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# TRANSCRIPT OF PROCEEDINGS

O/N H-896305

**THE HONOURABLE K. HAYNE AC QC, Commissioner**

**IN THE MATTER OF A ROYAL COMMISSION
INTO MISCONDUCT IN THE BANKING, SUPERANNUATION
AND FINANCIAL SERVICES INDUSTRY**

**MELBOURNE**

**9.30 AM, FRIDAY, 1 JUNE 2018**

**Continued from 31.5.18**

**DAY 29**

**MS R. ORR QC appears with MR M. HODGE QC, MR A. DINELLI and MS E. DIAS as Counsel Assisting with MS C. SCHNEIDER**
**MR P. COLLINSON QC appears with MR R. CHAILE and MR L. HOGAN for ASIC**


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THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Commissioner, the next witness is Mr Saadat from ASIC.

THE COMMISSIONER: Yes, is Mr Saadat in the hearing room?

MR COLLINSON: He is, Commissioner.

**<MICHAEL SAADAT, AFFIRMED [9.31 am]**

**<EXAMINATION-IN-CHIEF BY MR COLLINSON**

THE COMMISSIONER: Thank you very much. Do sit down. Yes, Mr Collinson.

MR COLLINSON: Commissioner pleases.

Mr Saadat, your full name is Michael Saadat?---It is.

Your title at ASIC is senior executive leader deposit takers, credit and insurance team?---Yes.

And your business address is level 5, 100 Market Street, Sydney?---Yes.

And you have with you, I hope, a copy of your original summons to give evidence before the Commission?---I do.

I seek to tender that.

THE COMMISSIONER: Exhibit 3.161 will be the summons to Mr Saadat.

**EXHIBIT #3.161 SUMMONS TO MR SAADAT**

MR COLLINSON: Now, Mr Saadat, you've prepared two witness statements. If I could ask you, please, to go to the first of those, dated 18 May 2018, paragraph 15?---Yes.

Now, I believe in line 2 you want to change the word "community" to "customer"?---That's correct.

If you could make that change with a pen and initial that change?---Yes.

With that change, is your statement true and correct?---It is.

I tender that statement, Commissioner.

THE COMMISSIONER: The witness statement of Mr Saadat and its exhibits is exhibit 3.162.

**EXHIBIT #3.162 WITNESS STATEMENT OF MR SAADAT AND EXHIBITS DATED 18/05/2018**

MR COLLINSON: Mr Saadat, you have a second witness statement dated 24 May 2018?---Yes.

Is that statement true and correct?---It is.

I tender that statement.

THE COMMISSIONER: Exhibit 3.163, further witness statement of Mr Saadat, 24 May, exhibit 3.163. Yes. Thank you, Mr Collinson. Yes, Mr Hodge.

**EXHIBIT #3.163 FURTHER WITNESS STATEMENT OF MR SAADAT DATED 24/05/2018**

**<CROSS-EXAMINATION BY MR HODGE [9.33 am]**

MR HODGE: Thank you, Commissioner.

Mr Saadat, I think you've said already you are the senior executive leader for ASICs deposit takers, credit and insurance team?---I am.

And you are also the regional commissioner for New South Wales?---I am.

And you report to the Commissioner and also to the – or the deputy chair, Peter Kell?---Yes, I do.

All right. And you've been the senior executive leader of the DCI team since July 2014?---That's right.

And your team has responsibility for a variety of things. One of the things that your team is responsible for is the oversight of lenders in relation to matters set out in the ASIC Act?---That's correct.


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And that would include the unfair contract terms regime?---Yes, it does.

And another thing that your team is responsible for are matters relevant to the Banking Code of Practice?---That's right.

And you've given the Commission two statements and they – the first statement addresses the Banking Code of practice or the negotiations in relation to the banking code of Practice, that's one thing, in the first statement?---Yes.

And the second thing that that first statement addresses is the implementation of the unfair contracts terms regime in relation to small business contracts?---Yes.

And then in your second statement, your second statement addresses perhaps more generally what ASIC has done in relation to the unfair contract terms regime that existed in relation to consumers before the expansion to small businesses?---Yes.

What I would like to start by doing is just asking you some questions about where things are at with the Banking Code of Practice. The ABA submitted a draft of the proposed Banking Code of Practice to ASIC in December 2017?---Yes.

And there have been some ongoing discussions and negotiations between ASIC and the ABA about the terms of that code of practice?---Yes, there have been.

And we've seen, and it's gone into evidence and I will take you to it in a moment, the latest draft that has been presented by the ABA was presented in April 2018?---Yes.

And the reason that that code has been presented to ASIC is so that ASIC can consider whether to approve it under the Corporations Act; is that right?---Yes.

And could you explain to the Commissioner what is the significance of ASIC approving a code under the Corporations Act?---The significance is largely that an approved code is determined to meet ASICs regulatory guidance as to what an approved code should look like. So we have got a regulatory guide, it's RG183, that sets out the criteria that we will apply when considering whether to approve a code. I can run through those, if you like. But other than the fact that we approve a code and indicate that it meets those standards, ASICs approval does not result in any change to the legal status of the code.

And how many codes has ASIC approved under section 1101A?---Just one.

What was that code?---It was a code in relation to the future of financial advice provisions. It's very much narrowly focused on the opt in requirements that apply and the fact that there's an ability for an industry to seek approval for a code that obviates the need to meet the legislative opt in requirements. So it's a very narrow issue code.


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So this ABA code, if it's approved, it would be the second code approved by ASIC under the Corporations Act?---That's right.

And it would be quite different from the scope of the first code that has been approved, in this ABA code is much wider in application and effect than the code you have already approved?---Yes, that's right.

And has that presented any particular challenges, those differences, in considering whether to approve the code?---Between the - - -

Having – you've approved one already, which is - - -?---Yes.

- - - a narrow code. I'm wondering if the much wider style of code that the ABA is seeking to have you approve has – seek to have you approve has presented any particular challenges?---Not really. We have always had this ability to approve codes, and our regulatory guidance has been in place for some time. The framework was set up with a view that there would be these types of broad-based industry codes submitted to ASIC for approval and this is the first time that we've had a broad-based industry code submitted to ASIC for approval.

And as it is ASIC obviously hasn't yet. perhaps won't, approve the draft code that has been put forward by the ABA. That's the current situation?---We haven't made a decision yet.

And is it – is the current draft of the code still under review; is that what's going on?---Yes.

Has the review been deferred in some way while these hearings are going on in the Royal Commission?---Yes.

All right. And so when was the decision made to defer reviewing the code?---I don't know the exact date. It was a couple of weeks ago, before the start of these hearings.

And in terms of the reasons for the deferral, could you just explain to the Commissioner what the things are that ASIC is considering that they think it might be relevant to take into account from these hearings?---The main sticking point is the definition of small business and the monetary threshold that exists within the definition that has been proposed by the ABA. And so that's unresolved at this point, and we're continuing to consider that issue. The reason for deferring a decision was also because we wanted to make sure that there was nothing that was going to emerge in this round of hearings that would be relevant to our consideration of whether the code should be approved. We've done a broad amount of stakeholder consultation but, you know, this round of hearings was also important to us.

All right. Can we bring up the code, I want to explore with you this issue of the definition of small business. If we bring up ABA.001.008.0434. And can we go to

page .0443. So this is the current definition that the ABA is proposing?---That's right.

And, in terms of the position that ASIC has communicated to date, it doesn't agree with this definition or wouldn't be prepared to approve the code with this definition in?---So we haven't made a decision about that. But the main part, the main area of feedback back or concern that we have raised with the ABA relates to part C of the definition, which is the $3 million figure.

And are you able to assist the Commission to understand what are the issues from ASICs perspective around this figure of $3 million, as compared with – presumably there are two possible comparisons. One is $5 million total debt to all credit providers and the other possibility is $5 million for the particular loan?---Yes. So the reason we've identified this as an area that we've raised with the ABA is because the independent review of the code recommended that the definition be set at $5 million, and $5 million for individual facilities. There have been other stakeholders that have also argued quite strongly for a $5 million definition, and because our objective is to make the code as good as it can be, and certainly the discussions that have happened with the ABA since December last year have reflected the fact that we wanted the code to improve in a number of respects, and they have made improvements in response to the feedback we have given them in many of those areas, but this remains the last big issue for us to resolve.

Do you understand that there are said to be prudential issues in relation to what figure is used here?---We have certainly had that feedback from the ABA.

And are you able to explain to us what the prudential issues are, as you understand it?---My understanding is that there are concerns that if these provisions were extended to larger loans, that effectively there would be covenant-like loans in place of large sizes. And that that would have implications for the preparedness of banks to lend, because the risk that they would be taking on is greater than had they had the ability to introduce additional covenants within those loan facilities.

And if possible I just want to try to bear down on that, so that we can get a better sense for the Commissioner of what that means. Is the issue simply that a bank might be less willing to lend or particular facilities that fall into that range of $3 million of total credit and $5 million of total credit because they're covenant like contracts?---Yes.

Is it any more complicated than that?---That's certainly the feedback we've had.

And is there some separate issue connected with APRA and the risk weighting of assets, as you understand it?---That has not been the main issue that has been raised with us. The main issue that has been raised with us is around the risks that exist for banks when they don't have the same ability to take default-based action under a loan facility.


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Have you had any feedback from APRA about this?---We have.

All right. And are you able to explain to us what that feedback is?---APRA have told us that their – they don't have strong views about whether the definition should be three or $5 million.

And in terms of the application of the code, it seems as if an issue that potentially arises with this definition is uncertainty, because you can't judge it – whether the code applies based simply on the particular facility being entered into. You can only determine it by reference to all of the other credit facilities that a borrower has. Do you agree with that?---Yes.

And is simplicity, in terms of being able to understand the application of the code, something that ASIC has to take into account in determining whether or not to approve the code?---Yes, it is one of the factors.

And is there any way that has been identified to test the proposition about the appetite of banks to lend if the limit is $5 million versus $3 million?---Test in advance of?

Yes?---There's – it has been suggested to us that that's not really possible; that – and the ABA has suggested that if we were minded to approve the code with the current definition that, after a period of time, a review would be done to determine whether the settings are correct and whether they can be changed to broaden the class of small businesses that might benefit from these protections.

Can I just ask if – we can take that down and go to the regulatory guide, which you have exhibited to your statement. That's MS-13. It's ASIC.009.0002.0088. And if we go to page .0106, this is the section of the regulatory guide that deals with independent review?---Yes.

And one of the conditions of approval of a code is that the code must be independently reviewed at intervals of no more than three years?---That's right.

And so one of the things that would happen, if you were to approve the code, is there would be a requirement that the code be reviewed in three years time?---That's right.

And that review would be independent of the actual organisation putting forward the code?---That's right.

And presumably that independent reviewer could make recommendations as to what ought to be done with the code?---Yes.

Whether or not the organisation was prepared to adopt those recommendations would depend on the organisation?---It would.

And ASIC, as we understand it, couldn't say, "Because those recommendations have been made, we will now – that is ASIC – will now change the code"?---We won't be able to change the code. All we can do is revoke approval of the code.

That's right. So what might potentially happen is if a recommendation was made and it wasn't adopted by the relevant organisation, then ASIC could consider whether it wished to revoke the code?---That's right.

And I wonder whether you are able to help the Commissioner to understand: where this code is borne out of an independent review – this current draft of the code is borne out of an independent review – and the independent review made a recommendation in relation to the definition and therefore – of small business, and therefore application of the code, but that has not been adopted by the organisation that is presenting it to ASIC, how does ASIC go about deciding whether it should approve the code in those circumstances?---So it's not a strict requirement that industry associations implement all the recommendations that are made. It's certainly one of the considerations. The way that we approach this is we do our own consultation with stakeholders about the issues that have been identified, both through the independent review, but also any other issues that might be relevant to those stakeholders, and we have discussions with those stakeholders, get their feedback, and then we form our own view about where the provisions have landed and whether they're satisfactory from the perspective of the regulatory guidance that we put out.

I understand. And is one of the considerations for ASIC, in deciding whether to approve the code, whether the approval of the code would represent a meaningful improvement in the current regulation or requirements that are imposed on the particular industry?---Yes, that's right.

And so one of the things, presumably, that ASIC has to balance up is it might be that industry is not prepared to move all the way to what some stakeholders would like industry to do, but nevertheless it's a meaningful improvement compared to what there would otherwise be?---That's right.

All right. And then I want to ask you, then, about just one other aspect of the draft code, which is ABA.001.008.0434. And can we go to page .0458. This is part of the code dealing with guarantee documents?---Yes.

I don't – I might be wrong, but I don't think there has been any particular issues that have been raised since the draft was submitted to ASIC about guarantee documents; is that fair?---Not about the documents. We did raise an issue in relation to reliance on third parties. But otherwise, no.

All right. And could you just explain to the Commissioner what the issue is that ASIC raised about reliance on third parties?---So - - -

Is it earlier in the - - -?---I think it might be. If you can take me to that.

Clause 51. See if this is – what you are thinking about – if we go to page .0451?---Yes, that's right.

So just to be clear about what the issue was: the issue was about whether or not a guarantor's resources could be taken into account by the lender in deciding whether or not to make the loan?---Yes.

And the modification was that it was permissible to take into account the guarantor's resources, but only if the guarantor had a connection to the borrower; is that right?---And also narrowing the clause so that the that banks would only take into account the resources of third parties that had a connection to the borrower more broadly as well.

Yes. So in fact, I think I have misstated it: being a guarantor itself is the creation of a connection between the borrower?---Yes.

With the borrower. So once you become a guarantor under this clause, it's possible for your resources to be taken into account in deciding whether to make the loan?---That's right.

All right. In terms of information that's provided to a guarantor, if we go back to .0458, what I'm interested in exploring – and the answer may be you just haven't received any feedback about this – is whether there have been issues raised with you about the adequacy of the requirements to ensure that a guarantor gives properly informed consent to entering into a guarantee?---That has not really been a feature of the feedback that we've had. We have had feedback about the guarantee provisions, but the disclosures that are provided has not been an area that has had strong feedback.

You – I'm not sure whether you are familiar with the opening of these round of hearings, but one of the things that we referred to was issues raised by New South Wales Legal Aid, and Legal Aid Queensland, about parents giving guarantees of their children's borrowings. Is that issues of parents giving guarantees of their children's borrowings one that has come up for consideration as part of ASICs consideration of the code?---I believe so. The feedback we have had is around the consequences that should apply if the guarantee provisions of the code are not complied with. Some stakeholders believe that there should be an automatic voiding of the guarantee if the pre-execution requirements for the provision of the guarantee have not been met by the bank.

And that was also the recommendation made by Mr Khoury, wasn't it, in the independent review?---I believe so, yes.

That hasn't been something that has been adopted into the code?---No.

And that's not one of the points of ongoing contention between ASIC and the ABA?---No.


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Although, strictly, ASIC hasn't yet approved the code so - - -?---That's right. Yes.

- - - it presumably hasn't given up any points?---No.

All right. I might then move to a different issue, Mr Saadat, which is the unfair contract terms regime. Now, the legislation to amend the ASIC Act to extend the unfair contract terms regime to small business received royal assent on 12 November 2015?---Yes.

And the amending legislation provided for a 12 month transition period to 12 November 2016?---Yes.

And the need, though, to – or the fact that the unfair contracts terms regime was going to be extended to small businesses was something that ASIC had been aware of for some time before that?---Yes.

And ASIC had, in fact, made – as you tell us in your statement – made submissions to Treasury in May 2014 supporting the extension of the unfair contract terms regime to small businesses?---Yes.

And in July 2015, ASIC became aware that the amending legislation was likely to be introduced in the next few months?---Yes.

And at that stage ASIC thought that the transition period was likely to be six months; is that right?---Yes.

And can we bring up ASIC.0506.0004.7936. This is some – or these are some internal emails from ASIC officers?---Yes.

And you've reviewed this in the course of preparing to give evidence?---I have.

All right. And if we go to page .7940 – we might need to bring up .7939 as well on the other side of the page. So, Ms Curtis, does she report to you?---She does.

All right. So this is an email from Ms Curtis to you on 22 July 2015 where she's identifying that you've been asked to assist with the introduction and the implementation of the business to business UCT enhancements?---Yes.

And consistent with what we have just talked about, we see on page 7940 the first dot point:

> *The UCT draft legislation was anticipated to receive royal assent in August or September.*

So that is within the next couple of months after this. Sorry, do you want me to – it's about a quarter of the way down the page?---Yes.


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And then the next bullet point:

> *Once introduced, the Act will have a six month transition period before the provision come into effect.*

?---Yes.

And then in the fourth bullet point it's noted that:

> *Treasury has asked ASIC and the ACCC to assist businesses to comply with the new legislation.*

?---Yes.

And:

> *The ACCC will receive $1.4 million for their campaign, however funding is not being provided to ASIC.*

?---Yes.

Do you know why funding wasn't being provided to ASIC for this?---It was a decision of the government.

All right. And then you will see there's then a heading which is Proposed Activities and it's explained:

> *We propose engaging in the following activities.*

?---Yes.

And the – if you come to the very bottom of the page, you see:

> *During the transition period, if identified, through surveillance work raising concerns about contract terms that appear to be unfair with the relevant business with the aim of having the UCT changed or removed and taking enforcement or other action as necessary.*

?---Yes.

Would you just explain to the Commissioner what is the type of surveillance work that ASIC would do in order to identify these types of problematic terms?---So for these provisions we would typically request the contracts that are in place, the standard form contracts that are in place by the business, and review those to determine whether they contain unfair contract terms.

All right. And if we go over the page to .7941, and we see top of the page:

*ACCC is planning to target five high risk industries with common UCT to try and get change during this time. We could review whether we wanted to undertake a similar exercise with, for example, ADIs or non-bank lenders.*

?---Yes.

And we will come back to that point in a moment, but if we just also note two bullet points down:

*The ACCC are also undertaking the following activities using the additional funding that they have received.*

?---Yes.

And there's a couple of activities, which are launching a digital advertising campaign and releasing two animated videos?---Yes.

So that was – those were, as we understand it, activities that – because of the absence of additional funding – it wasn't considered practical for ASIC to do?---That's right.

But the idea of reviewing the common terms for particular ADIs was something that ASIC was considering doing?---Yes.

And, as we know, that was something that didn't happen in 2015 or the early half – or the first half of 2016; do you agree?---Yes.

And is there a reason why, from your perspective, that wasn't? Given that it was raised in July 2015, why that wasn't undertaken over the course of the next year?---Our primary goal was to review revised contracts, to look at the changes that banks were making as a result of the UCT provisions being extended to business contracts, and so we had feedback from the banks that they were likely to use the full transition period of 12 months to update their contracts. For us, there didn't seem to be a lot of point looking at old contracts if those contracts were to be replaced with new contracts during the transition period.

I see. So there was a conscious decision made at some point in time to take that course?---Yes.

And do you know when that decision was made?---I couldn't give you a precise date.

All right. And so that we understand: the reason for not doing it was because you had had feedback presumably from the banks; is that right?---Yes.

That they were planning to use the full transition period in order to update their contracts?---Yes.


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And so then what ASIC was proposing to do was to wait until it had those updated contracts and then consider whether the updated contracts contained any terms that it considered to be unfair?---That's right.

All right. And the amending legislation, as it turned out, received royal assent in November 2015?---Yes.

And in January 2016 ASIC began finalising an information sheet that it was intending to publish?---Yes.

And that was to give guidance to small businesses to assist them to understand how the UCT provisions apply to small business contracts?---Yes.

And that was published?---It was.

Can I ask a question about that. Can we go to – I'm sorry, I tender that document, Commissioner.

THE COMMISSIONER: Emails between Curtis, Saadat and others, July 2015, ASIC.0506.0004.7936, exhibit 3.164.

**EXHIBIT #3.164 EMAILS BETWEEN CURTIS, SAADAT AND OTHERS DATED JULY 2015 (ASIC.0506.0004.7936)**

MR HODGE: Was there some reluctance or questioning of whether the information sheet should be published in January 2016?---Not that I recall.

Perhaps if I just show you, if we go to ASIC.0506.0002.5171. If we go over the page. So there's an email at the bottom of the page, you will see from Mr Tanzer to you?---Yes.

This was sent in January of 2016 and the question that he was just posing for consideration which you will see at the top of the page is:

> *Is there a reason why we are issuing the info sheet now, when the law doesn't come into effect for some months? I appreciate that we are asking in the info sheet for businesses who deal with small businesses to review their standard form contracts to make sure they comply with the new law, but wouldn't that be better achieved by a more targeted communication?*

That was the reference I was making to some reluctance?---Right.

And then if you go to the first page, you respond and explain:


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*The ACCC have already started in their education and subsequently Treasury has asked us to be aligned, for lack of a better word, with what they are doing.*

And I just want to understand – and you may not remember anymore, what is – what are the considerations that go into do you issue the information sheet now or wait until it's closer to the legislation actually coming into effect?---It's – there's not a lot of science to this. I think, for this type of thing, there's not a lot of cost to us in issuing an information sheet and putting it out publicly on our website. And if we think that additional communications are required, we can also provide those additional communications.

And you put out the information sheet and we can – I'm sorry, I tender that document, Commissioner.

THE COMMISSIONER: Emails between Tanzer, Saadat and others, January 2016, ASIC.0506.0002.5171, exhibit 3.165.

**EXHIBIT #3.165 EMAILS BETWEEN TANZER, SAADAT AND OTHERS, DATED JANUARY 2016 (ASIC.0506.0002.5171)**

MR HODGE: Thank you.

And then can we bring up exhibit MS-2 to Mr Saadat's statement, which is ASIC.0900.0002.0041. So this was – or this is the current version of the information sheet?---I believe so.

Do you know whether it has changed at all since it was originally published at the beginning of 2016?---Not that I know of.

All right. And so you see in the second paragraph, it says:

*Before the law comes into effect ASIC expects businesses to review their standard form small business contracts to remove any terms that could be considered to be unfair to ensure compliance by November 2016.*

?---Yes.

And then what the information sheet does is set out, or effectively summarise, what the legislation provides but also provide some examples of things that might raise issues?---Yes.

And I think I might have suggested that that was released in January 2016, I think it was released in February 2016?---That could be right.


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And I'm sorry, it was me misleading you, not you saying anything incorrect. And then in March of 2016 there was a joint webinar done by the ACCC and ASIC?---Yes.

And the webinar, as we understand it, was geared towards small businesses to help them to understand whether the contracts that they were entering into might contain unfair contract terms?---Yes.

And, in April 2016, there was then a major additional funding announcement for ASIC?---There was.

And that was the $127.2 million reform package?---Yes.

And one of the things that that was for was to ensure that ASIC and Treasury were able to implement appropriate law and regulatory reform?---That could be right, yes.

And then can we – there was some internal planning or business planning that ASIC did about the use of that extra funding?---Yes.

And can we bring up ASIC.0506.0003.5290. So these are some internal emails setting out what are referred to as project planning summaries?---Yes.

And is it fair to say this is about summarising potential business plan projects that ASIC could undertake over the next – I think it's four or five years?---Yes.

Having regard to that additional funding?---Yes.

All right. And then if we go to what should be another part of the attachment to that document which is ASIC.0506.0003.5300. So one of the potential projects was unfair contract terms and small business?---Yes.

And one of the points made in relation to the outcomes of the project is that:

> *The incidence of unfair contract terms for small businesses in credit contracts is untested and may be higher than under consumer contracts.*

?---Yes.

Continuing:

> *…given that –*

and then there's identifications of why that might be?---Yes.

And do you know, then, was this adopted? Was there a specific project then put in place in order to deal with unfair contract terms and small businesses?---Ultimately, there was.


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All right. And do you know when that – when you say ultimately, when that occurred?---Not exactly. So these planning documents were done, as you mentioned, in response to the additional funding that ASIC received and there were a number of projects that were directly linked to that additional funding, at least for my team. The work that we did on UCT was not, at that point, identified as a project that was linked to that additional funding. There was a range of other projects, which I can talk about, if you like. But subsequently we made a decision that we would do work on UCT, and that led to the work that I describe in my witness statement.

All right. And one of the points you would make, I assume, is there are many different demands on ASICs resources?---Yes.

And ASIC has to make a decision as to how it will use its finite resources to deal with what is potentially an infinite or near infinite number of issues that arise in relation to financial services?---Yes.

And so it's ultimately always a matter of judgment about prioritising what are the things where we think we can best use the money and are in most urgent need of attention?---Yes.

And then – I'm sorry, I tender that document, Commissioner.

THE COMMISSIONER: The preliminary planning document unfair contracts terms, ASIC.0506.0003.5300 with accompanying email concerning project planning May 2016, ASIC.0506.0003.5920, exhibit 3.166.

**EXHIBIT #3.166 PRELIMINARY PLANNING DOCUMENT UNFAIR CONTRACTS TERMS (ASIC.0506.0003.5300) WITH ACCOMPANYING EMAIL CONCERNING PROJECT PLANNING DATED MAY 2016 (ASIC.0506.0003.5920)**

MR HODGE: Thank you, Commissioner.

Now, you've referred in your statement and we will come to this in a moment to a telephone call that occurred between ASIC and the ACCC at the end of August 2006?---Yes.

What I'm just interested in understanding from your perspective is between March 2016, when the webinar is done, and 24 August 2016 when the phone hook-up happens with the ACCC, what are the things that ASIC is doing in relation to the now impending extension of unfair contract terms to small business?---So I think I describe in my witness statement a number of presentations that we make to industry at various times to highlight the incoming obligations. We have regular discussions with industry about a range of topics, and that could be individually with institutions or, you know, with a range of institutions at the same time. And so we would – we


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would talk about these new laws in those discussions. So that was the nature of the work that we did between that period.

All right. And then on 24 August there was, of 2016, there was a phone call between, I think it was Richard Weksler of the ACCC and Jennifer Braw of ASIC; is that right?---Yes.

You've exhibited a file note of that telephone conversation?---Yes.

If we just go to that, which is exhibit MS-9, ASIC.0900.0005.0002. And what's explained on the first page is that the ACCC has been proactively looking into a handful of companies representing five industries?---Yes.

And then if we go over the page to .0003 is then set out what the ACCCs approach is, which you see that about halfway down the page?---Yes.

And what's explained is initially the ACCC has been sending out letters to companies asking for contracts where contracts cannot be found online; where the contract has been reviewed the ACCC identifies problematic terms and adopts a reverse onus approach asking the company to amend the term and, if they won't, to explain why; where there are outstanding concerns the company has been, and will be, warned of potential action after 12 November?---Yes.

And then says the ACCC is looking to produce an industry report of 20 to 30 pages reporting on where it has landed in relation to the various industries before 12 November?---Yes.

And then if we just skip down, what is communicated on behalf of ASIC is that there has been limited work in the area, which includes writing to one Advertiser about its credit application, responding to the Tasmanian Small Business Commissioner and writing to small business to remind to review contracts?---Yes.

I will come back to that in a moment, but what is then explained is:

> *The ACCC is very keen to issue a joint media release with ASIC which would ideally include some comments by us about banking sector contract terms.*

?---Yes.

Now, I just want to understand a few things about this. Was the contents of this discussion communicated back to you at the time?---It may have been.

All right. Were you – do you remember whether you were aware that the review of five industries that ASIC had promised back in July 2015 had actually gone ahead and undertaken.

THE COMMISSIONER: That's the review by ACCC?

MR HODGE: I'm sorry, the review by – I apologise Commissioner. I will withdraw that question and put it again.

Do you remember whether, by August 2016, you were aware that the ACCC had gone ahead and done the review of five industries that you had known about back in July of 2015?---I don't specifically remember, but it's quite likely that I would have been aware at the time.

All right. Do you remember whether you were aware that it appeared as if – and you might disagree with this putting of an appearance – but it appeared as if the ACCC had done much more to actively attempt to engage with the implementation of the expanded UCT provisions?---I don't remember that being the case, but I wouldn't sort of disagree that the ACCC had done more than us by that point.

All right. And is there – in your mind when you reflect back on this now, is there a reason or explanation for why you think they had done more than you by this point?---So I think because they had received additional funding to do some of this work, I expect that was part of the reason. The other part of it was that we had – we subsequently commenced reviewing contracts from the banks and because we had been told that those contracts – the revised contracts would not be in place well before the commencement of the UCT provisions, that ultimately led us to doing that work later than the ACCC had done it.

All right. Now, one of the things that's said in that note is that:

> *ASIC has written to industry to encourage members to review contracts.*

?---Yes.

We have just been trying to figure that out. So this is 24 August 2016. When had ASIC written to industry about reviewing contracts?---I can't point to a specific communication, and I certainly haven't – I don't think I've referenced a communication in my witness statement.

It looks like, from the communications you've exhibited in your witness statement – and we might bring up one of those, which is MS-3, ASIC.0020.0004.0373?---Yes.

Like ASIC starts writing to some of the industry bodies two days after that telephone conversation with the ACCC?---Yes.

And one of the other things we're interested in, just in relation to that letter, is you see about halfway down the page it says:

> *Certain terms in bank standard form lending agreements have been brought to our attention as potential unfair contract terms.*

?---Yes.

Are you able to just explain to the Commissioner – so at this stage, on 26 August 2016, what is the feedback that ASIC has been received about certain terms in banks' standard form lending agreements?---I think at that point the primary source of feedback had been a Parliamentary joint committee inquiry into the impairment of customer loans, which - - -

Right. We might just – I would prefer that you not commit an offence, Mr Saadat. So in terms of - - -

THE COMMISSIONER: Parliamentary Privileges Act engages with us and with you and with everyone, so we are a little sensitive, Mr Saadat.

MR HODGE: We are being very careful about what you say. So I understand. So one issue relates to something that happened in Parliament. Apart from anything that happened in Parliament, is there anything else you can identify that would have been relevant?---There would have been a range of discussions around stakeholders that ultimately led to that view being formed.

You see it says:

> *These terms are expressed to provide the ability for banks to –*

and then there's a series of five bullet points?---Yes.

It appears to us, but perhaps we have understood it, as if that is – that list is really just drawn from the words of section 12BH of the ASIC Act. Perhaps it might help if I show you that. So if we put the letter on one side of the page and then bring up RCD.0009.0037.0001, and then if we go to page .0072. So this is – you know as part of the statutory regime there are examples given of what might constitute an unfair contract term?---Yes.

And so it looks like the first one, which is void or limit their obligations, is 12BH subsection (1) subsection (a):

> *a term that permits, or has the effect of permitting, one party to avoid or limit performance of the contract.*

?---Yes.

And then unilaterally terminate the contract, is subsection (b)

> *a term that permits, or has the effect of permitting, one party to terminate the contract.*

?---Yes.


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And then penalise the borrower for breaching or terminating the contract, while avoiding such responsibilities themselves, is subsection (c):

> *a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract,*

?---Yes.

And then the fifth bullet point:

Unilaterally vary the contract terms is subsection (d):

> *a term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract.*

?---Yes.

Do you know whether, apart from just adopting the general statutory examples, whether there have been any identification of more specific terms that were common to ADIs contracts that had been identified as problematic?---I think we had done some work on that, but in terms of this particular communication it was written at a more general level, and it was written to the industry associations rather than the individual institutions.

I understand. And that then raises an interesting question which is: why write to the industry associations rather than to the particular – particularly the large ADIs at this stage?---The industry associations represent the large and small institutions, and for us it was more efficient to write to these industry bodies. The other thing I would say about the population of institutions that we regulate is that they were all very much aware about these new protections. I think in contrast to the ACCC, which has responsibility for the entire economy, the institutions that we regulate had been actively involved in the development and passage of this legislation, including lobbying against the legislation applying to them. So we were not concerned at all that they were not aware that the legislation had come into effect or when its commencement date was.

But it does raise an issue, doesn't it: they're aware of the legislation and, as you pointed out, because they have been actively lobbying against it?---Yes.

And it follows you were aware of their resistance to the legislation and its application to them?---Yes.

And perhaps it might be thought that that would be a reason for ASIC to very actively seek to make sure that they were going to have contracts that didn't contain unfair contract terms by the time the legislation came into effect?---Yes.


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I'm just wondering how do you reconcile what seem to be those competing ideas?---Well, I think that is what we ultimately did. We – through the work that we did, after this period, after this letter was sent and the work we did shortly before and after the commencement of the new obligations, our intention at that point was to get the industry lifting its standards and approach to compliance with the UCT, and doing that on an industry-wide basis. And starting with the big four banks in particular.

Can we go to ASIC.0024.0003.0044. This is an internal email chain where the proposal seems to be made for the first time to begin reviewing the lending contracts of some of the big banks?---Yes.

And if we look at the bottom of the page we see Ms Braw, who had been on the telephone conference with ASIC, sending an email on 1 September 2016?---Yes.

And she says:

> *As discussed –*

so she has obviously already had discussion with Ms Curtis –

> *I propose that we review lending contracts to small business that are secured over property as this was the type of contract and concern that was considered in the loan impairment inquiry.*

And then she sets out the following and identified list of the following lenders that would be reviewed?---Yes.

And says that they could ask for – touch base before sending an information request to be able to further specify the type of agreement that would be sought?---Yes.

And then there's the list there of the big four and a number of other banks adding up to 10 or so. I think actually – yes, 10?---Yes.

And then the response, Ms Curtis forwards that email on to you, and explains that – and this is now on 6 September 2016 – and says it's proposed to send out an information request to those banks?---Yes.

Had there been some change so that you now thought that the banks had finished making the amendments to their contracts?---No. I don't think we knew that at that point.

All right. So – but there were – this then represents a change of approach, because you were going to wait until the contracts had been amended before reviewing them. Now you're just moving in to try to review them?---Well, I think at this point, given that the legislation was commencing within two months, we felt it was appropriate to obtain copies of those contracts.

I tender that document, Commissioner.

THE COMMISSIONER: Emails between Curtis, Saadat and others, September '16, ASIC.0024.0003.0044, exhibit 3.167.

**EXHIBIT #3.167 EMAILS BETWEEN CURTIS, SAADAT AND OTHERS DATED SEPTEMBER 2016 (ASIC.0024.0003.0044)**

MR HODGE: And you approved the proposal – what was proposed here?---I believe so.

And then on the next day, on 7 September, there were letters that were sent out to ANZ, Commonwealth Bank, National Australia Bank, Westpac, Suncorp, Heritage Bank and Rabobank?---I believe so, yes.

And I think you set that out, if it helps, at paragraph 27 of your statement?---Yes.

And you've set out in your statement that there was then various correspondence with the banks. And this begins – perhaps we go to page 10 of your statement .0010?---Yes.

Would it help if I give the document reference again? It's ASIC.0902.0007.0001.

THE COMMISSIONER: Doc reference I've got for the statement is what you are after, is it, Mr Hodge?

MR HODGE: Yes.

THE COMMISSIONER: ASIC.0902.0007.0055, the statement reference.

MR HODGE: Thank you Commissioner. You have a different document ID from me, which is of concern.

THE COMMISSIONER: I wonder whether I have got the same statement. I hope I have.

MR HODGE: We will find out soon enough.

THE COMMISSIONER: Yes.

MR HODGE: Can we go to page 10 of that statement. Thank you. So what you set out in your statement, starting at the bottom of the page in paragraph 35, are then the communications that then occur between ASIC and the major banks?---Yes.


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And so in the case of all of the banks, there was a letter that was sent on 7 September 2016 saying that ASIC would like to review the standard form small business contracts to determine whether the contracts contain potentially unfair terms?---Yes.

And if we go over the page to page 11 and we see, on 12 September 2016, ANZ responded and amongst other things said ANZ was reviewing standard form contracts across several business units to ensure that it captured all standard form lending contracts which may be offered to small business customers as defined by the UCT provisions?---Yes.

And that it's review of contractual documentation was ongoing?---Yes.

And if we then go over the page, we can see there's back and forth between ANZ and calk about various terms of the contracts?---Yes.

And then if we go to page 13 – page 13, we see the – this is a slightly different version of the statement. We see that there's a response on 9 November 2016 to ASICs letter from ANZ?---Yes.

And then, similarly, if we then go, we see the next bank is CBA. If we go to the next page, we see the final piece of correspondence before 12 November 2016 with CBA is an email on 10 November 2016 which is an acknowledgement from ASIC to CBA?---Yes.

And then the next bank, if we go over the page, is NAB. And if we go to the next page after that we see there's – the last piece of correspondence is an ASIC acknowledgement on 10 November 2016?---Yes.

And then the next bank is Westpac, and if we go two pages over we see there's the last piece of correspondence before 12 November 2016 is another acknowledgement email from ASIC to Westpac on 3 November 2016?---Yes.

And then the next bank is Suncorp?---Yes.

And that's over the page. And we go over the page again, we see, or over the page again, we see the last piece of correspondence before 12 November 2016 is ASIC confirming an extension until 30 November 2016?---Yes.

And one of the things we were trying to understand then is between 12 November 2016 and the issue of the joint media release by ASIC and the Ombudsman in March 2017, what does ASIC do in relation to reviewing or further reviewing these – say if we just start with the big four, the big four's contract terms?---So there was quite a lot of activity around that time which was related to this work, including the work of the Small Business and Family Enterprise Ombudsman. They had done – they had conducted an inquiry which was relevant to this work, and we had provided input to that inquiry. That inquiry produced a report in December 2016. At the same time, the banks were reviewing their Code of Banking Practice, and one of the areas that


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was of particular focus was around the protections in the code for small business borrowers. And so there was, effectively, some overlap between our work to ensure that the banks were complying with the UCT laws, but also getting to an agreed industry position on what the industry would do to protect small business borrowers.

We might return to that question in a different way in a moment. What you tell us in paragraph 40 of your statement is that after ASIC had completed the initial review, and I think the correspondence we just referred to, that's the initial – the bringing in of documents for the initial review?---Yes.

And the conducting of the initial review; is that right?---Yes.

Then after it had completed its initial review, that it had identified a number of terms in the small business loan contracts that it considered were potentially unfair?---Yes.

And you also tell us in paragraph 41 of your statement that during this process, ASIC became concerned that some of the banks whose small business contracts ASIC had reviewed had taken what you described as being a minimalist approach to ensure their small business contracts complied with the UCT law?---Yes.

They appeared to ASIC to have made only a few changes that were deemed absolutely necessary?---Yes.

And – or – I should say or – they had merely inserted the word "reasonable" into particular terms to qualify what was otherwise what I thought you have described as a broadly stated and potentially unfair contractual right?---Yes.

And does it follow then in ASICs view such changes were not sufficient to make the contracts comply with the new UCT law?---We were concerned that they weren't sufficient.

And - - -

THE COMMISSIONER: And did the bank's approach surprise ASIC?---No.

MR HODGE: And so as at the date of the commencement of the law, on 12 November 2016, ASIC remained of the view that of that selection of small business contracts that had reviewed a number of those provisions contained – a number of those contracts contained provisions which in ASICs view were unfair?---Potentially unfair, yes.

And therefore not in compliance with the law?---Yes.

And that that reflected the general approach that the banks seemed to have taken to reviewing their contracts?---Yes.


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And you have emphasised the word "potentially" unfair. Could you just explain to the Commissioner why you place a particular emphasis on that word?---Partly because ASIC cannot make a determination about whether a term is unfair. Only a court can decide whether a term is unfair, and so the way we approached this is to identify where we have concerns. But we wouldn't specifically or explicitly state that a term is unfair unless a court had found it to be unfair.

I understand. Now, can we bring up ASIC.0506.0002.8421.

THE COMMISSIONER: Sorry, could we just go back to the answer you last gave. Would ASIC consider expressing its view that a term was unfair?---We could express our view.

No doubt you could, but would you consider expressing, for example, to a bank, the view that in ASICs opinion clause X of contract Y is unfair because?---Yes. We would or – we would do that. Although, Commissioner, I think we would only do that where we had formed a view that we were prepared to take that matter to court and seek a declaration on that basis if the bank were not to accept our position. We would – if we weren't yet at the point at being ready to commence proceedings, we would probably stop short of stating directly that a term is unfair in ASICs view.

Yes.

MR HODGE: Mr Saadat, the document that's now up on the screen is a chain of internal emails to which you are a party from ASIC from October 2016?---Yes.

Have you reviewed these documents again in the course of preparing to give evidence?---So I can't exactly recall what's beneath this particular email. Maybe if you show me, that will jog my memory, but - - -

That's bundled – we will go to that in a moment, which is a briefing paper. What I just wanted to understand was: was there a – do you recall whether, in the middle of 2016, there was it would be some meeting between the ACCC, or with the ACCC about unfair contract terms. If it helps, if we go over the page, we see an email which is:

> *Hi Warren, further to Jenna's email requesting a briefing on the UCT provisions for your meeting with the ACCC next week.*

Do you recall whether there was a meeting to occur?---I don't specifically recall.

All right. And then if we go to the attachment, which the briefing paper, and that should be ASIC.0506.0002.8423. So this is a two page briefing paper. We can see at the bottom it's dated 12 October 2016?---Yes.

And then if we go over the page to the second page, you see Approach to Enforcement?---Yes.


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And what's being set out there is ASICs summary of what ASICs approach is going to be to enforcement?---Yes.

And then at the second half of the page, ASICs summary of what it understands the ACCCs approach is going to be to enforcement?---Yes.

And ASICs approach is that:

> *The deposit taking credit and insurers team –*

which is – is that your team?---Yes.

Continuing:

> *…expects businesses to proactively review their small business contracts to ensure readiness by 12 November 2016. However, a consultative approach is proposed where ASIC will assist noncompliant businesses to comply with their obligations in the first few months of the new regime.*

?---Yes.

And:

> *If a business is uncooperative then enforcement action will be considered.*

?---Yes.

And on the other hand you see the ACCCs approach, which is set out halfway down the page?---Yes.

Continuing:

> *They are currently following a consultative approach working with businesses to ensure that they are ready to comply from 12 November.*

?---Yes.

Continuing:

> *From 12 November 2016 they intend to take enforcement or other substantive action where they find breaches of the UCT provisions.*

?---Yes.

And that's a fair summary of the divergent approaches that were being adopted by ASIC and the ACCC at that time?---I think – I think the thing to point out about that is that I would – it would appear, based on the evidence that the ACCC provided


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yesterday, that the definition of what constitutes enforcement action is not exactly the same between ASIC and the ACCC. So when we talk about enforcement action, we have a specialist enforcement team within ASIC. That's not my team. And we have, under our legislation, the ability to commence formal investigations and then take court action, if necessary. And when that work is being conducted by an enforcement team we typically refer to that as enforcement action, but there's a – there's a range of other regulatory action that happens outside of ASICs enforcement teams, including in my team, where we reach outcomes with institutions and get them to modify their behaviour without having to use people from our enforcement team as part of that work. I understood from yesterday's evidence that the ACCC would describe some of that work as work falling within the definition of enforcement action. I think they called it administrative action. So I think the dichotomy is not as clear-cut, because the two agencies take a different approach to how we're structured organisationally, and the way that our powers work, and the way we conduct our surveillances and investigations.

Can I just make sure I understand what it is that you are describing is the difference. If either the ACCC or ASIC commences litigation, that would fall within the meaning of enforcement?---Yes.

For both of them, as you understand?---Yes.

If either of them accepts an enforceable undertaking would that fall within the meaning of enforcement?---For us it probably would, although that work might be done by an enforcement team or it might be done by my team. Where it's done by an enforcement team it typically attracts the enforcement label; where it's done by my team it may not attract the enforcement label.

And then you were referring to administrative action, that's the thing where you think there might be some difference?---Yes. So the types of outcomes that were described included engaging with an institution and telling them that they need to make changes to their contracts, and having that resolved without the need for a formal court proceeding or even an enforceable undertaking, and that type of work happens a lot as well at ASIC, but it's typically not done by enforcement teams at ASIC. It's done by the kind of team I work for at ASIC.

Perhaps we might have a different understanding of what the ACCC is talking about with an administrative resolution. You understand that an administrative resolution is something formal that the ACCC commissioners resolve on; is that your understanding?---No, that's not my understanding.

So your understanding when you talk about an administrative resolution is that there's just an agreement reached between ASIC and the lender?---Yes. And a media release is then published to record the outcome of that agreement.

Okay. And so the distinction that you're drawing is that it might be that the ACCC would regard reaching an agreement from which they then publish a media release as

something that falls within enforcement whereas you wouldn't?---Well, that's how I understood Mr Gregson to describe that work and, in fact, the fact that that work occurs within what is called the ACCCs enforcement area.

Right. And I'm just trying to figure out, then, is it your view that there isn't actually as significant a difference in approach between how ASIC went about dealing with UCT and how the ACCC dealt with UCT as appears to be the case?---In broad terms, I would say that's right. I know that the ACCC has commenced litigation against two institutions or two firms, but in broad terms I would say that whilst the ACCC did receive additional funding and did conduct more education and outreach, and also did a review of industries prior to the commencement of the legislation, that our general approach to enforcement is very similar.

I'm not sure whether you are or aren't answering my question. My question is about how you approached – how each of the regulators had approached the expansion of the UCT to cover small businesses. Is that what you're dealing with?---Yes.

Or are you – it's just at the end of the answer you said, "Our approach to enforcement isn't that different"?---In relation to the UCT.

I see. Just if I can test that for a moment. Stepping back even from the unfair contract terms expansion to small businesses, since the unfair contract terms regime came into effect in 2010, how many court actions has ASIC commenced in relation to the UCT?---We haven't commenced any court actions.

All right. There has been a court action commenced in relation to unfair contract terms under the ASIC Act?---By ASIC?

No?---By the ACCC?

Yes?---Under delegation?

Yes?---Yes.

So the only – am I right in thinking the only regulator that has commenced a piece of litigation under the ASIC Act in relation to the unfair contract terms is actually the ACCC?---Yes.

And that was done by virtue of the delegations that ASIC and the ACCC sometimes exchange in relation to matters?---Yes.

And, to be fair, to make sure the Commissioner understands that in context, that particular piece of litigation was litigation that the ACCC had commenced against Europcar; is that right?---I believe so.

And so it's likely that the explanation for the delegation is that, for some technical reason, it was found that the particular service that was being offered by Europcar fell within the definition of financial service?---That's right.

So it wasn't something that was ordinarily subject to regulation by ASIC?---Correct, yes.

So that's why the ACCC needed to use the delegation in that case?---Yes, for the avoidance of all doubt.

And just thinking about that, putting it in that context that there hasn't been any litigation commenced by ASIC in the past eight years in relation to the unfair contract terms regime, do you still think that the approach to litigation of ASIC and the ACCC is the same?---To litigation?

I'm sorry, you were framing it as enforcement, which includes litigation?---Yes, overall.

Perhaps if we just take litigation. Do you think the approach to litigation is the same?---It is to the extent that if we encounter businesses that are including terms within their contracts that are unfair, and those businesses don't change their contracts in response to concerns that we've raised, that we would take – we would commence proceedings against those businesses in appropriate circumstances.

And, again, if you think about this in the context that you've explained as at 12 November 2016, which is that you had the view that of the big four banks, they had terms in their contracts that may have been unfair contract terms?---Yes.

And that they had shown – these are my words, not yours – but little appetite to meaningfully change their terms?---Sure, yes.

And that that was a view that ASIC held that they had made only token efforts to try to change their terms?---Yes.

And that that was consistent with – I think you agreed with the Commissioner's question earlier, that was consistent with what ASIC expected of them?---It wasn't surprising to us.

I wonder, then, whether you can explain why not take the position of saying, "We are not satisfied with your terms and if you haven't improved them by 12 November 2016, then when the legislation comes into effect on 13 November 2016 we are going to go to the Federal Court and seek a declaration"?---So, there was a number of considerations that informed the approach. We saw this as an industry-wide issue. It wasn't just an issue confined to one institution, and we were seeking to get an industry-wide outcome in relation to how banks and other financial institutions approach the UCT laws. And so with that in mind, and given the banks in the subsequent discussions that we had with them, given that they were prepared


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consider further changes to their contracts, partly due to the public pressure that had been applied on them through things like the review that the Small Business Ombudsman had done but also because of the fact that their Code of Banking Practice was under review and that they were looking to make commitments to take them beyond what the law required, we saw that as an opportunity to get an outcome with the big four that we could then leverage across other financial institutions.

THE COMMISSIONER: When you speak of an industry-wide approach, are you speaking of industry-wide agreement or are you speaking of industry-wide compliance. The two are radically different, I would suggest?---Yes, Commissioner. I think we were aiming to get an outcome that went beyond the strict requirements of the law.

I don't think – I'm not sure that you've answered my question. Were you seeking industry-wide agreement or industry-wide compliance?---Well, maybe I don't understand the question. I think probably both. An agreement that they would modify their contracts so that it would comply with the law and, you know, potentially go beyond the law.

Yes.

MR HODGE: And so just so I understand the methodology, the methodology was to try to get the big four banks to move?---Yes.

Is that right? And then once the big four banks had moved to then try to leverage that with the smaller banks?---Yes.

And when did ASIC formulate that plan?---Probably in late 2016 and early 2017 because we had a series of discussions with the Small Business Ombudsman and we decided we would work together on that, and that was the strategy that we – that we decided to go with.

And so before the Small Business Ombudsman became involved, what was the strategy that ASIC was pursuing?---Well, it was – well, we would have, I think, effectively executed a similar strategy, but without the small business Ombudsman's input and involvement.

As at 12 November 2016, was there any strategy?---In terms of?

Of attempting to get banks to actually comply with the law?---Yes. So we had reviewed their contracts. We had identified concerns. Those concerns were not limited to one bank. So the strategy at that point was: how do we get the industry more broadly to comply with the UCT?

Can we bring up ASIC.0506.0003.2018. This is the joint media release that was put out by ASIC and the Ombudsman?---Yes.


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On 9 March 2017?---Yes.

And this was as a result, is it fair to say, of significant pressure from the Ombudsman about ASIC taking action in relation to unfair contract terms?---What do you mean by "pressure".

That is the Ombudsman was coming to ASIC and raising the issue and pressuring ASIC to do something?---The Ombudsman was certainly raising the issues with ASIC, but we had already started work on this and we had already reviewed the contracts and the Small Business Ombudsman was interested in working with us to put pressure on the banks to comply with the law.

And in the media release, is this accurately setting out the views that ASIC had at the time? That is, as at 9 March 2017?---Yes.

All right. And so its view was that the big four banks have substantial work to do to eliminate unfair terms?---Yes.

It refers to a joint review of small business standard form contracts undertaken by ASIC and the Ombudsman. When was that joint review undertaken?---I think that was undertaken in November – December 2016 and possibly into early 2017.

And what was the nature of that joint review?---So we had an external expert assist us with the review of these contracts and the identification of terms that were potentially unfair. And together we identified the four broad themes that we felt were the priority areas for us to focus on.

Did – I'm sorry, did ASIC and the Ombudsman jointly engage an external expert?---Initially, it was the Ombudsman that did.

Right?---Yes.

Was it – and this was as part of – the Ombudsman was conducting an inquiry at that point in time?---Yes, that's right.

In late 2016?---Yes, that's right.

And had the Ombudsman engaged an expert in order to review the big four banks' contract terms?---I think that was part of it.

And when you are talking about the review that was undertaken, was that the review undertaken by the Ombudsman's expert?---With – in conjunction with the Ombudsman's expert, following the publication of the Ombudsman's report.

I see. So the Ombudsman – I just want to make sure I've understood it correctly. The Ombudsman engaged an expert to assist her as part of her report?---Yes.

And then she published her report?---Yes.

And then after she published her report, was there some engagement between ASIC and the expert?---Through the Ombudsman, yes, and then we ultimately then appointed that expert ourselves.

All right. And when did you appoint that expert?---I think it was in April 2017.

Okay, so after the joint media release?---Yes.

All right. And then ASICs view as at March 2017, together with the Ombudsman's view, was that having reviewed small business loan contracts from eight lenders, you had each found that there has been a failure to take sufficient steps to comply with the new obligations under the unfair contract terms regime?---Yes.

And that that was despite being provided with a one year transition period?---Yes.

All right. And then you see at the bottom third of the page it says:

> *In their initial review ASIC and the Ombudsman found lenders continue to use clauses of concern.*

And it lists various clauses?---Yes.

And just so I again understand, is that referring to the review that that had been undertaken by the Ombudsman's expert as part of the Ombudsman preparing her report or is that part of ASICs review of the terms?---Both.

You both identified these clauses of concern?---Yes.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Joint media release ASIC and ASBFEO, 9 March 17, ASIC.0506.0003.2018, exhibit 3.168.

**EXHIBIT #3.168 JOINT MEDIA RELEASE ASIC AND ASBFEO DATED 09/03/2017 (ASIC.0506.0003.2018)**

MR HODGE: And actually, just before I move off that. Can we go over the page to 2019. You see there's a quote there from the deputy chair, Mr Kell?---Yes.

And it says:

> *ASIC is committed to ensure is the UCT provisions help to raise small business lending standards. Where we identify a potential unfair term we will work with*

*the lender to remove or amend the term and we have already started to raise these issues with lenders.*

?---Yes.

Just so I understand, the reference to having already raised these issues with lenders, is that a reference to the correspondence that is referred to in your statement between September and November 2016?---I believe so.

There wasn't some subsequent dialogue with lenders after September 2016, was there?---No.

No. And then it says:

*If the lender refuses to do so we will consider all regulatory options, including taking the matter to court, as ultimately a court can decide whether or not a term is unfair.*

?---That's right.

THE COMMISSIONER: Why work with the lender? Why not just say "Do it"?---So there was more than one lender that had these terms in their contracts.

Yes?---And we have to balance the different options. If a lender is prepared to make changes in response to the concerns we've raised, that can often be a faster and more effective way of getting that change in place as distinct from going down the path of taking court action. And so we were - - -

Taking court action might or might not follow saying "Do it". My question is: why say, in a media release, "We will work with those who are not complying" rather than saying, "Those who are not complying with the law should do so"?---I think that's – that was effectively what we were aiming to do. But, without the power to direct a business to behave in a particular way, I think perhaps our language was a bit more circumspect. But, you know, I think the clear message in this media release was that we wanted the banks to make changes.

Or to come and talk to you?---About the changes that were required to be made, yes.

MR HODGE: Now, can I then take you to WBC.107.001.7204. Thank you. Commissioner, this document is already an exhibit. It's an exhibit to the statement of Ms O'Donoghue, the witness from Westpac who gave evidence yesterday.

Mr Saadat, you see this is an email of 9 March 2017 from Mr Moyes, who is the head of regulatory response at Westpac, to you and to other people – I'm sorry, to Mr Kell and copied to you and to Ms Brooks of Westpac?---Yes.


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And have you reviewed this email in the course of preparing to give evidence?---I have, yes.

And Mr Moyes – I will summarise the email as – expresses surprise at reading the joint media release that ASIC had issued with the Ombudsman?---Yes.

Do you agree with that? And he expresses surprise because of what he describes as:

> *…an apparent finding that lenders have failed to take sufficient steps to comply with the new UCT obligations.*

?---Mmm.

And, sorry, just because it's being recorded you will need to say yes?---Yes.

And that – what he describes as an "apparent finding", that's an accurate reflection of what you had put in the media release; do you agree?---Yes.

And the reason he expresses surprise is because he says:

> *You may be aware that we engaged ASIC in advance of the UCT regime extending to small business and we also responded to ASICs requests to see our relevant small business contracts, including those for before and after the UCT changes came into place. We had not received any further requests from ASIC or any direct feedback since this earlier engagement, and so we were a little surprised that we were singled out with the other larger banks in today's release.*

?---Yes.

And his summary of what had occurred appears, based on what we have looked at, to be accurate. That is, Westpac had engaged with ASIC in those couple of months right before the UCT came into effect and then there hadn't been anything that had followed. Do you agree with that?---Yes. We hadn't engaged bilaterally with Westpac, subsequent to the middle of November 2016, and that's because we were working to identify the common issues that needed to be addressed across the big four banks.

And so what I'm struggling to understand, I think, is the strategy that is being pursued by ASIC which, as I've – as best I can understand it so far, was in July 2015 ASIC considered whether it should review the contracts of ADIs. Do you agree with that?---Yes.

But it didn't do so - - -?---Not until - - -

- - - at that time?---No, not at that time, that's right.


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And it knew that the ACCC was undertaking this review of – I think the ACCC was saying five industries; it ended up reviewing seven industries?---Right.

And as I understand it, at some point in time, either at the end of 2015 or the beginning of 2016, ASIC decided that it wouldn't review the contracts because it would wait until the banks had actually revised their contracts?---That's right.

And then, at the end of August 2016, ASIC sent letters which were sort of generic letters to some of the major lending associations?---Yes.

And then in September of 2016, ASIC then appeared to embark on a different strategy which was to engage with the lenders and to get copies of their contracts?---Yes.

And then, come the implementation date, ASIC wasn't satisfied. That is, come 12 November 2016, ASIC wasn't satisfied that the banks' contracts were in compliance with the UCT regime?---Yes.

But ASIC didn't engage with the banks after 12 November 2016 up until it published its media release on 9 March 2017?---That's right.

And it also didn't take any enforcement action against the banks in that period. I'm sorry. I should put it more generally: it hasn't taken any enforcement at all against the banks?---You mean court action?

Yes?---That's right.

Well, has it taken any enforcement action against the banks in respect of this UCT?---Well, during this period we are looking to enforce the law by getting the terms within those contracts changed.

During the period 12 November 2016 to 9 March 2017?---Up until 12 November, when we were reviewing the contracts to understand the changes that have been made, and subsequent to 12 November when we are working out the position around what terms still need to be changed, our approach at that point is to get the changes and – and enforce the law.

I'm just not sure - - -

THE COMMISSIONER: Or prevent continued breach.

MR HODGE: I'm sorry, Commissioner.

THE COMMISSIONER: Or prevent continued breach?---Yes.

MR HODGE: All right. Can we bring up WBC.104.002.2610. This is an internal email of Westpac that is summarising a discussion that has occurred between Ms

O'Donoghue of Westpac and Ms Brooks of Westpac with people from ASIC, although the people are not identified?---Yes.

Do you know whether one of the people was you?---I can't be certain. I don't think so, but I can't be certain.

All right. And this was a document that was tendered yesterday through Ms O'Donoghue. What the email records is ASIC having said to Westpac, so this is mid-April 2017:

> *ASIC advised that it had only undertaken a very high level review of Westpac and other lenders' small business lending documents, but was continuing to review at a more granular level, notably with Kate Carnell.*

?---Yes.

Is that an accurate statement of where ASIC was at, as at mid-April 2017?---So this was after we had issued the media release - - -?---

Yes?--- - - - in March 2017. I think we had identified the four key areas of focus that we wanted the banks to make changes in relation to, so I don't know if I would describe that as high level, but what happened subsequent to March 2017 was that quite a lot of work was required to be done about the detailed construction of the clauses within the contracts that the banks had. And so that – that's what – what was happening both following the media release, but also following a round table that we held with the banks, I think in May 2017, where we reached agreement on a number of – of the issues.

And then you see the second bullet point that's attributed to ASIC, is that:

> *ASIC recognised that Westpac had already amended many non-monetary default clauses, but stated that Westpac was not compliant with the UCT standards for non-monetary default clauses and, to a lesser degree, unilateral variance terms.*

?---Yes, I see that.

And do you know whether that reflects the view that ASIC held at the time about Westpac?---I don't remember the specifics.

Does it seem odd to you, in the context of whatever strategy it was that ASIC was pursuing, that it hadn't communicated this to Westpac earlier?---No. Because Westpac wasn't the only bank we were dealing with.

Well, perhaps – had you communicated it to other banks?---So up until March 2017, no, we hadn't communicated those issues directly to the banks. What we wanted to do with that Mead ca release effectively draw a line in the sand and articulate the

position that we had reached, having reviewed their contracts and identified the four areas that we thought were the high priority areas for them to focus on.

And then you see the next point is:

> *ASICs comments today are the first confirmation that ASIC considers Westpac to be noncompliant.*

?---Yes.

And do you accept that the first time that ASIC informed Westpac that it considered Westpac to be noncompliant was 13 April 2017?---No. I think they should have gotten that message when we put out the media release in March 2017.

I see. They should have understood from the media release that you were saying everybody is noncompliant?---Correct, yes.

All right. And then it also goes on to say:

> *However, ASIC indicated that Westpac is one of the more compliant lenders that it has reviewed.*

?---I don't understand the specifics of that, that comment.

Well, do you – you obviously – by April 2017, you've reviewed at least the big four banks' contracts. You had also seemingly been reviewing Suncorp's contracts?---I believe we had, yes.

And do you remember whether, of the big four banks, Westpac was one of the more compliant banks?---I don't. At this point, banks were making different changes and were offering up different proposals in response to the concerns that had been raised by us and the Small Business Ombudsman. And so at any point in time the relative position of one bank versus another bank was effectively in flux and I don't specifically remember, at this point in time, that Westpac was more compliant.

Can we then bring up another document which is RCD.0014.0013.0001. Is this that next media release that you were referring to?---It is, yes.

So this is issued on 16 May 2017?---That's right.

And this is after there has been a round table hosted by the Ombudsman and ASIC; is that right?---Correct, yes.

And if we go to page .0002, you see about the third paragraph says:


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*The Ombudsman and ASIC have publicly raised concerns that lenders, including the big four banks, needed to lift their game in meeting the unfair terms legislation.*

?---Yes.

Can I ask something about that language. This is a joint media release?---It is.

Is it fair to say using expressions like "needed to lift their game" isn't the typical type expression that ASIC would use in a media release?---That's probably right.

And one of the things this reflects then, is that ASIC is in a position where it has the Ombudsman pushing it and pushing the language that it's using in relation to unfair contract terms?---Yes.

And then if we go over the page to .0005, it says:

*ASIC deputy chairman Peter Kell said, "We made it clear that lenders have to significantly improve their lending agreements to small business to ensure they meet new rules.*

?---Yes.

And is that the message that was being conveyed at the round table by ASIC?---Yes.

All right. And it says at the bottom of the page:

*In March 2017, the Ombudsman and ASIC completed a review of small business standard form contracts and called on lenders across Australia to take immediate steps to ensure their standard form loan agreements comply with the law.*

?---Yes.

I'm just trying to understand the statement that the review was completed at that time. That seems somewhat inaccurate in terms of ASICs position; is that fair?---So I think it reflects the fact that it was in March 2017 that we were ready to publish that media release, and it was at that point that we put out the position publicly.

I tender that document, Commissioner.

THE COMMISSIONER: Media release, 16 May '17, of ASIC and ASBFEO, RCD.0014.0013.0001, exhibit 3.169.

**EXHIBIT #3.169 MEDIA RELEASE OF ASIC AND ASBFEO DATED 16/05/2017 (RCD.0014.0013.0001)**

MR HODGE: And then there were negotiations that went on between ASIC and the big banks over the course of the next 10 months or so?---Yes, I would say, yes.

And then eventually ASIC published a report in March of 2018; is that right?---Yes. The negotiations or the discussions were largely complete, I would say, by August 2017. There were some remaining issues that needed to be addressed, you know, including for example, Westpac's approach to cross-defaults. But we had largely reached the position that we were looking for by August 2017.

And in – when you referred to, for example, that Westpac cross-defaults issue, can I just understand that. That issue is still ongoing as at March 2018?---I'm not sure if it was still ongoing as of March 2018. I think there was - - -

Perhaps I can help you by showing a document?---Sure.

WBC.414.002.0409.

THE COMMISSIONER: Sorry. Can you give me the number again, if no one else.

MR HODGE: I'm sorry. It's WBC.414.002.0409.

THE COMMISSIONER: Thank you.

MR HODGE: And if you look at the bottom of the page, you see an email from Mr Green of ASIC to Westpac?---Yes.

And we can probably pop that out and see, on 6 March 2018, ASIC was saying:

> *ASIC once again reiterates its position that any non-monetary event of default under a separate finance facility or security agreement, which is treated as an event of default, as say a cross-default under the main small business loan contract, must fall within the specific events of non-monetary default as per the ABAs position.*

?---Yes.

So I think that probably helps you to answer my question?---Yes.

Was the issue ongoing at March 2018?---Yes.

It was still ongoing?---Yes.

And how has it been resolved?---Westpac has made the changes that we were looking for.

All right. Has Westpac published its contracts as of yet – as of yet, do you know?---No, I don't believe they have. I think they've published a waiver document


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that sets out the changes they've made, and that waiver document is being provided to small business customers. I think importantly, though, in relation to not only Westpac's changes but all the changes that have been made by the big four banks, the position that we reached was that these changes would be retrospective back to 12 November 2016, so that no customer – no small business customer would be disadvantaged by the failure of the banks to make those changes as at 12 November 2016.

Well, let's just reflect on that. The effect of the legislation from 12 November 2016 is that if the term is unfair it is void; do you agree?---Yes.

So if these terms have been amended in order to remove unfairness, but for their amendment, they would be void as at 12 November 2016; do you agree?---Yes.

So I'm not sure that I understand why the banks retrospectively agreeing to amend terms that would otherwise be void is a particularly significant improvement on the position. Are you able to explain that?---No. I think it is a significant improvement, because I think it means that in practical terms no small business customer is disadvantaged.

And is that because the alternative would be the bank might seek to rely on the term and then it would be necessary for the small business customer to go to court to seek a declaration that the term is void?---That's right.

Presumably one of the things that could have happened is that, if there were particular types of terms that were a cause of concern for ASIC that were identified as at November 2016, it could have commenced a proceeding or multiple proceedings against one or more of the banks seeking a declaration that particular terms in particular contracts were void?---We could have done that.

And not only would that have affected the particular term, if it was declared void, but also it presumably would have set a pretty clear benchmark for the rest of the industry?---Perhaps. I think the risk with that is that because the terms do vary from contract to contract, and arguments about what a lender's legitimate interests are can vary, sometimes what we find with litigated outcomes is that the outcome doesn't necessarily have a broader applicability and in this case an outcome against one bank in relation to one contract about one particular term may not necessarily have a broader applicability if you have a slightly differently worded term in a different contract.

When you say "sometimes we find that the litigated outcome isn't effective", I just – can we just understand that. ASIC hasn't had any litigated outcomes from the unfair contract terms regime?---That's right. I was talking more generally about litigated outcomes in terms of the fact that they're often decided on their facts and sometimes those facts are not more broadly applicable to other circumstances.


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All right. And I think you're not – litigated outcomes is really something that's for the next witness from ASIC to speak about; is that fair?---That's right.

And were you here in the hearing room yesterday when the witness from Suncorp gave evidence?---I was.

Did it concern you that now – yesterday was 31 May 2018, today is 1 June 2018, that Suncorp still doesn't know or hasn't completed its review in order to determine whether the terms in some of its contracts are unfair?---Yes.

And when you reflect – I'm sorry, I should ask, were you aware of that before that evidence was given yesterday?---Yes.

And how long have you been aware of that for?---I couldn't give you an exact date, but it's – people in my team raised that with me in the last couple of weeks.

That Suncorp still hadn't completed its review?---That – that's right.

What about other banks? Does ASIC hold a concern about whether say Bank of Queensland has properly reviewed its contracts to bring them into line with the unfair contract terms regime?---So we have got a concern more broadly that other institutions may not have made changes that are necessary and we've commenced a piece of work to review the contracts of other – both bank and non-bank lenders to understand whether they've incorporated the changes that we have outlined are necessary in report 565.

And just if you reflect on the Suncorp situation, does that suggest to you that there has been any failure on the part of ASIC in relation to the implementation of the UCT regime in relation to small businesses?---A failure of what in particular?

Of ASIC. ASIC is implementing the legislation - - -?---Yes.

- - - as the regulator responsible to it. My question is hearing Suncorp say pretty candidly they didn't know, and hadn't completed their review, I'm wondering if that suggests to you any failure on the part of ASIC in the way it went about implementing the new regime?---I think – I think the strategy that we embarked upon to make sure that the big four banks had changed their contracts in the way that we felt was necessary was the right way to go; that they have about 83 per cent of market share when it comes to small business lending, and having them set the standard is very important because the rest of the industry does look at the conduct of the big four banks, and so I think given that we were able to reach the position we did with the big four, including in some respects as a result of the fact that the Code of Banking Practice was being reviewed, making sure that the commitments that were being made went beyond the strict requirements of the UCT law, I think that was a good outcome. And I think it's now something that we're able to apply more broadly. So ADIs like Suncorp, who are members of the Australian Banking Association, will as a result of the changes to the Banking Code be held to a much

higher standard than what the law requires, and our concern is now to make sure that those who are not members of that industry body, and who don't subscribe to the Code of Banking Practice are also doing the right thing.

When you reflect on what has happened, are there ways in which you think ASIC could have done a better job in implementing whatever its strategy was in relation to UCT?---I think if we were able to reach a position – reach the position that was ultimately reached in March 2017, had that position been able to be reached sooner, then I think - - -

Do you mean March 2018?---Sorry, March – no, no, March 2017 as in setting out the position of where the concerns were. Had we been able to reach – had we been able to crystallise that position sooner than March 2017, then I think we would have been able to get the result that was ultimately referred to in May, and then August 2017, sooner than that and have those contracts updated and in place before the commencement of the UCT regime. But I guess, due to a combination of factors, including the fact that the banks hadn't updated their contracts and we hadn't crystallised our position in terms of what additional changes were required to meet UCT, that wasn't able to happen sooner than it did.

Can I just ask one other thing, which is – just connects to the last module that the Commission of inquiry undertook in relation to financial advice: has there been any consideration that you are aware of as to the application of the unfair contract terms regime to financial advice contracts?---I can't tell you off the top of my head.

Is that something that's within the am bit of your responsibilities or outside your responsibilities?---It would be within the ambit of the financial advisors team at ASIC.

All right. Thank you, Commissioner. I don't have any further questions of Mr Saadat.

THE COMMISSIONER: Does any party other than ASIC seek to seek leave to cross-examine Mr Saadat? No. Mr Collinson.

**<RE-EXAMINATION BY MR COLLINSON [11.32 am]**

MR COLLINSON: Just three matters in re-examination, if the Commissioner pleases.

Mr Saadat, you mentioned – twice, I think – that the process you described that occurred between ASIC and the banks, as it turned out, went beyond the strict requirements of the UCT law. And you first gave that evidence in response to the Commissioner's question, which drew a distinction between compliance – whether ASIC was looking to insist upon compliance or agreement from the banks and you

answered after a little while "both" to that. But are you able to expand for the Commissioner's benefit on what you mean by going beyond the strict requirements of the law?---So a few things. The banks have agreed to apply the approach that was agreed in order to meet UCT compliance to loans of up to $3 million, which is significantly higher than the $1 million threshold that applies to loans that are greater than one year, and higher still than the requirements that apply for loans of less than 12 months where the UCT law is – has a threshold of $300,000. The other elements to that are that some of the specific commitments that have been made in relation to, for example, specific events of non-monetary default and the fact that the banks have confined themselves to, I think, 12 specific events of non-monetary default, I think it's arguable as to whether other potential events of non-monetary default would also be permissible by the UCT law, and so those kinds of changes that the banks have agreed to make, given that the law does allow for banks to have in their contracts terms which may be one sided but within – you know, within the legitimate interests of that bank, I think we've reached a position which is a really good outcome for small business customers because it gives them both certainty but also means that a range of potentially other terms that might be legally permissible are not included in those contracts.

And you are aware that the Khoury review came out in 31 – on 31 January 2017?---Yes.

And there was a process of engagement between ASIC and the banks in relation to the draft code during 2017?---Yes.

In giving your evidence just now about the banks going beyond the strict requirements of the law, are you referring just to their discussions with ASIC in respect of their contracts, or the code as well?---Both.

In relation to this period – this is my second question, between 12 November 2016 and March 2017, which you were asked questions about, and the question of what ASIC was doing in that period, you made reference, I think, to the Khoury review, which I said a little earlier was dated 31 January 2017, and also the report of the Small Business Ombudsman, which I can tell you or remind you came out on 3 February 2017. Are you able to expand for the Commissioner's benefit on what the relevance of those impending reports was to the period November 2016 to March 2017?---So those inquiries and reports identified both – so the Ombudsman's report identified areas which she felt included conduct that fell short of the law, but also conduct that she felt was important for the banks to adopt that went beyond the law. So there was a range of recommendations that the Ombudsman had made to the banks about improving their conduct. At the same time Phil Khoury, through his review of the Code of Banking Practice - - -

Sorry to interrupt. Can I just interrupt you. Did you see any drafts of the Ombudsman's report before its final release on 3 February?---I think we may have, yes.

Yes. Sorry, if you could continue?---And so the work that Phil Khoury was doing at the same time in identifying opportunities for the banks to include initiatives or clauses within the Code of Banking Practice that went above the minimum requirements of the law was also an opportunity for us to identify specific commitments that the banks could make. I have – I should say that around this time the banks were telling us that whilst they were willing to make further changes to their contracts, that their position was that they had in fact complied with UCT, but that they were willing to make more changes. And I think partly that was due to the recognition that they were required to make additional changes in any event because the Code of Banking Practice would ultimately see that happen.

And did you see drafts of the Khoury review before it was finalised?---Yes, we may have.

Now, if hypothetically ASIC had commenced proceedings, that is court proceedings, against one or more of the banks in say December 2016, doing the best you can, because it's really a hypothetical question, what do you think the effect would have been upon this process that occurred between ASIC – and I think that you described was substantively concluded by August 2017?---I think that depends on whether any litigation was contested by the banks, and I expect it would have been contested, and I think in that scenario it's quite likely, I think – based on experience with other cases that ASIC has been running, including a current case against Westpac in the Federal Court – that it would have taken much longer for ASIC to get a declaration that any of the terms that we were concerned about were unfair.

Leaving aside getting a declaration in the court. What effect would it have – would it, in your view, have had on the process of engagement between ASIC and the banks that occurred, I think, substantively between about March 2017 and August 2017?---So I think in that case, had we commenced proceedings, there would have been no further discussions about changes occurring to contracts because the banks would have effectively awaited the outcome of that litigation before making changes.

Just one last point. I think you covered this, but Suncorp is a member of the ABA?---It is.

So the new code would apply to Suncorp's dealings with small business borrowers?---It will.

No further questions.

THE COMMISSIONER: Yes. Thank you, Mr Hodge.

MR HODGE: Nothing arising from that, Commissioner.

THE COMMISSIONER: Yes, thank you very much.

Mr Saadat, you may step down?---Thank you.

**<THE WITNESS WITHDREW [11.40 am]**

MR HODGE: The next witness is Tim Mullaly.

THE COMMISSIONER: Yes, Mr Mullaly.

**<TIMOTHY MULLALY, AFFIRMED [11.40 am]**

**<EXAMINATION-IN-CHIEF BY MR COLLINSON**

THE COMMISSIONER: Thank you, Mr Mullaly do sit down, yes, Mr Collinson.

MR COLLINSON: The Commissioner pleases.

Your full name is Timothy Mullaly?---Yes.

And your business address is level 7, 120 Collins Street, Melbourne?---It is.

And your position is presently senior executive leader, financial services enforcement team, at ASIC?---That's correct.

Now, you have an original of your summons to appear to give evidence before the Commission?---I do.

I will tender that, Commissioner.

THE COMMISSIONER: Exhibit 3.10 the summons to Mr Mullaly.

**EXHIBIT #3.170 SUMMONS TO MR MULLALY**

MR COLLINSON: And secondly, Mr Mullaly, you have a copy there of your witness statement dated 30 May 2018?---I do.

I tender that.

THE COMMISSIONER: Exhibit 3.171 is the statement of Mr Mullaly and its exhibits.

**EXHIBIT #3.171 STATEMENT OF MR MULLALY AND EXHIBITS DATED 30/05/2018**

THE COMMISSIONER: Thank you. Yes, Mr Hodge.

**<CROSS-EXAMINATION BY MR HODGE [11.42 am]**

MR HODGE: Thank you, Commissioner.

Sorry, is it Mr Mullaly or Mullaly?---Either, I don't mind. I'm not that particular.

I will call you whatever you want. All right. Now, Mr Mullaly, you've been the senior executive leader of the ASIC financial services enforcement team since July of 2012?---That's correct.

And in that role you're responsible for managing ASICs enforcement investigations in relation to financial services?---Yes. Just in relation to financial services.

And that would include both licensed and unlicensed?---That's correct.

So, for example, if an unlicensed person is purporting to provide financial service you might be responsible for the enforcement proceeding against them?---That's correct.

And you're also responsible for ASICs enforcement investigations in relation to financial services?---That's correct.

Can I ask again, just out of curiosity – and tying back to module 2 – the issue of taking an unfair contract terms proceeding in respect of the contract between an advice licensee and a consumer, is that something that would fall within your ambit of responsibility?---Yes.

Do you know whether any consideration has been given to the application of the unfair contract terms regime to those types of contracts?---I'm not aware that it has.

You're not aware that it has; is that right?---Yes. That's what I said, yes.

All right. Now you've, in your witness statement, set out some figures relating to proceedings and investigations that have been commenced by ASIC?---That's correct.

And I would like to go to that just so we can get a better sense of what they mean, so it's page 9 of Mr Mullaly's statement. That's ASIC.0800.0005 – and it's – 0009 is the relevant page. Thank you. So you were asked, in response to a rubric sent by the Royal Commission, to break down a number of figures about proceedings that had been commenced by ASIC over the course of just over the last 10 years?---That's correct. Or 10 and a bit years.

Since 1 January 2008?---That's correct.

So almost 10 and a half years, not quite?---Yes.

And as we understand it, if we look – starting at the bottom of the page, since the 1 January 2008, ASIC has commenced 1102 proceedings?---That's correct.

And those would be proceedings under the Corporations Act?---Yes.

That would be one possibility. Under the ASIC Act?---That's correct.

And the National Consumer Protection Act?---That's correct.

Would there be any other legislation?---State Crimes Act, Insurance Contracts Act possibly, as well.

All right. So then when we go over the page we see the breakdown of that, which is there have been 238 criminal proceedings?---That's correct.

And is it right – or I should ask, does ASIC run those criminal proceedings itself or are they conducted by the Director of Public Prosecutions?---Those particular proceedings will be conducted by the Director of Public Prosecutions. ASIC does, in another area of ASIC, run its own prosecutions in relation to reporting breaches and other books and records type breaches.

All right. And then there's 277 civil proceedings?---That's correct.

And again that could be under the ASIC Act, Corporations Act, NCCP Act, Insurance Act, and there was something else you mentioned?---Well, it wouldn't be under State Crimes Act.

I see. It wouldn't be under State Crimes Act. All right. And then – and we will come back to that in a moment. And then there's 587 administrative proceedings?---That's correct.

Could you explain to the Commissioner what you mean by administrative proceedings?---Those administrative proceedings will be proceedings run by an ASIC delegate. So they would be to ban people from various industries, whether it be credit or financial services, or it might be actions against the licensee themselves to remove licences or to suspend licences or put conditions on licences. And it – I think includes as well – sorry, it doesn't include infringement notices, that's separately run.

And – sorry, does the 587 administrative proceedings, does that include 370 infringement notices?---No.

That's something separate?---Yes.


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And so again, just to make sure I've understood: an administrative proceeding doesn't mean going to a tribunal in order to have the tribunal make a decision or it does?---Not an external tribunal, no.

It's just an internal function that ASIC performs where there's a certain part of ASIC that has to determine whether or not to, for example, suspend somebody's licence?---That's correct.

All right. And then of those – I'm sorry, and then what you then explain at subparagraph (c) is ASIC has issued 370 infringement notices?---That's correct.

With total – is it penalties, is that how it's described?---No, very much not penalties. ASIC has no ability to impose a penalty.

How do you describe it? A fee?---Well, sorry, I should say we do – we describe it as an infringement notice. I need to now correct myself: penalty. It's not a penalty in the true sense of something imposed by the court system.

Yes?---And it's not a fine.

And there's provision under the ASIC Act for ASIC to issue infringement notices for – and I will summarise it as being where ASIC has a reasonable belief that a contravention of certain provisions of the ASIC Act has occurred?---That's correct.

And are there also other statutory provisions in other Acts that give ASIC the power to issue infringement notices?---There is.

All right. And so the 370 infringement would include both infringement notices issued under the ASIC Act and also infringement notices issued under other Acts?---That's correct.

And then ASIC has accepted 194 enforceable undertakings - - -?---That's correct.

- - - since 1 January 2008?---Yes.

And again the enforceable undertakings, are they – what's the statutory regime that governs them?---Well, in both the ASIC Act and in the Credit Act there's provision that enables ASIC to accept an enforceable undertaking offered by an entity.

All right. And then in paragraph 29 you then move to specifically proceedings commenced in relation to contraventions of the ASIC Act?---That's correct.

And so that we can put this in some context, the ASIC Act contains the various consumer protection regimes that – or the consumer protection regime that ASIC administers?---In relation to financial services, yes.


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And there's various prohibitions on various things in the Corporations Act which ASIC is also responsible for?---That's correct.

Does ASIC describe those as consumer protection or is that treated as something else?---I'm not sure what you mean by "treated as something else".

Do you – there's something that you refer to concerned with market regulation?---Well, ASIC has a very, very broad mandate. So ASIC regulates the financial markets and financial market participants. ASIC regulates auditors, it regulates liquidators, it regulates people from the financial services industry, it regulates people from the credit industry, regulates superannuation trustees, regulates managed investment schemes, directors, etcetera. So we take action, enforcement action over a broad sort of mandate. In a sense all our work is aimed at protection of the consumers. Those are the consumers of the services provided by all those entities.

Perhaps if we just try to – I will use my favourite term – break it down. If we could just break this down. Under the Corporations Act that contains, for example, the provisions you've referred to dealing with receivers, for example, and liquidators?---Liquidators, yes.

And it contains various provisions concerned with, effectively, the provision of market information or disclosure of information about financial products?---There is provisions for that, yes.

And when you are referring to regulation of superannuation trustees, is that under the Corporations Act or is that under a different Act?---Aspects will be under the Corporations Act. Aspects will be under the ASIC Act, and aspects will be under the ..... Act.

All right. So what we are focused on then here in paragraph 29 is just proceedings that have been commenced under the ASIC Act?---Yes.

And you identify that, since 1 January 2008, ASIC has commenced 110 proceedings alleging an ASIC Act contravention?---Yes. Or multiple contraventions.

Yes, that's right. One proceeding might involve multiple contraventions?---That's correct.

And so that averages out at a bit over 10 a year; is that right?---That's – yes.

And would that include a criminal proceeding or would that only be civil proceedings?---They would only be civil proceedings.

Because there are - - -?---I – there are - - -


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There are criminal prohibitions under the ASIC Act. I'm just wondering whether that might be captured as well or you're not sure?---Yes, I'm not sure.

All right. And then you break down, of those 110, which relate to consumer protection breaches?---That's correct.

And of the 110, 23 of the proceedings relate to what's defined as a consumer protection breach in section 12GBB of the ASIC Act?---That's correct.

And I will attempt to summarise what a consumer protection breach is as defined in 12GBB, and then we will see whether we agree on that. A consumer protection breach for the purposes of 12GBB is one that is capable of attracting a civil pecuniary penalty; is that right?---That's correct.

All right. And so, for example, a breach of the prohibition on unconscionable conduct is one that's capable of attracting a civil penalty?---That's correct.

So it would be captured as part of the consumer protection breach defined in 12GBB?---That's correct.

And a contravention of 12DB, which relates to false or misleading representation as to particular types of things, for example the price of services, that could also attract a civil penalty?---That's correct.

And would therefore be caught within the definition of consumer protection breach?---That's my understanding.

And also a contravention of 12DI, which has two types of prohibitions, but effectively prohibits receiving payment for financial services where either you're not intending to provide those financial services or you don't provide those financial services. That's also caught within the definition of consumer protection?---That section is – whether it's described in that way I couldn't say, but that section definitely is.

12 – sorry?---DI.

You couldn't say whether 12DI is – whether I have accurately described it?---As you explain it, no.

All right. Are you familiar with 12DI?---I certainly am.

Okay. ASIC – just on that. That would be, we might say, the section relevant to fees for no service conduct?---It's certainly a section relevant to fees for no service conduct.

And ASIC has never commenced a proceeding under 12DI; is that right?---No.

And just to complete our very quick tour through the complicated provisions of the ASIC Act, 12DA prohibits false or misleading – I'm sorry, misleading or deceptive conduct in relation to financial services?---Yes.

But that is not a consumer protection breach section; is that right?---It doesn't attract a civil – a pecuniary penalty. And on what you've indicated in terms of 12GBB – excuse me – I think that's right. Whether it's caught up as a consumer protection breach, as you've described it, in other ways, I couldn't be certain. But, yes, it doesn't attract a pecuniary penalty.

All right. And perhaps just reflecting for a moment on the absence of any proceedings commenced alleging a contravention of 12DI, is there a reason for that, do you think?---Well, the reason is that we haven't had a matter where we thought there was sufficient evidence for us to be able to bring an action under 12DI.

All right. And then you see in paragraph 30, you say:

> *In relation to the banks, since 1 January 2008, ASIC has obtained in excess of $700 million in compensation remediation or return of funds to investors.*

?---That's correct.

And I just want to make sure we understand what that number means. That's not – none is that is pecuniary penalties, is that right?---No, that's right.

And that doesn't include the infringement notices amount?---No.

That's just ASIC has engaged with a financial services entity, and the financial services entity has agreed to make compensation or remediation; is that right?---That's correct.

Would there be some circumstances in which ASIC has commenced and succeeded in a court action and obtained orders for – that effectively provide for remediation?---Sorry, could you ask that question again.

Yes. So ASIC obviously has commenced some civil proceedings under the ASIC Act and presumably in some of those proceedings seeks order for redress in relation to consumers?---That's correct.

Do you know whether the $700 million includes moneys that have been made pursuant to a redress order?---I'm fairly certain that it doesn't include any moneys in that. Can you excuse me for a minute. Thank you.

And then it also obtained $54.3 million in community benefit payments?---That's correct.


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And community benefit payments are the donations that banks will agree – financial services entities will agree to make when they give an enforceable undertaking?---Yes. It's equivalent, in a sense to a community service type order that the courts can order under section 12GLA. However, we seek to obtain those or agree those through generally enforceable undertakings. Sometimes they're offered without an enforceable undertaking being required.

I see. And that was the next thing I was going to ask you. Sometimes, in order to resolve a moment of tension with ASIC, a financial services entity will agree to make a donation to something?---I'm not sure that I would say "to resolve a moment of tension" is an apt description.

Perhaps would you say to resolve an investigation that's being undertaken?---Well, I'm not sure that even to resolve an investigation. It seems that that is suggesting that a payment can make something go away, and that's obviously not the case.

I'm just trying to understand, when you say you've obtained $54.3 million in community benefit payments, and some of that has come from commitments that are made under enforceable undertakings, some of that is made voluntarily; is that right?---Some – yes, that's correct.

So, for example, Westpac, in the context of an issue about responsible lending, agreed to make a donation of $1 million to something. You're not sure?---It's quite possible, but I would need to see something about the specifics.

All right. But I just want to understand the point you're making, which is a bank might agree to make the donation, but that's not necessarily a resolution of the situation. I'm using the word tension, I think - - -?---Yes. I - - -

And then investigation, you weren't comfortable with either of those?---Yes. Yes, generally we will have an investigation underway into particular issues involving an entity, and the manner in which we finalise that investigation may include a range of actions by that other entity or person on the other side. So perhaps if I am able to explain by way of examples. We might accept an enforceable undertaking. That enforceable undertaking will have a number of things that the offeror has to do and part of that might be as well payment of a community benefit payment. We may decide that we will finalise a matter in a very similar way, but do it without the need for an enforceable undertaking, so there will be orders of change in conduct or to do certain things and along with that is also an offer to pay a community benefit payment.

Perhaps if I show you an example which I think – I hope will illustrate the point you are trying to make. Can we bring up RCD.0006.0004.0010. This is what I was referring to before, which is a – I'm not sure whether I should use the word "resolution" or whether you would be uncomfortable with that?---No. I think it was perhaps – perhaps I read something into it which I shouldn't have. So I apologise if I have.


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Was it because I used – I used the expression "moment of tension". Was that the point of concern?---Well, that did seem to suggest that, you know, in a moment of pique something will happen and I'm not sure that that characterises the way in which these things operate.

I see. No, no, that wasn't – no, I apologise. That certainly wasn't what I was implying. I was attempting to find a way to describe a situation in which there is a disagreement between ASIC and the relevant regulated entity - - -?---Yes.

- - - but there's no enforceable undertaking, there's no proceeding that has been commenced?---Yes.

There's just a disagreement?---Yes.

And – or a concern, I think might be the way we should express it, given this document. So this is a media release by Westpac. Commissioner, you might recall in the first round of hearings there was a case study that was concerned with this conduct. So, as we understand it, there was a concern of ASIC about the circumstances in which Westpac was providing credit card limit increases?---That appears to be the case, yes.

Do you recall this particular case?---I do, in very general terms. It's a matter that wasn't within my team.

All right. I see, it was dealt with by a different team?---Yes, as I – my recollection is that this was dealt with by Mr Saadat's team.

I see. It didn't reach the point of coming to enforcement, is that - - -?---I would need to - - -

As far as you can recall?---I - - -

I'm not trying to trick you, I just - - -?---Yes. I simply can't recall.

All right. But this is the type of resolution that you are talking about, which is ASIC had a concern about Westpac's provision of credit card limit increases and Westpac agreed to improve its practices and then committed to a remediation program and agreed to donate $1 million over four years to support financial counselling and literacy?---That's correct.

And then that would – would that result in a resolution of the issue?---It would finalise that particular matter with ASIC, yes.

All right. I tender that document, Commissioner.

THE COMMISSIONER: ASIC media release, 16-009MR, RCD.0006.0004.0010 becomes exhibit 3.172.


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**EXHIBIT #3.172 ASIC MEDIA RELEASE, 16-009MR (RCD.0006.0004.0010 )**

MR HODGE: Thank you, Commissioner.

And then if we move to paragraph 31 of your statement. So we go back to ASIC.0800.0005.0010, and go to 0010. The – if you look at paragraph 31, this is now where you're referring specifically to what proceedings have been commenced against the banks and we should be clear about this. We, that is the Royal Commission, gave you a particular definition of "the banks," which was the Commonwealth Bank, Westpac, ANZ, NAB, Bank of Queensland and Suncorp, or entities related to them?---That's correct.

And so you're referring here to proceedings commenced by ASIC against those six entities or entities related to them?---Yes, that's correct.

And you've identified that in the last 10 and a half or almost 10 and a half years ASIC has commenced 10 proceedings - - -?---That's correct.

- - - against those entities. And five of those allege a contravention of the ASIC Act?---That's correct.

And, of those five, four of them are the BBSW cases?---That's correct.

And one of them is the case against Bank of Queensland in respect of Storm Financial?---That's correct.

And I may be testing you now, but I just want to see if we can figure out what the other five are. One of them, I suspect, is that ASIC commenced a proceeding against Commonwealth Bank in relation to Storm and then it was resolved?---That's correct.

Is that one of those five?---Yes.

And then another was that ASIC, in the last year or so, commenced a proceeding against ANZ in relation to Esanda Car Finance?---That's correct.

And that was in relation to responsible lending?---That's correct.

And that was resolved earlier this year with an agreed civil penalty of $5 million?---That's correct.

And a third case is that ASIC commenced a proceeding against some Westpac related entities in relation to a failure to comply with the best interests duty where the Westpac entities were running a telephone campaign – I'm sorry, I should say alleged because I'm not sure – this is reserved at the moment, this case?---It's reserved.


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The Westpac entities were running a telephone – or alleged to be running a telephone campaign to recommend people switch their superannuation to Westpac superannuation funds?---Well, generally, yes, that's correct.

That's sort of a rough summary of the allegations?---Yes.

And that case – that was commenced in the Federal Court and it's reserved at the moment?---That's correct.

A fourth case is that ASIC has commenced a proceeding against – another proceeding against Westpac alleging a failure to comply with responsible lending obligations?---That's correct.

And that's a case set down for hearing at the end of the year, or in the second half of the year?---Yes. I think there's a date set for trial now.

And then do you know what the fifth proceeding is? I might be testing you now?---I think there might have been a second one against Bank of Queensland in relation to Storm.

I see. But that second proceeding didn't involve contraventions of the ASIC Act?---That's correct.

Thank you. And then if we then go over the page to page 12, we see at the bottom of the page ASIC has issued 45 infringement notices to the banks, again using our definition, totalling $2.1 million?---That's correct.

And then if we go over the page again, to page 13, we can see what those are?---That's correct.

Can I ask a question just about the CBA one, which is the six infringement notices. Is that – is that figure definitely right? Is it one million or should it be $180,000?---I would have to look. It does – now that I look at it, it does look a little bit out of place.

Yes, I wondered. I'm not sure we have it here, I just have a feeling that that might be – might have an extra zero in the middle of it. Now, again I will test you, was that in relation to automated responsible lending; do you recall – does that assist?---I believe that it was.

All right. Yes, I've got your media release from 14 September 2016, but unfortunately I don't have a document ID on it. But in any event – so if that's – if that's the case, rather than $2.125 million, it might be something a bit lower than that; is that right?---That would be correct, on a quick glance.

And a number of these infringement notices are not contraventions of the ASIC Act. They are – sorry, I should withdraw that. None of them are strictly contraventions of


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the Act, they're infringement notices issued on the premise that ASIC has a reasonable belief that there's a contravention; is that right?---That's correct.

And in paying an infringement notice the payer doesn't have to – or doesn't admit that there has been a contravention; is that right?---It's not an admission of contravention.

And a number of these infringement notices are infringement notices issued in relation to what I might term market conduct under the Corporations Act. Things like failure to comply with the continuous disclosure rules and infringement notice issued by the market's disciplinary panel, breach of derivative transactions reporting; that sort of thing?---That's correct.

All right. And so of these various infringement notices that you've identified here in – I think you've explained in paragraph 34, ASIC had reasonable grounds to believe that a person who contravened subdivision D of division 2 of part 2 of the ASIC Act, which relates to consumer protection, when issuing the six notices?---Six infringement notices yes.

And had reasonable grounds to believe that a person had contravened section 12DB, which is the prohibition on false or misleading representations, when issuing three notices; is that right?---That's correct.

All right. Now, I want to then explore with you, having understood these numbers, the approach that ASIC takes to deciding whether or not to pursue a court proceeding or an infringement notice and how that decision is made. And I wonder if we might do this by reference to one example. Can we bring up RCD.0006.0004.0004. So this is a press release from September 2014. This is one of the sets of infringement notices that you were referring to in your statement?---Yes.

And this is an infringement notice to NAB for misleading UBank advertisements?---Yes.

And the penalty – I'm sorry, the contravention that ASIC reasonably believes has occurred is a contravention of the prohibition on false or misleading representations?---That's correct.

And the penalty – it says penalty?---Yes.

Anyway, the amount that is paid pursuant to the infringement notice by NAB is $40,800?---That's correct.

Now, presumably – and that, I should say, or we should be clear about this, there were four infringement notices issued. Each of them was for $10,200?---That's right, I believe.


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And presumably, had ASIC taken a proceeding against NAB to court and sought a pecuniary penalty against NAB for the misleading advertisements, it would have sought a pecuniary penalty that was exponentially more than the amount of the infringement notice?---That's correct.

Can you explain to the Commissioner then what's the process by which a decision is made to stick with an infringement notice rather than seeking a pecuniary penalty?---Well, we consider the nature of the conduct and the seriousness of the conduct. We consider whether or not there was a deliberate attempt or dishonest attempt to break the law or whether there was inadvertence. We consider the cooperation of the entity in seeking to finalise and resolve the matter with ASIC, and we consider what might be the market impact of that particular conduct. We also consider our resourcing priorities and implications of one form of action over another, and so all of that is considered. And we go through a process of recommendations by the team, through me as the senior executive to the Commission, and make a decision whether infringement notices are the appropriate outcome.

And do you recall having been involved in this particular decision?---I think I was involved in this decision, yes.

And one of the things that the deputy chairman is quoted as saying is:

> *ASIC's crackdown on misleading advertising has seen action taken against 10 entities this year. ASIC will continue to take action where we believe firms have not provided clear, consistent information in their advertising.*

?---I could see that, yes.

And do you recall – does that reflect a particular priority that ASIC had, either at that time or in general, to crack down on misleading advertising?---ASIC, around that time or slightly before – we determined that we hadn't been using the infringement notice powers that we had available to us, And we determined that we would start using them more in the context of advertising.

I see. And I'm just trying to understand – and you may not be able to help us. Why not commence a court proceeding against NAB and seek a pecuniary penalty?---Well, I – at this stage I can't recall all the facts and circumstances around it, but as I say, I think we would have gone through that sort of essential synthesis of information and determined that the appropriate outcome in relation to that particular matter was the issuing of infringement notices.

And I wonder, has there been any change that you've observed over the course of the last two or three years in ASIC in terms of its appetite to commence civil proceedings seeking pecuniary penalties against entities for contraventions of the consumer protection legislation?---There hasn't been a significant uptake in the amount of action – civil penalty action that you've just mentioned.


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Does ASIC have a view about whether it is preferable for it to pursue court proceedings against larger entities?---It's not as simple as we will prefer to take action against larger entities. It depends on the particular – I'm sorry – particular facts of each matter. Certainly, one of the considerations that we give to both commencing an investigation but also to the type of outcome that we will seek is whether that outcome will have an impact on the market, whether it will change behaviour, both specifically and more generally.

Does ASIC recognise that obtaining declarations and pecuniary penalties from the Federal Court is a significantly greater deterrent when compared with infringement notices and enforceable undertakings?---We recognise that it certainly is a deterrent. In some respects, I think there's evidence to be obtained around whether or not particularly enforceable undertakings have a – or the amount or nature of the general deterrence message that is proffered by an enforceable undertaking, but we recognise that having the courts determine these issues is a matter which is significant and sends a message to the market, definitely.

Do you accept that if you went to court and obtained declarations of contraventions against one of the large banks, of the consumer protection legislation and obtained a pecuniary penalty against that entity, that that would have significantly greater general deterrent effect than reaching an enforceable undertaking with that entity?---Again, I think there's evidence to be sought in relation to that as to the general deterrent effect and specific deterrent but, more appropriately for this, the general deterrent effect of enforceable undertakings. And ASIC is in fact funding research in relation to that, academic research in relation to that. But I take – I don't argue with the point that a determination by the court provides a very strong general deterrent message, and ASIC brings civil penalty cases before the Federal Court on a regular basis.

Well – and let's just be clear about what that means. You mean not just under the ASIC Act, under other Acts?---Under – ASIC brings enforcement action through the court system, essentially once a week for the last 10 years.

Let's just see if that works. Sorry, did you say civil enforcement action?---No, I said enforcement action through the courts. So ASIC brings action, and I think it's set out in my statement, 238 criminal proceedings and 277 civil proceedings over the last 10 and a half years.

Yes?---We utilise the court system significantly.

Yes. This is page – I'm sorry, I should just tender that media release, Commissioner, which I haven't done. That's RCD.0006 - - -

THE COMMISSIONER: Yes, ASIC media release 14-235MR, RCD.0006.0004.0004, exhibit 3.173.


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**EXHIBIT #3.173 ASIC MEDIA RELEASE 14-235MR (RCD.0006.0004.0004)**

MR HODGE: And so if we go back to ASIC.0800.0005.0010 and go to page .0010. Just so the Commissioner is clear on what you're talking about, when you say approximately once a week, that's a sum of the 238 criminal proceedings and 277 civil proceedings; is that right?---That's correct.

And the 238 criminal proceedings, they would be proceedings conducted by the Director of Public Proceedings, I think you said?---They're prosecutions conducted by the DPP on a referral - - -

From ASIC?--- - - - from ASIC after an investigation by ASIC, yes.

And then the civil proceedings will be proceedings under, as we have identified, a number of different acts?---That's correct.

All right. And would that include bringing a proceeding to seek a disqualification order against a director, for example?---Not all of those actions would be caught up in that because, as I perhaps didn't indicate clearly enough, we have a small business compliance deterrence team that brings a lot of actions in relation to proceedings against companies. Also, I think against directors as well. But certainly there would be some proceedings for disqualification of directors caught up in those proceedings.

Do you – in terms of your running of the team, have you observed any change in the appetite for bringing responsible lending cases against the big four banks?---Well, we have a proceeding on foot at the moment in relation to Westpac Bank. A change in appetite – I think, from an enforcement perspective, we are always looking to seek the right or the best outcome, in our judgment, in relation to any matter. If we think it is necessary to bring a court action for responsible lending, then we will do so. And I think our action in relation to Westpac, which is filed, so allegations at this stage, in relation to Esanda, and even more recently but not bank related but in relation to Thorn, you know, we have brought those actions through the court system.

And just in relation to Esanda, that was another responsible lending case?---It was, yes.

And ANZ agreed in that case to pay a pecuniary penalty of $5 million?---That's correct.

And was there a reason – I'm sorry, I should ask. Were you involved in the decision as to whether you do that by infringement notice or court proceeding?---I was certainly involved in that decision-making process.

And can you explain to the Commissioner – so why, in that case – why go with a court proceeding seeking a pecuniary penalty rather than an infringement


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notice?---That particular proceeding arose out of some other investigations that we undertook in relation to false loan applications, particularly in the motor vehicle industry. So we saw quite a lot of this occurring and, in particular, in relation to a particular matter in Western Australia. And we took the view that it was important not just to take action against those car dealerships or mortgage brokers – sorry, not mortgage brokers, loan brokers that were involved but also to say, "Hang on sec, what is happening at the bank end, are they doing their job properly to try and stop this type of behaviour?" So we looked at what was happening at the bank end and considered that there was a failure in relation to the responsible lending obligations and therefore determined that the best way to resolve that matter was through a court outcome.

Perhaps – I will just ask you one other thing, and that is: does ASIC have a view or a policy about whether it would prefer an enforcement approach to an engagement approach?---Sorry, sorry - - -

So in dealing with – in dealing with the banks or other financial services entities, there are different ways that ASIC might deal with them. It might take an enforcement approach where what is – at the minimum, what it's contemplating is an infringement notice and at the maximum what is contemplating is a court proceeding. Or it might take an engagement approach where it is involved in negotiation with them, and that might tend to preference towards either no enforcement outcome or something short of an enforcement outcome. Does ASIC have a view, as you understand it, between those two?---I don't think ASIC has a preference for one or the other.

Commissioner, I don't have any further questions of Mr Mullaly.

THE COMMISSIONER: Yes. Other parties seek leave? Yes, Mr Collinson.

MR COLLINSON: If I can give some evidence from the bar table, Commissioner. I am instructed that on page 13 of Mr Mullaly's statement, the figure is $180,000 for CBA in the second last entry. And actually the figure 6 is apparently incorrect. I am instructed it should be 4.

THE COMMISSIONER: Well, if Mr Mullaly is content to adopt that, we can have the exhibit changed. But, Mr Mullaly, that's putting you on the spot?---Well, I will take it from both Counsel Assisting and my counsel that it's 4 and 180,000.

MR COLLINSON: Are you happy to make that change?---I'm happy to make the change.

THE COMMISSIONER: Perhaps if we can – have you got the original exhibit or who has the original exhibit?---I've got the original statement here.

Would you be good enough to make the amendments?---I'm not in a position to give you the total amount at the bottom.


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Yes. Just a moment, Mr Mullaly. What changes are we making?

MR COLLINSON: My learned friend has kindly pointed out, Commissioner, that the change from a million and 80 to $180,000 will affect arithmetically the total at the bottom.

THE COMMISSIONER: Yes.

MR COLLINSON: I don't have that figure just at this moment.

MR HODGE: Can I – well, it will decrease by $900,000. So it means it should be $2225 and 950 cents is that helpful to you? If you just change – I'm sorry 1 million, 225 - - -?---Perhaps if you could just do it a little bit slower.

Yes. So you see the total you've got 45?---Yes.

That's going to drop to 43. I'm sorry, I'm now leading your - - -

MR COLLINSON: Away you go.

MR HODGE: I have to close sometime this afternoon. So it should be 43?---Yes.

And the total should be $1,225,950. That's assuming there's no other changes?---Apologies for that.

That's all right.

**<RE-EXAMINATION BY MR COLLINSON [12.26 pm]**

MR COLLINSON: Mr Mullaly, just a couple of points. You say in your statement that ASIC hasn't conducted any proceedings in respect of section 12DI of the ASIC Act?---That's correct.

And my friend almost always gets everything right but in this respect, when he referred to section 12DI, I think he said there were two limbs, the first of which is where the person intends not to supply the service, and I think he described the second limb as a case where the service is in fact not provided. I don't think we need to go to the section, but it's in – the gist of it is, for the second limb, that at the time of acceptance there are reasonable grounds for believing that the person will not be able to supply the financial services within the period specified by the person – or if no period is specified, within a reasonable time. That's just a preliminary to my question which is: has – don't say what the advice is, but do you know whether ASIC has obtained external advice from counsel as to the proper construction of section 12DI?---We have.


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THE COMMISSIONER: Did that consider the case of charging someone's estate for provision of a service to the deceased?---Not specifically, Commissioner.

MR COLLINSON: My second question was – you were asked some questions about enforceable undertakings, and I want to ask you this: have there been instances where ASIC has resolved a proceeding against a party on the basis of both an enforceable undertaking and a civil penalty order?---Yes, we have.

Are you able to say how common that is?---It's not – sorry, it's not frequent. I couldn't say how many times we've done it, but I think the BBSW matters are matters where that has occurred. I think in very recent responsible lending matter of Thorn there was both civil penalty matter and enforceable undertaking, and I'm sure that there will be other examples as well.

Are you able to summarise for the Commissioner what the advantages of an enforceable undertaking are?---Well, it's certainly – in respect of changes to internal processes, compliance processes, those are things that are - - -

Why is that?---Well, we are able to get agreement with the entity providing the enforceable undertaking. We can be quite specific about what it is that we would like changed in terms of those compliance processes. We're able to get independent oversight in relation to that and then, in a sense, a follow-up as well. So if an independent expert makes recommendation that further changes are required under the enforceable undertaking, that's what will generally occur: those additional changes are made. Something that's a little bit harder to get under an administrative proceeding.

And what's the consequence of a breach of an enforceable undertaking?---It's enforceable by ASIC through the courts.

My learned friend asked you some questions, or a question, about whether ASIC has given any consideration to reliance upon the UCT laws in the context of a financial advice licensee?---That's correct.

And if people would permit me, can I jog your memory about a possibility, ASIC v Kobelt, K-o-b-e-l-t, do you have any recollection about any consideration was given to that subject matter in that context?---Yes, it was.

In what respect? Are you able to elaborate?---Well, I will say Mr Kobelt – well, first of all, that case is subject to a special leave application to the High Court at the moment.

Yes?---And - - -

Well, the less you say the better, perhaps?---Well, yes, that's the first thing. The second is that Mr Kobelt is not a financial services provider, which is my response to that particular question. However, in relation to that matter, we considered whether

– or we considered issues around unfair contract terms. However, what we found in that case was the conduct also amounted to – or we allege that it amounts to unconscionable conduct and we are able to get far significant outcomes, I think, in terms of court process going – by pleading an unconscionable conduct case.

Thank you. My last question is: as you know, your statement says in paragraph 30 that in the period since January 2008, ASIC has obtained in excess of $700 million in compensation from the banks. Does that mean just the banks that were nominated by ASIC or the banking sector more broadly?---Well, that's the – no. Those are the banks that - - -

ASIC asked about – I'm sorry - - -?---ASIC was asked about.

The Royal Commission asked about?---Yes.

Yes, I'm sorry. Yes?---That's correct.

Just - - -?---So the figure is – would be larger than that, yes.

Yes. Are you able to just assist the Commissioner with what – the enforcement team that you're in charge of has an annual budget or annual spend on enforcement?---It does, yes.

Yes. And do you know what the average spend on proceedings against the banks has been in the last three years?---Not on proceedings, and not specifically in relation to my budget. You know, I simply don't have that figure at hand, but what I can say is that over the last three years about 25 per cent of ASIC's enforcement budget, perhaps a touch higher, has been spent on investigations and enforcement action in relation to the banks.

And by "banks", do you there mean a wider group than just the banks that the Commissioner asked about?---Generally, it will be the big four. So ANZ, CBA NAB, Westpac. However, it also includes AMP and Macquarie in terms of our wealth management project.

Yes. No further questions.

THE COMMISSIONER: Mr Hodge?

MR HODGE: Nothing arising, Commissioner.

THE COMMISSIONER: Thank you very much, Mr Mullaly. You may step down and you are excused.

**<THE WITNESS WITHDREW [12.35 pm]**


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MR HODGE: Commissioner, that concludes the case study. Could I ask, could we adjourn until 2 pm.

THE COMMISSIONER: 2.

MR HODGE: And I will close then.

THE COMMISSIONER: Yes, we will resume sitting at 2 pm.

MR HODGE: Thank you.

**ADJOURNED** **[12.35 pm]**

**RESUMED** **[2.00 pm]**

THE COMMISSIONER: Mr Hodge.

MR HODGE: Thank you, Commissioner. Commissioner, we have now concluded the case studies for this module on small business lending. In closing, we will summarise the findings that we submit are open with respect to those case studies and pose various questions for submissions that we think will assist you in your further work. Before we turn to those case studies, we wish to say a little more about the process that preceded these hearings, including how we selected the case studies for this round of hearings for your consideration. In preparing for this round of hearings, we reviewed the over 630 public submissions that related to small and medium size enterprises.

We also spoke to a wide range of interested stakeholders, including the Financial Services Ombudsman, Mr Khoury; the Council of Small Business Organisations Australia; Financial Counselling Australia; the Legal Advice for Small Business Clinic, which is a joint initiative of the University of Canberra and ACT Legal Aid; Legal Aid New South Wales; Legal Aid Queensland; and the Consumer Action Law Centre. In addition, we spoke to a range of statutory and government bodies about policy and regulation in relation to small business lending and that included ASIC, the ACCC, APRA, the small business Ombudsman, and Treasury.

We issued 164 notices to produce, which returned over 75,000 documents. Based on this work, we identified and interviewed more than 40 individual borrowers about their experiences in relation to business lending, to identify and select the most appropriate case studies for consideration by the Commission during the oral hearings. The Commission, in the last two weeks, has heard evidence from selected borrowers or consumers in nine of the case studies, along with other case studies that have not included a consumer witness. We selected individual borrowers whose


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stories we thought would allow you to best explore and examine the issues presented in relation to lending to small and medium enterprises.

As we think these case studies have demonstrated, the dealings between any small business borrower and a financial services entity is almost always complicated. The relationship with the bank intersects and is intertwined with the operation of the business and often also the personal financial situation of the individual or individuals behind the business. In all of the case studies involving individual borrowers and, indeed, for all of the individual borrowers with whom we spoke in advance of these hearings, the causes of the failure or deterioration in the performance of the business were multifaceted but, fundamentally, the problems had their roots in the performance of the business rather than anything else.

Now, that does not mean that the failure was through some fault of the borrower. It simply reflects that the performance of a business is dependent upon many factors. Many businesses are dependent upon the general state of the economy. If there is a general deterioration in the economy, for example the GFC, many businesses will suffer and some may not survive. But small businesses are also subject, like all other businesses, to risks specific to the business: renovations at a shopping centre might drive down foot traffic and put a business operating at the centre to, or over the edge. In this closing address, we will deal with each of the case studies as part of six particular topics.

And those topics are, first, responsible lending; second, guarantees by third parties; third, consumer redress systems; fourth, the Bankwest business lending book; fifth power and communication; and sixth and finally, regulation and self-regulation. For each of the case studies we will identify the findings that we, as Counsel Assisting, regard as being open on the evidence or, if we consider it to be the case, findings which are not reasonably open. We will invite the entity involved in the case study to respond with written submissions. Perhaps of greater – or much greater importance in this module is that we will also identify more general questions that arise in relation to these topics, and all parties with leave to appear will be invited to provide written responses to those general questions.

Can I turn then to the first topic, which is responsible lending. And Commissioner, as we foreshadowed in the opening, one of the overarching questions that you will need to question is what obligations in relation to responsible lending, if any, ought to apply in relation to small business lending? Should the obligations in relation to small business lending differ from the obligations that apply with respect to consumer lending? For reasons we will expand upon in a moment, Commissioner, our submission is that the answer that you ought to arrive at is that no additional statutory obligations should be imposed with respect to the making of loans to small businesses but, before we reach that general level, we will deal with each of the three relevant case studies.

The first case study concerns irresponsible lending by ANZ. The Commission heard evidence from Ms Kate Gibson of ANZ: in 2014 a company operated by a husband


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and wife, whose names are the subject of a non-publication direction, sought facilities from ANZ of about $220,000 in order to purchase a gelato franchise. They relied upon cash flow forecasts that it appears have been provided by the franchisor. The loan was secured by a number of guarantees and indemnities including a second mortgage over the investment property of one of the partners. In 2016 the company made a complaint to FOS. One of the bases for this complaint was that the borrowers could not afford to repay the loan.

FOS made a recommendation in favour of the borrower company and, in doing so, one of the things that FOS considered was that ANZ had relied on projected cash flow forecasts that were overly optimistic. ANZ disagreed at the time, and continues to disagree, with this recommendation for this reason – on the basis of that reason. FOS subsequently issued a determination in favour of the borrowers. Ms Gibson's evidence was that ANZ continues to disagree with FOSs determination but ANZ has in fact complied with the determination. Ms Gibson gave evidence that when a banker submits a loan for a start-up business the ANZ Banker is required to form an opinion as to the reasonableness of the business plan and the cash flow forecast provided in support of the loan application.

The Commission heard evidence that the cash flow forecasts that were relied upon in this case were contained in a business plan which was very generic in nature and that there were inconsistencies between the various cash flow forecasts contained in the business plan. Ms Gibson's evidence was that in the circumstances of this case study she would have expected the banker responsible for this loan to have a conversation with the customer to make sure that the borrower understood the business. Ms Gibson was not aware of whether the banker had had this conversation with the customers in this case and there was nothing in the file notes to suggest that this had occurred.

Ms Gibson told the Commission that, having considered the whole of the loan application in relation to this case study, her opinion was that in assessing and approving the loan, ANZ had not exercised the skill and care of a prudent and diligent banker. At the time that this loan was entered into, three of the four KPIs used in ANZs incentive scheme focused on financial targets. During this period, that is during the period that the loan was made, the key message given by ANZ to its small business bankers was to relentlessly acquire new to bank customers.

The Commission heard evidence that in the period immediately prior to the loan in this case study being approved, the banker involved had not met his new to bank lending targets. This banker was later subject to performance management for unrelated loans and the Commission heard evidence that during this performance management process the banker stated that his conduct was in part due to the excitement of closing new deals, a culture of sales pressure that you felt weighed heavily at the time. Ms Gibson gave evidence that ANZ has since rebalanced its KPIs to have less of a financial focus.


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Now, on the evidence and having regard to Ms Gibson's acknowledgement it is open to you, Commissioner, to find that, in assessing and approving the loan the subject of this case study, ANZ may have failed to exercise the care and skill of a diligent and prudent banker as required by clause 27 of the Code of Banking Practice. But it should be emphasised that Ms Gibson was not agreeing with the reason for the FOS conclusion. Rather, Ms Gibson, who is obviously a very careful and very competent banker was expressing dissatisfaction with the number of errors that she had picked up on her review of the file.

ANZ is invited to provide written submissions addressing the finding we have identified to be open to the Commissioner, as well as any other findings that it regards as available on the evidence. The second responsible lending case study is concerned with the failure of a Pie Face franchisee. The Commission heard evidence from Ms Marion Messih and Mr Alastair Welsh of Westpac. Ms Messih and her brother and sister-in-law, trading through a company called Marjo, borrowed $362,500 from Westpac to purchase an existing Pie Face franchise located in Werribee Plaza using two residential properties as security.

Ms Messih and her business partner received advice from an accountant prior to entering the loan, and that advice cast doubt on the business profitability, but they chose to press ahead in the belief that through hard work they could make the business profitable. Westpac was also aware of these assessments and considered them as part of the loan prior to purchase of the franchise. Marjo began trading in August 2012. The business struggled and major renovations at the plaza from late 2013 caused sales to decrease. Despite working hard, the business was never profitable and by early 2014 Marjo could not make its repayments to Westpac.

In November 2014, Pie Face went into voluntary administration and, at that point in time, Marjo shut the store. Marjo took a dispute to FOS claiming that it should not have been given the loan by Westpac. FOS agreed and all interest and bank charges were removed from the loan. However, the principal remained to be paid, and Ms Messih sold her investment property in order to pay down the loan. Despite FOSs determination, Mr Welsh of Westpac disagreed with the basis of FOSs assessment that the loan should not have been made.

Mr Welsh gave evidence about Westpac's accredited franchise program, which is intended to manage risks of lending to franchisees through obtaining information from the accredited franchisor about its business models and fiscals. Mr Welsh gave evidence that the franchise policy is a risk based management approach and lending outside the franchise policy, as occurred in Marjo's case, is a risk based decision for the bank. The presence of other incomes and the giving of security over residential property mitigated that risk in the case of Marjo.

After Ms Messih had sold her investment property she made a second complaint to FOS about Westpac applying the entirety of the proceeds of the sale to pay down the loan. The second complaint was not determined in her favour. That finding suggested that Ms Messih did not fully understand the nature of the guarantee, which


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was a joint and several one, that she had given. FOS did, however, find that Westpac had breached FOSs terms of reference in sending Ms Messih 13 text messages related to arrears on one of her accounts during the period 17 November 2016 to 3 December 2016. The sending or receipt of all of those text messages caused Ms Messih to feel overwhelmed and stressed.

Westpac admitted that the sending of collection notices to Ms Messih while her second FOS dispute was on foot breached FOSs terms of reference. Westpac also admitted, in relation to these collection notices, that regardless of the existence of the FOS complaint it was inappropriate for this many automatic collections messages to be sent to a customer in such a short period of time. Mr Welsh had looked into why the text messages had been sent and his evidence was that it was because the relevant loan had not been flagged as being subject to a FOS dispute. Of course this suggests that, but for the FOS dispute, the automated sending of these text messages would occur. There was no evidence adduced by Westpac to date to adequately explain whether this is a normal practice for Westpac or, if it is not, whether Westpac has investigated its system to determine why this would occur where there was no FOS flag.

On the evidence, the following findings may be open to you, Commissioner. First, Westpac breached clause 3.2 of the Code of Banking Practice in failing to act fairly and reasonably towards 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. Second, 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 clause 13.1 of the FOS terms of reference.

Westpac is invited to provide written submissions addressing each of the findings that we have identified and any other findings that it regards as being reasonably open on the evidence. In addition, Westpac is also invited to provide written submissions on the question of whether Westpac has adequate systems in place to ensure compliance with its obligations under the Code of Banking Practice and the FOS terms of reference with respect to collection activities.

The third case study relevant to responsible lending concerns a business loan from the Bank of Queensland to a company operated by Sue Richards for the purpose of purchasing two Wendy's franchise outlets in Adelaide. The Commission heard evidence from Ms Richards, as well as from Mr Douglas Snell, general manager of performance product and governance of Bank of Queensland. In early 2012, Ms Richards and her husband decided to buy the Wendy's outlets at a Westfield shopping centre in order to secure their financial future.

Ms Richards consulted with an adviser about the purchase of the business, who told her that the bottom line profit looked "skinny". Ms Richards evidence was that he was confident that she could improve the profits of the business and she proceeded to sign a contract of sale based on a conditional letter of offer from Bank of Queensland. The conditional letter of offer stated that the indicative monthly


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repayments would be $4,420 over 84 months. Ms Richards also signed a Wendy's franchise agreement prior to being provided the final letter of offer from Bank of Queensland.

Bank of Queensland final letter of offer, when it was provided, stated that the monthly repayments were almost double, well over $8000, those in the offer letter in the conditional offer letter that had been provided, and the term was only three years. Ms Richards gave evidence that she felt stuck between a rock and a hard place, with no way to get out of the contract, and so she accepted Bank of Queensland's offer. The business – Ms Richards' business found it very difficult to make the monthly repayments and it was quickly in default. Eventually, it was liquidated. In 2014, FOS found that Bank of Queensland had misled Ms Richards about the size of the monthly repayments and that there had been maladministration by Bank of Queensland in respect of the loan.

Despite Bank of Queensland having already concluded internally that it had engaged in irrespective lending, Bank of Queensland contested the complaint before FOS. Mr Snell conceded that this was inappropriate. Mr Snell also conceded that Bank of Queensland's failure to acknowledge the maladministration was neither fair nor reasonable to Ms Richards. Mr Snell also gave evidence about the incentive structure for Bank of Queensland's owner manager branches, which constitute just over 60 per cent of Bank of Queensland's branches. The Commission heard that in 2012 the level of compliance in owner manager branches was low, although efforts had been made to improve this. Mr Snell was not aware of how it would be possible Bank of Queensland's owner remuneration model which functions on the basis of commission, to align with the Sedgwick recommendations. Mr Snell said this was a matter still under consideration by Bank of Queensland.

On the evidence, it is open to the Commission to find that Bank of Queensland breached clause 27 of the Code of Banking Practice in failing to exercise the care and skill of a diligent and prudent banker in its approval and assessment of the Suerich business loan. Further, it's open to find that Bank of Queensland breached clause 3.1B of the code in failing to promote an informed decision of Ms Richards by failing to provide effective and timely disclosure of the repayment amount and the term of the loan. And, finally, it is open to find that Bank of Queensland may have breached clause 3.2 of the code in failing to act fairly and reasonably towards Suerich in contesting the FOS complaint despite being aware of the maladministration in the inception of the loan.

Bank of Queensland is invited to provide written submissions addressing each of the findings that we have identified, Commissioner, as well as any other findings that it regards as available on the evidence. In addition, a question that arises in this particular case study is as to the likely consequences of owner manager branches of Bank of Queensland being recipients of trailing or other commissions particularly having regard to the findings of the Sedgwick report into retail banking remuneration. Bank of Queensland and all parties with leave to appear are invited to make written submissions in response to that question.


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Now, having addressed those three particular case studies, Commissioner, we will now turn to the general questions in relation to responsible lending. In all three franchise cases, questions were raised as to the scrutiny of the projected cash flow assessment or past cash flow provided to support the loan application, both by the lender, but also by the borrower. We wish to make some observations Commissioner as to views that would be open to you about cash flow projections and the personal responsibility of borrowers. These observations ought to be tested and we will frame, at the conclusion of these observations, some general questions to do so. In all three cases, banks were lending on the basis of the potential income of the business as what is often referred to as the first way out for the loan.

The second way out is the security provided by the borrower or guarantor. The potential income is based on the projections made by or on behalf of the borrower and, in one of the cases we looked at, the projections came from the borrower's accountant; in another case, the projections came from the franchisor from whom the borrower planned to enter into a franchise agreement; and in the third case, the serviceability assessment was based on the profit and loss statements of the vendor of the business. Under the Code of Banking Practice, banks are required to act with prudence and diligence in assessing small business loan applications.

Of course, it might be thought the banks would also wish, in respect of all lending, to act as prudent and diligent bankers, and one way of understanding the standard that is imposed by the Code of Banking Practice might be that the bank ought to act to satisfy itself to a reasonable standard that the borrower will be able to repay the credit facility. That is to say, the prudent and diligent banker is acting in order to protect the bank. The bank is not warranting the success of the borrower's business, nor is the bank acting as an advisor to the business borrower and nor can it be expected to be.

In each of the three cases, the borrower was relying upon some third party for advice and assistance. In one case, the third parties were an accountant and a franchisor; in another case, the third parties were a broker and a franchisor; and in a third case, the third parties were an accountant and a lawyer. Those are the people to whom the borrower can turn and ought to turn for advice and assistance in decision-making. Now, we acknowledge that in many cases this very legal way of looking at things and the relationships between the borrower and third parties and the borrower and the bank might be undermined by the nature of the relationship that banks want to encourage with their customers, being one of trust and partnership, evidenced by slogans promising that, "We are here to help or support your business every step of the way" or "It's possible to love a bank."

But slogans are not legal obligations, though they no doubt contribute to the expectations of the community as to the role and nature of the bank and its relationship with the customer. In all three of the cases the businesses failed not because of some issue reflective of a very technical flaw in the loan assessment, such as the interest rate rising outside of a particular buffer that had been used in the calculation of serviceability, but rather the business failed because, fundamentally,


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the performance of the business did not live up to the projections that were presented to the bank and the hopes and the aspirations of the borrower.

Small business entrepreneurs are, by their nature, optimistic about the ability of the business to succeed. Any increase in regulatory requirements on banks to scrutinise the optimism of the small base borrower must necessarily be premised on the premise that banks are too willing to make loans to small business. Neither the case studies nor the work that we have done outside of the hearings suggests that this is the case. It follows that our submission is that it is not open to you to conclude that it is necessary or desirable to increase the obligations of banks making small business loans so as to make those obligations akin to, or similar to, or more like, the responsible lending obligations imposed by the National Credit Act.

Nevertheless, we acknowledge that this is not a view that is universally held and as we indicated in opening, more regulation was contemplated some years ago. All parties with leave to appear are invited to provide written submissions addressing the following three questions which arise from the three case studies in relation to the applications for business loans and serviceability assessments. Question 1: how much responsibility does the borrower and lender bear in assessing the cash flow forecasts and other factors when deciding whether to enter into the loan contract? Question 2: what are the outer limits of a bank's duty to act as a prudent and diligent banker in assessing a business loan application? Should that outer limit – or should the outer limit of this duty be codified? Question 3 - - -

THE COMMISSIONER: It's not just outer limit; it's content more generally, I think.

MR HODGE: Yes, Commissioner.

THE COMMISSIONER: I think what exactly is the content of the duty of prudent and diligent banker? You observed that, in its expression, it appears to speak of the relationship that the banker owes to the banker's employer. But then how does that duty, which is one level understandable vis-à-vis employer – what is its content when it is said as it is in the Code of Banking Practice that, "We owe you," that to say the potential borrower, and also – as we will come to – the potential guarantor, "We owe you the duty to act as a prudent and diligent banker." So what's the content? What are the limits?

MR HODGE: Yes. And just – that's right. So there's an important distinction that needs to be drawn there between, on the one hand, the duty that is imposed under the Code of Banking Practice is a duty to act as the prudent and diligent banker. The consequence of it being part of the code, and therefore part of the contractual obligations, is that there is then a contractual obligation to the borrower that the banker will act as such. So there's two slightly different issues there. One is the nature of the obligation to the borrower, the other is the nature of the content of the duty.


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And as I understand it, Commissioner, what you are emphasising is it's important that those people given leave to appear address that part about what exactly is the content of this standard, but perhaps guided by the fact that it's also a duty that is then imposed in an obligation to the borrower. Commissioner, the third question - - -

THE COMMISSIONER: It's an area which is too readily slipped over with a series of statements where it's the content of the particular statement that is masking the real underlying issue.

MR HODGE: Yes. Commissioner, the third general question is: should any of the provisions of the National Credit Act which apply to consumer credit contracts also apply to credit contracts with small and medium sized business commerce. If so, why and to which small and medium business customers? If not, why not? In answering particularly the last question posed, we suggest that it will be particularly helpful for you to receive submissions addressing the effect that the imposition of such obligations would have on the provision of credit to small and medium sized business customers and by reference to the specific obligations arising from the National Credit Act in relation to consumer lending.

THE COMMISSIONER: This, as in most of the areas of the general questions, it's important to understand them as questions. They are not interrogative statements of opinion already formed. On the contrary, they are questions that are to be addressed and considered according to whichever side of the argument the particular party seeks to put itself. It's not going to be useful if somebody says, "The question was framed in this way, therefore the underlying opinion is X, therefore I needn't address that opinion." That's not the basis on which the questions are being put. They are not interrogative statements of opinion.

MR HODGE: Thank you. We wish to also address the case study concerning the Commonwealth Bank's overdrafts. And that case study concerned two related issues. First, the responsible lending practices of CBA in the course of the development of its simple business overdraft product. And secondly, a systemic issue which resulted in CBA charging over double the interest rate on both business overdrafts and also the SBOs, or simple business overdrafts, and the way in which CBA responded to this issue, including remediating affected customers. Mr van Horen, executive general manager of retail products within the retail banking services division at CBA, gave evidence in relation to both of these matters.

As to the first issue, the responsible lending practice, I will briefly outline the relevant facts. Between March and December 2012, CBA ran a pilot program of offering simple business overdrafts to existing business customers of CBA. These customers were selected based on a methodology that assessed them as a low risk of default by considering various criteria including their recent banking with CBA. A pre-assessed overdraft facility was offered to over 10,000 CBA customers through a mass mail out in 2012. The Commission heard evidence that in 2012 CBA offered this product in circumstances where there was no genuine assessment as to whether


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these customers wanted an overdraft facility and the income or expenses of these customers and whether they could afford to repay the loan.

This conduct arose because CBA considered that the SBO product would better meet the needs of small business customers without inquiring into the individual circumstances of each person. During the pilot program of the SBO, offers to small business customers, there was no verification of income and expenses, but that was later changed in 2015 once the product was offered more widely. The automated pre-assessed offers during the pilot program were made in circumstances in which the customers were not asked whether they wanted an overdraft and therefore CBA took an approach that it could not take if the business was a consumer rather than a business.

Consistent with this approach during the pilot program, the SBO product was priced to reflect the risk to CBA from choosing not to verify the income and expenses of small business customers before offering the SBO. Commissioner, we do not submit that it is open to find that this conduct is either below community standards or in breach of clause 27 of the Code of Banking Practice, nor do we suggest that it is open to find that there were otherwise breaches of law by reason of CBAs conduct during this period.

But the second issue is CBAs overcharging of its overdraft customers. Between December 2011 and March 2017, CBA overcharged some of its business customers with overdraft accounts by charging them 33.94 per cent monthly interest rather than the correct interest rate of 16 per cent. The conduct affected 337 BOD customers and 2354 SBO customers. All BOD customers and 1490 SBO customers were remediated by 6 July 2017 in an amount of just under $3 million. By reason of a change in CBAs position, which occurred only during the Royal Commission, there will be some further remediation of customers now, where they were incorrectly charged amounts of less than $5.

All affected business customers had been sent various bank statements over time which were misleading or false in that they misstated the amount of interest payable. CBA first discovered a pricing defect with SBOs in August 2013 as a result of a customer complaint. CBA implemented a low-level and manual fix without inquiring as to whether the scale of the problem was larger than one customer. The overdraft conduct was also discovered to affect BODs in November 2013. CBA did not implement a system fix until May 2015. This fix was not effective. In 2015, five customers approached CBA with complaints about being overcharged on their overdraft accounts. At that time, CBA did not investigate whether the overcharging issue applied to business accounts more broadly.

One customer later lodged a complaint with FOS, which was the catalyst for the issue being elevated to Mr van Horen. The Commission heard evidence that, following the FOS complaint in 2016, CBA investigated whether the overcharging issue affected business accounts more broadly. It did. The remediation program took an average of 960 days, or over two and a half years, from the commencement


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of the overcharging issue, to the completion of the remediation for affected customers. The amount of remediation was $913,147 in respect of BOD customers and $2,075,417 for SBO customers. CBA did not notify the board in 2013 when the overcharging issue was first discovered or in 2015 and 2016 when further customer complaints were made and CBA investigated the issue across all accounts.

However, the CEO of CBA met with ASIC on 15 May 2018 and one of the issues discussed was the overcharging issue. Both retail banking services and the institutional banking and markets divisions, considered the question of whether ASIC ought be notified, pursuant to section 912D of the Corporations Act, of a breach of the financial services law, each forming the view that it was unnecessary to do so. As matters transpired, eight days prior to Mr van Horen giving evidence, CBA did notify ASIC that there had been a breach of section 12DA of the ASIC Act by reason of the fact that in providing statements which inaccurately set out the amount of interest payable, CBA had misled or deceived its customers.

Commissioner, the following findings may be open to you on those facts. First, consistent with the notification made by CBA, it will be open to you to conclude that the conduct of CBA may have constituted a contravention of section 12DA of the ASIC Act. Secondly, despite being aware of the issue as early as 2013, CBA failed to notify ASIC of this issue pursuant to section 912D of the Corporations Act, until 15 May 2018, well in excess of the requirements under section 912D, subsection 1(b), to inform ASIC as soon as possible and within 10 business days. Thirdly, as Mr van Horen's evidence demonstrated, each time that CBA sent a statement that said that the interest rate was 16 per cent, when in fact the interest rate being charged was much higher, CBA made a false or misleading representation as to the price of the financial services that CBA was providing.

Mr van Horen conceded that at least 25,000 such statements were sent. It might well be thought that it is open to find that the sending of each of those statements constituted a contravention of section 12DB subsection 1(g) of the ASIC act which prohibits false or misleading representations with respect to the price of financial services. And, importantly, Commissioner, as we heard in evidence morning, unlike a contravention of section 12DA, which CBA has acknowledged, a contravention of section 12DB can attract a pecuniary penalty, and no doubt that is a matter that ASIC will consider in light of the notification. CBA is invited to provide written submissions addressing each of the findings that we have identified to be open as well as any other findings that it regards as available on the evidence.

Commissioner, we will now turn to consider the second topic of interest, which is the taking of a guarantee from a third party for a business loan. The relevant case study, Commissioner, concerned Carolyn Flanagan who provided a guarantee to Westpac and a mortgage over her home in order to secure a business loan obtained by a company established by her daughter and her daughter's partner. Ms Flanagan began was on a disability pension and suffers from a number of serious medical conditions including cancer, removal of part of her tongue in 2004, macular degeneration, and


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poor eyesight for the last 10 years, all of which were present at the time that she attended a Westpac branch with her daughter.

Ms Flanagan began gave evidence that in signing the guarantee she had to have someone read out the documents due to her inability to read them herself. Some facts, on the evidence available, were unclear. Westpac's documentation is inadequate. The most likely chain of events is that Ms Flanagan ultimately signed the guarantee and mortgage on about 10 December 2010 in the presence of a solicitor. However, Ms Flanagan did so in circumstances in which a Westpac banker had compromised the process that was intended to ensure she received independent advice. That banker had pre-filled in the answers to the various questions necessary to ensure that Ms Flanagan was properly advised and understood the guarantee.

Remarkably Mr Welsh, who gave evidence to the Commission, said that it was not uncommon for such forms to be pre-filled. The banker had also pre-signed, purportedly as a witness, both the guarantee and the mortgage. Westpac commenced action seeking the sale of Ms Flanagan's home after the borrowers defaulted under the business loan. Ms Beiglari from New South Wales Legal Aid gave evidence to the Commission that she assisted Ms Flanagan in respect of that claim, including by way of a complaint to FOS. Ms Beiglari sought an outcome that would allow Ms Flanagan to remain in her home until Ms Flanagan died.

Westpac rejected that request at FOS and FOS reached a determination that was not in Ms Flanagan's favour. However, Westpac subsequently accepted a settlement offer after New South Wales legal aid contacted a senior person – senior contact at Westpac. Mr Welsh admitted that Westpac ought to have progressed the hardship request earlier. However, he did not see a problem with Westpac accepting a guarantee from Ms Flanagan in the first place nor with the application of Westpac's policies. Mr Welsh agreed that there were warning signs that the banker ought to have observed. While Westpac's policy required Ms Flanagan to have a direct benefit, the evidence was that she had no real direct interest in the business and was not an employee drawing a wage.

THE COMMISSIONER: Is there anything that suggested she had any indirect benefit in the business?

MR HODGE: The indirect benefit, put as highly as it can possibly be put, is that she was registered as a shareholder of the business, as a $1 shareholder of a company of which Westpac did not possess the constitution, of a proprietary company where there was no suggestion that there would ever be a dividend paid.

THE COMMISSIONER: Not immediately apparent to me – and Westpac no doubt will tell me – why Ms Flanagan's case differs in any relevant respect from that considered in Garcia, where Mrs Garcia was treated as a volunteer. Yes.

MR HODGE: Indeed, Commissioner. And perhaps, if we can add to that, notwithstanding that the loan was to purchase a business, it was not possible to


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identify from Westpac's records how much precisely the business cost or what proportion of the loan amount was used to purchase the business. On the face of Westpac's documents, the submission that we make is that it is open to find that no reasonable person could have been satisfied that Ms Flanagan had any meaningful direct or indirect interest in the business.

Commissioner, we also submit that it is open to you to find on the evidence that Westpac may have contravened section 12CB of the ASIC Act, which prohibits unconscionable conduct, by accepting and relying upon a guarantee from Ms Flanagan, or may have engaged in unconscionable conduct in circumstances in which (a) Westpac was in a superior bargaining position to Ms Flanagan; (b) Ms Flanagan's personal circumstances included that she was on a disability pension, otherwise without an income, unable to read and of poor health; (c) Westpac's records suggest that it made inadequate efforts to identify any real interest in Ms Flanagan in the loaning, notwithstanding that this was the premise that it took the guarantee; and (d) Westpac's own employee compromised the process intended to ensure that Ms Flanagan gave informed consent to her entry into the guarantee and was properly advised as to the obligations that she was taking on. On the evidence, Commissioner,

THE COMMISSIONER: Go on.

MR HODGE: It is also open for you to find that the following conduct may have amount to conduct below community standards and expectations: first, Westpac's acceptance and reliance upon the guarantee; second, Westpac's failure to respond to Ms Flanagan's question for a life interest in a timely and reasonable way, which Westpac admitted that it ought to have acted more promptly on; and thirdly, Westpac's continued insistence that its behaviour in taking the guarantee from Ms Flanagan was acceptable.

THE COMMISSIONER: Just on this question of compromising the proceeds about independent advice, it may have a couple of aspects – and I don't pretend for the moment to try to identify them all – but one aspect that may or may not be worth considering is: what is a third party to make of the documents, if they are called on to consider them after the death of Ms Flanagan? Let it be assumed that the executor of her estate, upon her death, was to be met with a claim on the guarantee. Let it be further assumed that the bank supplies to the executor the whole of its file, disclosing the circumstances in aid of a proposition that Ms Flanagan was advised to, and did, seek independent advice.

What is the third party to know – in this case the executor, to know about what the bank has done, or the bank officer has done, in as, I think Mr Welsh may have said, helpfully filling out the form before it is taken to the solicitor, the third party will know nothing of those things, will they?

MR HODGE: That's right, Commissioner.


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THE COMMISSIONER: Yes. These documents are bankable documents. Forms and solemnities are there to be observed for a reason. Yes.

MR HODGE: Commissioner, Westpac is invited to provide written submissions addressing each of the findings that we have identified to be open, as well as any other findings that it regards as available on the evidence. Now, Commissioner can we say the case study throws up a more general issue about the circumstances in which a bank accepts a guarantee from a third party. Particularly, as has been identified by Legal Aid New South Wales and Legal Aid Queensland, the guaranteeing of a child's business borrowings by a parent.

Before we frame some more general questions, we would make the following observations as to matters that it might be open to you to find. First, there are established equitable principles in relation to unconscionability as outlined in cases including Amadio and Garcia, to which you have referred, Commissioner, that will protect guarantors. Secondly there is also a national statutory prohibition on unconscionable conduct in relation to financial services. Thirdly, there may be statutory remedies available for contracts made in New South Wales under the Contracts Review Act. Fourthly, following from the first three points, there is, therefore, an established set of legal protections capable of being relied upon by a person in the position of Ms Flanagan.

The first general question is: is there any inadequacy or gap in those established protections? If so, what is it? If not, would the protections apply in the case of Ms Flanagan? And Commissioner you have already raised the question for Westpac specifically as to whether Garcia would apply. The fifth observation is this: all of the legal protections to which we have referred operate, necessarily, after the event and depend upon successfully seeking the intervention of a court to prevent reliance by the financial institution on the guarantee.

The difficulty that creates is apparent from the case of Ms Flanagan: had Legal Aid New South Wales not persisted and been able to rely upon their contacts and other parts of Westpac, what could Ms Flanagan have done? How feasible would it be for Ms Flanagan represented by legal aid to run a case against Westpac? Against that background, the result achieved by Legal Aid New South Wales was excellent. It gave Ms Flanagan what she desired, which was the right to stay in her house. Sixthly, requiring a guarantor to have a direct interest in a business borrowing is unlikely – that is requiring, by statutory intervention, a guarantor to have a direct interest in a business borrowing is unlikely to be the answer. If a parent wishes to guarantee a borrowing out of love and affection, then why should that parent – so long as fully informed and consenting – not be able to do so?

THE COMMISSIONER: Well, Ms Flanagan's evidence was if a parent can't help a child, who can?

MR HODGE: That's right. And in addition, as Westpac's behaviour amply illustrates, the test of direct interest or benefit is open to being applied in a manner


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that is meaningless and process driven. Seventhly, it might be thought that the answer to the problem then is to require a guarantor to have independent legal advice. But the question then arises: is it possible for a solicitor to give sufficiently substantive advice that goes beyond merely explaining that the documents are legal documents and have legal consequences, without additional information? Would requiring banks to provide additional financial information to a solicitor advising a guarantor such as information concerning serviceability, address that problem? It might increase the burden on the solicitor advising the guarantor that the legal professional is well regulated and has professional indemnity insurers with an economic interest in ensuring good practice in relation to issues such as these.

Having regard to those observations, the second question to which all parties with leave to appear are invited to provide written submissions has two parts. First, is it desirable to take steps to increase the likelihood that a third party guarantor of business borrowings will be properly advised and make an informed decision before entering into a guarantee? And, if so, what might those steps be? Secondly, what difficulties will be created for banks or borrowers by steps that require more information to be provided to legal or financial advisors of a guarantor before the guarantee is signed?

Commissioner, the third topic that we will address is consumer redress systems. Suncorp's dealings with the Lows is a case study that explored this topic. This case study concerned the treatment by Suncorp of Jennifer Low and her son, Rien Low. The Commission heard evidence from Rien Low; David Carter, the CEO of the banking and wealth division at Suncorp; and Philip Field, the lead Ombudsman, banking and finance, at FOS. Mr Low's father passed away in November 2015 in a workplace accident, leaving approximately $1 million in outstanding loans including business loans with Suncorp. The loans were granted in 2013 and 2014.

Mr Low's father had been the sole breadwinner and his mother had limited income with which to service the loans. In 2017, FOS determined that the final business loan of $240,000, which was granted to the Lows in 2014, constituted irresponsible lending, for reasons that included failure to make proper inquiries into the purpose for the loan. FOS determined that the debt should be reduced by the amount of interest paid, and that Suncorp should not be permitted to charge further interest. The determination specified that if the parties were unable to reach an agreement for repayment of the debt within 30 days of a proposal being made by Mr Low, Suncorp could be entitled to commence recovery action.

A series of offers and counter offers about repayment of the debt were made between the Lows and Suncorp. The Lows offered to continue to make the minimum or slightly higher loan repayments free of interest, in accordance with the FOS determination, over the original timeframe of the loan. Suncorp initially sought to accelerate repayment of the loan by proposing that the entirety of the balance be paid between six and 12 months. Mr Low sought further assistance from FOS in relation to these negotiations. FOS initially declined to assist him, because the case was closed. Mr Low brought a fresh complaint to FOS and also raised, as part of the


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complaint, an incorrect automated letter that the Lows received, signed by Mr Carter, setting out minimum repayment amounts for the loan.

Mr Low gave evidence that the Lows felt pressured by Suncorp to withdraw the FOS dispute and the Lows subsequently discontinued the proceedings. Mr Low gave evidence on how stressful the experience had been for him and said that it had taken its toll on his mother and the rest of his family. Mr Carter gave evidence about Suncorp's decision to refuse Mrs Low's offer to repay the loan over its original term on an interest-free basis, characterising it as an interest-free loan spanning 17 years. He said such a proposal was unreasonable and contrary to what he described as an industry practice. Mr Carter gave evidence that it was Suncorp's view that the effect of the determination was to eliminate the loan contract and instead leave what he called a residual debt. Mr Field, the lead Ombudsman, gave evidence that FOS does not consider a loan contract in cases of maladministration to be void.

Mr Field said that FOS had erred in advising the parties that 12 to 18 months was a reasonable timeframe for repayment of the loan. On the evidence, the following findings may be open: Suncorp failed to comply with clause 27 of the Banking Code of Practice in had failing to properly investigate the purpose of loan, in imprudently assessing the affordability of the loan in a way that was dependent on the development property to generate income for repayments, and in failing to control the use of the loan funds. In addition, it may be open to find that Suncorp also failed to comply with the obligations in clause 3.2 of the code to act fairly and reasonably in a consistent and ethical manner by conducting its negotiations with Mrs Low about a repayment plan for the loan following the FOS determination in a manner that was unfair and unreasonable.

On the evidence, Commissioner, it is also open to you to make findings that Suncorp engaged in conduct that fell below community standards and expectations by defending the complaint about the loan in FOS, including by adducing further material to FOS following its recommendation that the loan had been irresponsibly advanced, in circumstances where Suncorp ought to have examined and been aware of the loan approval deficiencies and the irrelevance of the material that was adduced.

By demanding repayment of the entirety of the loan within an unreasonable timeframe, in circumstances where Jennifer Low had offered to make regular repayments of the principal in accordance with the loan, by asserting that the loan was void ab initio and should be repaid in priority to the other loans with Suncorp, in circumstances where the FOS determination neither rendered the loan void nor required repayment in priority to other loans, and by communicating with the Lows about the loans over a period following Mr Low's death in a manner that caused Jennifer and Rien Low distress.

The evidence, Commissioner, we submit supports a finding that FOS did not function as an effective mechanism for redress in this case, and that neither the recommendation nor the determination made clear that Jennifer Low could repay the


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debt under the loan in accordance with her obligations under the loan contract and in priority to the other loans. Further, FOS then told the parties what it considered to be a reasonable period for repayment of the loan, despite Mrs Low's offer to make repayments at the same rate or a higher rate than the existing repayment schedule. Suncorp and FOS are each invited to provide written submissions addressing each of the findings that we have identified as being open to the Commissioner in respect of their respective conduct as well as any other findings that they regard as being available or open on the evidence.

All parties with leave to appear are invited to provide written submissions addressing the following inform questions which arise from this case study. First, if a business loan is determined to have been affected by maladministration, should the financial services provider be permitted to require the loan to be repaid within a timeframe shorter than the remaining term of the loan in circumstances where the borrower is willing and able to meet the repayment schedule under the loan? Secondly, could FOS improve its processes for dealing with loans that are determined to have been affected by maladministration and, if so, how? Should the incoming body, AFCA, adopt a different process?

Commissioner, the fourth topic to which we now turn is the Bankwest business lending book. As you know, we heard evidence from four customers of Bankwest who had been customers in the period after the takeover of Bankwest by CBA in 2008. And you will recall in opening that we referred to the fact that the conduct of CBA after it purchased Bankwest from HBOSS in 2008 has been the subject of significant controversy. We referred to various inquiries that have considered elements of Bankwest's conduct in the period after 19 December 2008 and we specifically addressed what we described as ulterior motive theories.

We concluded that the Commission had not seen any evidence from primary sources that supported these theories and from the review of this evidence, it appeared that the theories were premised on misconceptions in relation to the facts and contractual arrangements to which we referred in opening. We do not intend to repeat what we said in opening. For these case studies our attention was focused on considering how CBA addressed the risks that it identified in the business loan book after it had acquired Bankwest. The four case studies that we selected from the public submissions were intended to explore (a) the experiences of those particular customers and (b) the general question of how a bank might legitimately respond to its perception of increased risk in respect of a particular loan or lending in a particular industry and in what circumstances such conduct might be unconscionable or below community standards.

As with other issues, we have considered this by way of case study. And as you appreciate, Commissioner, it is not possible to address each and every public submission that is made. To date, the Commission has received 43 public submissions from former customers of Bankwest in the period following the CBA acquisition. It has also received a handful of submissions which were provided directly. The four consumer witnesses from whom we heard evidence were amongst


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those who had provided public submissions to the Commission. Before examining the case studies in a little detail, it is necessary to make some further observations about the general issue of the state of Bankwest's loan – business loan book.


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In preparation for exploring these issues at the hearings, the Commission issued a number – I suspect CBA would say many, noticed to produce for CBA for contemporaneous documents which would cast light on these issues. Over 13,000 documents were received in response to these notices. Further, the Commission sought and received statements of evidence. Oral evidence was led from Mr David Cohen, CBAs chief risk officer, but also in relation to a narrower range of issues from Mr Brett Perry and Mr Peter Clark, both of whom are senior employees at CBA.

Through the examination of those internal Bankwest and CBA documents, and the evidence of Mr Cohen, we submit that it would be open to you to conclude that the following became apparent to CBA in the period of approximately 18 months after it purchased Bankwest. First, there were indications of problems and serious problems with the quality of the business loan book. Mr Cohen's evidence was that the quality of the Bankwest business loan book was not as good as CBA had expected it to be. That is, by March 2009 there had been a notable increase in the concentration of troublesome assets – troublesome assets, and from July 2009 to February 2010 there had been a significant transfer of assets into CAM with a value of $1.4 billion. Further, during 2009 the provisions that were being made for the Bankwest business loan book had been increasing.

Second, there were indications of problems, and again significant problems, with the diversity of the loan book. That is, Bankwest had a high exposure to commercial property during the period of and immediately after the GFC. Mr Cohen gave evidence that CBA had come to learn that Bankwest had adopted a very aggressive strategy with respect to commercial property Australia wide, but particularly in relation to property and construction projects and exacerbated on the east coast. Mr Cohen's evidence was that, in his experience, banks place limits on the concentration of lending in a particular industry as there is value in the diversification of the loan portfolio. And you will recall, Commissioner, that some similar evidence was given last week by Mr Welsh.

Further, it is prudent to avoid excessive concentrations in a particular industry in case that industry suffers rapid or even gradual deterioration or decline. Third, there were indications of problems with business functions, including loan management by Bankwest. Mr Cohen's evidence was that it became apparent that some of the relationship managers at Bankwest were not actively monitoring the progress of a loan through its life cycle as they ought to have been, and he said that there were concerns about the operation of the business itself when it was assessing credit.

Indeed, by way of example, we heard evidence that, up until April or May 2009, Bankwest did not have a watch list process in place to identify loans for which the credit health had started to deteriorate. Fourth, there were indications of problems with aspects of the risk management function, including provisioning. The evidence was that there was an underlying question as to whether the Bankwest business loan portfolio was being credit rated in accordance with the equivalent CBA standard, including concerns about the risk ratings that were given to particular loans. There


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are also concerns about adequate collective provisioning of the Bankwest business loan book.

The evidence that Mr Cohen gave was that, as these risks came to light following the acquisition, CBA took steps to address the risks, and that evidence is entirely consistent with the internal documents that we have reviewed. One of those steps was that Bankwest put in place a reduced cap on the commercial property exposure in the business loan book and targets to further reduce this exposure over time. Another of those steps was Project Magellan. It was but one of a number of different reviews that were carried out over different aspects of the business loan book. Those reviews occurred in 2009 and 2010. By the time that Project Magellan had been completed, around 60 per cent of the Bankwest business loan book was reviewed.

The evidence was that Project Magellan concerned, or was concerned with, a more accurate assessment of provisioning of the Bankwest loan book and that was required to meet prudential obligations and allow the Commonwealth Bank group to accurately complete the June 2010 financial statements and report its profit to the market. Mr Cohen's evidence is consistent with what we have observed from our review of extensive contemporaneous documentary evidence. A small fraction of what we have reviewed was tendered during the course of Mr Cohen's evidence. You will recall, Commissioner, from the opening, the distinction that we noted between impairment and provisioning on the one hand and default and enforcement on the other. Project Magellan was primarily concerned in the first instance with impairment and provisioning.

It will be open to you to conclude, we submit, that a task of the nature of Project Magellan was necessary so as to address the risks that CBA and Bankwest had identified in the Bankwest business loan book following the acquisition. Looking at it in hindsight, CBA had valid concerns about Bankwest's approach to credit writing and account management and was witnessing the continued unexpected – was witnessing continued unexpected provisions being made throughout 2009. In this context, the focus of Project Magellan on reviewing part of the loan book that had not been identified up until that point in time as troublesome or impaired in order to consider whether further provisioning needed to be made for accurate reporting of the group's end of financial year accounts, seems both prudent and responsible. Further - - -

THE COMMISSIONER: Well, it may be required – give a true and fair view of the accounts, to give accounts that – to file accounts that give a true and fair view, amongst other things, you've got to look at your provisions.

MR HODGE: That's right.

THE COMMISSIONER: Yes.

MR HODGE: Further. The review of the documentary evidence produced to the Commission has not revealed evidence that Project Magellan itself was undertaken


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with any motive to deliberately make certain types of assessments with respect to particular accounts or particular classes of accounts. It is not open, we submit, on the evidence and on the documents available to find that Project Magellan was intended to be, or was intended to be part of, a process of deliberately defaulting loans against Bankwest customers. It was in this context that the Commission heard four case studies relating to customer experiences of Bankwest during this period.

Each of those case studies had been reviewed as part of Project Magellan. The case studies spanned the range or spectrum of classifications that might have been given as part of that review: green, red and double red. The case studies also spanned industries where CBA had identified risks in the Bankwest loan book either in relation to the trends within the industry or the size of the Bankwest exposure to property development, land banking, and pubs and clubs, and the cases ranged from loans of approximately $1 million in the case of Mr Stanford, to a very significant business loan of over $50 million taken out by the Doherty hotels.

These case studies have allowed the Commission to hear evidence as to how accounts identified as troublesome or impaired were handled in Bankwest post-acquisition by CBA. The case studies also highlighted some of the issues that arise out of the common terms covenants and financial undertakings that are included in many business loans. The management of business loan accounts as business conditions or profitability deteriorate, and the enforcement of business loans in light of common terms covenants and financial undertakings included in the business loans which are relevant, of course, beyond the Bankwest context.

Can I now address in turn each of the individual case studies. The first Bankwest case study to which we turn is that of Michael Kelly. His case concerned the terms offered to an existing business customer when renewing or rolling over business facilities including interest margins, reducing LVR covenants, and requiring the payment of upfront interest. As well as hearing evidence from Mr Kelly, the Commission heard evidence from Mr Perry, general manager of group credit structuring at CBA. Mr Kelly told the Commission about his experiences as a Bankwest customer in respect of two facilities, both of which were obtained by corporate entities of which he was a director and shareholder, and each of which was secured by land development projects in Western Australia in the period between 2007 and 2012.

Mr Kelly's original facilities were not long enough to enable the rezoning or development processes to be finalised so issues arose when the facilities needed to be renewed. He gave evidence of the fact that he considered the interest rate margin on the facilities was increased on a number of occasions, and only very short facilities were offered as a means of encouraging him to exit his facilities. Further, he pointed to a reduction in the LVR on one of the loans and the reduction of the facility in the other as being motivated for that same purpose of encouraging him to exit.

Mr Kelly said that these changes were made after Bankwest informed him that it was looking to reduce its exposure to property development and therefore that it was


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unlikely that his facilities would be renewed, but he said that at no point did either of the companies miss a repayment or interest repayment on either of the loans. In the end, Mr Kelly and his co-investors refinanced in mid-2012 with Bendigo and Adelaide Bank. Mr Perry, on behalf of CBA, gave evidence that at the time the borrower enters into the facility, the borrower ought to understand that the facility has a particular term and that at the expiry of that term the bank may or may not be willing to refinance and, indeed, if the bank is willing to refinance, it may be on different terms.

His evidence was that, when loans are extended or rolled over, that these are new contractual arrangements. Mr Perry accepted that Bankwest wanted to exit from the Wildlines and Silversuns accounts as soon as it was practically possible to do so by having these companies refinance their loans with another bank. This reflected the eventual view at the time that Bankwest was overexposed to commercial property. His evidence was that, at the relevant time, Bankwest's policy was not to end facilities early but, rather, to exit at the end of the term. In this case, that is in the case of Mr Kelly, there had been no early withdrawal as Bankwest had let the facilities run their respective terms.

Mr Perry's evidence was also to the effect that the risk grade given to an account would have an effect on the interest rate charged on the facility, but Mr Perry was unable to identify a contemporaneous guidelines or models on explain the various interest rate changes that were being applied to the Wildlines and Silversun accounts. As to the period in late 2010 and early 2011, when the facilities were under negotiation, Mr Perry did accept that there were inconsistencies in the information that was given to Mr Kelly about the charging of default interest rates.

The second Bankwest case study was that of Mr Stephen Weller, who owned the Nambucca hotel. His case study highlighted Bankwest's over – I'm sorry, Bankwest's reliance on non-monetary defaults including LVR covenants, and a shortening of the loan period after which a deed of forbearance was executed. Those issues arose in a context where there had been no monetary defaults during the course of his facility. Further, the case study raised Bankwest's failure to provide a valuation to the borrower. And you will recall, Commissioner, that it was Mr Peter Clark, the chief credit officer of CBA that gave evidence in relation to Mr Weller's case.

Mr Weller gave evidence about the business facility that Bankwest entered into with Bainbridge Enterprises number 1, of which Mr Weller was a director, to finance the purchase of the Nambucca Hotel and later to enable – to advance funds to enable Mr Weller to buy out his partner. The 2008 facility was for a term of 15 years and included non-monetary covenants but no LVR. Mr Weller and his wife gave personal guarantees for the facilities. Mr Weller's evidence was that in 2010, which was the conclusion of an initial interest-free period on the 2008 facility, he was offered a varied facility by Bankwest although this offer reduced the term of the loan to two years.


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In his evidence about negotiations following this offer, Mr Weller accepted that he had been offered a facility with the original 15 years expiry date reinstated but that, after further negotiations over interest rate and principal repayments to levels that were acceptable and affordable to him, the offer he eventually signed was a 12 months facility. He was concerned that the maintenance of the 15 year term would have resulted in significantly higher interest rates being incurred. Despite a downturn in trading in 2010 and beyond, Mr Weller's evidence – which was accepted by Bankwest – was that he was never in default of any monetary payments owed under the facility.

In the latter part of 2012, Bankwest informed Mr Weller and his wife of the need for an updated valuation of the hotel and the need to reduce the principal on any new facility. In response, Bankwest organised a valuation and Mr Weller engaged an agent to sell some of the hotel's poker machines, and he and his wife put their residential home on the market. Their home had never been security for the facility. Mr Weller's evidence was that he met with Bankwest in December 2012, by which time he understood Bankwest had a draft of the valuation, but would not provide him with a copy. It was also at this meeting that Mr Weller said that Bankwest told him that they were not prepared to rollover the facility because there was insufficient time and that Bainbridge would need to enter into a deed of forbearance with the bank. Mr Weller's evidence was that he received the first draft of this deed of forbearance two days before the facility was due to expire.

The deed of forbearance was entered into two weeks later. However, Bankwest shortly thereafter notified Mr Weller of a breach of its terms. Over the next three years, Mr Weller and Bankwest were involved in a FOS dispute before receivers were appointed and ultimately the personal guarantee given by Mr Weller was called upon by Bankwest resulting in a settlement. The evidence of Mr Weller raised three main issues to which Mr Clark responded on behalf of the Commonwealth Bank. First, the lack of transparency around the final valuation of the hotel. Secondly, the shortening of the term of the facility through a series of variations to the facility. And thirdly, the relationship between breaches of financial covenants and the entry into the deed of forbearance.

Mr Clark agreed that if significant decisions are made in relation to a customer's financial commitments, without the customer being shown the valuation, there is a lack of transparency. Mr Clark's evidence was that it was no longer the policy of CBA to withhold valuations from customers who have paid for the valuation. Indeed, Mr Clark said that it just seems a fair thing to do. As to the length of the facilities, Mr Clark explained that banks prefer shorter term facilities as longer term facilities come with higher risks. Quite simply, he explained that over time more things could go wrong if the facility is longer.

Further, he explained that the inclusion of financial covenants such as ICR and DSR ratios is part of prudent management of a business loan as it allows monitoring of the business and comparison to forecasts and expectations. As to the breaches and non-monetary covenants generally, Mr Clark's evidence was that it was very rare in his


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experience for a bank to actually call a default and demand repayment as a result of a breach of one of the financial ratio covenants alone. This is a matter upon which Mr Cohen also gave evidence, and we will come to that in due course. The third case study was that of Michael Doherty. Mr Doherty's case study concerned the effect of changes in a bank's approach to valuation of secured property, and what that may have on a decision not to renew the facility.

The Commission heard evidence from Mr Doherty himself, and Mr Clark also responded to that evidence. Mr Doherty gave evidence in relation to a business facility that he obtained in 2008 from Bankwest for approximately $50 million which was used to develop a hotel in Hobart. Ultimately, the development project was not completed before receivers were appointed in 2012. A focus of the case study was upon the use of valuations of the development by Bankwest in its decision-making with respect to the facility, in particular, where the facility was initially offered and several years later when Bankwest was making decisions about whether to extend or renew the facilities.

The development was a complex hotel and retail development, and the evidence before the Commission demonstrated that there were various approaches that could be taken to valuation of the property. Mr Doherty's evidence was that he understood that when the facility was offered in 2008 the development was valued on a mixed use basis meaning that various components of the development were assessed by reference to their different functions. That was in contrast to an approach of valuing the hotel on one line, which would have resulted in a lower valuation. Mr Doherty's evidence was that he understood that the mixed use valuation must have been relied upon because the offer included a 65 per cent LVR covenant which would not have been satisfied from the outset without relying on the higher valuation.

Mr Clark conceded, when the facilities were approved by Bankwest, the documentation showed that a mixed use valuation had been used in the approval process. Mr Doherty gave evidence that in July 2011 Bankwest decided not to extend the facilities despite the fact that the project was very close to completion and would soon be operational. Receivers were appointed about six months later. Mr Doherty complained that Bankwest had received a valuation which Bankwest had insisted on being done on an in-one-line basis, and Mr Doherty's evidence was that he had raised his concerns about Bankwest's choice of valuation method on multiple occasions with Bankwest, and directly with the valuer, because he was concerned about the approach and the possibility of undervaluation of the property.

Mr Doherty's evidence was that he was not given a copy of the valuation once it was completed, although he was told by a Bankwest staff member that it was a contributing factor in Bankwest's decision not to extend the facility. Mr Clark accepted that although in earlier decision make process Bankwest had been prepared to rely on the mixed use valuation, Bankwest's position had changed by 2011. Mr Clark did not know why the approach had changed. Mr Clark's evidence was that ultimately the valuation method adopted in the July 2011 valuation did not have a bearing on the outcome of the Doherty account.


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While Mr Clark said that he had no basis on which to question Mr Doherty's evidence that he had been told by a Bankwest staff member that the valuation put the facility in breach of the LVR covenant, his review of the file had revealed no formal notice of breach. Moreover, his evidence was that the high LVR was not itself the reason the facility was not renewed. Rather, there were concerns about money owed to creditors, the time for completion, and the relationship with the borrower, and these ultimately informed Bankwest's decision not to renew or renegotiate the facility. Mr Clark did accept that it would have been a fair thing to do to show the valuation to Mr Doherty. Mr Clark's evidence was that Bankwest ultimately lost $38 million in respect of this account.

The fourth and final Bankwest case study was that of Mr Brendan Stanford who operated the Coronation Hotel. This case study concerned CBAs reliance on non-monetary default clauses to exit a connection which was being financially maintained, and also the use of investigative accountants. In this case study, the Commission heard evidence from both Mr Stanford and also from Mr Cohen. Brendan Stanford and his brother Michael entered into a banking relationship with Bankwest in 2006 to purchase the hotel. They borrowed $1.2 million to assist with the purchase price of $1.6 million. In 2010, the Commonwealth Bank became concerned about the falling value of the hotel.

Even though the Stanfords had made all principal and interest repayments due under the business loan, the bank began to issue breach letters for non-monetary defaults relating to reporting covenants and DSR and ICR covenant breaches. Although the bank acknowledged the Stanfords first class repayment history, in light of the non-monetary covenant breaches the bank made a decision to exit the banking relationship. The Commission heard evidence from Mr Cohen that non-monetary defaults, in particular breaches of financial ratios, are powerful indicators of trouble to come and that the bank anticipated financial breaches based on the non-monetary defaults.

The Commission heard that the bank did not adequately communicate its position in respect of non-monetary defaults and did not adequately communicate why those non-monetary defaults had led the bank to conclude that the only viable option was to sell the hotel. The Commission heard evidence that, in the second half of 2011, Bankwest appointed PPB Advisory as investigative accountants to produce a report on the state of the business at the hotel. The Commission heard evidence that Mr Stanford had no recollection of PPB Advisory being appointed – I beg your pardon, had no knowledge of PPB Advisory being appointed until he received a telephone call from his brother.

The Stanford brothers subsequently received correspondence from Bankwest's lawyer at the beginning of November 2011, which gave the Stanfords seven days to acknowledge whether there had been a material adverse change in the financial condition of the hotel based on the investigative accountant's report. The letter also required the Stanfords to pay the fees of $9,900 within seven days. It did not enclose a copy of the investigative accountant's report and the Stanfords never received a


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copy of the investigative accountant's report. The Stanfords engaged legal representation who wrote to the bank's lawyers to ask for a copy of the report and the invoice for the work. Neither were provided to the Stanfords.

This conduct arose because, at the relevant time, the CBA policy regarding investigative accountants was that it was appropriate to not provide the investigative accountant report to the Stanfords and to only provide them with seven days notice, but that policy has now changed and the policy of the bank is that 30 days notice ought be given and also that parts of the investigative accountant's report should be provided to the borrower. The Commission heard evidence from Mr Cohen that in his view it was unfair of CBA to only give the Stanfords seven days to respond to the matters raised in the report, to ask the Stanfords to respond to concerns raised in the report when that report was not provided to them, to only provide the Stanfords with seven days to pay the costs, to make the Stanfords pay for a report with which they had not been provided. and to not be fully transparent or engage in open discussions with the Stanfords as to the bank's intention to sell the hotel.

Based on the evidence of Mr Cohen, under the current CBA policy, as we have said, the bank will provide 30 days for a customer to respond and the bank would provide a copy of the report in most but not all circumstances and not necessarily including all of the report. The Commission heard each of Mr Clark and Mr Cohen acknowledge that the bank's failure to provide valuations or investigative accountant's reports fell below what was expected and was now the subject of different policies. Further, in relation to Mr Stanford, Mr Cohen conceded that there was a lack of open and transparent engagement with the borrowers which fell below community expectations.

It is apparent, however, that any such admissions do not amount to admissions of misconduct and we do not suggest to you, Commissioner, that there are any open findings of misconduct in relation to these case studies. As well as the matters which were conceded by CBAs witnesses, it would also be open to the Commissioner – that is to you – to conclude that the conduct of CBA in relation to each of the four witnesses involved errors of communication and transparency, which are below community standards and expectations. CBA is invited to provide written submissions addressing each of the findings that we have identified to be open as well as any other findings that it regards available on the evidence.

Some of the issues raised by these case studies have relevance to business lending more generally and in light of this, all parties given leave to appear are invited to provide written submissions addressing the following questions. First how, if at all, are banks to deal with circumstances in which, for reasons extraneous to the conduct of the borrower, the bank no longer wishes to fund a particular business or industry. That is, what is the bank to do if, for example, the market has changed such that its security is no longer adequate? What are the obligations, if any, on a bank in those circumstances?


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Secondly, is there any reason why valuations or investigative accountant's reports ought not be provided to customers in circumstances in which the reports have been paid for by the customer and the bank wishes to take reliance, at least in part, on such reports? Is there any reason why such transparency obligations should be limited by the size of the loan or limited to providing only parts of the report? Thirdly, is it appropriate for a bank to take enforcement action when no monetary defaults have occurred and the bank can rely only on non-monetary defaults? Why or why not? Should there be some additional protection for borrowers in these circumstances and ought the bank be obliged to explain such matters? The fifth topic to which we now turn, Commissioner - - -

THE COMMISSIONER: And I think also arising out of those is: is there a disconnection between what the banks are saying in their advertising, their annual reports, their other public documents, and their conduct?

MR HODGE: Yes, Commissioner.

THE COMMISSIONER: And if there is a disconnection between them, what, if anything follows from that? The answer may be nothing follows from it. I don't know. But are customers to place any significance upon statements of the kind to which I think I referred in the course of – was it Mr Cohen's evidence or someone else's evidence?

MR HODGE: It was certainly somebody's evidence.

THE COMMISSIONER: I'm so glad you remember it with that degree of precision; it's about the degree of precision I've got at the moment, Mr Hodge. I'm sorry, but I think that the parties all know what I'm referring to.

MR HODGE: Yes. We might call that our fourth question, if that's convenient. Commissioner, the fifth topic to which we now turn is power and communication and we will address two case studies as part of this topic. The first case study concerns Bank of Melbourne withholding of funds in deposit to correct an error made by the bank. The Commission heard evidence from Bradley Wallis, one of the directors of Thir, and Alastair Welsh the general manager of commercial banking at Westpac. In June 2016, Thir obtained two loans from Bank of Melbourne: an investment property loan to refinance an existing mortgage over an investment property, and the Byabarra loan to purchase a property at Byabarra in New South Wales. There was an existing business operating from that property.

In the loan application form, Mr and Mrs Wallis indicated that the loan was for the purpose of purchasing a property with a house and business located on it. The loan application was supported by a projected profit and loss statement for the business. The Commission heard evidence that before the loan was approved, the banker, the banker's regional manager and the bank's credit mortgage team were all aware of the fact that there was a business operating on the property. The Commission also heard evidence that both the banker and his manager stood to gain financially through


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potential bonuses if the loan was approved. At the relevant time, the banker performance targets were heavily weighted towards financial performance.

Despite the commercial nature of the property, the bank approved the loan as a residential loan. Following the failure of the business in June 2013, Thir asked the bank to revalue the investment property and the Byabarra property. The Bank of Melbourne's credit team identified that the property had been characterised as a residential loan when it should have been characterised as commercial. Later, on the sale of the investment property, the bank refused to discharge the over the investment property unless $100,000 of the proceeds of sale were deposited and held in the Bank of Melbourne term deposit account, pending the restructure of the other loan from a residential loan into a commercial facility so as to make up for the security shortfall that would exist if the loan was reclassified.

After Mr Wallis questioned the bank's entitlement to withhold these funds the bank told Mr Wallis that the loan documents gave the bank the ability to control the flow of any settlement fund in relation to discharging securities. Mr Welsh's evidence was that it was for the bank's credit team – or it was the bank's credit team that had made the decision to withhold the funds and that there was no evidence that the bank had relied on legal advice before making this decision or communicating it to Mr Wallis. Mr Wallis submitted a complaint to FOS. FOS considered the bank had incorrectly advanced the Byabarra loan as a residential loan.

Although FOS considered that the bank was entitled under the terms of its mortgage memorandum of provisions to retain part of the sale proceeds of the investment property, FOS considered that in the circumstances it was not fair for the bank to do so. In his evidence Mr Welsh agreed that the clauses of the mortgage memorandum relied on by the bank to justify withholding the $100,000 from Mr and Mrs Wallis were too complex for a customer to understand. Mr Welsh also agreed in withholding these funds the bank had not acted in accordance with these clauses. Mr Welsh accepted that the bank retained the $100,000 as a bargaining chip to get Mr and Mrs Wallis to agree to restructure the loan and in withholding these fund the bank had acted unfairly.

On the evidence, the following findings may be open with respect to the Bank of Melbourne. First, that 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 Thir and Mr and Mrs Wallis in a consistent and ethical manner. Secondly 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, the Bank of Melbourne engaged in conduct which was misleading or deceptive in contravention of section 12DA of the ASIC Act.

It may also be open, Commissioner, to find that in representing to Thir and Mr and Mrs Wallis the bank had a legal entitlement to withhold the $100,000, and in


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withholding these funds from Thir and Mr and Mrs Wallis to rectify the bank's own security shortfall, the Bank of Melbourne engaged in conduct that fell short of community standards and expectations. Before we turn to the next case study, we make a general observation, which is that this and other case studies considered during the hearings highlight that the lower level of regulation over business lending, as opposed to consumer lending, means that there is a particular need to be, for banks to be mindful of not focusing on relentlessly acquiring new business. The danger of that type of selling model was identified particularly in relation to the case studies involving ANZ, Westpac and the Bank of Queensland.

All parties with leave to appear are invited to provide written submissions addressing the following questions which arise from several of the case studies in relation to the sales culture for business loans. First, should the sales culture for small business reflect that of consumer lending in that business bankers are discouraged from focusing primarily on financial incentives in their key performance indicators? Secondly, specifically in relation to this case study, should lenders be required to clearly draw the cross-collateralisation clauses and its effects to the attention of borrowers? If so, how should this done? Westpac, I should also say, is also invited to specifically address the findings that we have submitted may be open, and any other findings that it considers may be open on the evidence.

The next case study concerned the failure of communication by the National Australia Bank to Ross Dillon of the NABs intention to use all of the surplus proceeds from the sale of Goanna Downs which was Mr Dillon's home and the property that provided security for a personal guarantee that had been given by him and his wife in respect of the business facilities of National Music. The Commission heard evidence from Mr Dillon, who made a public submission to the Commission; Mr Bassett, a former employee of NAB; and Mr Ross McNaughton, the current general manager of the strategic business services division at NAB. The evidence was that, from as early as 2011, Mr Dillon had discussed with the NAB his intention to sell Goanna Downs and use the proceeds to inject funds into National Music and to purchase a smaller property in Melbourne so as to be closer to his children and future grandchildren.

In March 2015, Mr Dillon met with Mr Bassett and informed Mr Bassett of his intention to sell Goanna Downs and inject around 200,000 to $300,000 into National Music. It was also Mr Dillon's evidence that he said to Mr Bassett that he then intended to purchase a new home in Melbourne. Mr Bassett did not discuss with Mr Dillon what NABs expectations were in respect of the sale proceeds. Mr Bassett recalls meeting Mr Dillon on this date, but does not recall the details of the discussion. Nor did the NAB inform Mr Dillon that it would require further security in the event that Goanna Downs was sold. Mr McNaughton, on behalf of the National Australia Bank, considered that the lack of communication between his bank and Mr Dillon regarding the bank's expectations in respect of the sale proceeds was not an example of poor communication between the bank and its customers.


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After Mr Dillon sold Goanna Downs on 30 April 2015 for $2.22 million, Mr Dillon was informed that the bank would be retaining the entire sale proceeds from Goanna Downs with the funds remaining after repayment of the mortgage to be put towards reducing the overall debt position of National Music. At no time was National Music in monetary default in respect of the facilities with the NAB. At no time had the bank made a call under the guarantee. The Commission heard evidence from Mr Bassett that at no time prior to 30 April 2015 was Mr Bassett aware that the bank intended to take all of the sale proceeds from Goanna Downs to reduce the facilities in National Music.

Mr Bassett conceded that the SBS manager at the time, Ms Moynahan, informed him of the plan to use all of the sale proceeds to reduce debts owed by the company, National Music, after the sale contract had been signed. Mr McNaughton admitted that the NAB did not have a right to apply the proceeds from sale from Goanna Downs to National Music's facilities. He also admitted that the communication could have been better by NAB to inform Mr Dillon before the sale as to, first, what the bank would like to do with the sale proceeds; and secondly, what the bank would require in respect of its security position going forward. Mr McNaughton's evidence was that despite the failure of the bank to communicate with Mr Dillon its intention to take the entire proceeds of sale, it had acted with integrity towards Mr Dillon, and treated Mr Dillon with respect and courtesy as required under the SBS governing principles.

It is open to you, Commissioner, to find that NAB might have engaged in misleading or deceptive conduct. First, the bank did not inform Mr Dillon that the intentions he had expressed to the bank in respect of the proceeds of sale would not be possible because the bank would require either all of the surplus to reduce the debts of National Music or an alternative proposal of security from him. Second, the bank represented to Mr Dillon that it was entitled to use the proceeds of sale to reduce the debts of National Music in circumstances in which the bank has now acknowledged that it did not have the legal right to do so.

The bank's failure to communicate its expectations and intentions to Mr Dillon may also have been a breach of clause 3.2 of the Code of Banking Practice in that it may have failed to act in a consistent and ethical manner. NABs conduct also fell below community standards and expectations. Despite Mr McNaughton's evidence to the contrary, it is open to you to find that the relevant NAB bankers may not have adhered to NABs policies which required them to engage earlier with Mr Dillon, to be open and honest with him, and to clearly articulate the bank's position and the basis of the decision.

NAB is invited to provide written submissions addressing each of the findings that we have identified to be open to you as well as any other findings that it regards as available on the evidence. All parties with leave to appear are invited to provide written submissions addressing the following question: when and how much disclosure should a bank provide a director of a business in respect of a decision of the bank's workout division, in this case, the SBS division of NAB, where that


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decision will affect a customer's use of a personal asset which indirectly secures the obligations of their business to the bank?

Commissioner, we finally turn to the sixth topic, which is regulation and self-regulation of the SME lending sector. Your terms of reference require you to require into the effectiveness and ability of regulators of financial entities to identify and address misconduct by those entities. In this final section we will deal with some evidence from the regulator and the peak industry body about some aspects of their roles in relation to small business lending. The Commission has heard evidence from a number of witnesses about the review of the Code of Banking Practice, which is a form of self-regulation by the banking industry, and which our case studies have shown is one of the only sources of conduct obligations on banks in relation to small business.

Philip Khoury gave evidence, as the opening witness of this round of hearings, about his role as the independent reviewer of the current 2013 version of the code. He gave evidence of the strong view expressed to him by small business representatives that the recommendations of his review would have to be significant or transformational in nature to have any prospect of overcoming scepticism in the community towards the banking industry. The revised draft of the code, which emerged after Mr Khoury's review, has also gone into evidence. It includes, for the first time, a section or sections dealing specifically with small business.

Mr Khoury expressed disappointment with parts of this draft, including the definition of small business, protections afforded to guarantors, and the accessibility of the code for small business customers. The Commission also heard evidence from the CEO of the Australian Banking Association, Anna Bligh, about the ABAs approach to Mr Khoury's recommendation and the ABAs request that ASIC approve the code under its regulatory guide 183, which the ABA believed would reassure customers. The evidence given to the Commission identified that the principal point of contention remaining between the ABA and ASIC in respect of the draft code is the definition of "small business".

The ABAs position is that the definition of "small business" should only extend to businesses with a total debt of $3 million or less to all credit providers, while ASIC had raised the question of whether the small business definition should extend to businesses with a total debt of $5 million or less. Ms Bligh considered that what constituted the two ends of the spectrum of small and large businesses was understood, but that what remained was to find an appropriate middle. The Commission heard from Ms Bligh that there were a number of reasons for the ABA taking their current position, including that borrowers with facilities above $3 million tended to be more sophisticated and have access to commercial and legal advice.

She also noted that a higher threshold may create a competitive disadvantage for smaller banks as a may result in a loss of control over the entirety or near entirety of their loan books due to the consumer protections contained in relation to non-monetary defaults and financial indicator covenants in the code. She also said that


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placing limits on enforcement or default based actions, as the code would do, may increase the risk for a bank to make a loan which consequently may be factored into the price of facilities or the willingness of the bank to extend credit at all.

The Commission also heard evidence this morning from Mr Saadat, a senior executive leader and regional Commissioner of ASIC, that the contrary position put forward by some stakeholders is that a $5 million threshold is more appropriate. The evidence of Ms Bligh is that ABA is intending to market test the effect of the changes and is willing to undergo a two year review supervised by ASIC. The new code has not been approved by ASIC as at today. It was submitted for approval over five months ago. Ms Bligh and Mr Saadat have both said that the ABA and ASIC are awaiting until the conclusion of this round of hearings in case any issues will be raised that should be considered by the parties before the finalisation of the code.

The Commission also heard evidence about the implementation of the unfair contract provisions in the ASIC Act, which were extended to small businesses on 12 November 2016, and the regulator's response to those changes. The Commission, yesterday, heard evidence from Suncorp about the work they had done to amend their standard form business contracts to comply with changes in law. In that regard the evidence of Mr Kluss, Suncorp's executive general manager of lending, was that Suncorp had not yet completed its review of its small business standard contracts despite early and ongoing engagement with ASIC.

Mr Kluss admitted that it had taken Suncorp over two years since the legislation passed to amend a limited number of standard form business contracts. He said that the reason for the delay was due to the number of credit contracts being reviewed, but he admitted that Suncorp's processes had taken too long. The evidence of Westpac and other banks on their compliance with the UCT regime was also tendered into evidence. The unfair contract terms regime in the ASIC Act relates to financial services and is therefore the responsibility of ASIC. But as you know, and as we explained in opening, the ACCC is responsible for the unfair contract term regime in the Australian Consumer Law which deals with all other parts of the Australian economy.

The Commission heard evidence from both regulators, both ASIC and the ACCC, which revealed a different approach to implementation and enforcement of these new provisions. Yesterday, Scott Gregson, the executive general manager of consumer enforcement at the ACCC told the Commission that once the amending legislation was passed – I'm sorry, once the amending legislation took effect on 12 November 2016, the ACCC moved into an enforcement mode, although it had engaged with the relevant industries in the lead up to that date including by way of contract reviews and publishing a report a few days before the legislation took effect. That is consistent with the ACCCs approach to compliance, which uses enforcement as one of its effective tools to ensure broader compliance in the industry.

Commissioner, this morning you heard evidence from Mr Saadat and Mr Mullaly of ASIC in relation to ASICs approach to enforcement of the UCT and more generally.


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We don't propose, given how recently you heard that evidence, to summarise that evidence again. Consideration of all of the evidence in relation to the code, the UCT and the protective provisions of the ASIC Act raises the following general questions to which all parties given leave to appear are invited to make submissions. First, is ASICs approach to the UCT provisions and the consumer protection provisions under the ASIC Act more generally, appropriate and moulded to the risks of the contraventions and practical resources constraints on ASIC?

Secondly, has ASICs approach been effective in ensuring compliance with the UCT provisions that came into effect in November 2016 and the consumer protection provisions of the ASIC Act generally? Thirdly, is the proposed code – whether or not it is approved by ASIC – adequate to address any residual concerns about the coverage of obligations imposed on the banks? Would the absence of ASIC approval undermine the effectiveness of the code? Commissioner, that concludes our closing submissions.

THE COMMISSIONER: Can I add two questions, one and two of those general questions, Mr Hodge: is ASICs approach to various things appropriate; has ASICs approach to various things been effective? The utility of the submissions will depend very much on whether the parties go beyond simply assertion one way or the other. Simply saying, "Yes, it is", "No, it isn't", is not going to be particularly enlightening. According to whichever stance is taken, or if no stance is taken, if a party seeks to say, "We don't know, we can't say, we don't wish to say," I will be much assisted if the parties explain and seek to justify whatever may be the position they adopt.

Simply saying, "Yes" or "No" doesn't help. Simply saying, "I have nothing to say about this subject", without saying why the party thinks it either cannot or should not, will be not as helpful as it may be. So I know what I'm asking is difficult. But the questions are difficult. Therefore, whatever assistance the parties can give will be valued, but no less importantly. The greater the extent to which the parties can justify their position by reasoned argument, the more likely it is to be persuasive.

MR HODGE: Commissioner, before we adjourn, there are some documents, a list of documents that we need to tender.

THE COMMISSIONER: Yes. There's that and then there's a couple of housekeeping things about submissions dates and times. So what do we do first? The joys of tendering documents?

MR HODGE: Could we just – I have handed up, or hopefully it has been handed up to you, a list of documents. These were documents that were, in most cases, referred to during the course of the hearing and the day on which they were referred to is noted, but the document itself wasn't tendered at the time. And then there are a couple of extra documents including a statement of a NAB witness that ought to be tendered as well. Would it be convenient - - -

THE COMMISSIONER: That is the statement of Mr Sellby.


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MR HODGE: That's correct. Would it be convenient – having handed that up to you, Commissioner, we could just publish that on the website, if you would prefer, and - - -

THE COMMISSIONER: It should be published.

MR HODGE: Yes.

THE COMMISSIONER: And it – the documents that are identified there can be received and numbered sequentially in the sequence of exhibit numbering, but it will be as well that they are published so that parties and others can see what it is that is being put in.

MR HODGE: Thank you, Commissioner.

THE COMMISSIONER: Yes.

MR HODGE: And then housekeeping matters.

THE COMMISSIONER: Yes. More than perhaps housekeeping. Firstly, times for submissions, and length of submissions. As to the case study submissions, as in past case study – as in past rounds of evidence, case study submissions of not more than 20 pages should be provided no later than 4 pm on Friday next, 8 June, by those who are the immediate parties to the case studies. So 20 page limits there. The general submissions, bearing in mind that Monday 11 is Queen's Birthday, should be made available by 12 noon – no later than 12 noon, Tuesday, 12 June. And having regard to the nature of the questions that have been raised, parties may have up to 30 pages to make their submissions on those subjects, the general questions that have been raised in the course of running.

Can I say something about documents that parties refer to in their written submissions. It is an issue that has arisen in the last two rounds of hearings. It is my expectation that the documents that a party refers to in its written submissions will be restricted to the documents that have been tendered in evidence during the course of the public hearings. All parties who have leave to appear have, and have had, the opportunity to seek leave to tender documents during the course of the hearings, and if a party – and, therefore, I would ordinarily expect that the record is now complete.

If, contrary to that, and a party wishes to refer to a document in its written submissions that was not tendered in evidence during the course of the hearings, that party will need to submit an application to tender the document and a submission as to why the document – which will explain why the document was not tendered during the public hearing but should now be tendered. If a document is received in evidence as a result of that process, that document will be published on the website along with the other documents tendered during the course of the public hearing. We need to come back always to the fact that this is a public inquiry and things are to be


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done like that: in public with a public record where people can ultimately – I know it takes time – but can ultimately look at the exhibits that have been tendered.

I should also add, for the avoidance of doubt, although I think Suncorp will be advised specifically of this fact: I have received – or the solicitors for the Commission have received communication from Consumer Action Law Centre putting in issue some statements which they would say were attributed to them in the course of Mr Morgan's evidence. CALC will have leave to make general submissions on the issues that were thus raised. They are issues about FOSs treatment of the remedies that are to be given in cases where there is maladministration or found to be maladministration of a loan. Again, as I say, those things should be recorded publicly as well as simply observed from the fact of the submissions. Now, is there anything else that arises, Mr Hodge?

MR HODGE: No, Commissioner.

THE COMMISSIONER: Thank you very much. We will adjourn until the next round of hearings, which is in Brisbane.

MR HODGE: Thank you, Commissioner.

**MATTER ADJOURNED at 4.05 pm UNTIL MONDAY, 25 JUNE 2018**


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**Index of Witness Events**



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|---|---|
| EXHIBIT #3.171 STATEMENT OF MR MULLALY AND EXHIBITS DATED 30/05/2018 | P-3008 |
| EXHIBIT #3.172 ASIC MEDIA RELEASE, 16-009MR (RCD.0006.0004.0010 ) | P-3017 |
| EXHIBIT #3.173 ASIC MEDIA RELEASE 14-235MR (RCD.0006.0004.0004) | P-3022 |


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