

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

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

**Round 4 Hearing – Agricultural Lending & Enforcement Practices**

**Closing Submissions**

**PART A – PROPOSED FINDINGS**

**RUDDY CASE STUDY**

1. Counsel Assisting has made submissions that, on the evidence, it is open to the Commissioner to make a number of findings of "misconduct" (as that term is defined in the Letters Patent) concerning the Ruddy Case Study, because Bankwest breached the obligation in clause 2.2 of the Code of Banking Practice (**Code**)<sup>1</sup> to act fairly and reasonably towards Mr and Mrs Ruddy (together the Ruddys) in a consistent and ethical manner.
2. Counsel Assisting has also made submissions that, on the evidence, it is also open to the Commissioner to find that Bankwest engaged in conduct that fell below community standards and expectations.
3. Counsel Assisting submits that, on the evidence, it is open to the Commissioner to find that there were a number of causes of the misconduct which are attributable to Bankwest's culture and governance practices, as well as its remuneration practices and inadequate internal systems.
4. Bankwest's response to these submissions is set out below.

**Factual Findings Alleged by Counsel Assisting**

5. Bankwest accepts Counsel Assisting's summary of the factual background to the Ruddy Case Study, subject to the following matters:
  - (a) Between March 2012 and November 2013, Bankwest granted a number of temporary and permanent increases to the Ruddys' overdraft facility. The first permanent increase from \$100,000 to \$200,000 occurred on 24 September 2012. Bankwest contemplated a further permanent increase to the Ruddys' overdraft facility (to \$260,000) in early May 2013 as part of the annual review of the Ruddys' facilities and approved a permanent increase to \$270,000 on 21 May 2013.<sup>2</sup> Ms Taylor's evidence was that those increases were to support the Ruddys given the

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<sup>1</sup> The relevant Code for this case study is the one that commenced in 2004.

<sup>2</sup> Exhibits ST-80 and ST-81 to the Statement of S Taylor, dated 24 June 2018.

cyclical nature of farming and the impact of drought and not to allow Bankwest to charge the external valuation fees to the account.<sup>3</sup>

- (b) The deduction of the valuation fees did not cause the Ruddys to be in excess of their facilities.<sup>4</sup>
- (c) Following receipt of the proceeds from the sale of Sunrise and settlement amount from the Ruddys, Bankwest wrote off the remaining outstanding amount of \$604,275.18.<sup>5</sup>
- (d) Following settlement, the Ruddys were able to retain the operating farm, Arranfield,<sup>6</sup> and currently own Arranfield outright.<sup>7</sup> Bankwest did not register or record any default actions against the Ruddys' and is not aware of any circumstances that may have restricted the Ruddys' future capacity to obtain finance as all security held was released by Bankwest.
- (e) At the time Bankwest offered the facilities to the Ruddys, Bankwest employees were only eligible for short-term incentive payments if they met certain risk and behaviour objectives.<sup>8</sup> The amount an employee was eligible to receive then varied according to how that employee had performed against each of the performance criteria.<sup>9</sup>

6. Although one of the loan facilities was in both of their names and the other was only in Mr Ruddy's name, for the purposes of these submissions the loans will be treated as one facility.

### **Alleged Breaches of Clause 2.2 of the Code**

#### *First Alleged Misconduct Finding - offer of loan facilities on the basis of an incorrect valuation*

- 7. Counsel Assisting alleges that Bankwest's conduct breached clause 2.2 of the Code by offering the loan facilities to the Ruddys on the basis of an incorrect valuation.
- 8. Bankwest accepts that the offer of finance made by Bankwest to the Ruddys was conditional on an adequate valuation of the two properties owned by them - which were intended to be provided as security for the facilities offered. These two properties, known as "Arranfield" and

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<sup>3</sup> Statement of S Taylor, dated 24 June 2018 paragraph 67; T3486.38-T3487.21; and T3535.38-41.

<sup>4</sup> T3535.10-20; and Exhibit ST-83A to the Statement of S Taylor, dated 24 June 2018.

<sup>5</sup> Statement of S Taylor, dated 24 June 2018 paragraph 106.

<sup>6</sup> Exhibit ST-40 to the Statement of S Taylor, dated 24 June 2018.

<sup>7</sup> Statement of M Ruddy, dated 21 June 2018 paragraph 64; Statement of S Taylor, dated 24 June 2018 paragraph 135(b).

<sup>8</sup> T3531.4-9.

<sup>9</sup> T3461-25 - T3462.30.

“Sunrise” were valued by the person who was to become Mr Ruddy’s initial relationship manager (otherwise referred to in these submissions as “the bank manager”).

9. The bank manager was a Bankwest accredited valuer, having completed Bankwest’s required external valuation accreditation.<sup>10</sup>
10. The bank manager valued Arranfield at \$1.1 million and Sunrise at \$1.2 million.<sup>11</sup>
11. While no question has been raised concerning the accuracy of the value attributed to Arranfield, Bankwest accepts, that the bank manager made errors when valuing Sunrise. The Financial Ombudsman Service (**FOS**) found and accepted this position.<sup>12</sup> The bank manager relied primarily for his valuation of Sunrise on a comparison with the values of properties that were significantly larger than Sunrise and applied an incorrect land size for Sunrise in arriving at his valuation.
12. The Ruddys’ loan application was considered by Bankwest’s Credit Department, which was required to assess both the serviceability of the loan and the adequacy of the security provided. As conceded by Ms Taylor in evidence,<sup>13</sup> the errors are readily apparent on the face of the valuation. The errors in the bank manager’s valuation of Sunrise should therefore have been detected during this approval process, but they were not.
13. Nor were the errors detected by several bank officers who reviewed the Ruddys’ facilities at various times in the period October 2011 to May 2013. It should be noted that in 2011 the Relationship Manager did seek external advice in relation to both valuations and was advised by two external valuers that the values were in line with the original valuations.<sup>14</sup>
14. During cross-examination, Ms Taylor accepted that by getting the valuation wrong, Bankwest had engaged in conduct that fell below community standards and expectations.
15. Counsel Assisting has submitted that in addition, Bankwest’s conduct breached clause 2.2 of the Code. It is convenient, at this juncture, to make some observations about that provision, and how the concept of fairness operates in a consideration of whether the clause has been breached.
16. Clause 2.2 of Code provides:

*We will act fairly and reasonably towards you in a consistent and ethical manner. In doing so we will consider your conduct, our conduct and the contract between us.*

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<sup>10</sup> T3473.39-40.

<sup>11</sup> Statement of S Taylor, dated 24 June 2018 paragraphs 115-116 and Exhibits ST-74 and ST-75.

<sup>12</sup> Exhibit ST-57 to the Statement of S Taylor, dated 24 June 2018.

<sup>13</sup> T3528.20-25.

<sup>14</sup> Exhibit ST-85 to the Statement of S Taylor, dated 24 June 2018 at p.0528.

17. Any consideration of whether clause 2.2 of the Code has been breached must involve a consideration of the commercial context in which the Bank is operating. It follows that in considering whether clause 2.2 of the Code has been breached, consideration should be given to a range of factors, including:
- (a) whether the conduct was an honest or inadvertent mistake, or whether it was deliberate, or dishonest;
  - (b) whether the conduct had an adverse impact on the consumer;
  - (c) what the relevant financial institution did once it became aware of the conduct; and
  - (d) how the conduct should be considered in the context of the overall activities of the financial institution and its relationship with the customer.
18. Insofar as the last matter is concerned, while a particular event should be considered in the broader context of the Bank's relationship with the customer, it is also important that consideration be given to any particular event. That is, the fact that there may be more than one instance of conduct should not lead automatically to the conclusion that the cumulative effect of those events amounts to a breach of clause 2.2 of the Code. Similarly, the fact that there may be only one instance of conduct, should not lead automatically to a conclusion that it was an isolated event and therefore not a contravention of the Code. An objective balancing exercise needs to be undertaken in each instance, taking all of the circumstances into account.
19. In considering the errors in the valuation of Sunrise, Ms Taylor did not concede that the bank manager's conduct amounted to misconduct.<sup>15</sup> FOS determined that the valuation did not render the lending inappropriate and that the facility would likely have been granted even if an accurate valuation of Sunrise had occurred.<sup>16</sup>
20. However, Bankwest accepts that it is open to the Commissioner to infer that the bank manager deliberately and dishonestly engaged in the overvaluation of Sunrise, given the details about the bank manager's broader conduct which was later identified by Bankwest.<sup>17</sup> Further, as discussed in paragraphs 24 to 30 below, Bankwest accepts that it did not do enough when it became aware of the bank manager's conduct.
21. The broader context of Bankwest's relationship with the Ruddys includes the fact that Bankwest ultimately wrote-off \$604,275.18 in debt in respect of the Ruddys' facility,<sup>18</sup> but it

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<sup>15</sup> T3477.5-6.

<sup>16</sup> Exhibit ST-57 to the Statement of S Taylor, dated 24 June 2018 at p.0048.

<sup>17</sup> For example, Exhibits 4.104 (CBA.4000.0110.0241); 4.105 (CBA.4000.0110.0223); 4.106 (CBA.4000.0110.0223); 4.107 (CBA.0002.2115.3931); and 4.108 (CBA.0002.2114.0587).

<sup>18</sup> Statement of S Taylor, dated 24 June 2018 paragraph 106.

also involves other deficiencies (which are discussed in the further misconduct allegations below).

22. Having regard to all of these matters, and regardless of the eventual write-off in respect of the Ruddys' facility, on balance Bankwest accepts that it is open to the Commissioner to make a finding that the bank manager's action in overvaluing the Sunrise property was a contravention of the obligation in clause 2.2 of the Code.
23. Bankwest has now implemented a control framework that requires any internal valuation conducted by a bank officer to be reviewed by Commercial Valuations Business Credit, a team of registered valuers employed by the Bank who work separately in the risk department and must review and accept all internal valuations prior to funding.<sup>19</sup> It is Bankwest's submission that this system would detect errors of the kind identified with the valuation of Sunrise.<sup>20</sup>

*Second Alleged Misconduct Finding - inadequate steps to inquire into bank managers valuations*

24. The second alleged breach of clause 2.2 of the Code arises from the failure to take adequate steps to inquire into the bank manager's valuations of the Ruddys' properties after Bankwest learned of the bank manager's misconduct in relation to other Bankwest customers, including that internal valuations undertaken by the bank manager may have been inflated.<sup>21</sup>
25. As noted above, the bank manager was responsible for the initial overvaluation of Sunrise. The bank manager left Bankwest's employ, having resigned, in March 2012. At about the time, or shortly after, the bank manager left Bankwest's employ, Bankwest discovered a number of irregularities in his conduct with relation to other Bankwest customers. This caused Bankwest to undertake a review of the bank manager's loan portfolio files.
26. One of the issues that emerged in relation to the bank manager's conduct was a concern that he might have valued certain security properties inaccurately. That discovery ought to have alerted Bankwest to the possibility that the valuations of the Ruddys' properties might not have been accurate.
27. Despite a review of some of the bank manager's other files, Bankwest did not discover the errors in the valuation of Sunrise until May 2013.
28. Bankwest accepts that:
  - (a) by early April 2012 Bankwest ought to have discovered the errors in the valuation of Sunrise;<sup>22</sup> and

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<sup>19</sup> Statement of S Taylor, dated 24 June 2018 paragraphs 139-140. See also T3527.42-47 and T3528.1-5.

<sup>20</sup> Exhibit ST-88 to the Statement of S Taylor, dated 24 June 2018. See also T3528.19-21.

<sup>21</sup> CBA.4000.0105.0147 (Tender Bundle Tranche 36).

<sup>22</sup> T3470.13-23.

(b) as discussed in paragraph 35 below, it ought to have alerted the Ruddys to concerns about the bank manager's conduct and its potential impact on their facilities.

29. Bankwest accepts that, for conduct of a sufficiently serious nature, it should have caused the files of all customers, who may have been potentially impacted, to be reviewed. Bankwest also notes that the circumstances of an employee's departure from the organisation must now be recorded on its Human Resources system.<sup>23</sup> In this way, information about the reasons for an employee's departure are available for reference.

30. Bankwest accepts that the failure to sufficiently inquire into the bank manager's valuations fell below community standards and expectations.<sup>24</sup> In addition, given the matters outlined in paragraphs 26 to 29 above, Bankwest accepts that it is open to the Commissioner to find that this failure was a breach of clause 2.2 of the Code.

*Third Alleged Misconduct Finding - reliance on breach of LVR to renegotiate terms of facilities*

31. The third alleged breach of clause 2.2 of the Code relates to Bankwest's reliance on the loan to value ratio covenant breach occasioned by the 2013 valuations to renegotiate the terms of the Ruddys' agreements with the Bank in a way that was disadvantageous to the Ruddys.

32. Ms Taylor accepted that it was not fair for Bankwest to rely on the revised 2013 valuations to require a restructure of the Ruddys' facilities by requiring them to list Sunrise for sale and to make a debt reduction of \$50,000 by the end of 2013, and that it is open to the Commissioner to find that this behaviour breached clause 2.2 of the Code.<sup>25</sup>

33. However, Bankwest also notes that whilst it was not reasonable for Bankwest to require the Ruddys as a contractual term to sell one of their security properties by way of an amendment to their facilities in June 2013, the sale of that property in order to address the ongoing and worsening financial position that the Ruddys found themselves in at that date was inevitable in the circumstances (see paragraphs 39 and following below).

*Fourth Alleged Misconduct Finding - failure to inform clients of bank manager's conduct*

34. The fourth alleged breach of clause 2.2 of the Code relates to Bankwest choosing not to inform the Ruddys, and the bank manager's other clients, of the bank manager's conduct after it had been detected.

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<sup>23</sup> T3493.24-26.

<sup>24</sup> T3471.42-46.

<sup>25</sup> T3489.4-9.

35. Bankwest accepts that the Ruddys should have been informed that there were concerns in relation to other valuations undertaken by the bank manager. There is no evidence that they were provided with this information.
36. Bankwest accepts that it is open to the Commission to find that if there was a failure to inform the identified clients of the issue was a breach of clause 2.2 of the Code.<sup>26</sup>

*Fifth Alleged Misconduct Finding - failure to inform Ruddys of debit of valuation fees*

37. The fifth alleged breach of clause 2.2 of the Code was the failure to inform the Ruddys that it would charge the fees of the 2013 valuations to their overdraft account prior to doing so.
38. The issue of the charge for the valuations requires consideration of some context, as set out below.
39. The Ruddys had overdrawn their facilities with Rural Bank when they accepted the Bankwest facilities.<sup>27</sup> They ran into further financial difficulties almost from the outset of their relationship with Bankwest. By the end of January 2012, three months after the inception of the overdraft facility, they had utilised approximately \$77,000 of the available \$100,000 overdraft. From a review of the overdraft facility statements, it appears that none of that money had been used for the Ruddys' stated aim at the time of entry into the facilities, of buying further livestock.<sup>28</sup>
40. In part, this situation was caused by the use of \$18,000 of the overdraft to clear the excess on their Rural Bank facilities. The fact that the Ruddys had exceeded their facility limits at Rural Bank was not known to Bankwest at the time that the October 2011 facilities were offered.
41. In addition, the Ruddys wrote and / or cashed a large number of cheques within the initial weeks of the facility's inception.<sup>29</sup> Had the Ruddys not had these additional obligations - which were unknown to Bankwest in October 2011 - they would have had available to them the \$100,000 in their overdraft for the purposes of purchasing further livestock. As they did not have these funds available, and because the breeding model required them to purchase

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<sup>26</sup> T3471.42 - T3472.5.

<sup>27</sup> Prior to accepting the facility offered by Bankwest, the Ruddys had in place facilities with Rural Bank consisting of the following: a term loan in the name of Mr and Mrs Ruddy in an amount of \$425,000; a term loan in the name of Mr Ruddy for an amount of \$325,000; and an overdraft facility for \$270,000. The Rural Bank facilities had been approved in May 2011, and each of the term loans was for a period of 5.5 years, expiring in November 2016. Although the combined limit on the Rural Bank facilities was \$1.02 million, as at the date of settlement the Ruddys had exceeded their limits on those facilities and were indebted to Rural Bank in an amount of \$1,045,906. The effect of this was that in order to fully clear their facilities with Rural Bank the Ruddys were immediately required to draw approximately \$18,000 of the \$100,000 overdraft facility provided to them by Bankwest. See Exhibits ST-57 at p.0058, and 83A to the Statement of S Taylor, dated 24 June 2018.

<sup>28</sup> See Exhibits ST-57 at p.0049 and ST-84 at p.0215 and p.0221; and also ST-83A to the Statement of S Taylor, dated 24 June 2018.

<sup>29</sup> See Exhibit ST-83A to the Statement of S Taylor, dated 24 June 2018.

further livestock, they increased their stock leases with the Bank of Queensland in order to finance these purchases.<sup>30</sup> This had the effect of increasing both their overall debt position and their ongoing repayment obligations.

42. Over the course of the next two years, the Ruddys' financial position deteriorated further as a result of factors not anticipated either by them or by Bankwest at the time that the October 2011 facility was offered to the Ruddys. A number of these factors have been identified by Mr Ruddy. They include:

- (a) Mr Ruddy's illness;<sup>31</sup>
- (b) a flood in January 2012, followed by low rainfall for the remainder of the year;<sup>32</sup>
- (c) a drop in cattle prices as a result of the drought;<sup>33</sup>
- (d) the Australian Government's live cattle export ban and consequent further decline in cattle prices.<sup>34</sup>

43. The transition to the breeding model by the Ruddys was expected to limit their income.<sup>35</sup> But the effect of the above factors was to reduce this income beyond expectations, with the result that the Ruddys struggled to meet their ongoing repayment obligations. This was not because of the frequency or amount of these repayments, but because of the limited income being earned by the Ruddys. In fact it should be noted the pricing of the Ruddy facilities was far more competitive than the Rural pricing<sup>36</sup> which would have resulted in an annual saving on interest payments.

44. It is in this context that the Ruddys sought and - by necessity - were granted numerous temporary overdrafts, and permanent increases to their facilities in order to meet their repayments and other ongoing expenses. This pattern commenced from as early as March 2012 and continued until the end of 2013. Each of these extensions and increases, as well as the income of the Ruddys, is described in the evidence of Ms Taylor.<sup>37</sup>

45. In May 2013 Bankwest approved the last of these extensions, the effect of which was to extend the overdraft facility to \$270,000, as of 15 July 2013. Bankwest's records indicate that

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<sup>30</sup> T3438.45 - T3439.9. See also Exhibit ST-81 to the Statement of S Taylor, dated 24 June 2018.

<sup>31</sup> Statement of M Ruddy, dated 21 June 2018 paragraph 47.

<sup>32</sup> T3443.33-40.

<sup>33</sup> T3443.33-40.

<sup>34</sup> T3443.33-40.

<sup>35</sup> T3438.30-43.

<sup>36</sup> Exhibit ST-57 to the Statement of S Taylor, dated 24 June 2018 at p.0058.

<sup>37</sup> Statement of S Taylor, dated 24 June 2018 at paragraphs 64 and 65; and Exhibits ST-12, ST-13, ST-14, ST-15, ST-17, ST-18, ST-20, ST-21, ST-22, ST-25, ST-29, ST-30, ST-31, ST-32, ST-33 and ST-83A.

Mr Ruddy was conscious of his "heavy debt load" and was "considering the sale of Sunrise property, as it has minimal contribution to farm income".<sup>38</sup> Bankwest also recorded that there was "little scope for further debt increase", and that it was waiting for the outcome of new valuations of the properties.<sup>39</sup>

46. External valuations in May 2013 valued Sunrise at \$750,000 and Arranfield at \$900,000.<sup>40</sup> Mr Ruddy was informed that these valuations would be undertaken<sup>41</sup> and he was also informed that he would need to pay for the valuations.<sup>42</sup> The FOS Recommendation and Determination<sup>43</sup> held that Bankwest was entitled to obtain the valuations in 2013 and that the Ruddys were not entitled to compensation for losses alleged by the Ruddys to have arisen from Bankwest "sweeping" the cost of the valuations from the Ruddys' account.<sup>44</sup>
47. In the circumstances, Bankwest accepts that the failure to specifically inform the Ruddys of the timing of the debit from the account fell below community standards and expectations.<sup>45</sup> However in the circumstances, and in light of the findings by FOS, Bankwest does not accept this conduct breached clause 2.2 of the Code.
48. Recognising that the conduct did fall below community standards and expectations, as Ms Taylor noted in her evidence, it is now Bankwest's standard practice to engage in open dialogue with customers, as early as possible, to clarify the cost of the valuation, confirm that the cost will be borne by the customer and confirm in advance that the amount will be debited from the customer's account.<sup>46</sup>

### **Ruddy Case Study - Conduct Falling below Community Standards and Expectations**

49. A number of submissions have also been made by Counsel Assisting concerning the conduct of Bankwest which is said to fall below community standards and expectations. Each of these circumstances is set out below.

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<sup>38</sup> Exhibit ST-81 to the Statement of S Taylor, dated 24 June 2018.

<sup>39</sup> Exhibit ST-81 to the Statement of S Taylor, dated 24 June 2018.

<sup>40</sup> Exhibits ST-77 and ST-78 to the Statement of S Taylor, dated 24 June 2018.

<sup>41</sup> T3444.27-28.

<sup>42</sup> T3444.40-41.

<sup>43</sup> Exhibits ST-57 and ST-60 to the Statement of S Taylor, dated 24 June 2018.

<sup>44</sup> Exhibit ST-57 to the Statement of S Taylor, dated 24 June 2018 at p.0053.

<sup>45</sup> Statement of S Taylor, dated 24 June 2018 at paragraph 14; and T3488.5-7.

<sup>46</sup> Statement of S Taylor, dated 24 June 2018 at paragraph 142.

*First alleged conduct falling below community standards and expectations - inadequate care in preparation of the internal valuation of Sunrise*

50. Counsel Assisting has submitted that Bankwest failed to take adequate care in preparing the original internal valuation of Sunrise in October 2011 and that this is conduct which fell below community standards and expectations.
51. As noted above at paragraph 11, no question has been raised concerning the value attributed to Arranfield, an internal valuation which was undertaken by the same bank manager at the same time.
52. The cost of valuation can be a genuine issue for some customers, as expressed by Mr Ruddy in evidence,<sup>47</sup> and in those circumstances it is prudent for a bank to have available a valuation system which involves no cost to the customer. Further, in regional and rural areas, where external valuers may not be available, may not have important local knowledge, and where the timing to obtain an external valuation may be prolonged, internal valuations benefit some customers.
53. However, the October 2011 valuation of Sunrise contained clear errors, and those errors were not detected by other personnel within the bank. Bankwest accepts that this conduct fell below community standards and expectations (see paragraphs 12 and 13 above). While Bankwest concedes that adequate care was not taken with respect to the valuation of Sunrise, it does not concede, or accept, that this is reflective of the use of internal valuers as a whole, or that such conduct is systemic within Bankwest.

*Second alleged conduct falling below community standards and expectations - inadequate systems for detecting issues in internal valuations*

54. It is also submitted that Bankwest failed to have adequate systems in place to detect that the internal valuation was incorrect and that the community would expect that a bank would have controls in place to ensure that any inadequacies in a valuation were identified. Bankwest accepts this submission. As noted in paragraphs 12 and 13 above, the valuation of Sunrise contained errors which were not detected by personnel within Bankwest. It ought to have been.
55. Bankwest has remedied this omission through the introduction of a system whereby any internal valuation conducted by a bank officer is reviewed by a separate risk professional who is also a registered valuer and sits within the risk management team, as noted above at paragraph 23. It is Bankwest's submission that had this system been in place at the time, it would have detected the errors of the kind identified with the valuation of Sunrise. While

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<sup>47</sup> T3436.19-26.

Bankwest accepts that it did not have adequate systems in place at the relevant time, this is no longer the case.

*Third alleged conduct falling below community standards and expectations - inadequate processes*

56. Third, it is alleged that Bankwest's processes were lax in several significant respects as demonstrated by the misstated valuations, the undated guarantees, and separately, the signing of the guarantees before the letters of offer.
57. Ms Taylor was unable to explain these errors, including the fact that the valuation reports completed in 2011 were dated in late 2012, after the bank manager had left Bankwest.<sup>48</sup> In Bankwest's submission, these errors are not symptomatic of any deliberate conduct on the part of Bankwest but rather are errors which fall within the category of innocent mistakes.
58. Bankwest accepts that the community would expect greater care to be taken on the part of a bank in relation to these issues.

*Fourth alleged conduct falling below community standards and expectations - motivation for increase in facility limits being payment of valuation fees*

59. Fourth, it is submitted that when formulating its strategy for dealing with the Ruddys after the receipt of the May 2013 valuations, Bankwest determined that the appropriate course was to declare the May 2013 letters of offer null and void, forbear the Ruddys loan to value ratio covenant breach, and issue new letters of variation. It is alleged that in issuing the new letters of variation, Bankwest appears to have been motivated by a concern to increase the Ruddys overdraft sufficiently so that Bankwest could charge the external valuation fees to the account.
60. Ms Taylor did not agree with the proposition put by Counsel Assisting concerning the motivation of Bankwest.<sup>49</sup>
61. A review of the Ruddys' accounts leading to the increase in the facility demonstrates that the increase was not motivated by the requirement to charge the external valuation fees, but rather, by a need to assist the Ruddys to make those payments necessary to continue their farming operation and to provide them with some additional financial headroom.<sup>50</sup>
62. In this regard Bankwest notes that the extension of the Ruddys' overdraft had already been contemplated at a point prior to 13 June 2013, which is the date of the email from Gary Douglas to Mitchell Durack, said to engender this motivation.<sup>51</sup> That increase had already

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<sup>48</sup> T3475.37-47 and T3476.1-10.

<sup>49</sup> T3486.20.

<sup>50</sup> Exhibit ST-81 to the Statement of S Taylor, dated 24 June 2018.

<sup>51</sup> Exhibit 4.98 (CBA.4000.0096.1798); and T.3485.33 - T3486.18.

been approved on 21 May 2013,<sup>52</sup> and offered in the letter of offer dated 24 May 2013,<sup>53</sup> later rescinded and replaced with the letter of offer dated 21 June 2013 which made the identical offer of an extension to \$270,000.<sup>54</sup>

63. As at 31 May 2013, a review of the Ruddys accounts indicates that they had a limit of \$200,000 against a drawn overdraft balance of \$247,623. At this time the Bank allowed a temporary excess of \$60,000 above the overdraft limit. As at 28 June 2013, the limits had not yet been extended beyond \$200,000, against a drawn overdraft balance of \$228,490.<sup>55</sup> The temporary excess of \$60,000 had expired. However, as the approval had been granted for an increase in the limit to \$270,000 as at 21 May 2013,<sup>56</sup> the Bank continued to permit the Ruddys to utilise the account as if that limit had been formally extended, throughout June and early July 2013. That the Ruddys continued to make withdrawals, and also credited the account from time to time during this period, is apparent from a review of the accounts.<sup>57</sup>
64. The extension of the overdraft facility limit to \$270,000 was not made until 15 July 2013. The valuation fees were debited from the account prior to this (on 14 and 17 June 2013 respectively). The debiting of the fees did not cause the Ruddys to exceed that limit and funds remained available to them.<sup>58</sup>
65. With respect, Bankwest accepts the proposition put by the Commissioner in the hearing that the extension of the limit was to assist them to pay debts that they sought to pay, one of which was the valuation fees.<sup>59</sup> However Bankwest rejects the submission that the motivation for the extension of the facility was to ensure there were funds available to pay for the valuations.
66. The primary motivation for the increase as set out in the May Credit Paper<sup>60</sup> was to enable the Ruddys' excesses position to be normalised with an approved limit and to provide additional funding capacity to allow the Ruddys to continue to trade.<sup>61</sup> This also ensured that the Ruddys would not be subject to excess interest rates, a factor that had been considered and managed by ensuring temporary excesses were formalised quickly throughout the relationship thereby ensuring that the Ruddys would maintain their overdraft on normal rates.

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<sup>52</sup> Exhibits ST-80 and ST-81 to the Statement of S Taylor, dated 24 June 2018.

<sup>53</sup> Exhibit ST-28B to the Statement of S Taylor, dated 24 June 2018.

<sup>54</sup> Exhibit ST-23 to the Statement of S Taylor, dated 24 June 2018.

<sup>55</sup> Exhibit ST-83A to the Statement of S Taylor, dated 24 June 2018 at p.1451 and p1.453.

<sup>56</sup> Exhibits ST-80 and ST-81 to the Statement of S Taylor, dated 24 June 2018.

<sup>57</sup> Exhibit ST-83A to the Statement of S Taylor, dated 24 June 2018 at pp.1452 - 1455.

<sup>58</sup> Exhibit ST-83A to the Statement of S Taylor, dated 24 June 2018 at pp.1452-1453.

<sup>59</sup> T3487.11-22.

<sup>60</sup> Exhibit ST-80 to Statement of S Taylor, dated 24 June 2018.

<sup>61</sup> Exhibit ST-80 to Statement of S Taylor, dated 24 June 2018.

67. Finally, CBA notes that, in resolving the matter with the Ruddys' Bankwest wrote off the entirety of the overdraft, including all of the interest charged to the facilities.<sup>62</sup> The Ruddys ceased making any payments into the overdraft account on or about 16 September 2014, at which point the account was \$279,280.24 overdrawn. To the extent the Ruddys were receiving income from their continued farming operations, that income was not used to reduce their debt to Bankwest.

*Fifth alleged conduct falling below community standards and expectations - dealings with FOS*

68. Ms Taylor accepted that Bankwest did not deal with FOS in a full and frank way in relation to the Ruddys dispute, assuming that the staff member who dealt with the dispute had access to all of the details concerning the bank manager.<sup>63</sup>

69. Bankwest accepts that the manner in which it dealt with FOS fell below community standards and expectations. However, this was a result of the staff member handling the matter not having relevant information relating to the bank manager's conduct at the time, rather than a deliberate effort to conceal relevant facts.

70. As Ms Taylor explained in her evidence, there were not many people employed in the relevant part of Bankwest in 2016 who were present in 2013.<sup>64</sup>

71. It is apparent from the face of the FOS Recommendation that the internal valuations which were carried out were, in fact, provided to FOS.<sup>65</sup>

*Sixth alleged conduct falling below community standards and expectations - guarantee*

72. Sixth and finally, the guarantee provided by the Ruddys' son changed multiple times during the life of the facility. Ms Taylor said that she was "troubled" by the changes, and accepted that there was no explanation as to why the guarantee was not maintained with the facilities.<sup>66</sup>

73. Accordingly, Bankwest accepts that the manner in which the guarantee was amended fell below community standards and expectations. However, Bankwest also notes that at no time did it seek to rely on, or enforce, this guarantee.

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<sup>62</sup> Statement of S Taylor, dated 24 June 2018 at paragraphs 106 - 112.

<sup>63</sup> T3492.1-4.

<sup>64</sup> T3491.27-31.

<sup>65</sup> Exhibit ST-57 to the Statement of S Taylor, dated 24 June 2018.

<sup>66</sup> T3522.16-20.

## Causes of Misconduct

74. Counsel Assisting made two submissions concerning the causes of the misconduct.
75. First, it is said that it is open to the Commissioner to find that a significant cause of the misconduct was Bankwest's remuneration and incentive scheme.
76. Second, it is said that it is open to the Commissioner to find that Bankwest did not have in place adequate internal systems to minimise the risk of conflict of interest posed by internal valuations. Each of these issues is addressed further below.

### *First alleged cause of misconduct*

77. It is said by Counsel Assisting that the evidence establishes that at the time Bankwest offered the facilities to the Ruddys, 60% of its KPIs for employees like the bank manager were weighted towards profitable growth. Half of that, or 30%, was allocated to asset sales targets. Provided that employees met a risk gate opener, they could then be eligible for short-term incentive payments.
78. It is also said that the evidence established that in the 2011 financial year, Bankwest employees were able to double their base salary through such bonus arrangements and this created a culture of prioritising sales to the detriment of diligent and prudent conduct in relation to loan approvals.
79. Bankwest does not consider the KPI or incentive scheme available at the time was a significant cause of the misconduct. While there was a financial weighting at the time of 60%, it was not a gate opener. That meant that performance on this KPI was moderated by the other metrics. Bankwest does, however, acknowledge that performance on financial KPIs, could have been a contributing factor to conduct.
80. In the 2011 financial year, two Relationship Managers out of 88 (including Business Development Managers) in the Bankwest Rural and Regional Business were eligible to receive a maximum Short Term Variable Remuneration (STVR) potential of 100% of their base salary.<sup>67</sup> From 2012 to present, no Relationship Managers or Business Development Managers could receive more than 40% of their base salary in variable remuneration.<sup>68</sup>
81. While the Ruddys' bank manager received his base salary and was eligible in 2011 for a STVR potential of up to 57% of his salary, his actual variable remuneration payment for 2011 was 27% of his base salary and he did not receive a short-term incentive in the 2012 financial year.<sup>69</sup>

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<sup>67</sup> Exhibit 4.95 (CBA.0001.0394.0750).

<sup>68</sup> Exhibit 4.95 (CBA.0001.0394.0750).

<sup>69</sup> Exhibit 4.95 (CBA.0001.0394.0750).

82. The maximum potential STVR opportunity as a percentage of base salary has reduced from 2012 for the Bankwest Rural and Regional Business Relationship Managers and Business Development Managers. The majority of the employees in such roles have been eligible for a maximum potential STVR of 20% to 30% of their base salary from 2011 to 2017.<sup>70</sup>

*Second alleged cause of misconduct*

83. It is submitted that the only cross-check completed on internal valuations in 2011 was for the internal valuation to be provided to the credit team with the credit submission. At that time, the credit officer was required to validate the valuation prior to approving the deal. Counsel Assisting has submitted that this was not an adequate mechanism to address the inherent risk of conflict of interest posed by internal valuations.

84. It is also submitted that Bankwest continues to permit internal valuations by its sales professionals, and applies growth-focused key performance indicators to those employees. Bankwest does not consider that this places such sales professionals in a position of conflict of interest that is not appropriately controlled, as long as the valuations are checked by another employee. This check now takes place, and involves a detailed review of the valuation and all source documents by a registered valuer who must review and accept all internal valuations, and who has been employed by Bankwest with in excess of 20 years valuation experience.

85. At the time the internal valuations for the Ruddys were undertaken, the process required a credit officer to check the valuation and make an assessment of the strength of the application, taking all of the circumstances into account. The system was intended to ensure that a bank manager was not able to, effectively, sign off on their own business.

86. In the case of the Sunrise valuation, it is apparent that the system did not operate as intended. A cursory review of the valuation indicates that there are errors in its construction, as noted by Ms Taylor in evidence, who also stated that she observed those errors despite not being a registered valuer or internally badged valuer.<sup>71</sup> Had the valuation been reviewed as intended, it seems apparent the errors would have been identified. That there were other defective valuations identified in due course, which were completed by the same bank manager, indicates that the system did not provide an adequate control at the relevant time.

87. As has been noted in this submission, processes have been improved to ensure a more robust review process. Bankwest does continue to permit internal valuation assessments of rural properties to be undertaken, according to the policy, which is summarised below:<sup>72</sup>

(a) Internally Badged Registered Valuers:

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<sup>70</sup> Exhibit 4.95 (CBA.0001.0394.0750).

<sup>71</sup> T3528.20-21.

<sup>72</sup> Exhibit ST-88 to the Statement of S. Taylor, dated 24 June 2018.

- (i) are accredited through an externally recognised training organisation;
  - (ii) are permitted to complete valuations of rural properties to the value of \$5m solely, or \$12.5m jointly with an accredited Regional Manager;
  - (iii) are required to forward all internal valuations to Commercial Valuations Business Credit, a team of registered valuers employed by the Bank who work separately in the risk department and must review and accept all internal valuations.
- (b) Sales Professional (who are not accredited as Internally Badged Registered Valuers):
- (i) may not undertake a valuation;
  - (ii) can accept valid external sources to confirm valuations subject to policy guidelines and restrictions;
  - (iii) external sources which can be used to confirm valuations include contracts of sale not greater than 12 months old (must be arm's length), Valuer General's rates notice or a valuation from any registered valuer, not greater than 12 months old;
- (c) All valuation assessments internal or external progress through Bankwest's Credit Control Frameworks and require review of validation of all inputs by Business Credit against source documents.<sup>73</sup>

88. Accordingly, Bankwest submits that the current system is sufficient to address any inherent conflict of interest posed by internal valuations, of which there have been very few in recent years.<sup>74</sup> As noted at paragraph 52 above, it is Bankwest's view that a process by which internal valuations may be undertaken is important in circumstances where it is not practicable or feasible to obtain an external valuation for rural and remote customers.

89. The checks and balances are, in Bankwest's submission, adequate to ensure that customers may be serviced in this way, while ensuring an appropriate level of protection to customers to mitigate any potential risk.<sup>75</sup>

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<sup>73</sup> Exhibit ST-88 to the Statement of S Taylor, dated 24 June 2018.

<sup>74</sup> In evidence Ms Taylor said that there have been 24 internal valuations completed in the last 3 years, across 11 internally badged valuers: T3526.39-41.

<sup>75</sup> On one view, the risk posed by internal valuations is no greater than the risk posed by a bank manager acquiring the customer's financial information so as to complete the loan application. The same conflict of interest may potentially arise. Bankwest does not understand Counsel Assisting to be suggesting, however, that the application process poses any conflict. It is Bankwest's submission in any event, that such a risk is mitigated through its credit

## CBA PROCESSING ERRORS CASE STUDY

90. Counsel Assisting has made written submissions that, on the evidence, it is open to the Commissioner to find:
- (a) CBA breached its statutory obligation under section 912A(1)(a) of the Corporations Act 2001 (Cth) (**Corporations Act**) to "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly".
  - (b) CBA breached its obligation under clause 3.2 of the Code of Banking Practice (**Code**) to "act fairly and reasonably towards [customers] in a consistent and ethical manner".
91. CBA does not take issue with the accuracy of the matters summarised in the Background section of the Counsel Assisting's written submission. However, CBA submits that the Background section of the written submission omits several matters which are material to determining whether the proposed findings ought be made.

### Section 912A(1)(a) of the Corporations Act

92. The statutory obligation under section 912A(1)(a) of the Corporations Act to act "*efficiently, honestly and fairly*":
- "... must be read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty."*<sup>76</sup>
93. Counsel Assisting's written submission does not suggest CBA has acted dishonestly in relation to the processing errors, and does not submit any such finding is open to the Commissioner.
94. Counsel Assisting submits that it is open to the Commissioner to find that CBA has breached the requirements of Section 912A(1)(a) in relation to acting efficiently and fairly.
95. In construing "*fairness*" for the purposes of section 912A(1)(a), when used in conjunction with the word "*honesty*", it connotes a person who is "*not only not dishonest, but also a person who is ethically sound*".<sup>77</sup>

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approval process, but also notes that it is not possible to control for every potential circumstance where a banker may undertake to game the system.

<sup>76</sup> *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 672.

<sup>77</sup> *Ibid.*

96. In determining whether a licensee has acted inefficiently for the purpose of section 912A(1)(a), the ultimate question is whether the licensee's performance of its functions fell well short of the reasonable standard of performance that the public was entitled to expect.<sup>78</sup>

97. As noted in CBA's submission in Part A of Round 1 hearings (at [29]) the test of "*efficiently, honestly and fairly*" has been interpreted broadly as encompassing conduct that "*is morally wrong in the commercial sense*": *R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA)*<sup>79</sup> or "*falls short of the reasonable standard of performance that the public is entitled to expect*": *Story v National Companies and Securities Commission*.<sup>80</sup> However, the only case which has examined the application of section 912A(1)(a) to a major financial institution is *Re Saxby Bridge Financial Planning Pty Ltd and Australian Securities and Investments Commission*.<sup>81</sup> In that case, the Administrative Appeals Tribunal:

- (a) Found that any alleged breach of section 912A(1)(a) needed to be considered "*in the context of the business operation as a whole*", including the scale of the organisation and the number of total transactions.
- (b) Concluded there had been no breach of the requirement to act "*efficiently, honestly and fairly*", in light of:
  - (i) the fact that the licensee's business included "*250 employees in four offices in three states*"; and
  - (ii) that '*the scale of the [licensee's] business was large enough to expect that close examination of its operation would inevitably reveal some contraventions of the law among the many thousands of transactions...*'.

In this context, the breach of the relevant law was not sufficient to persuade the tribunal there had been any breach of the requirement to act "*efficiently, honestly and fairly*".

98. The conclusions of the Tribunal were not challenged on appeal.<sup>82</sup>

99. CBA submits that the conduct the subject of the "*CBA Processing Errors Case Study*" does not justify a finding that CBA has breached section 912A(1)(a) of the *Corporations Act 2001* (Cth). When that conduct is viewed in the context of CBA's business as a whole (as it must be), the following matters in particular weigh against finding any breach of section 912A(1)(a):

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<sup>78</sup> *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 679.

<sup>79</sup> (1989) 1 ACSR 93 at 110.

<sup>80</sup> (1988) 6 ACLC 560 at 576.

<sup>81</sup> (2003) 46 ACSR 286; [2003] AATA 480.

<sup>82</sup> See *Australian Securities and Investments Commission v Saxby Bridge Financial Planning Pty Ltd* (2003) 133 FCR 290; 47 ACSR 649; [2003] FCAFC 244.

- (a) The relatively small number of CBA customers affected by the processing errors when compared with the total number of CBA customers.

The number of customer entities affected by the processing errors totalled 8,408.<sup>83</sup> This figure overstates the number of CBA customers (as distinct from customer entities) affected.

- (b) The relatively small financial impact to the average CBA customer entity affected by the processing errors.

The average refund to the customer entities affected by the CBA processing errors was approximately \$900,<sup>84</sup> which figure totalled adjustments applied over a period of up to nine years.<sup>85</sup>

In calculating the amount to refund to affected customer entities, CBA resolved any issue of uncertainty in favour of the customer,<sup>86</sup> and as a consequence, the amount of the refunds overstate the true effect of the processing errors on CBA customers.

- (c) CBA's conduct after the processing errors were discovered, including:
- (i) CBA's proactive notification and ongoing engagement with ASIC in relation to the processing errors;<sup>87</sup>
  - (ii) CBA's improvements to its processes to reduce the risk of any similar errors occurring in the future,<sup>88</sup> and
  - (iii) CBA's remediation to the affected customer entities.

### *Clause 3.2 of the Code of Banking Practice*

100. The effect of clause 3.2 of the Code is similar to the effect of section 912A(1)(a) of the Corporations Act. However, clause 3.2 of the Code places more emphasis on fair, reasonable and ethical conduct, as opposed to efficiency (to which the clause does not refer).

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<sup>83</sup> Witness statement of Joanna Charlene White, dated 21 June 2018 [CBA.9000.0069.000] (**White Statement**) at [16].

<sup>84</sup> Calculated by dividing the total compensation paid by the number of customer entities, both of which are set out in the White Statement at [16].

<sup>85</sup> White Statement at [7].

<sup>86</sup> White Statement at [12].

<sup>87</sup> White Statement at [19].

<sup>88</sup> White Statement at [31] – [33].

101. It is not, and could not be, suggested that CBA's conduct in relation to the processing errors was deliberate. No criticism is made of CBA in relation to the manner in which it remediated the customer entities affected following the discovery of the processing errors.
102. CBA submits that, in light of the factors identified at 16 above, no finding should be made to the effect that CBA has breached clause 3.2 of the Code with respect to the matters the subject of the CBA Processing Errors Case Study.

### **Conclusion**

103. CBA submits that the findings identified at [12] and [13] of Counsel Assisting's written submission ought not be made.