

[19] In response to the question identified by Counsel Assisting in paragraph 31(d) of the CAS.
[20] See pages 23 to 28 in Part B – response to Question 2C.
[21] In response to the questions identified in paragraph 93 of the CAS.
[22] Effected by the *National Credit Protection Amendment (Home Loans and Credit Cards) Act 2011* (Cth).

are required to prepare and make available Key Facts Sheets in a form prescribed by regulation.[23] In relation to fees, the regulations require Key Facts Sheets to state the annual fee and late payment fee and provide a web address for the full list of fees.[24] As to other credit products, their fee structures are generally less complex than credit cards, and would be readily understood. Key Facts Sheets are also required to be published for home loans, which must set out establishment and ongoing fees.[25]

137. Documents like Key Facts Sheets are useful documents for consumers in presenting key fees in an easy to read format which allows comparison between competing products. Development by the industry of a standard form of short disclosure document for other common credit products, such as personal loans, may assist consumers to understand key terms and fees of those products. In relation to credit cards, the Commonwealth Treasury has published a consultation paper on credit cards in May 2016 entitled *"Credit cards: improving consumer outcomes and enhancing competition"*. A possible reform which was considered but which has not yet been pursued is to require credit card providers to provide regular summary information in a simple and standardised format, on statements and through internet banking, which summaries matters such as year-to-date interest charges and fees.[26]

[23] Regulation 28LFA and Schedule 6 of the *National Consumer Credit Protection Amendment Regulations* 2011. Westpac's Key Facts Sheet for credit cards is at https://www.westpac.com.au/personal-banking/credit-cards/credit-cards-fact-sheet/
[24] Westpac's full list of credit card fees is at www.westpac.com.au/creditcardfees
[25] Regulation 28LB and Schedule 5 of the National Consumer Credit Protection Amendment Regulations 2011.
[26] Commonwealth Treasury "Credit cards: improving consumer outcomes and enhancing competition", May 2016, pp 19-20.