

Westpac Banking Corporation - Submissions on Rubric 3-11 Case Study

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

8 June 2018

INTRODUCTION

- 1 These submissions set out the findings that Westpac Banking Corporation (**Westpac**) submits should be made by the Commission on the matters identified in Counsel Assisting's closing submissions in relation to the Westpac case study addressed as part of the Commission's consideration of "responsible lending" in the context of small business lending.
- 2 This case study concerns a business loan that Westpac provided to Marjo (Vic) Pty Ltd (ACN 158 128 566) (**Marjo**) in July 2012 for the purpose of purchasing a Pie Face franchise in Werribee, Victoria (the **Business**). After the Business failed in 2014, issues arose concerning the origination of the loan, the application of the proceeds of sale of one of the security properties and Westpac's automated collections activities pending a Financial Ombudsman Service (**FOS**) dispute. Westpac does not accept that the loan was inappropriately made or that it was not entitled to apply the proceeds of sale of the security property as it did. Westpac accepts that it should not have continued to send Ms Messih collections messages after her complaint had been referred to FOS.
- 3 The submissions are structured as follows:
 - a. Part A addresses the proposed findings identified by the Commission as to Westpac's conduct in relation to the loan to Marjo;
 - b. Part B addresses the adequacy of the systems and processes in place for the sending of collections text messages, in response to the questions raised by Counsel Assisting;¹ and
 - c. the Annexure sets out the factual findings that Westpac submits the Commission should make with respect to the case study.

A. PROPOSED FINDINGS IN RELATION TO THE MARJO CASE STUDY

- 4 Counsel Assisting identified the following findings as potentially open:
 - a. Westpac breached cl 3.2 of the Code of Banking Practice (**COBP**) in failing to act fairly and reasonably to Ms Messih in a consistent and ethical manner by continuing to undertake collections activities against Ms Messih after Ms Messih had made a complaint to FOS;² and
 - b. in continuing to undertake collection activities against Ms Messih after Ms Messih had made her complaint, Westpac breached its obligation as a member of the FOS under cl 13.1 of the FOS Terms of Reference (**FOS TOR**).³
- 5 Westpac's response to those proposed findings is set out below.

¹ Transcript 1 June 2018 (Hodge QC), T3031:30

² Transcript 1 June 2018 (Hodge QC), T3031:20-24.

³ Transcript 1 June 2018 (Hodge QC), T3031:24-26.

Clause 3.2 of the Code of Banking Practice

Potential finding: Westpac breached cl 3.2 of the Code of Banking Practice in failing to act fairly and reasonably to Ms Messih in a consistent and ethical manner by continuing to undertake collections activities against Ms Messih after Ms Messih had made a complaint to FOS.⁴

- 6 Westpac accepts that in these circumstances it did not meet the requirement of clause 3.2 of the COBP to act reasonably towards Ms Messih.
- 7 As outlined in the Annexure, Westpac inadvertently sent Ms Messih 13 collections text messages between 17 November 2016 and 3 December 2016.⁵ The text messages were sent to Ms Messih due to a human processing error which failed to link Ms Messih's home loan with the lodgement of the FOS dispute by Marjo.⁶ That linking is part of Westpac's standard operating procedure on receipt of a FOS claim.
- 8 Unfortunately, the failure to properly flag Ms Messih's account was compounded by a short term technical issue which arose at the same time, due to a system transfer problem with Westpac's SMS provider. The computer error caused more text messages to be sent to Ms Messih on consecutive days than would ordinarily occur. Westpac's usual practice where accounts are in arrears is to send, at most, one text message every three days. When a text message is sent, Westpac receives a report of whether the text message was delivered or not delivered. If the message was not delivered, then it automatically triggers a further message to be sent. The technical issue arose as the system was incorrectly registering messages as not being delivered. The technical issue was discovered in November 2016. But for this issue (and assuming no FOS dispute was on foot), Ms Messih would have received no more than five text messages during this period, spaced out with more days between each. The technical issue was fixed in early 2017.
- 9 On 9 February 2017, FOS issued a Recommendation finding that Westpac had inappropriately sent Ms Messih collections messages after the matter had been referred to FOS, in contravention of the FOS TOR.⁷ FOS recommended that Westpac pay Ms Messih \$6,500 for the text messages sent.⁸ That payment was made on 23 February 2017.
- 10 Clause 3.2 of the COBP requires Australian Bankers' Association (**ABA**) members to act fairly and reasonably towards customers in a consistent and ethical manner, and in doing so, to consider the customer's conduct, the bank's conduct and the contract between them.
- 11 Sending collections text messages is now a commonplace practice. Such messages alert customers who may not be aware that they have outstanding accounts to a business' request for payments and to remind them of the need to make the required payments. However, Westpac

⁴ Transcript 1 June 2018 (Hodge QC), T3031:20-24.

⁵ Ex 3.22 Witness Statement of Welsh [WBC.900.003.0001] (**Welsh Statement**): [165]; Ex 3.22.68 AW3-68 [WBC.404.012.4242].

⁶ Welsh Statement: [165].

⁷ Welsh Statement: [166] – [167]; Ex 3.22.69 AW3-69 [WBC.404.012.4195].

⁸ Ex 3.22.69 AW3-69 [WBC.404.012.4195].

accepts that this should not be done during a FOS dispute and, regardless of any FOS dispute, the frequency of messages sent should be appropriate. Westpac accepts that its inadvertent text messages to Ms Messih were inappropriate and adhered to the compensation recommendation made by FOS.

Clause 13.1 of the FOS Terms of Reference

Potential finding: In continuing to undertake collection activities against Ms Messih after Ms Messih had made her complaint, Westpac breached its obligation as a member of FOS under cl 13.1 of the FOS Terms of Reference.⁹

12 Clause 13.1(a)(iii) of the FOS TOR provides that where an Applicant lodges a dispute with FOS, the Financial Services Provider must not take any action to recover a debt the subject of the Dispute, to protect any assets securing that debt or to assign any right to recover that debt while FOS is dealing with the dispute.

13 Westpac accepts that in sending collections text messages to Ms Messih while FOS was dealing with Ms Messih's complaint, it breached its obligation under clause 13.1 of the FOS TOR.

B. ADEQUACY OF SYSTEMS

Whether Westpac has adequate systems in place to ensure compliance with its obligations under the Code of Banking Practice and FOS Terms of Reference with respect to collections activities.¹⁰

14 Westpac believes that it has adequate systems in place to ensure its compliance with its obligations under the COBP and the FOS TOR.

15 Westpac's system to ensure that customers are not subject to collections activities once a complaint has been lodged with FOS can be described as follows:

- a. Notice of the complaint is received from FOS by the Westpac Customer Experience Team. The complaint is loaded into Westpac's complaints system as a new line of activity by the Westpac Customer Experience Team. The new entry in the complaints system includes the FOS case reference and other information. This indicates to anyone looking at the customer profile through the complaints system that all collections actions should cease.
- b. If the account is with Westpac Group Collections, a standard email is sent from the Customer Experience Team to Group Collections advising of the customer details, and requesting that all activity on the account be ceased until further notice as it is subject to a complaint. A note is then incorporated into the collections system to advise anyone

⁹ Transcript 1 June 2018 (Hodge QC), T3031:24-26.

¹⁰ Transcript 1 June 2018 (Hodge QC), T3031:30-33.

looking at the customer profile through the collections system that all collections actions should cease. Westpac Group Collections cross checks that the note in the collections system is loaded. An email is also sent to any third parties, such as lawyers, who are undertaking recovery action on behalf of Westpac.

- 16 FOS currently provides Westpac with information in relation to the accounts which are the subject of the complaint. However, some customers have multiple accounts with Westpac, for example a home loan account and a business loan account, which may not necessarily be nominated by FOS. This is particularly so where accounts are in different names. Westpac is reviewing its capacity to introduce enhanced account searching across platforms to address this issue. In the case of Ms Messih, the human error that permitted the continued sending of collections text messages was a failure to load the relevant note on the collections system against all related accounts. While the current processes are adequate, these steps will further enhance Westpac's ability to identify accounts which have not been nominated.

ANNEXURE PROPOSED FINDINGS OF FACT

17 Westpac submits that it would be open for the Commission to make the following findings of fact in relation to the Marjo case study.

Marjo

18 Marjo was established in May 2012 by Marion Messih, her brother and his wife, for the purpose of purchasing and operating a Pie Face franchise located in the Werribee Plaza.¹¹ All three were directors and shareholders of Marjo.¹²

19 At the time of the loan application, Ms Messih was an office manager and bookkeeper¹³ and owned two properties, including her home at Taylors Lake, Victoria (**Taylors Lakes Property**) and an investment property at Maribyrnong, Victoria (**Maribyrnong Property**), both of which were subject to mortgages with the Commonwealth Bank of Australia (**CBA**).¹⁴ Ms Messih's sister-in-law was also an office manager and Ms Messih's brother was a self-employed mechanic.¹⁵ Ms Messih's brother and his wife jointly owned a property at Point Cook, Victoria (**Point Cook Property**) which was subject to a mortgage with Westpac.

20 Initially, the intention was that either Ms Messih or her sister-in-law would work in the Pie Face business full-time and the other would continue her full-time employment and assist in the business on the weekends. This later changed, so that Ms Messih and her sister-in-law decided they would both work in the business full-time.¹⁶ That decision affected the financial viability of the business.

Marjo's loan application

21 On 12 June 2012, Marjo applied to Westpac for a Business Loan (**Loan**) in the amount of \$350,000 to fund 100% of the purchase price of the business, as well as an overdraft facility, a banker's undertaking and a business credit card.¹⁷

22 In support of Marjo's loan application, the directors provided Westpac with historical profit and loss statements for the Business,¹⁸ and cash flow forecasts for the Business prepared by Marjo's accountant.¹⁹ They also provided information about their personal financial circumstances,²⁰ as well as the contract of sale,²¹ and the Pie Face Licence agreement.²² The accountant's cash flow

¹¹ Ex 3.17 Witness Statement of Messih [WIT.0001.0035.0001] (**Messih Statement**): [12]; Transcript 22 May 2018 (Messih), T2177:6-7.

¹² Messih Statement: [12].

¹³ Messih Statement: [2].

¹⁴ Messih Statement: [3].

¹⁵ Transcript 22 May 2018 (Messih), T2175:38-46.

¹⁶ Messih Statement, [6]; Transcript 22 May 2018 (Messih) T2176: 1-7.

¹⁷ Welsh Statement: [119]; Ex 3.22.32 AW3-32 [WBC.404.001.0053].

¹⁸ Welsh Statement: [121]; Ex 3.22.35.1 AW3-35 [WBC.404.001.0668]; Ex 3.22.35.2 AW3-35 [WBC.404.001.0704].

¹⁹ Welsh Statement: [121]; Ex 3.22.34.1 AW3-34 [WBC.404.001.0302]; Ex 3.22.34.2 AW3-34 [WBC.404.101.0666]; Messih Statement: [19].

²⁰ Welsh Statement: [121]; Messih Statement: [18].

²¹ Welsh Statement: [121]; Ex 3.22.36 AW3-36 [WBC.404.001.0939 at .0982].

²² Welsh Statement: [121]; Ex 3.22.36 AW3-36 [WBC.404.001.0939].

forecast was prepared in line with the historical profit and loss statements for the Business.²³ The contract of sale contained a warranty by the vendor of the franchise that the financial statements provided to Marjo disclosed a true and fair view of the affairs, financial position and assets and liabilities of the business.²⁴

23 Westpac has a Franchise Policy.²⁵ However, the Franchise Policy does not apply in circumstances where the loan amount sought is more than the Sector Value Ratio (**SVR**). In 2012, the SVR for Pie Face franchisees was 50% of the purchase price of the business. As Marjo had applied to borrow 100% of the purchase price of the Business, the loan application was assessed by the Credit Officer under the Business Lending Credit Policy, and not the Franchise Policy.²⁶

24 On 26 June 2012, the final credit submission was submitted by the local business banker.²⁷ On 3 July 2012, Westpac approved Marjo's application and on 6 July 2012, Ms Messih and her sister-in-law signed the loan documentation for:²⁸

- a. a Business Loan of \$350,000;
- b. a Business Overdraft of \$31,000;
- c. a Banker's Undertaking of \$15,000; and
- d. a Business Credit Card with a limit of \$10,000.

25 The security provided for the Loan and other facilities included:

- a. a guarantee and indemnity by Ms Messih. Ms Messih's guarantee was secured by a new mortgage over the Maribyrrong Property. To support Marjo's application, Ms Messih had agreed to refinance her existing CBA home loan and investment property loan with Westpac;²⁹
- b. guarantees and indemnities by Ms Messih's brother and sister-in-law, secured by a new mortgage over the Point Cook Property; and
- c. a general security interest over Marjo's existing and future assets and undertakings.³⁰

26 In about July 2012, Marjo finalised the purchase of the Business and Ms Messih and her sister-in-law travelled to Sydney for a month of compulsory training with Pie Face. Due to the length of the

²³ Ex 3.22.39 AW3-39 [WBC.404.012.0462 at .0467]; For example, the cash flows take into account a figure for cost of sales comprising about 38% of the gross sales, which is in line with the ratio recorded in the historical accounts.

²⁴ Welsh Statement: [121]; Ex 3.22.36 AW3-36 [WBC.404.001.0939 at .1005] (cl 2.1(a)).

²⁵ Ex 3.22.25 AW3-25 [WBC.410.001.2092]

²⁶ Welsh Statement: [126]; Transcript 23 May 2018 (Welsh), T2235: 20-27.

²⁷ Welsh Statement: [123]; Ex 3.22.38 AW3-38 [WBC.404.001.1016].

²⁸ Welsh Statement: [128]; Ex 3.22.40 AW3-40 [WBC.404.003.0138].

²⁹ Welsh Statement: [119]; Ex 3.22.33 AW3-33 [WBC.404.014.0466]; Messih Statement: [21]; Ex 3.17.1 MAM-1 [WBC.404.001.0186].

³⁰ Welsh Statement: [131] – [132]; Ex. 3.22.41 AW3-41 [WBC.404.001.1321]; Ex 3.22.42 AW3-42 [WBC.404.001.1297].

training, Ms Messih resigned from her job as an office manager. She and her sister-in-law decided that they would both work in the Business full-time.³¹

Operation of the Pie Face Werribee shop 2012-2013

27 In about August 2012, Marjo commenced operating the Business.³² From the outset, the business did not trade well.³³ Ms Messih's evidence was that the figures presented by the previous owner were exaggerated because he had run the business down.³⁴ Over the next 12 months, Ms Messih and her sister-in-law managed to double the sales revenue, and the business continued to grow until late 2013. Ms Messih gave evidence that they set themselves short-term goals to try to turn the Business around.³⁵

28 In late 2013, the Werribee Plaza car parks were closed ahead of major renovations in 2014. Ms Messih described the effect of this as follows:

*They closed all the car parks, bar one. And it was a month before Christmas, which is the worst time of the year to do that, because you're waiting for Christmas sales and increase people [sic] in the shopping centre to make your business viable and actually make some money, because that's actually the busiest time of the year, between late November and January. But people avoided Werribee Plaza with a passion. There's no parking. You can't get in and out of the place. Why shop there? People went elsewhere...*³⁶

Substitution of security

29 In early 2014, Ms Messih's sister-in-law and brother were separating and her sister-in-law sought to remove the Point Cook Property as security for their guarantees. On 30 April 2014, Ms Messih and her sister-in-law signed a Request to Release/Substitute Security under which Marjo requested that Westpac release the security it held over the Point Cook Property, in return for security of a term deposit of \$40,000. Ms Messih received a letter stating, among other things, that the limit of her liability was \$399,309, which was the then outstanding balance of the Marjo loans.³⁷

30 In January 2015, Ms Messih's brother was released from his obligations under the indemnity and guarantee. Ms Messih and her sister-in-law remained guarantors under the facilities. The security provided by Ms Messih's sister-in-law in respect of her liability under her guarantee and indemnity comprised the term deposit of \$40,000, whereas the security provided by Ms Messih in respect of her liability under the guarantee and indemnity comprised the Maribyrnong Property.³⁸

³¹ Messih Statement: [26] – [27].

³² Messih Statement: [28].

³³ Transcript 22 May 2018 (Messih), T2181:1-5.

³⁴ Transcript 22 May 2018 (Messih), T2181:8.

³⁵ Transcript 22 May 2018 (Messih), T2181:12-13

³⁶ Transcript 22 May 2018 (Messih), T2181:31-38.

³⁷ Welsh Statement: [131] – [133]; Ex 3.22.44 AW3-44 [WBC.404.001.0388 at .0436].

³⁸ Welsh Statement: [131] – [133].

Servicing of the Loan

31 In early 2014, following the commencement of the renovations at the Werribee Plaza, Marjo was struggling to make its monthly repayments to Westpac.³⁹ In about May 2014, Westpac entered into a payment arrangement with Marjo, which allowed Marjo to make payments weekly.⁴⁰ In mid-2014, Marjo fell behind and failed to meet those payment obligations as well.⁴¹

Pie Face Franchise

32 In July 2013, Westpac discredited the Pie Face franchise system on the basis that guarantees were called upon and payment arrangements were in place in respect of tax liabilities.⁴²

33 In November 2014, administrators were appointed to Pie Face, the franchisor. Nevertheless, the franchisor was continuing to meet its obligations to Marjo.⁴³ On 28 November 2014, Marjo closed the Business in order to avoid liability under its lease.⁴⁴

34 Following a request for hardship, Westpac granted hardship assistance to Marjo under which repayments on the Loan were reduced to zero until April 2015 and arrears were capped, to allow Ms Messih and her sister-in-law time to find alternative employment.⁴⁵ However, when the hardship period finished, Ms Messih and her sister-in-law were still not able to meet the repayment obligations.⁴⁶

Repayment of the Loan and the FOS Complaint

35 Ms Messih sold the Maribyrnong Property. Although the property secured the entirety of the business debt, Ms Messih wished to use the proceeds of sale to repay only half of the debt, with the other half to be met by Ms Messih's sister-in-law in weekly instalments of \$100.⁴⁷ Westpac informed Ms Messih that it would not accept the proposal because, if it were to do so, it would have converted approximately \$145,000 of the debt to an unsecured loan.⁴⁸ On 9 September 2016, Ms Messih signed a release which provided that all of the proceeds would be applied to the outstanding debt.⁴⁹

36 However, on 20 September 2016, Ms Messih made a complaint to FOS disputing Westpac's entitlement to apply the proceeds of sale of the Maribyrnong Property to the Loan. Later, Ms Messih also complained that Westpac had sent her 13 collections text messages between 17 November 2016 and 3 December 2016.⁵⁰ The text messages were sent to Ms Messih due to a human processing error which failed to link Ms Messih's home loan with the lodgement of the

³⁹ Messih Statement: [31].

⁴⁰ Messih Statement: [31].

⁴¹ Transcript 22 May 2018 (Messih), T2183:1.

⁴² Ex 3.23 Emails between Skujins, Jacquier and Others [WBC.404.014.0582].

⁴³ Transcript 22 May 2018 (Messih), T2189:13-27.

⁴⁴ Transcript 22 May 2018 (Messih), T2183:14-19; Exhibit 3.22.51 AW3-51 [WBC.404.003.0190].

⁴⁵ Messih Statement: [34].

⁴⁶ Transcript 22 May 2018 (Messih), T2183:45 – T2184:13.

⁴⁷ Transcript 22 May 2018 (Messih), T2185:19-28; Welsh Statement: [159]; Ex 3.22.60.1 AW3-60 [WBC.404.003.0003]; Ex 3.22.60.2 AW3-60 [WBC.404.003.0009]; Ex 3.22.60.3 AW3-60 [WBC.404.003.0010].

⁴⁸ Welsh Statement: [160]; Ex 3.22.61 AW3-61 [WBC.404.003.0002]; Ex 3.22.62 AW3-62 [WBC.404.003.0011].

⁴⁹ Welsh Statement: [161]; Ex 3.22.63 AW3-63 [WBC.404.001.1142].

⁵⁰ Welsh Statement: [162]; Ex 3.22.68 AW3-68 [WBC.404.012.4242].

FOS dispute.⁵¹ Westpac is confident that the human error was an isolated incident and not indicative of a systemic issue.

- 37 In addition, a technical issue, due to a system transfer problem with Westpac's SMS provider, caused more text messages to be sent on consecutive days than would ordinarily occur. Westpac's usual practice is to send, at most, one text message every three days. The technical issue was discovered in November 2016. But for this issue, Ms Messih would have received no more than five text messages spaced out with more days in between.
- 38 On 9 February 2017, FOS issued a Recommendation, which stated (among other things) that Westpac was entitled to apply the proceeds of sale of the Maribyrrong Property as it had, but that it had inappropriately sent Ms Messih collections messages after the matter had been referred to FOS.⁵² FOS recommended that Westpac pay Ms Messih \$6500 for the text messages sent.⁵³ That payment was made on 23 February 2017.
- 39 In closing submissions, Counsel Assisting stated that FOS's findings concerning the application of the proceeds of sale suggested that Ms Messih did not fully understand the nature of her guarantee.⁵⁴ Westpac does not accept that the findings in the FOS Recommendation make such a suggestion. FOS characterised Ms Messih's complaint as one of unfairness rather than illegality and found that Westpac's application of the proceeds of sale was not unfair.⁵⁵ The Recommendation makes no mention of the guarantee.
- 40 Ms Messih's sister-in-law is currently paying Ms Messih \$120 per week to pay off her share of the Loan.⁵⁶

⁵¹ Welsh Statement: [165].

⁵² Welsh Statement: [166] – [167]; Ex 3.22.69 AW3-69 [WBC.404.012.4195].
Ex 3.22.69 AW3-69 [WBC.404.012.4195].

⁵⁴ Transcript 1 June 2018 (Hodge QC), T3030:39 – T3031:1.

⁵⁵ Ex 3.22.69 AW3-69 [WBC.404.012.4195 at .4198].

⁵⁶ Transcript 22 May 2018 (Messih), T2185:39-40.