

# Westpac Banking Corporation - Submissions on Rubric 3-10 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 the "power and communication" topic in the context of small business lending.
- 2 This case study concerns loans provided by Westpac, through its Bank of Melbourne business (**BOM**), to Thir Pty Ltd (**Thir**), which were secured by two properties that BOM had assessed as residential. BOM subsequently identified that it considered that the second property was commercial in nature. When Thir sold the first property, BOM required that a portion of the sales proceeds be placed in a term deposit to address a security shortfall caused by the reclassification of the second property. Westpac accepts that it should not have done so.
- 3 These submissions address the proposed findings identified by Counsel Assisting as to Westpac's conduct in respect of Thir. The factual findings that Westpac submits the Commission should make with respect to this case study are set out in the Annexure.

## PROPOSED FINDINGS IN RELATION TO THE THIR CASE STUDY

- 4 Counsel Assisting identified the following findings as potentially open:
  - a. By requiring the loan to be restructured in 2017 and retaining the \$100,000, BOM breached clause 3.2 of the Code of Banking Practice (**COBP**) in failing to act fairly and reasonably towards Mr and Mrs Wallis in a consistent and ethical manner.<sup>1</sup>
  - b. By representing that it had a legal entitlement to withhold \$100,000 from Mr and Mrs Wallis in a term deposit account, in circumstances in which the mortgage memorandum provisions only permitted this to be done where the \$100,000 was to be used to pay down the Byabarra loan, BOM engaged in conduct which was misleading or deceptive in contravention of s12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**).<sup>2</sup>
  - c. In representing to Thir and Mr and Mrs Wallis that the bank had a legal entitlement to withhold the \$100,000, and in withholding these funds to rectify the bank's own security shortfall, BOM engaged in conduct that fell short of community standards and expectations.<sup>3</sup>
- 5 Westpac's response to those proposed findings is set out below.
- 6 Capitalised terms have the same meaning as defined in the Annexure.

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<sup>1</sup> Transcript 1 June 2018, T3058:10.

<sup>2</sup> Transcript 1 June 2018, T3058:21.

<sup>3</sup> Transcript 1 June 2018, T3058:21.

### Clause 3.2 of the Code of Banking Practice

**Potential finding:** By requiring the loan to be restructured in 2017 and retaining the \$100,000, Bank of Melbourne breached clause 3.2 of the Code of Banking Practice in failing to act fairly and reasonably towards Mr and Mrs Wallis in a consistent and ethical manner.<sup>4</sup>

- 7 For the reasons discussed below, Westpac accepts that BOM did not act fairly and reasonably in requiring Thir to provide the term deposit. It does not accept that it acted unethically in doing so.
- 8 On 23 June 2017, Mr Wallis on behalf of Thir requested that the Byabarra Property be revalued as Thir was considering borrowing against any additional equity to buy a property on the Gold Coast for the Wallis family to live in.<sup>5</sup>
- 9 In the course of arranging the revaluation of the Byabarra Property, the banker identified that the Byabarra Property had been initially classified by BOM as a residential property when the loan was originated where in fact it appeared that it should have been classified as a commercial property.<sup>6</sup> As a consequence, and because the applicable loan to value ratio between commercial and residential property is different, there was a security shortfall in respect of the property. BOM would only have been prepared to lend up to 65% of the value of the Byabarra Property if it had been initially classified as commercial, compared to 80% on the basis of its initial classification as residential property.<sup>7</sup>
- 10 On 19 September 2017, Thir sold the Port Macquarie Property for \$720,000. BOM made it a condition of discharging its mortgage over the Port Macquarie Property that the Byabarra Loan be redocumented as a business loan, and that \$100,000 of the proceeds of sale be placed in a term deposit as security for the Byabarra Loan until the security shortfall on the Byabarra Loan was addressed by the Byabarra Property being revalued at a higher value, which the customer expected would occur.<sup>8</sup> The period for which the term deposit would be required was anticipated to be limited to a matter of weeks as it was anticipated that the security shortfall would be addressed by the revaluation in that time period.<sup>9</sup>
- 11 The term deposit was released on 2 February 2018, after Thir entered into an agreement to sell the Byabarra Property, with sufficient proceeds to discharge the Byabarra Loan.<sup>10</sup>

<sup>4</sup> Transcript 1 June 2018, T3058:10.

<sup>5</sup> Ex 3.59 Witness Statement of Alastair Derek Dawson Welsh dated 17 May 2018 in response to Rubric 3-10 [WBC.900.001.0505] (**Welsh Statement**): [101]; Ex 3.59.42, Ex AW2-41 [WBC.403.007.1206]; Ex 3.54 Statement of Bradley Paul Wallis dated 22 May 2018 [WIT.0001.0040.0001] (**Wallis Statement**): [31]; Transcript 24 May 2018 (Wallis), T2408:23-47.

<sup>6</sup> Welsh Statement: [102].

<sup>7</sup> Welsh Statement: [103].

<sup>8</sup> Welsh Statement: [104]-[107]; BPW-9 [WBC.403.006.4064] at .4067.

<sup>9</sup> Ex 3.66 [WBC.403.001.1737] at .1737 and .1738.

<sup>10</sup> Welsh Statement: [114]-[116].

- 12 Alastair Welsh, Westpac's General Manager of Commercial Banking, gave evidence that the Byabarra Property should have been assessed as a commercial property, and the loan should have been offered as a business loan.<sup>11</sup> Westpac accepts that, having discovered that the Byabarra Property should have been classified as a commercial property rather than as a residential property, BOM should not have sought to address the security shortfall and the better course would have been to accept the position.<sup>12</sup>
- 13 Mr Welsh agreed that it was unfair for BOM to have withheld the sum of \$100,000 from Mr and Mrs Wallis and Thir, acknowledging that BOM was seeking to address a security shortfall that was the result of its own error.<sup>13</sup> Westpac accepts that by reason of BOM's conduct, it failed to act fairly and reasonably towards Thir in accordance with cl 3.2 of the Code. However, Westpac does not accept that the conduct was unethical. The term deposit was meant to be temporary. It was expected that the issue would be resolved quickly by the completion of the revaluation of the Byabarra Property and then the term deposit would be released. At the time, Mr Wallis expected that the Byabarra Property was worth over \$800,000 (which was \$150,000 more than the purchase price paid by Thir in June 2016).<sup>14</sup>
- 14 As it turned out, Mr and Mrs Wallis decided to sell the Byabarra Property and the Byabarra Loan was paid out. On 2 February 2018, the term deposit was released together with interest.<sup>15</sup> The reasons why the term deposit was required were explained to the customer and the approach avoided the customer having to pay down the existing loan.

### Section 12DA of the ASIC Act

**Potential finding:** By representing that it had a legal entitlement to withhold \$100,000 from Mr and Mrs Wallis in a term deposit account, in circumstances in which the mortgage memorandum provisions only permitted this to be done where the \$100,000 was to be used to pay down the Byabarra loan, Bank of Melbourne engaged in conduct which was misleading or deceptive in contravention of s12DA of the ASIC Act.<sup>16</sup>

- 15 Westpac submits that it is not reasonably open to the Commission to find that any representations made by BOM to Mr and Mrs Wallis about the term deposit were misleading or deceptive conduct in breach of s 12DA of the ASIC Act, for the reasons set out below.
- 16 Section 12DA of the ASIC Act prohibits a person engaging in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive. The Commission should find that BOM did not contravene s 12DA of the ASIC Act on the following grounds.

<sup>11</sup> Transcript 25 May 2018 (Welsh), T2434:36; T2443:2-5.

<sup>12</sup> Welsh Statement: [121(a)].

<sup>13</sup> Transcript 25 May 2018 (Welsh), T2458:44 – T2459:17; T2463:24-44.

<sup>14</sup> Welsh Statement: [107]; Wallis Statement: [16].

<sup>15</sup> Welsh Statement, [107], [114] – [115]; Ex 3.59.52, Ex AW2-50 [WBC.403.007.1453] at .1457.

<sup>16</sup> Transcript 1 June 2018, T3058:21.

17 First, BOM's conduct was not misleading or deceptive, or likely to mislead or deceive, because BOM had a legal entitlement to withhold the sum of \$100,000 in a term deposit account, and, accordingly, any representations to that effect were correct rather than being misleading. BOM took the course of requiring the sum of \$100,000 from the proceeds of sale of the Port Macquarie Property to be placed in a term deposit as security for the Byabarra Loan, until the security shortfall on the Byabarra Loan was addressed by the Byabarra Property being revalued at a higher value, on the basis of clauses 22.1 and 22.2 and the definition of "amount owing" in the BOM Memorandum of Provisions.<sup>17</sup> The material parts of those clauses and the definition of "amount owing" are set out below:

22.1 Money received under this mortgage is to be used towards paying the *amount owing* ...

22.2 If, at the time we receive the money, any part of the *amount owing* is not then due for payment, we may retain an amount equal to that part. We must hold it in an interest bearing account and use it ... to pay the *amount owing* when it becomes due for payment.

*amount owing* means, at any time and subject to clause 32, all money which one or more of you owe us, or will or may owe us in the future, *including* under this mortgage or an *agreement covered by this mortgage* ....

18 Under clauses 22.1 and 22.2 of the BOM Memorandum of Provisions, BOM was permitted to retain moneys received under the mortgage and use such moneys to pay an *amount owing*. If at the time the moneys were received an *amount owing* was not due for payment, BOM was permitted to retain an amount equal to a part of the *amount owing* until the *amount owing* was due for payment, which it was required to hold in an interest bearing account. At the time that the Port Macquarie Property was sold, there was a balance outstanding under the Byabarra Loan. That was an "amount owing" for the purposes of clause 22 of the BOM Memorandum of Provisions. That amount was not due for payment at that time. Consistent with clause 22.2, BOM retained the sale proceeds in an interest bearing account.

19 The terms of clause 22 of the BOM Memorandum of Provisions are directed to BOM's entitlement to receive and retain moneys under clause 22 and ensuring such moneys are not used or paid out in a manner contrary to clause 22. BOM was entitled to retain proceeds from the sale of the Port Macquarie Property under clause 22. There is no suggestion BOM used or paid any part of the amount retained in a manner that was contrary to clause 22.<sup>18</sup>

20 Second, the representation made by BOM was, at most, that BOM held the opinion, based on reasonable grounds, that under its contractual arrangements with Thir it had a legal entitlement to withhold \$100,000 in a term deposit account. The authorities make it clear that a representation of opinion as to a matter of law will not be misleading, even if the opinion turns out to be incorrect,

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<sup>17</sup> Welsh Statement, Tab 31, [WBC.403.006.4386].

<sup>18</sup> FOS directly considered the issue and concluded that the Bank of Melbourne was legally entitled to act as it did.

provided at least that the opinion is genuinely held and there are reasonable grounds for it.<sup>19</sup>

There is nothing to suggest that BOM did not genuinely hold the opinion that it had the legal entitlement it asserted, and there were plainly reasonable grounds for that opinion (even if, contrary to the first ground, it was not correct).

- 21 As to the first of those matters, the available evidence is all consistent with the fact that BOM held the opinion that it had a legal entitlement to withhold \$100,000 in a term deposit. The Regional General Manager informed Mr Wallis of the BOM Memorandum of Provisions that BOM relied upon in the following terms:

The particular document that relates to the bank's ability to control the flow of any settlement funds in relation to the discharging/partial discharging of securities is the BOM Memorandum of Common Provisions, particularly page 9, sections 22.2, 22.3, 23a, 23b along with section 27.1 but not limited to other relevant section (sic) of the agreement terms.<sup>20</sup>

- 22 As to the second matter, the information provided to Mr Wallis about the BOM Memorandum of Provisions was of a technical nature and it is likely the Regional General Manager obtained legal advice before conveying to Mr Wallis the basis for BOM's entitlement to withhold \$100,000 in a term deposit account. While Mr Welsh could not point to a document in BOM's records that confirms legal advice was obtained, he said that, in his experience, it is likely the Regional General Manager did so.<sup>21</sup> Even if he did not, however, it is clear from the clauses in the BOM Memorandum of Provisions identified in the Regional General Manager's email to Mr Wallis that he had a reasonable basis for representing that BOM had an entitlement to withhold \$100,000 in a term deposit account.
- 23 Thus, even if (contrary to the first ground) on the proper construction of clause 22 of the BOM Memorandum of Provisions those clauses did not confer a legal entitlement on BOM, there is no basis for doubting that BOM genuinely held the opinion that they did, or for concluding that there were not reasonable grounds for that opinion.
- 24 Third, Mr Wallis, on behalf of Thir, was not misled by BOM's representation. Mr Wallis adhered to his own belief that BOM was not entitled to withhold the sum of \$100,000. Mr Wallis treated the statements as representations of BOM's belief, on which he held a different view, which further demonstrates that the representation was merely one as to BOM's belief or, at most, a representation of opinion on a matter of law. Moreover, it is not reasonably open to the Commission to find that BOM's representation was likely to mislead or deceive, let alone misleading or deceptive, in circumstances where the only person to whom it was directed was not misled by it.

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<sup>19</sup> *Inn Leisure Industries Pty Ltd v D F McCloy Pty Ltd* (1991) 28 FCR 151 at 167 (French J, as his Honour then was); see also the authorities cited in *RAIA Insurance Brokers Ltd v FAI General Insurance Co Ltd* (1993) 41 FCR 164 (Beaumont and Spender JJ) at 172-174.

<sup>20</sup> Ex 3.54.9, Ex BPW-9 [WBC.403.006.4064] at .4065.

<sup>21</sup> Transcript 25 May 2018 (Welsh), T2453:19-41.

25 For the above reasons, it is not reasonably open to the Commission to find that Westpac engaged in conduct in breach of s 12DA of the ASIC Act in its dealings with Thir.

### **Community standards and expectations**

**Potential finding:** In representing to Thir and Mr and Mrs Wallis that the bank had a legal entitlement to withhold the \$100,000, and in withholding these funds to rectify the bank's own security shortfall, Bank of Melbourne engaged in conduct that fell short of community standards and expectations.<sup>22</sup>

26 Westpac refers to and repeats paragraphs 15 to 25 above which apply equally to any suggested finding that, in representing to Thir and Mr and Mrs Wallis that BOM had a legal entitlement to withhold the sum of \$100,000, BOM engaged in conduct that fell short of community standards and expectations. It submits that it did not engage in such conduct.

27 Westpac refers to and repeats paragraphs 7 to 14 above in relation to the taking of the term deposit. Westpac accepts that requiring the term deposit, following its own mistake, was conduct that fell short of community standards and expectations.

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<sup>22</sup> Transcript 1 June 2018, T3058:21.

## ANNEXURE

### PROPOSED FACTUAL FINDINGS IN RELATION TO THE THIR CASE STUDY

#### Provision of loans to Thir

- 28 On 27 May 2016, BOM made a loan offer to Thir in the amount of \$460,000, secured by a first priority registered mortgage over Thir's property at Oxley Highway, Port Macquarie NSW 2444 (the **Port Macquarie Property**). The loan was accepted and entered into by Thir on around 8 June 2016 (the **Port Macquarie Loan**). The mortgage over the Port Macquarie Property was governed by BOM's Memorandum of Provisions that was registered with the New South Wales Land and Property Information with dealing number AF751541 (the **BOM Memorandum of Provisions**).<sup>23</sup>
- 29 On 2 June 2016, BOM made a loan offer to Thir as trustee for the Wallis Family Trust in the amount of \$516,000, secured by a first priority registered mortgage over the property acquired by Thir at Comboyne Road, Byabarra NSW 2446 (the **Byabarra Property**). The loan was accepted and entered into by Thir on or around 8 June 2016 (the **Byabarra Loan**).<sup>24</sup>
- 30 The Byabarra Loan was offered in the form of a residential loan and the loan application was assessed on the basis that the Byabarra Property was residential property.<sup>25</sup> The value of the Byabarra Property was assessed on the basis of the price in the contract of sale, rather than a valuation, as permitted by the consumer lending policy (as opposed to the relevant business lending policy).<sup>26</sup> If the Byabarra Property was in fact a residential property, the consumer lending policy would have permitted the loan to be assessed on the basis of the purchase price in the contract of sale as the purchase price was less than \$2 million.<sup>27</sup> As the Byabarra Property was assessed by BOM as a residential property, BOM was willing to lend Thir a larger proportion of the value of the property than it would have been if it were assessed to be commercial property (80% rather than 65%), because BOM considered residential property to be a more reliable form of security.<sup>28</sup>
- 31 The Byabarra Property included both residential and commercial aspects.<sup>29</sup> Mr Welsh gave evidence that the property should properly have been assessed as a commercial property, and the loan should have been offered as a business loan.<sup>30</sup> The consequence of the loan being

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<sup>23</sup> Welsh Statement: [81]; Ex 3.59.31, Ex AW2-31 [WBC.403.002.0077] and Ex 3.59.32 [WBC.403.006.4386].

<sup>24</sup> Welsh Statement: [82].

<sup>25</sup> Welsh Statement: [83]; Ex 3.59.33, Ex AW2-32 [WBC.403.002.0069].

<sup>26</sup> Welsh Statement: [83]; Ex 3.71 [WBC.050.034.8298] at .8414; Transcript 25 May 2018 (Welsh); Transcript 25 May 2018 (Welsh), T2467:4-9.

<sup>27</sup> Ex 3.71 [WBC.050.034.8298] at .8414.

<sup>28</sup> Welsh Statement: [85]; Transcript 25 May 2018 (Welsh), T2430:25-41.

<sup>29</sup> Welsh Statement: [83].

<sup>30</sup> Transcript 25 May 2018 (Welsh), T2434:36; T2443:2-5.



assessed in that manner would have been that BOM would have offered to lend Thir a lower amount<sup>31</sup> at a higher interest rate.<sup>32</sup>

## Byabarra

32 The Wallis family relocated to the Byabarra Property in the months after the Byabarra Loan was made. They undertook renovations and re-opened the café and bed and breakfast business on the Byabarra Property in September 2016. The business began to struggle within five to six weeks after it was re-opened. By March/April 2017, Mr and Mrs Wallis decided it was no longer viable for them to operate the business and they decided to try to sell the business although they were unsuccessful in doing so. During that time, Mr Wallis also applied for a job on the Gold Coast and the family relocated to the Gold Coast. The Wallis family had difficulty finding a suitable rental property and decided to buy a property on the Gold Coast to live in.<sup>33</sup>

33 By June 2017, Mr and Mrs Wallis' financial circumstances had changed dramatically. Mr Wallis had left his job in Melbourne and the Wallis family had relocated to Byabarra. The business on the Byabarra Property was not viable and the family then relocated to the Gold Coast. Mr and Mrs Wallis had incurred costs in renovating the Byabarra Property and borrowed money from their parents to cover the costs of operating the business.<sup>34</sup>

## Term deposit

34 On 23 June 2017, Mr Wallis on behalf of Thir requested that the Byabarra Property be revalued as Thir was considering borrowing against any additional equity to buy a property on the Gold Coast for the Wallis family to live in.<sup>35</sup> In the course of arranging for that revaluation, BOM identified that the Byabarra Property had been classified as a residential property when the loan was originated where in fact it was considered likely that it should have been classified as commercial property.<sup>36</sup> As a consequence, BOM considered that it had a security shortfall, on the basis that it would only have been prepared to lend 65% of the value of the Byabarra Property if it had been classified as commercial.<sup>37</sup>

35 On 19 September 2017, Thir sold the Port Macquarie Property for \$720,000. BOM made it a condition of discharging its mortgage over the Port Macquarie Property that the Byabarra Loan be redocumented as a business loan, and that \$100,000 of the proceeds of sale be placed in a term deposit as security for the Byabarra Loan until the security shortfall on the Byabarra Loan was

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<sup>31</sup> Welsh Statement: [86].

<sup>32</sup> Welsh Statement: [113].

<sup>33</sup> Transcript 24 May 2018 (Wallis), T2406.1 – T2408.47.

<sup>34</sup> Wallis Statement: [24]-[26]; Transcript 24 May 2018 (Wallis), T2406.1 – T2408.47.

<sup>35</sup> Welsh Statement: [101]; Ex 3.59.42, Ex AW2-41 [WBC.403.007.1206]; Wallis Statement: [31]; Transcript 24 May 2018 (Wallis), T2408:23-47.

<sup>36</sup> Welsh Statement: [102].

<sup>37</sup> Welsh Statement: [103].

addressed by the Byabarra Property being revalued at a higher value, as the customer expected.<sup>38</sup> That action was taken on the basis of clause 22 of the Mortgage Provisions.

36 It was expected the issue would be resolved quickly by the completion of the valuation of the Byabarra Property and the term deposit would be released. At the time, Mr Wallis expected that the Byabarra Property was worth over \$800,000 (which was \$150,000 more than the purchase price paid by Thir in June 2016).<sup>39</sup>

37 The term deposit was released on 2 February 2018, after Thir entered into an agreement to sell the Byabarra Property, with sufficient proceeds to discharge the Byabarra Loan.<sup>40</sup>

38 On or around 31 October 2017, Thir made a complaint to FOS with respect to the term deposit.<sup>41</sup> In the course of that matter, BOM provided a number of responses to information requests from FOS. On 18 December 2017, BOM provided FOS with an email from the Business Banker then managing the Thir account which acknowledged that:

*the loan was incorrectly provided to [Thir] as a home loan at the outset given the valuers [sic] comments that the security offered was a commercial property and not a residential property. Therefore [BOM] incorrectly provided a home loan product to [Thir].<sup>42</sup>*

39 FOS issued its recommendation on 29 March 2018.<sup>43</sup> The recommendation:

- a. noted that BOM accepted that it did not obtain a valuation over the Byabarra Property when the Byabarra Loan was originated and that it had incorrectly advanced the loan as a consumer rather than a business loan; and
- b. concluded that BOM was entitled to require that the term deposit be established from the proceeds of the sale of the Port Macquarie Property under clause 22 of the Mortgage Provisions, but it was unfair for it to have done so; and
- c. concluded that Thir had not suffered any financial loss because BOM had paid a commercial rate of interest on the term deposit, but recommended that BOM pay Thir \$2,000 for non-financial loss.<sup>44</sup>

40 BOM accepted FOS's recommendation.<sup>45</sup> Thir also accepted FOS's recommendation.

41 On 10 April 2018, BOM paid Thir \$2,000 in accordance with the recommendation.<sup>46</sup>

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<sup>38</sup> Welsh Statement: [104]-[107]; BPW-9 [WBC.403.006.4064] at .4067.

<sup>39</sup> Welsh Statement: [107]; Wallis Statement: [16].

<sup>40</sup> Welsh Statement: [114]-[116].

<sup>41</sup> Welsh Statement: [111]; Ex 3.59.48, AW2-47 [WBC.403.005.0435].

<sup>42</sup> Ex 3.184 [WBC.403.007.1108].

<sup>43</sup> Welsh Statement: [117].

<sup>44</sup> Ex 3.59.52, AW2-50 [WBC.403.007.1453].

<sup>45</sup> Welsh Statement: [119].

<sup>46</sup> Welsh Statement: [119].