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TRANSCRIPT OF PROCEEDINGS

O/N H-871452

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

9.45 AM, THURSDAY, 15 MARCH 2018

Continued from 14.3.18

DAY 4

MS R. ORR QC appears with MR A. DINELLI and MS E. DIAS as Counsel Assisting with MS S. ZELEZNIKOW
DR M. COLLINS QC appears with MR M. RUSH, MR N. DE YOUNG and MS K. BRAZENOR for ANZ
MR R. DICK SC appears with MR J. WATSON and MS E. BEECHEY for APRA
MS L. NICHOLS SC appears with MS C. VAN PROCTOR for ASIC
MR C. SCERRI QC appears with MR P. KULEVSKI for CBA
MS D. HOGAN-DORAN SC appears with MS J. SHEPARD for Aussie Home Loans
MR P. ANASTASSIOU QC appears with MR B. JELLIS for Commonwealth
MS K. REES SC appears with MR D. HEALEY for Citigroup
MR A. SLEVIN appears for Finance Sector Union of Australia
MR D. MACKAY appears for ING Bank
MS W. HARRIS QC appears with MR R. CRAIG, MS K. FOLEY and MS P. THIAGARAJAN for NAB
MS R. DOYLE SC appears with MR D. FAHEY for Smartline Home Loans
MR J. SHEAHAN QC appears with MS P. NESKOVCIN QC and MR J. ARNOTT for Westpac

THE COMMISSIONER: Yes, Ms Orr.

MS ORR: If the Commission pleases. The next witness is Mr Daniel Huggins.

THE COMMISSIONER: Mr Huggins, can you come into the witness box, please.

<DANIEL HUGGINS, AFFIRMED [9.45 am]

<EXAMINATION-IN-CHIEF BY MR SCERRI

THE COMMISSIONER: Thank you, Mr Huggins, do sit down. Yes, Ms Orr – Mr Scerri, sorry.

MR SCERRI: Commissioner, I think - - -

THE COMMISSIONER: Too early a start. Yes.

MR SCERRI: I think Ms Orr is going to call the witness, but there are a couple of corrections. It might be useful to do those first before the statement is tendered. Or would you prefer that I tender the – that I tender - - -

THE COMMISSIONER: It would be easier if you take him through his formal details, take him through the corrections and deal with his statement.

MR SCERRI: Thank you, your Honour.

THE COMMISSIONER: Yes.

MR SCERRI: Mr Huggins what is your full name?---Daniel James Huggins.

What is your business address?---11 Harbour Street in Sydney.

Have you made a witness statement in this Royal Commission?---I have.

And have you also received a subpoena to attend and give evidence?---Yes, I have.

I understand – do you have a copy of the – sorry – sorry, you have made two witness statements, haven't you?---Yes, that's right.

Do you have those in front of you?---Yes, I do.

Are the contents of those statements true and correct except for a couple of matters I want to draw to your attention?---Yes.

So with the first witness statement, sir, I understand you wish to make a correction to paragraph 34 C?---Yes, that's correct.

Is that correct?---That's correct.

Would you tell the Commissioner what the correction is, Mr Huggins?---I need to delete 34C and then also make a correction to 34B.

What's the deletion in 34C?---Delete all of 34C.

Yes. And what's the correct to 34B?---I need to add something to the back of 34B, which says:

> *…and also uses the eChoice brand.*

Would you strike out 34C and initial it in the margin and with 34B, would you write in the additional words. And I understand there is a correction to paragraph 57B?---Yes, that's correct.

What's that correction, sir?---At the bottom of paragraph B, I need to delete reference to exhibit 12.

Why is that?---It incorrectly refers to brokers, when it is actually referring to HLS Business, which is further in – earlier in the statement.

What's HLS?---Home Lending Solutions, which is a proprietary, not a broking channel.

Thank you. Would you strike out 57B.

THE COMMISSIONER: I think just the exhibit.

THE WITNESS: Just the bottom piece, yes.

MR SCERRI: The relevant sentence. Yes, the reference to the exhibit, I mean. So what have you struck out, Mr Huggins - - -?---I've just - - -

- - - in 57B?---Just the bottom part of 57B which states exhibit DH12 is a copy of the template letter typically sent by CBA to mortgage brokers prior to being accredited, but that is incorrect and has been deleted.

Thank you. Now, with those corrections, I might have asked you this already, is that statement and true and correct?---Yes, it is.

And your other statement is true and correct as well?---Yes, it is.

Thank you, Commissioner, we tender the subpoena and the two statements.

THE COMMISSIONER: Exhibit number 1.26, I think we are up to, will be a summons to Daniel James Huggins.

EXHIBIT #1.26 SUMMONS TO DANIEL JAMES HUGGINS

THE COMMISSIONER: Exhibit 1.27 will be witness statement of Daniel James Huggins dated 2 March 2018.

EXHIBIT #1.27 WITNESS STATEMENT OF DANIEL JAMES HUGGINS DATED 02/03/2018

THE COMMISSIONER: Exhibit 1.28 will be supplementary witness statement of Daniel James Huggins dated 7 March 2018.

EXHIBIT #1.28 SUPPLEMENTARY WITNESS STATEMENT OF DANIEL JAMES HUGGINS DATED 07/03/2018

THE COMMISSIONER: Yes.

MR SCERRI: Thank you Commissioner.

THE COMMISSIONER: Yes, Ms Orr.

<CROSS-EXAMINATION BY MS ORR [9.50 am]

MS ORR: Mr Huggins, you supervise the home buying division at CBA nationally; is that right?---Yes, that's right. For all of the yellow branded parts which is the Commonwealth Bank parts, but not the Bankwest parts.

And have you done that since 2014?---Yes, that's correct.

And you describe yourself in the first statement that you made to the Commission as responsible generally for home loan products under the CBA brand; is that correct?---Yes, that's correct.

And you are familiar with the policies that govern CBAs relationships with brokers and head groups?---Yes, I am.

Do you sit on any committees at CBA?---Yes. I sit on the risk committee and I am chairman for the sub risk committee for home buying.

THE COMMISSIONER: I'm sorry, you are going to have to keep your voice up a little, Mr Huggins. The last thing you mentioned?---Sorry. Yes. So I sit on the risk committee, which is the overall risk committee for the retail bank and I also sit on a sub risk committee, which is my home loans sub risk committee. They're the two risk committees I sit on.

Yes.

MS ORR: And you said you were chairman of that risk committee, did you?---The sub risk committee, that's right, yes.

Yes. Thank you. And you are also the chairman of Residential Mortgage Group Proprietary Limited?---That's right. That a subsidiary within the bank, which sole purpose is to provide funding to the Aussie Home Loans business but isn't involved with the day to day management of Aussie.

So Residential Mortgage Group, or RMG, as you refer to it in your statement - - -?---Yes.

- - - is a separate residential mortgage lending arm of CBA?---That's right. It's a – it's a 100 per cent owned subsidiary which is – sole purpose is to provide the funding for the Aussie Select product within Aussie.

So for financial reporting purposes, the RBA lending gets consolidated into CBAs financial – I'm sorry, RMG lending gets consolidated into CBAs financial reports?---That's right.

Yes?---It gets consolidated into the RBS business, that's right.

And you have said, I think, that the home loan products that RMG offers are not CBA branded products?---That's right. They are Aussie Select products; is that right.

But they are CBA funded home loans?---That's correct. Yes.

And they are what I think we've referred to already in the hearings, they are a white label home loan product?---That's right. So they use the Aussie brand, but they don't use the CBA brand at all. So they're not linked to the CBA brand, they're linked only to the Aussie brand.

And why don't they use the CBA brand?---Well, CBA has its own products that are offered through that channel, so, you know, it is to have multiple brands and market at Aussie as a specific – its own offering which – which is a different product, it's not as fully featured. People who take the Aussie product, for example, don't have access to the CBA branch network or to the call centres. So, you know, they're sort of separate brands and have separate offerings.

So you have said that the familiar white label product that RMG offers is called Aussie Select 2?---That's right.

So it is made to consumers through two mortgage broking entities; is that right?---That's right. It's made select – made through Aussie Home Loans, it's is also made through an aggregator called NMB, National Mortgage Brokers, that used to be owned by Aussie, but was recently divested from Aussie. So it still continues to offer that product because it was set up when it was a part of Aussie.

So I want to make sure I understand this: the Aussie select home loan is made available through Aussie Home Loans, which is a wholly owned CBA subsidiary, it's provided by Residential Mortgage Group which is another wholly owned CBA subsidiary and it's funded by CBA?---Correct.

So that – I want to put to you that is all a bit confusing for the customer, is it not, Mr Huggins?---Well, it's clear to the customer that Residential Mortgage Group is funding the home loans and that it is an Aussie product. It's also very clear, in all of our statements that Aussie is 100 per cent owned subsidiary of the group.

Is it clear to the consumer that it is ultimately CBA funding the home loan?---Well, yes, I think it is clear to the consumer that Aussie Home Loans is owned by CBA and, therefore, if you were taking an Aussie branded product that would be associated with the CBA.

But Aussie offers home loans from lenders other than CBA?---That's right.

Right. And what's the reason for having Residential Mortgage Group as a separate entity, separate corporate entity from CBA?---I think it's just cleaner from a funding perspective to keep that asset – to keep the funding vehicle separate. The other reason I believe it was set up, it was before I was with the group when it was set up but we use different systems, so we utilise different systems so it allows those systems to also be used as a separate company that provides the systems that are used by RMG to provide that product, because we're unable to put an Aussie product on to the CBA systems.

THE COMMISSIONER: Mr Huggins, you're dropping your voice again. I'm sorry?---Sorry.

Just – yes, I think either move a bit closer or if I can just – recall my age, Mr Huggins. That enough?---My apologies.

MR SCERRI: And mine, your Honour.

MS ORR: So Mr Huggins, home lending is a very significant part of CBAs business; would you agree with that?---Yes.

And CBA markets itself as Australia's biggest home lender?---That's right.

And as 31 December last year, you tell us in your statement that CBAs total lending was $586 billion; that's paragraph 15 of your statement, Mr Huggins?---Correct. That all's ending.

Yes?---Not home lending that all lending.

Yes. Of that total lending of $586 billion, 374 billion, or 64 per cent was home lending?---That's correct.

Yes?---Was the RBS home lending, that's right. Yes, the retail bank's home lending, yes.

Sorry, there is two acronyms in play here that are similar?---Sorry, yes.

RBS is the CBA retail banking service. So that's CBA?---Yes.

And RMG is the Residential Mortgage Group corporate entity that we've been discussing?---That's right, and the 374 – the RMG part will be included in that.

I see?---But what's not included is that is anything that Bankwest is doing. So Bankwest is another entity of the group, which will be included in that $586 billion of total lending, but wouldn't be in the yellow brand. Yellow brand is the CBA brand, orange brand is the Bankwest brand and this is yellow – the 374 is the yellow brand plus the RMG part.

What sort of percentage would we get to if we added the orange brand?---That's a good question. Probably about 80 per cent, I would think off – sort of 80, 80 plus per cent, I would think.

You explain in your statement that CBA provides loans through two different channels?---That's right, yes.

That a proprietary distribution channel and a third party distribution channel?---That's correct.

And the proprietary distribution channel involves loans that are offered directly to customers through a CBA lender or an authorised representative of CBA; is that correct?---That's correct, yes.

And the third party distribution channel is loans being offered to customers indirectly through mortgage brokers?---That's right, yes.

And as at 31 December last year, 41 per cent of CBA's home loan portfolio came through the work of mortgage brokers?---That's right.

Yes. So almost half. A very significant proportion of CBAs lending?---So this is the portfolio. So 41 per cent of the portfolio, the back book was with brokers but the flow, which is the new business, which is being written, in the first half of this year was about 36 per cent. So the flow is at the moment slightly lower than the portfolio, and this number is the portfolio.

So the flow has reduced, you said, in the first part of this year?---The flow has been reducing over the last couple of year, yes.

Yes?---As a proportion. So the proportions have been changing - - -

Yes?--- - - - and we've been writing on slightly lower proportions through our broker network, the third party network and slightly more through the proprietary channels.

And has that been an objective of CBA to reduce the proportion of home loans coming through the mortgage broking channel and increase the proportion of loans coming through the proprietary channel?---Yes, we've certainly been investing heavily in our proprietary channels to try and increase the proportion that have been coming through

The loans that come to you through your proprietary channel are more profitable, they have a higher margin for CBA; do you agree with that?---This – they are more profitable, yes, but it is less the margin and more the other costs which are associated with that. There aren't the same commission costs associated with – with a proprietary loan versus a third party loan. We don't load into those costs when we are making that, however the full costs of the branch network, so we've got a – you know, approximately 1000 branches and we don't take all of those costs and load them into the cost of the home loan, we sort of consider, "Well, those are fixed costs which exist there" and in that case we are able to utilise that network for our lenders.

But do - - -

THE COMMISSIONER: But do you allocate any part of branch network costs to the lending side?---That analysis is occasionally done, but when I think about the loans, I'm more thinking about it on a marginal cost basis, rather than a fully loaded cost basis. It is how I tend to run the business.

MS ORR: Do you agree with my proposition that CBA has an objective of increasing sales through its proprietary channel and reducing sales through its mortgage broking channels, switching those proportions?---I think there is a difference between the sales and the proportion. We certainly have a objective to increase the proportion of loans that are coming through the proprietary channels, but I still want to sustain a strong broking channel and, therefore, the sort of dollar sales, you know, I'm comfortable with where they are now but I would like to move the proportions. So if I could hold the current level of sales and my broking channel and then grow and then the proprietary channel, that would be – you know, that would be part of the objective.

Mortgage brokers are commonly used by consumers these days, so the mortgage brokering channel will always remain, will it not?---Yes, I mean it's certainly – I think it is used by around 56 per cent of funded loans now. So it's a substantial part of the market. And there is a very good service proposition which is offered by brokers which consumers like. So yes, I would expect that it's a part of the market which is likely to be sustained.

So CBA deals with mortgage brokers through mortgage aggregators and mortgage franchisers; is that correct?---That's right. We collectively – I would collectively refer to those as head groups - - -

Yes?--- - - - but, yes, that's right.

Could you explain to the Commission what a mortgage aggregator is?---So an aggregator is someone that brings together a lot of brokers into sort of a platform and then aggregates that business together and then sends it off to us, so we would deal with 26 aggregators and head groups, rather than having to deal with 13.5,000-odd brokers who are accredited with us. We are able to deal with a smaller number of aggregators and those aggregators then provide services to those brokers to assist those brokers. So they provide that customer relationship management systems, they – you know, and a range of other services to those brokers.

And what's the difference between a aggregator and mortgage franchisor?---So the franchisor will have the brokers operating under the brand and under the ACL, the Australian Credit Licence, where an aggregator – the brokers under an aggregator, you know, would have their own – their own brands, and may also have their own ACL as their own Australian Credit Licences.

And Aussie Home Loans is a mortgage franchiser?---That's correct.

Right. So CBA enters into contracts with these head groups with the mortgage aggregators and mortgage franchisors; is that right?---Yes, that's right.

You gave a figure of 26 before, is that the figure of mortgage aggregators and mortgage franchisers that CBA currently has contractual arrangements with?---That's right.

And Aussie Home Loans is one of those head groups?---Yes, it is.

Are there other CBA subsidiaries amongst those head groups?---Yes, there are subsidiaries. Well, there is other entities that we have a relationship with – I think that's in my statement here – FinConnect, which is a wholly owned subsidiary, and also uses the eChoice brand, and then Mortgage Choice, which isn't a subsidiary but which CBA has a shareholding in this and 34 ABN now D.

So CBA owns a number of the head groups that it deals with, either wholly or partially?---Three of them, yes.

Thank you. You've exhibited to your statement a document which is a template of CBAs contractual arrangements with a head group?---Yes.

I want to turn to that document and ask you some questions about it?---Sure.

It is your exhibit DH4, CBA.001.0028.0344. I'm sorry, I might have left a 0 off the first numbers: 0001.0028.0344. So this is a contract between CBA and a head group, it's a template for a contract from 17 August last year. Is this still the form of template that used between the contractual arrangements between CBA and the head groups?---Yes, this is the standard template.

Thank you. Could we turn to 0347 of that document. So these are the categories of service that the head group is to provide to CBA; is that right?---Yes, that's right.

And we see there from the first one, that the head group at 2.1, is to personally interview the potential customer?---Yes, that's right.

But to understand that, we need to go to some definitional clauses, because it's not the aggregator or the franchiser that interviews the customer, is it, it is a broker who works for the aggregator or the franchisor?---That's right. The aggregator or the franchiser. So the head group can have a nominee which will provide these services. It could also be provided by direct employee, so there is both ways.

I will take you to it if you need to see it, but there is a reference later in the document to what a personal interview generally means - - -?---Mmm.

- - - at page 50 of the document. And it generally means a face-to-face interview between the applicants and the nominee for the purpose of obtaining and recording information to complete and submit an application?---Mmm.

Do you see that?---Yes.

And the nominee is also described in the contract as any person nominated by the intermediary - - -?---That's right.

- - - as the head group as a nominee, employee or agent?---Mmm.

So that's generally the mortgage broker, is that right?---Yes, that's right.

Okay. Now, that we have – we haven't moved to that page, that all right. I wanted to take you back to page 4 – the page we were on. There is a requirement in clause

2.4 (a) for the head group to provide to CBA all relevant information in support of the customer's application for the products, in the format required by CBA or as agree the between us from time to time, including evidence and verification of employment, income, and assets; is that correct?---Yes, that's right. Yes, that's right.

So the verification of the customer's employment income and assets is outsourced to the broker?---No, not the verification. So they are required to provide that information to us and then we will verify and validate that information from those primary source documents.

So why the reference to verification here in the contract with the head group?---Well, we would expect that a broker is looking at those documents and therefore – and the application, you know, ensuring that the information they are providing to us is accurate, but I'm not outsourcing the verification of that to brokers. I then – once I receive that information, then do that work myself.

Yes. Are head groups or brokers agents of CBA?---I'm not sure what the legal definition of an agent is – I mean, but they are certainly, you know, representing the brand as an accredited – as an accredited broker.

Would you describe them as an agent of CBA?---That's not terminology I would normally use in the business, I would sort of use a – you know, a broker or an accredited broker rather than an agent. I guess I sort of see an agent in my language as sort of more being in line with an employee and a broker isn't an employee.

It might not be language that you use, but it's language used in this document, isn't it, Mr Huggins. Could I take you to 0367 of this document. You can see the doc ID numbers on your copy?---Yes, I can.

Yes. Now, could I ask you to look at – this is in the schedule to the agreement, I would like you to read clause 1.14 there:

> *In respect of each application for a product you must ensure completion and where necessary collection by you as our agent in accordance with our procedures of customer identification, tax file number disclosure, privacy protection of information forms, and any bank account opening application.*

?---Mmm.

So the head group is told that they are CBAs agent?---Yes. Yes, in this document. Yes, in this document, yes.

Okay?---As I mention that not sort of the language I would commonly use in the – in the business, but yes, I see it's written here.

Are head groups required to promote CBA products?---Not – no, not to promote them. I mean, they are encouraged. You know, a broker – where it meets the needs and objectives of a customer to – you know, to put the CBA product to that customer where it's most appropriate for the customer.

Could I ask you to look at page - - -

THE COMMISSIONER: And your view of when it's appropriate might be that it's often appropriate; is that right?---Yes. I mean, I would argue we have the best product in the market, so I would think it probably is. But, you know - - -

Well, rather than dance round the point, Mr Huggins, the fact is you expect these people to push CBA product, don't you?---I – I don't expect them to push the product where they know that product is not appropriate for the customer, and there may be instances where our products are not appropriate for that customer. But where they assess that the product is appropriate for the customer then I would hope that they offer the CBA product to them. But there will certainly be circumstances where a CBA product is not appropriate for a customer.

MS ORR: Well, this head group contract expressly tells the head group that they are to promote your products. I would like to show you 370. And if we could have 369 and 370 displayed at the same time, that would be helpful. And you will then see, Mr Huggins, that these closes are part of part 2, which imposes general obligations. We will just need to see the first part:

> *General obligations on the head group. You must –*

and then if we look at 2.10:

> *You must promote our reputation and our products.*

Do you see that there?---Yes.

Yes. Could I turn to part 3 of this document, at 349. And it might be useful again to have 349 and 350 displayed at the same time. This is the part of the agreement with the head group that deals with the commissions that CBA will pay to them?---Yes. That's correct.

Yes. And do you see from these pages that the head group receives both an upfront commission and a trailing commission for any home loans that are submitted through the head group that CBA approves?---Yes.

So trailing commissions carry through for the life of the loan; is that right?---Yes, that's correct.

And they are calculated by reference to the net balance of the home loan account at the end of each month?---That's correct.

So the larger the loan the larger the trailing commission?---That's correct, yes.

And the longer the period of the loan the longer the period over which the trailing commission will extend?---That's correct.

And head groups pass on the commission that is paid to them by CBA, or at least part of that commission, to their brokers?---That's correct. That's my understanding, yes.

Yes. And see - - -?---Sorry. There may be some franchisers which pay a salary and therefore don't pass on the commission, but generally people would pass on the commissions.

So the general arrangement is that CBA pays the aggregator or the franchiser upfront and trailing commissions and a proportion of that is passed on to the broker?---That's generally the case, yes.

And CBA has recognised, has it not, that upfront and trailing commissions for mortgage brokers can lead to poor customer outcomes?---Yes. I think we have acknowledged that there is a conflict in the commission structure, as I think has been recognised by other as well, in that the commission structure is linked to the size of the loan and therefore the – there is a conflict in that the upfront commission – the larger the loan, the larger the upfront commission and then, as you mentioned before the longer a loan takes to pay off – and the larger it is – then the larger the trailing commission and that can lead to a conflict – well, there is a conflict between – between the customer, you know, and – and the broker.

Because it's in the mortgage broker's interests to get the largest loan approved possible to extend over the longest period of time for the customer to repay it?---That's – that's how they would maximise their income, yes.

These sorts of problems have been acknowledged by your CEO?---Yes – yes.

Yes. Can I show you a document which is a letter from your CEO, Mr Huggins, which is at CBA – it's not attached to your statement – CBA.0001.0038.0929. I think you will have been shown this document?---Yes – yes. My legal team has shown me this document, yes

Yes. You have read through it?---Yes, I have.

And you can see it's a letter dated 10 February 2017, if we could just pull up the second page so we can see the author. And perhaps we could have both those pages on the screen at once. So this is a letter from Mr Narev, your CEO, to Mr Stephen Sedgwick, the independent reviewer for the Retail Banking Remuneration Review on 10 February 2017?---Yes, that's correct.

Could we look at paragraph 3 on the second page. And we see there – and I should say this is a submission – annexes a submission made by CBA to Mr Sedgwick as part of his review?---Yes. I believe it was a confidential submission to Mr Sedgwick made by Mr Narev.

Yes. What we see in paragraph 3 of this document is that Mr Narev says to Mr Sedgwick under the heading The Need for Greater Consistency in Mortgage Sales Remuneration:

> *We agree with the reviewer's observations that while brokers provide a service that many potential mortgagees value, the use of loan size linked with upfront and trailing commissions for third parties can potentially lead to poor customer outcomes. Mortgages also sit outside the financial advice framework, even though buying a home and taking out a mortgage is one of the most important financial decisions an Australian consumer will make. We would support elevated controls and measures on incentives relates to mortgages that are consistent with their importance and the nature of the guidance that is provided. For example, the delinking of incentives from the value of the loan across the industry, and the potential extension of regulations such as future and financial advice to mortgages in retail banking.*

So that reflects CBAs position on these matters?---Yes, it certainly reflected – yes, Mr Narev's views to Mr Sedgwick, that's right.

Yes. And that therefore is CBAs position on these matters?---That's right, yes. I mean, we – yes.

THE COMMISSIONER: Well, you seem hesitant about that. Is there some hesitation about this now being CBAs position?---I think this has been CBAs position. I think the way in which you would achieve this obviously needs consideration. So, yes, that's why there is a hesitation in that moving to this – you know, for example, delinking of incentives – you need to be considered about how you would achieve that. And, you know, there's a range of – there's a range of things to consider in that.

MS ORR: Why don't I take you, Mr Huggins, to the issues paper submission that was annexed to this letter sent by Mr Narev to Mr Sedgwick where there is a discussion of how this might be done. That document is CBA.0001.0038.0931. There we go. You have seen this document as well, Mr Huggins?---Yes.

And this document was sent by Mr Narev with that letter to Mr Sedgwick in February last year?---Yes, that's right. Yes.

Can we turn to 944 within this document, under the heading Issues Specific to Remuneration of Third Parties. And you see there is a submission here which is directed to answering a question, which is:

Is there sufficient evidence to support a bank's discontinuing the practice of volume-based commissions to third parties in respect of new and increased mortgages?

And the first point that made there is that:

As the reviewer identifies, the use of upfront and trailing commissions linked to volume can potentially lead to poor customer outcomes. Our analysis of loans applied for through the proprietary versus broker channel shows that, firstly, broker loans are reliably associated with higher leverage; secondly, even for customers with an identical estimate of ex ante risk, loans through the broker channel have higher leverage; thirdly, loans written through the broker channel have a higher incidents of interest only repayments. Meaning customers pay down their loans more slowly.

Now, that's important, is it not, because we've talked about the life of the loan being directly related to the amount of the commission that the broker receives?---Yes, that's right.

Paper goes on to note that:

Broker loans have higher total debt to income levels, higher loan to value ratios, and higher incurred interest costs compared to proprietary.

Do you agree with these points so far?---Yes. These were the findings that were made out.

Yes. And:

Over time higher leverage means broker customers have an increased likelihood of falling into arrears, pay down their loans more slowly and on average pay more in interest than proprietary customers.

You agree with that?---Yes, that's correct.

Yes. Now, the paper goes on to note that these findings are consistent with the hypothesis that differences in remuneration between the channels are driving different customer outcomes, and lends some support to the case for discontinuing the practice of volume-based commissions for third parties. Do you agree with that proposition?---Yes.

Then the paper talks about multiple considerations that need to be looked at. And these are the sorts of things I think you were referring to?---That's right. And that's why I hesitated in that, you know, there are a range of considerations that you would – you would need to make.

And the considerations that are referred to here are that:

Any changes will need to be made uniformly across the industry and across both proprietary and broker channels to eliminate bias and avoid significant market disruption.

Now, is this – in the words of the Commissioner, to another witness yesterday – a "first mover problem"?---Yes, there is a – there is two problems. One, there is a first mover problem in that the person who moved first would likely – you know, lose a lot of volume. The second problem is you create a conflict if one person or half of the people move, and the other half don't, because then a broker is in a position where if the loan was best suited to one person who, you know, had a – where do they put the loan? So you are creating a conflict and you have a first mover problem opinion.

THE COMMISSIONER: I thought that was called a market and competition?---Yes. Well, it is certainly competition, that's right.

Yes.

MS ORR: But the paper goes on to note that:

A move to a flat fee payment would enable brokers to be agnostic towards loan size and leverage. However, consideration is needed on the payment amount, on how to link the fixed payment to an underlying security rather than a product, ie, to avoid unintended incentives to split loans into multiple fixed or variable products, and on appropriate clawback periods to disincentive advise the churning of loans to maximise broker income.

Now, I will come to this concept of "churn" later, but finally here, we see that the paper records that:

a move to flat fee could also consider the removal of trail commissions, which can encourage brokers to suggest slower pay down strategies, eg interest only, that maximise broker trail commission income.

So you agree with these propositions that are articulated in this document that Mr Narev sent to Mr Sedgwick last year?---Yes.

In February of last year?---That's right.

We are here now in March of 2018, CBA has known all of these things for some time, but CBA has not stopped paying volume based commissions to brokers?---That's right.

Has CBA taken any steps towards ceasing its practice of paying volume based commissions to brokers?---No, we haven't.

And the incentives for head groups have not been, therefore, delinked from the value of the loan in the way Mr Narev referred to in the letter?---No, that's correct.

And so why not go ahead and do what your CEO has told Mr Sedgwick should occur?---Well, I think as Mr Narev mentions in his note that, you know, these changes would – one – need to be on a – done on a uniform basis. Otherwise, you know, what is a very important business to the Commonwealth Bank could be substantially damaged. In addition to that, you know, there are a range of other considerations which would need to be made to move a commission structure. One of those is that – and is articulated in here – that you don't create additional conflicts in what you move to. Second, in moving a commission structure, you need to make sure that there are some segments of the population who currently utilise brokers that may not be able to continue to access the services of brokers if you were to change the commission structure. For example, a first home buyer who benefits from the – from the services, but requires more work. And also you need to make sure that the brokering industry remains viable in a move to – to any new commission structure model.

THE COMMISSIONER: Why? Why do you need to ensure the broking industry remains viable? Why does CBA need to be concerned about that?---Because our – our customers – our research shows that our – that our customers value it. Our research shows there's about 20 per cent of our customer base – so our existing customer base prior to getting mortgages – who would only go to the broker channel, and therefore it remains an important channel for CBA to continue to be able to provide services to customers, given – given that's the case. So there is a segment of customers who – based on our research – would only use a broker and therefore that's – the only way to get access to them is through the broker.

Whether or not they are told that CBA is altering the arrangements and you will no longer – if you deal through a broker – end up paying trail commissions for the life of your loan?---Sorry?

You think this problem is not soluble by telling the customer what change you make and why you make it?---I – no, I don't think it's solve – it's a – the mortgage market is a competitive market and so, for the majority of customers that will go to a broker – there will be some customers certainly where the CBA product is definitely the best product, they will only ever choose CBA. But there is a large portion of customers whose needs can be met by a range of other providers in the market and therefore if we were to move unilaterally then I think a – you would see those customers in a competitive market, whose needs can be met by other providers, move to those providers and therefore it would have a very material impact on the business.

Well, the balance that then has to be looked at is the balance between risk of poor customer outcome, threat to profit. Is there any other element that would need to be taken to account in that assessment?---As long as the risk of poor customer outcome also included, you know, the fact that this is a service that customers like. It's often – it's a very good service often, and, you know, you would need to make sure that customers were getting that as a – big decision for customers, many in the broking industry are providing good advice and help to customers in what's a big decision. So you would just need to consider some of those things as well.

MS ORR: You have raised a lot of difficulties with making this move, Mr Huggins. What I want to put to you is that those difficulties are all surmountable and that CBA hasn't started the process of dealing with any of those difficulties. Do you agree with that?---I'm not sure I would suggest that the difficulties are surmountable for – if CBA were to act alone.

Could we go back to the part of the head agreement that deals with the commissions, Mr Huggins. So back to – I'm sorry, I will find the full number – it's your exhibit DH5?---DH4?

I'm sorry?---I'm still on the commission's page.

Exhibit 4, 0001.0028.0344. I apologise?---44.

44. So back to your exhibit 4 in your statement?---Yes.

And back to the pages that we were dealing - - -?---350.

- - - with in relation to commissions, which are 0349 and 0350?---Yes.

We had both of those pages on the screen before?---Yes.

So do we see from these two pages, Mr Huggins, that the head group has a – what's called a flexible commission plan?---Yes, that's right.

In the sense that there are three commission models that the head group can choose from?---That's right. They can choose three different intermediary models in 3.1.

So we see the two – I'm sorry, the three different models in clause 3.1?---Yes.

They can select a commission plan which applies to all nominees?---Yes.

They can have each nominee select their own commission plan?---Yes.

Or they can select the nominees who can select their own commission plan and also select a commission plan for their nominees?---So they can do one - - -

That's a hybrid?--- - - - or two or both. Yes.

A hybrid, yes?---Yes.

The decision to have a flexible commission plan that allows a head group to choose between these different commission structures was made after CBA conducted research on different commission structures in 2014?---That's correct. Yes.

Yes. Could I show you another document that not annexed to your statement, Mr Huggins. It's CBA.0001.0031.0057. You've seen this document before, Mr Huggins?---Yes, I've seen it. It was conducted just before I became the general manager for home loans.

Yes. So it's September 2014?---Mmm.

It's a piece of research done by ACA Research for CBA on identifying the optimal mortgage broker commission structure?---That's right.

And this research led to the flexi commission plan that we see in the head group?---Yes. That's right. The context to the research was we were replacing the commission structure. Sorry, the commission system. So we were reinvesting and rebuilding the commission system and, as part of that rebuild, we had the opportunity to offer – rather than just one commission structure, we were able to offer more or build the capability to do that. So this research was informing whether that was a – whether it was something we should do or not.

Could I ask you to turn to 0063 to see the methodology that was used in this research. Do you see there was a quantify online methodology used, a survey that went for approximately 10 minutes. Participants were sourced from a list of CBA active brokers across Australia, with a total 489 mortgage brokers taking part, and respondents were incentive advised for their participation. And the surveys completed in that period of September 2014. Now CBA, we see, specified that the results should be representative of its broker base by tier and state. A representative spread was achieved in the final sample, so weighting was not necessary. And we see further down the page an explanation of CBAs broker tiers. And I want to ask you about each of those. So the first one listed there is the diamond tier of mortgage brokers. They are mortgage brokers who write at least $15 million and/or at least 75 loans in settlement volume, plus they achieve any three of the five quality metrics. Does CBA still have this system of diamond, gold, silver and bronze brokers?---So we have recently announced that we are changing that and we are removing – we have removed the requirement for there to be this volume threshold. So the segmentation has been simplified down to two tiers: essential and elite. And you would have, in that new tiering system, quality metrics and then a series of complimentary metrics. But you would be able to get into that elite tier, which is where we offer our best service offering, without – without necessarily hitting a volume target. So you could get there without the volume and then everyone in the – in the essential level, as is the case with all of these others, they were offered a sort of very good baseline level of service, but then the best services is in that. So this was the – this was in place at the time and has been for the couple of years post this. In practice, when you look at the diamond brokers, many of them weren't actually meeting these volume targets. But either way – so we have recently announced that we are going to simplify that, remove the volume target, and we are progressively rolling that out now.

So you have say you have recently announced that change?---Yes.

When was that change announced?---It has been announced at our PD days which were happening in sort of January and February, so in the last couple of months, based on work that been going on into – you know, during 2017.

It’s not something you have referred to in your statement?---I think I have referred to it in my statement, in the – in that – in the back end where it was other changes which were being proposed. That may be the accreditation scheme. So no, we may not have – I don’t think we were asked about the segmentation scheme. So we have also changed the accreditation scheme which I’m happy to talk to, but I think in my statement I was just asked about the accreditation policy, so we addressed the changes that have been made to it the accreditation – new accreditation policies and ongoing accreditation, but I don’t think I was asked about segmentation. So no, it wasn’t, in the statement on segmentation.

So that change has been announced, you said, at PD days in January and February?---Yes.

Has there been a transition yet, or - - -?---The transition is happening now, yes.

The transition is happening?---Yes.

Okay. So there are still some brokers who understand where they sit in the segments by reference to diamond, gold, silver and bronze?---I mean, yes. It would be a – that would be a familiar thing with brokers. It was around for a long time, so it would be familiar to them. But we recognised that – you know, there’s a – there’s a conflict created in this structure in that, you know, someone – because it’s volume based it means that, you know, someone that’s right on the threshold of being a diamond broker – and being a diamond broker is valuable because you get the extra service – can create a conflict. So that’s why we’ve made the change.

So what are the benefits, or what were the benefits, of being a diamond broker as opposed to a bronze broker?---So the benefits were primarily around service and, you know, I think this research shows later that the turnaround time the – sort of that service level is really important to brokers. So we offer a – and because it’s so important to all brokers, we offer a sort of uniformly good proposition to brokers. You know, so even a bronze broker, you know, should be getting a two to four day turn around. But we offer an even better level of service for that diamond broker. So everyone gets a good level of service, but if you are a diamond broker then you are going to get a – you are going to get a faster turnaround. I think there is some other benefits as well around access to people and sort of advice on loan structuring and some of those things. But the predominant benefit – and if you spoke to people in the end industry, I think they would say the predominant benefit is that turnaround time, which people really value. So we have the good baseline and then a diamond broker gets an elevated level.

So do I understand that to mean that CBA processes the applications submitted by diamond brokers faster - - -?---Faster.

- - - than it processes the applications submitted by gold, silver or bronze broker?---Yes, that's correct.

And that's in recognition of the volume of home loan applications that are being submitted by diamond brokers as opposed to gold, silver or bronze?---Yes. When this system was in place, that's right, it was volume linked and you got better service for being volume linked. And that why we changed it.

To encourage brokers to submit and recommend to customers CBA loans over loans from other lenders?---No. It was in recognition of the fact that – I mean, everybody got a good level of service, but I can only offer the very best service, which is more expensive – I have only got a limited amount of resource. I have got 13 and a half thousand brokers, so I can't offer a one-day turn around to 13 and a half thousand brokers. I have to choose who I am going to offer the best service to and, at this stage, the way of segmenting it was by volume in recognition of those brokers who were the largest – you know, the largest writers of business. But you tended to see the – and part of the reason we changed it – you tended to see that, you know, the people who had lots and lots of volume would end up in these tiers where, you know, someone who had a lot lower volume, just because they may have been in a smaller town, you know, wouldn't end up in these tiers. So, you know, we've – we've changed it to both acknowledge the conflict and also to try and get some of those people who are writing great loans, that are bringing fantastic service to customers but, you know, would never be able to get into these tiers. We want – would like them to be able to get access to the – to the best service.

How long was this segmentation of brokers in place before CBA, as you put it, acknowledged the conflict that it created?---I don't know exactly how long. It was certainly in place as long as I – I was running the business. It was in place when I started. In June 2015 I took over responsibility, when I became the EGM I took over responsibility for the broking business. It was in place then. It had obviously been in place ..... so, you know, certainly several years. And when I came into the business I started discussing it with Sam Boer, who was the head of the business, and we've changed it accordingly.

So at this time in 2014, when this research was being done, and until relatively recently, brokers were segmented in this way and rewarded according to the volume of loans that they submitted in terms of the timeliness of the turnaround by CBA. And we see the different volume targets for each of the levels within this document, down to the bottom. A bronze broker is one someone who wrote less than $5 million in settlement volume. I should just ask: these figures relate to what period?---I would have to check. I think it's annually.

Annually?---Yes.

And below a bronze broker, who wrote less than $5 million in settlement volume, was a bronze non-performing broker?---Mmm.

And that was someone who settled less than one loan in the year to date?---Yes. That's right. So they were inactive brokers who – yes, who aren't writing business.

Who – I'm sorry?---Who – who – who aren't sort of having any activity with CBA.

And what were the consequences of being regarded by CBA as a bronze non-performing broker?---My understanding is there was really no consequence over this – over this time period, up until recently, when - - -

Yes?---When we decided in 2017 to do credit – some of those brokers, based on quite a lot of thinking that I had done and, you know, some – yes, a desire to improve the average quality of the accredited broker with CBA and improve customer outcomes.

We will come to that in some detail, Mr Huggins. But before I leave the discussion of these categorisations of brokers, I assume a customer who goes to a broker has no way of knowing whether the broker they are dealing with is a diamond, gold, silver, bronze or bronze non-performing broker?---I think that's generally – generally right from my understanding. I have seen occasionally, you know, a certificate on the wall that says, "I'm a diamond broker with CBA", but generally I think that would be right. Right.

Okay. And can I just ask you to look at 0067 before I leave this segmentation. We see there a chart explaining the broker classification. And we see that diamond, gold and silver tiers are referred to as "high volume and high tier" brokers; is that right?---Yes, and this – yes, the way they have broken it up here, yes, that's right.

And then the bronze tier is high volume and low tier. And the low volume tier is down the bottom there?---Yes, that's right.

Okay. So high volume, high tier, high volume, low tier, and low volume brokers was another way of looking at this categorisation of brokers?---For this – for this research, yes. That how they broke it up. Generally, in the business we would – we would have over this time period just seen as diamond, gold, silver, rather than the high volume – high volume, high tier, but in this research that's how they cut it up.

So the reason this document has references to diamond, gold, silver, bronze, as we saw from the last page, is that there was a desire to make this research representative across the breadth of CBAs brokers. Do you recall seeing a reference to that effect?---Yes. Yes.

So there were 489 brokers surveyed. Some of them wanted to move to a flexible commission plan, some did not; is that right?---Yes. That was the outcome of the research that – that it was suggested that people would want a flexible plan. It's interesting what happened when we put the plan in place.

Well, could we talk about what was reported in the research first?---Sure. No problem, yes.

First. So if we turn to 75, 0075. This slide summarises some reasons that were expressed for not wanting to choose a commission plan, saying "lender choice should be about client needs". And do you see the reference there on the first column to the second gold broker expressing the view that:

> *It takes away from what we do and it would be hard not to be biased if we were always changing and picking commission structures.*

That was one of the views expressed?---Yes, that's right.

And if we turn to the following page, 76, we see that this is a slide about the reasons for wanting or not wanting a number of commission remuneration plans to choose from. These are verbatim responses. And on the right-hand side the reasons given for not wanting to select a commission remuneration plan include, from a bronze broker:

> *Because it adds more work to my process and might unduly influence me as to which lender to pick.*

And from a diamond broker towards the bottom:

> *It gets too complicated and could influence choice of lender.*

And down the very bottom, from a silver broker:

> *It will create conflict of interest.*

So these were views that were expressed to CBA in this research about the potential move to a flexible commission plan?---Yes. Yes, that's – that's right.

And - - -?---Yes. I mean, I think it – it almost refers back to what we were saying a second ago, about if you were to make a substantial move and sort of really move your commission structure away from others in the market, per the question before, you know, there's a – there's a view that could actually influence people's decisions.

So this – this document records a way of dealing with these concerns expressed by brokers in this research at 0105. Do you see the last major dot point:

CBA will need to educate brokers about the program, clearly demonstrating that the flexible structure will not increase commissions, just deliver greater control over business income. A third – 30 per cent – of those who don't want to select commission plans responded that lender choice should be more about client needs, expressing concerns that flexible commission structures would unduly influence lender choice. This was particularly evident among the high value, low tier segment who appear to be especially client-centric in their decision-making.

That – what do you understand that reference to mean. Shouldn't all brokers be "client-centric" in their decision-making?---Yes. Yes, they should be.

So you had close to a third of those polled in this survey telling you that they didn't want to select commission plans, because they thought it would unduly influence lender choice and their job should be about client needs, but CBA went ahead and went with a flexible commission structure; is that right?---I don't think it was a third. I think it was 30 per cent of the people who didn't want - - -

I'm sorry. I'm sorry, you're right?---So – so yes, we went ahead. But, I mean, the research influenced the – the way that it was set up. So when you look at plan B, you know, there's – there's not a substantial difference between the – the different plans, about five basis points, and then – and then there's a difference in the way the trail commission comes together. So it certainly was taken into consideration when – when it was designed.

And I think you wanted to say something earlier, Mr Huggins, about what you saw once the flexible commission structure was in place?---Yes. We spent money to develop this system, to allow multiple plans and I think – less than 80 people are on plan B out of 13 and a half thousand brokers. So, you know, 99 point – you know, whatever that is, 99.95 or whatever it is, people are on the standard plan, plan A. So despite the fact the research showed that people would like this and that – and that they would like more flexibility, people have not moved away from the standard plan. Which is common in the market and, you know, has evolved over time as the plan that, you know, brokers seem to like. And this would show that even when you offer them choice they are not going to move away from it.

Could you remind us what the standard plan is?---So the standard plan is 65 basis points upfront commission, 15 basis points of trailing commission for the first three years and then it increases to 20 basis points from the fourth year. So it's a set plan.

Yes. Commissioner, I will tender that document.

THE COMMISSIONER: That's CBA.0001.0031.0057, ACA Research Identifying Optimal Mortgage Broker Commission Structure. And that will be exhibit 1.29.

EXHIBIT #1.29 ACA RESEARCH IDENTIFYING OPTIMAL MORTGAGE BROKER COMMISSION STRUCTURE (CBA.0001.0031.0057)

MS ORR: Can we go back to the head group agreement again - - -?---Sure.

- - - Mr Huggins?---Yes.

This time to 0353?---Sure.

And perhaps again we could have this page and the page following brought up. This relates to a different topic in your contracts with head groups. It's not about commissions, it's about commission allowances; is that right?---It is, but it's linked to the commission. So if we look at the previous page, which we were just looking at, on 350, you can see the standard plan has a base upfront commission of 50 basis points, plus you can have some commission allowances which are then on 353. So you say 50 basis points and on top of that you can get 15 basis points with allowances, which then makes up the 60 basis points that I talked about before. But practically we haven't been applying these allowances since – my understanding from the team is of late 2014 they were essentially competed – competed away.

What do you mean by that, Mr Huggins?---We were applying them through 2014, and when you see the research that you were referring to previously, what you see in that research in some of the back pages is that brokers say that part of the reason that the CBA at that time was good – encouraging conversion was because of the commission structure we had in place. Because we were applying these. So if you didn't have a – a high – yes, if the quality wasn't high enough or your conversion, you know, didn't meet the thresholds then you wouldn't get the upfront commission assessed quarterly. But we got – my understanding, as I mentioned, I wasn't in the business. So I, in preparing for this, was discussing with my team, you know, the research and this, and we were getting a lot of complaints about the fact that, you know, we were – we were doing this and that others in the market weren't, and therefore we weren't competitive in the – in the upfront commission amounts and so we decided to – to discontinue the application of this. So – although it – it is in the contract, we haven't been applying it for the last couple of years.

I see?---So everyone has practically been getting the 65 basis points of commission up front, as I mentioned before.

Without needing to meet the criteria in this table?---That's right. Yes. That's right.

So they don't have to meet the submission quality criteria?---They - - -

Or the conversion criteria, they just get that as part of the commission?---That's right. Not as part of the commission, and then I'm not sure we will talk about it later, I'm sure we will talk about it later, as we have changed the new accreditation program we have tried to bring some of these features into the accreditation for new brokers as well as for ongoing accreditation to try and capture this and raise the standards.

So within this document we see that what it says about commission allowances in 4.3 is that if the total loan amount, which is minus any money that the customer owes on an existing CBA home loan – so that's referred to as "new money" – is less than $5 million in a particular month, then CBA didn't have to pay the commission allowance for that month. Is that not a clause that's enforced any longer?---No, not that I'm aware of.

Right. But it remains in these contracts?---It's in the contracts, yes – yes.

And it's capable, therefore, of being enforced. But in practice you say it's not?---That's right. The – that's right. Every quarter we make a decision on whether it's applied or not, and practically it's not being applied.

And if the average monthly settlement for a head group in respect of CBA products falls below $5 million, CBA also is entitled under this document to terminate its arrangement with the head group; do you agree with that? I can show you the clause if that assists, Mr Huggins?---It might be worth just looking at it. But - - -

3.14, at 379?---Yes. It makes sense, yes.

So another volume requirement there, a monthly volume requirement that has to be met to not risk termination of the agreement by CBA?---Yes, that's right. That right exists in the contract. I'm not aware, in my time of us, having – having applied that. But the right exists.

And I'm not sure - - -

THE COMMISSIONER: Well, not having applied it because the occasion hadn't arisen?---I'm – yes, I'm not sure. I'm not sure whether there are any of our head groups that currently write less than $5 million. So I'm not sure that – yes.

MS ORR: Could we move to another part of this document, which is part 6. And that deals with something called the Connect Referral Program. This is on – at 355. I will just ask you while that's coming up on the screen, if you wouldn't mind Mr Huggins, and I think again we will just have that page. That's the only page that deals with this part. Could you explain to us what the Connect Referral Program is?---Yes. So there may be other products, you know, as is here that the – that the customer would like, that they have a need for. They might have a need for risk insurance or – or general insurance. And that product is sold by – or that need is met by our proprietary channels. So the broker is unable to provide any advice on those products. They are not trained, so we don't allow them to – to deal with those products, but they will be paid a commission should they refer a customer to us for one of these products and that customer subsequently takes out one of those – one of those products.

So it's - - -

THE COMMISSIONER: You speak of customer needs. These are needs that the customer may or may not be aware of, aren't they, Mr Huggins?---When they are – when they are first having the conversation, yes, that's right. That need may be discovered in the process of – of - - -

They might be persuaded they need something?---They could be, by the broker, but then it comes into our proprietary systems and our system there is that, you know, we have a needs based assessment, you know, and a financial health check to make sure that that product is appropriate for their needs.

I just want to suggest to you that the expression "customer needs" is a euphemism?---Yes. I mean, our – our processes around how we are discussing this with customers is – is discussing with customers what their needs and objectives are in making sure that the product is appropriate for those needs and objectives. So, you know, I can't comment that the conversation that's happening with the broker, which we are not in, but certainly when that comes into our branch network the – the approach there is very robust.

MS ORR: So the upshot of this, Mr Huggins, is that if the broker suggests to the customer that they require another CBA product, such as a mortgage loan insurance product, and the customer ultimately signs up to that product, there is a monetary payment – another form of commission that's made – paid to the broker. I'm sorry, paid to the head group; is that right?---Yes, that's correct.

Paid to the head group, which we assume then, again, a proportion of which would go to the broker?---Yes, that's right.

Yes. Could we turn to part 7 of this document at 357. So perhaps we could have 356 and 357 on the screen together. I would just like to ask you about – I'm sorry, 356 and 357. Now clause 7.2 on 357, this part is about when commission is paid. And we see on the first page that total upfront commission is payable fortnightly, trail commission monthly, a referral services commission monthly. Then 7.2:

> *We will review the arrangement at least 12 monthly and, in addition to our other rights, have the right to alter the commission structure if your average monthly settlements for the previous 12 months in respect of the products –*

which are the CBA products –

> *fall below $5 million.*

?---Yes, that's right.

So this is another – another risk for the head group and the brokers if their volume to CBA is inadequate?---Yes, that's right.

Okay. Then part 10 of this document, at 363 Mr Huggins, deals with another monetary payment. A productivity and partnership program bonus?---Yes.

So this is a bonus paid to head groups and to get this bonus the head group needs to meet certain performance targets; is that right?---Yes. This program has since been changed in this. So - - -

THE COMMISSIONER: You are dropping your voice again, Mr Huggins. This program has since been changed, you said?---It has been – yes, it has been – this program has been changed so that the – any volume based – you know, aligned with what we did – yes, we have gone through and tried to remove these conflicts. So, you know, this in here sort of reflects a volume payment. That's a volume related payment. Which was the case – I think last year it was also linked to settlements. It has been changed this year so there isn't a settlements component to it. The base structure under the program is linked to the compliance and training programs of the organisation and then there's a series of quality metrics which would link to other payments under the program. But it has been disconnected from – from settlement volumes.

Just – I want to be clear about this Mr Huggins, because I did ask you earlier if this was still the template for the contracts between CBA and head groups. And I understood you to answer that it was?---Mmm.

But we are now seeing that there are multiple clauses in this contract that you say don't operate in the way the clause suggests?---That's right. We have – we have made a number of changes, you know, to the way we have been running the business since – since 2015 when I – when I took it over. And, you know, we were trying to improve the business on the way through and these contracts are in the process of being updated, but they haven't been yet, so this remains the standard template.

And all of these volume requirements remain in the contracts that are being signed up by head groups with you?---These contracts have been in place for quite some time. So, yes, they still remain in force.

Yes?---But, you know, as I mentioned, we are progressively going through and, you know – and removing these types of things. Whereas you – as you identify, you read it, and there is a conflict there on volume, so we are going through and removing those conflicts.

THE COMMISSIONER: The concept of one party to a contract removing provisions intrigues me, Mr Huggins. How does that work? You make a contract with someone else, contains certain provisions. You now say that, what, you can remove the provision?---No, I mean, in this case it's an optional payment. We don't have to pay this. It says, "We may pay it". And we have – we have gone back and said, "Look, the basis upon which we are going to pay these payments, we are just not going to link it to the settlement amounts that we were linking it to, because we think it improves the program." And people are – yes. They can not take the – you know, they are entitled not to say, "Well I'm going to opt out of it". But we haven't seen that.

MS ORR: The final part of this document I want to ask you some questions about, Mr Huggins, relates to the clawback of commissions in part 11?---Yes.

0364?---Yes.

Now, I want to summarise how I understand these clauses to work. And you can tell me if I have interpreted them correctly or not. As I read them, what these clauses do is create a situation where, if a customer repays their loan back within the first 12 months, CBA claws back the entirety of the commission that's paid to the head group?---That's right. If the loan was refinanced or repaid. So - - -

Yes. I was going to come to refinancing. It's the same situation. So if it's paid back or refinanced, within 12 months, the commission paid to the head group is taken back by CBA?---That's correct.

And if that happens within the first 18 months of the loan, then CBA claws back half of the upfront commission?---That's correct, yes.

So it is disadvantageous to brokers for customers to repay their loans quickly?---Disadvantageous for a broker to have a customer repay the entire loan - - -

Yes?--- - - - in the first, you know, 12 or 18 months.

And it's also disadvantageous to the broker if their customer refinances their loan within that period?---That's right. I mean, we – it would be surprising why you – why a customer would need to refinance the loan within the first 12 months. If you have actually had – had a conversation – if you have done your job properly, and understood the needs of the customer properly, you should be able to put them in a product which, you know, which they can be in for at least 18 months.

What if the customer wants a better rate on their product and becomes aware that they can get a better rate within the first 12 or 18 months?---Yes. I mean, they can – they are not locked into this. So they can refinance and the broker, in doing that, would then get another upfront commission from whoever they went with and that would offset – that would offset, obviously, the amount that we clawed back from them. But, you know, you don't want the incentive where the broker is able to, you know, get more and more and more commission the more and more and more they were, you know, refinancing a loan within the first 18 months. It's – you know, we wouldn't suggest that would be a great customer outcome either. So the way this works is in the first 18 months, or first 12 months they would get a clawback but we would expect that if that was the right thing for the customer, because there was a better rate somewhere else, then the broker wouldn't necessarily benefit from that but, because the broker – sorry, the broker would then have to – you know, would be able to offset the clawback, but the customer would benefit from the interest rate.

We don't charge any other – you know, break fees or deferred establishment fees or those sorts of things.

We can leave that document now. And can I ask you a few further questions about broker remuneration and incentives, because you deal with this in your statement. And you refer to five different types of remuneration that CBA pays to head groups: upfront commissions, trail commissions, CONNECT Referral Program payments, funding under the CBA Partner Quality Assurance Scheme, and non-financial benefits that are paid directly to brokers such as tickets to hospitality or sporting events and charity golf days. Now, we have already spoken about upfront and trail commissions and the CONNECT Referral Program. Can I ask you about the non-financial benefits. You tell us in your statement that since December 2017 – this is paragraph 44 if it assists, Mr Huggins?---Thank you.

Continuing:

> *Since December 2017 the non-financial benefits have been limited to an amount of $350 per person per event.*

So prior to that time there was no limitation on the number or value of non-financial benefits that CBA could give directly to brokers?---We didn't have a formal policy in place for that, no.

And the partner quality assurance scheme, that's a scheme by which CBA pays money to head groups to assist with training, development and compliance; is that right?---Yes. So that the PPP program, which you were referring to in the contract before. Is now called the PQAS Scheme. So the Partner Quality Assurance scheme. So when I said before that that PPP program - - -

That bonus?---Had been – yes, exactly – has been replaced. This is the – this is what it's been replaced with, this Partner Quality Assurance Scheme.

Yes, I see. And when you say in your statement that those payments are to assist with training, development and compliance, in 42 of your statement, what do you mean by that?---So we – we will provide funding for – you know. for a conference where there is training, where we may pay a base amount of funding where – where we are asking for certain compliance activities or maybe funding direct compliance activities to benefit us. So we have – we are trying to partner with head groups here to try and raise the compliance standards, and we are prepared to fund that with the head groups, to help drive better outcomes in terms of compliance for the – for the Commonwealth Bank.

And so when it was the previous version of this scheme the amount of money was connected with the volume and value of settlements?---That's right.

That's right?---Yes, that's right. So we would set – we would set a target on – on settlements at the start of the year, typically based on what that head group had written in the previous year, and then the payment would be linked to that and that's the – that's the bit that been removed.

But now you have moved to quality metrics, is that right, as the way to look at this?---Right. Yes. Yes, that's right. So there is a base payment which is made, which, you know, ensures that the head group gets some certainty and they can then invest in compliance functions or – or a training conference. And then there is a variable component and that variable components is linked into quality metrics. So we are measuring things like minimum living – you know, adherence to minimum living expenses, application quality, so there's a series of sort of five key metrics that we are reviewing and those quality metrics are running through the whole business now, in terms of how we think about ongoing accreditation of brokers, the head group standards, our – our own relationship managers are also moving towards those quality measures.

Can I take you to one of the exhibits of your statement that deals with these quality metrics, which is DH7?---Yes.

CBA.0507.0021.0225. So this is a document that relates to this new scheme that replaced bonus, the volume related bonus?---That's right, yes.

Now we have the PQAS Scheme?---Mmm.

Which is a recent – recent development; is that right?---Yes, that's right.

Late last year?---Yes. Late last year. I think it was put in place for FY18, which is – sort of started halfway through last year.

And on the final page of this document, which is 0228, we see the six quality metrics?---Yes.

Now, I want to suggest to you that one of them is still related to volume. Number 6: utilisation?---Yes.

Continuing:

> *The percentage of brokers who submitted at least one product application over the last 28 days.*

?---Yes, that's right.

So there is a volume component still within your quality metrics?---Yes. It's being removed in the next year coming. So we announced it - - -

You have got a lot that's being removed from these documents, Mr Huggins?---Well, I mean, this document was the current document and it is this year's document. But, as I mentioned, we are doing a huge amount of work to make sure that – that we are identifying these – you know, where they exist, and I'm taking proactive action to get rid of them where they exist. So this was in place, you know, and as you mentioned it – it was volume linked. It was in place to try and get at – we've got a lot of inactive brokers, which I'm sure we will come to, on the de-accreditation and we observed that those brokers have lower quality and really aren't meeting customer expectations. So it was in there for that. As we have now – we are now moving – and in this next half of moving to the new way in which we will assess ongoing accreditation of brokers – this isn't necessary anymore, because we've got our new way of assessing ongoing accreditation. I can get assurance around the quality of brokers who are accredited with CBA and I don't need to rely on the measures which, as you rightfully suggest, you know, can create conflict. The new way we will monitor accreditation will delink that and someone who doesn't write any volume with me can continue to retain their accreditation, but I will get some assurance activity and some training done with those people. So it is there now. You know, I don't want to – it has not yet been removed. It is there for this current period, but it is being removed for next year's program.

I see. All right. Now, I'm going to move to a new topic, Mr Huggins, which is about the disclosure to the customer of the remuneration that's paid by CBA. You were asked in your statement to explain how a customer is informed of the remuneration that a residential mortgage broker receives and in response you referred to two documents in your statement. And the first of those is CBAs broker loan consumer credit contract schedule, and that's part of CBAs standard loan documentation. And that document is exhibit DH8 to your statement, CBA.0507.0003.0448?---Yes, that's correct.

Now, the consumer credit contract schedule starts at 460 in this document?---Yes, that's correct.

It's a six-page document that's a schedule?---Yes.

And if we turn to the fifth page of that document, which is 464, we see a reference in item J, that you rely on, as one of the ways that the customer is told about the remuneration that's paid by way of commission; is that right?---Yes, that's right.

So in item J we see the following:

> *Commission we pay in relation to the loan contract to –*

and there will be a head group?---It will be the head group's name.

The head group referred to there. And then there is a reference to "amount" and that amount is listed in this document as not ascertainable; is that right?---Yes, that's right.

And you explain in your statement that it is always recorded as "not ascertainable" because the total amount of the commission is not known at the time of preparing the loan contract and will depend on factors such as the time it takes to pay the loan and, you say, also the extent to which the customer acquires other CBA products?---Yes, that's correct.

So, firstly, what does it matter if the customer requires other CBA products to be - - -?---There may – there may be a CONNECT payment that's payable to the broker.

Okay. So might be higher because of the CONNECT referral payment?---That's right.

But all the consumer is told is the identity of the head group and that there is an amount that is not ascertainable that will be paid to that head group; is that right?---Yes, that's right. We – as you mention, we – we were unable to calculate the amount that will be – we are unable to accurately calculate the amount that will be payable over the full life of the loan because the loan can pay down on a different profile and therefore we disclose "not ascertainable", we – and, you know, we rely on the broker who is required upper NCCP to disclose how much – under NCCP to disclose how much they are being paid both to the broker and to the head group. But we also don't know here what the arrangement is between the head group and the broker. So they – they may have their own variable .....

But this isn't about the broker?---No, that's right.

This is about the head group?---Yes.

And what CBA - - -?---Yes.

- - - pays to the head group?---That's right?---And it tells the consumer nothing?---No, that's right.

Nothing at all. Why can't you disclose the upfront commission?---We could. We haven't done that to date because we have seen this as the – you know, full amount as what should be put here.

You see it as the full amount, but the full amount isn't given, nor is any part of the amount. Why can't you disclose the rate at which the trailing commission will be applied?---We – we – we could disclose that. I would have to understand, from my team, what it takes to do that. But there's – you know, but we could do that. We are not doing it here, but we could do it.

It shouldn't take much, should it Mr Huggins, to tell the customer that there is an upfront commission of X dollars and there will be a trailing commission paid at a rate of X per cent on the balance that is outstanding at the end of every month, and there is also an amount that's being paid because there has been a referral of another CBA product under the CONNECT Referral Program?---No, that's fair.

And that amount under the CONNECT Referral Program is the set amount. It's a set dollar figure that attaches to whatever the product was that was referred. So why can't those things be included in these documents for the benefit of the customer?---They could be included. I would need to understand the systems changes and – but, you know, I'm not – they could be changed. I'm not, you know - - -

THE COMMISSIONER: Well, why aren't they?---They haven't been included because the – it was taken on the basis of – we can't provide the customer with an accurate dollar amount of – of that commission and, as you suggest, improvements can be made to that in terms of disclosure.

Would it be unfair to describe the proposition as being "economical with the truth"?---I think that's not – it was not our intention. In setting it up this way, we were – you know, our belief was we couldn't accurately calculate the dollar amount, and that's what we put in here, but I certainly that there are other ways to provide more – acknowledge that there are other ways to provide more transparency to the customers about what's being paid. We haven't done that to date and it's certainly something I will take away.

MS ORR: There is a second document that you refer to as well in this area, and that's the credit assessment summary document. That's your exhibit DH9, 0507.0004.1654. This is a very new document, isn't it, Mr Huggins?---Yes, that's right. We put this out in December, early December this year, and it continues - - -

Last year?---Sorry. We haven't got to December this year. Last year, sorry.

Yes?---2017.

So you introduced this document in December last year. But prior to that the document we've just referred to was the only document that the customer got that told them anything about the commission?---That's right. Yes.

So now from December 2017 this document goes to a group of people that you describe in your statement, at paragraph 48, as "personal customers". What do you mean by that?---So we – at the moment it's being extended, I have approved the funding to extend it, but at the moment it is going to individuals rather than businesses or trusts. So we sometimes lend to trusts and – and we are not yet providing this document to those. But that's being worked on and in the next several months it will be closed. But we have started with the majority of loans, which is individuals.

Yes?---But I wanted to be clear in my statement that it – that it wasn't covering the full universe, although we are extending it.

Yes. And at what stage in the loan process is this document provided to the customer?---So this document is provided when we produce that document pack. So when we produce the credit contract we provide this document to customers which summarises all of the information we have received and made our decision on to make sure the customer is signing that information as a – as an – as an accurate record. It would typically not be as long as this. This is sort of a sample, so it would typically not be as long with as many forms of income or expenses, but that – that's the point. When the customer has got the credit contract, they are about to sign, they get this document just to confirm that the information that's being used and – in approving their loan is still accurate. And also it allows us in here to, you know, talk about the needs and objectives and why – why a customer is – is, you know, doing what they are doing. Just get a, you know, a final check of – you know, have you given us the right information, is the information that has been provided to us appropriate? And for brokers that important. You know, this is one way in which we get a check back to that customer of the information.

So the bit the customer has to sign is at 1658 of the document?---Yes. That's right.

There's a declaration there made by the customer?---Yes.

And if we could perhaps move in to the one, two, three, four – the sixth dot point and highlight that:

> *By signing this document from December 2017 the customer acknowledges that the bank may pay a broker, or other intermediary, acting in relation to this inquiry for finance commission or other benefits in connection with the inquiry, and that any commission is disclosed in the consumer credit contract schedule.*

?---Mmm.

So let's pause there for a minute. The customer is acknowledging that CBA may pay a broker a commission and the commission is disclosed in the document we have just referred to, which does not in fact disclose the commission; is that right?---Yes. It discloses it as "not ascertainable". That's right.

Yes. So this doesn't advance things for the customer, I want to put to you, Mr Huggins?---From a disclosure perspective of the commissions.

Yes?---Yes. I – no, I think that' s– that's right. It's another check, I think it certainly advances things materially in terms of our other systems and controls.

No. Sorry, what I'm - - -?---But not relating to brokers.

What I'm asking you about is the customer understanding what commission is going to be paid by CBA to the head group. This acknowledgment, this part of this new document, tells them no more than the last document. In fact it might make it even less clear for them because now we are talking about the potential for a payment to the broker, not an actual payment to the broker?---Yes. That's right. I mean, this document is provided to sort of all customers. So - - -

Yes. And then the acknowledgment below that:

The customer acknowledges that as a broker or other intermediary may provide services to me or us, it is possible that a conflict of interest will arise. I/we consent to a broker or other intermediary acting in this way.

Now, can I pause there. Acting in what way? What is the customer acknowledging there?---That the broker, their intermediary, is acting as – providing services to them.

I see. Nothing to do with the possibility that a conflict of interest will arise, just an acknowledgment that a broker or intermediary may provide services to them?---That's right. I mean, we are asking the customer to acknowledge that there is a possible conflict that could arise, but I don't think we are asking – certainly it's not the way that it's intended to be written – that we are asking the customer to consent that the broker would, you know, apply a conflict of interest.

What are you asking the customer to consent to there? They are consenting to a broker or other intermediary acting "in this way". What way?---Providing the services to them and that those – and that there is a conflict of interest, as we've discussed before, in the remuneration structure. So, you know, we are asking the customer to consent to the broker, you know, acting and providing the services to them.

But how – how does the customer reading this know about the conflict of interests that you and I have been discussing? How is the customer directed to that? They are told that it's possible that a conflict of interest will arise, and that they consent to the broker or intermediary "acting in this way". What – what – what are they meant to understand and acknowledge when they sign this that's not apparent from those two sentences?---Look, it – it could be – it could be clearer. I think we are – again, it's a new document which – we are trying to raise the spanned standards and help, you know, make people aware that, look, there could be a conflict there. And, you know, as you start forensically examining it then, yes, there's – you know, there's possibly a way for it to be improved and I will certainly go back to my team and do that. But as I say, you know, we are trying to help people be aware of the conflicts and raise the standards and remove them. But yes, as you – as you suggest I will certainly go back to my team and – and suggest that, you know, we make some changes which make it clearer about very specifically what the conflicts are. But, you know, when – when I asked the team to put this document in place, you know, we – we thought it was a good first step.

The customer goes on to acknowledge, in this paragraph, that they:

…consent to the bank disclosing to a broker or other intermediary the fate of any application submitted and providing the broker or intermediary with a copy of the bank's approval terms and conditions. If the bank pays a broker or other intermediary a trailing commission, I/we also consent to the bank disclosing the information about the loan to them on an ongoing basis.

So that's all about the customer consenting to the bank providing information to the broker that they need for the purpose of the calculation of their commission, isn't it?---Yes, that's right.

But do you agree that this is likely to confuse a customer because, again, we are talking about if the bank pays a broker a trailing commission. The customer is not being told in document, or in the first document that you referred to, that a trailing commission is, in fact, being paid?---Look, as I acknowledge, it can certainly be clearer. You know, we – and I will – I will go back to the team and do that. I mean, it certainly was – our intent was to try and – and raise some of the conflicts and, you know, it can be clearer.

THE COMMISSIONER: You speak of some of the conflicts. I understand you to accept that a part of the conflict is relating commission to value of the loan; is that right?---Yes.

What other cause of conflict or source of conflict is there, other than relating size of commission to value of loan?---That's – that's the conflict I'm – I'm getting at here. That's the referral. I mean - - -

Just to identify a premise that is presently suppressed, but needs to be exposed, the amount of work the bank has to do as lender, does that amount of work vary according to the value of the loan?---No, it doesn't – it doesn't typically. The only reason I hesitate is sometimes a higher value loan can have a more complex loan structure. So if you are dealing with like-for-like loans, then no, the amount of work doesn't tend to vary.

Does the work of the broker vary according to the value of the loan, again - - -?---With the same caveat.

- - - making the like-for-like qualification that you just made?---No, I wouldn't think so.

That is to say if a flat fee were payable, regardless of value, would there remain a conflict of the kind that you have identified?---Not of the – not of the kind we have identified.

Would there be any other kind of conflict that would emerge if a flat fee were – a flat fee commission were to be paid?---Yes – yes, there are potentially some others if there is a bank paid flat flee. You need – you just need to be careful in designing anything like that, that you didn't – you know, if you were paying – yes, if it was a single flat fee then you would remove any potential for conflict between, "Well, if I pay one flat fee for, you know, one loan type or one other loan type", then you would remove that. You would also have to make sure that you didn't create a – a conflict which – which encouraged churn of the loan very, very quickly. And then, as we discussed briefly before, you just want to make sure that in any sort of structure like that that customers were still able to access brokers whose service they value. But that not a conflict as much, it's just a consideration.

I said to you earlier that the poles that are to be compared are commercial outcome, that is to say profit, and consumer outcome; is that right?---Yes.

Now, in observing those to be the poles, it does not follow that one pole is to be preferred necessarily over the other. The bank is a commercial enterprise, commercial enterprises are there to make profits. Sometimes we lose sight of that fact. What I invite your attention to is the need to make an explicit choice, and a thought out choice, between those two poles. Would you accept that?---Yes.

Some point, perhaps, in answer to Mr Scerri, it may be that you would wish to expand on why one choice has been made rather than the other, because it's all very well to highlight two poles. There's a lot of ground between the two poles?---There is.

The way in which you balance them is not simply a binary answer?---No, that's absolutely right.

But what I'm inviting attention to is that you need to front up to the question. As I say, Mr Scerri may or may not, as he's advised, choose to take that up with you, Ms Orr may or may not, as she's advised, take that up with you.

MS ORR: For now, Mr Huggins, I want to continue with the conflicts of interest topic and show you one more document before moving on to some questions about accreditation of brokers witness CBA. Could I ask that you be shown CBA.0001.0033.0741. Is this a document you have seen before, Mr Huggins?---Yes, it is.

Mortgage Broker Head Group Review Work Program?---Yes.

And we see from subsequent pages of the document, in the footer, that it's dated 15 May 2017?---Yes .

And we have been speaking about conflicts. I would like to show you page 743 of this document. And, while that's coming up, could you explain what this document is and what the mortgage broker head group review is?---So we put in place – this is our – effectively our audit of the head group. So this is the work program which – which we go through when we audit a head group, which was recently put into place to assess both their compliance with – with their contracts, but also – and as you're on the page here, also to understand their compliance programs and how good those programs are, given that our relationship is with the head group rather than direct with the broker.

So there is recognition of – in this document – of problems that you see in the compliance framework for head groups. We see the area compliance framework on first page there, and the third row down relates to conflicts of interest, and this document is reflective of much of what you have been saying, Mr Huggins. It's an acknowledgment on the part of CBA that there is a conflict of interest problem with head groups and we see there that what this document tells us is that governance systems and processes are in place to identify and assess conflicts and controls are in place to manage and/or disclose conflicts to consumers. Let's stop there. Can you explain what those systems, processes and controls are?---Well, this is the document that provides the work plan of what we are looking for when we - - -

I see?---When we go to the – to the broker. So it kind of - - -

I see?---So what we want to be doing here is going into the head group - - -

Yes?--- - - - and understanding, you know, there is the conflict of interest. So what – what are the head groups governance systems and processes that are there?

Yes. I see?---And we will ask them to show those to us and we will send people into look at them and make sure that we think that they are suitably appropriate.

So there's a recognition of conflicts of interest as a problem and this document is clearly placing that on the agenda for the reviews of head groups conducted by CBA. And particular conflicts are given here as examples. One them is:

> *Brokers are not focusing on achieving sales targets over the interests of the client.*

So that's the risk identified by CBA: the brokers are doing the opposite, they are focusing on achieving sales targets, not focusing on the interests of the client?---Yes, that's right. I mean, that a way of talking about the same conflict we have been talking about.

Thank you. I tender that document.

THE COMMISSIONER: Mortgage broker head group review working parties, CBA.0001.0033.0741, will be exhibit 1.30.

EXHIBIT #1.30 MORTGAGE BROKER HEAD GROUP REVIEW WORKING PARTIES (CBA.0001.0033.0741)

MS ORR: Commissioner, I was proposing to move to a different topic. That deals with broker accreditation.

THE COMMISSIONER: Yes.

MS ORR: I'm not sure if the Commission would like a brief break at any point this morning

THE COMMISSIONER: Probably desirable, I think, given that I have got everybody working forced march hours. It's about 20 to 12. I will come back at quarter to 12. Adjourn till quarter to 12.

ADJOURNED **[11.37 am]**

RESUMED **[11.45 am]**

MS ORR: Mr Huggins, I said I was going to move to the accreditation of brokers by CBA. All mortgage brokers who submit CBA home loans must be accredited by CBA?---That's correct.

And they also have to be accredited by their head group?---That's right.

And to be accredited by CBA they need to first hold an Australian credit licence, or an ACL?---The broker?

Yes?---No, they don't need to hold their own ACL.

Sorry. I will put it to you this way. They can either hold an ACL, or they can be an employee of someone who holds an ACL, or an authorised credit representative of an ACL. I'm sorry?---No. That's correct, yes.

Yes. So one of those things has to apply?---One of those three, that's right, yes.

And what generally is the case?---It's – it's split – generally it's either "I have got my own ACL" or "I'm a credit rep".

Yes. And in your statement you summarise the processes by which an individual broker is accredited by CBA?---Yes.

And one of those steps is completing a form called an Authority to Act; is that right?---Yes, that's right. They can either complete that form or they can complete it online.

Yes. But that form needs to be completed as part of the accreditation process?---That's right.

And you have annexed that form to your witness statement at DH11?---Yes.

It's CBA.0001.00027.4036?---Yes.

Now, can I start by asking you, Mr Huggins, why this form is called an Authority to Act?---I mean, the – it refers to the fact that the broker is acting, you know, as an authorised – as an accreditation broker and therefore will, you know, act on behalf of CBA in the – in the process of selling the home loan.

I see. So the mortgage broker is acting on behalf of CBA in submitting home loans to CBA for the customer?---That's right.

There's no contractual arrangement between CBA and the broker; is that right?---No, that's right. The contractual arrangement is with the head group and the broker must be accreditation with us, but it's through the head group.

And why is the accreditation of a broker by CBA necessary before a broker can submit a home loan application to CBA?---We want to ensure that that broker meets – meets our standards, and is able to meet the customer's expectations, that they have when they see a – a CBA logo on a window or on a website.

Could we look at page 3 of the Authority to Act document. So 4038. And there is a section there, section 5, Nominee/Broker Acknowledgment and Agreement. Do you see that?---I do.

So the broker has to sign this acknowledgment, acknowledging that to maintain accreditation with CBA they need to submit a minimum of four home loan applications and settle a minimum of three home loans in a six month period; do you see that reference there in the second-last dot point - - -?---Yes, I see that reference.

- - - Mr Huggins?---Yes.

And that – that something that by signing this document they acknowledge they have to do to maintain their accreditation?---That – that's right.

And it's a requirement, for them to obtain accreditation in the first place, that they agree to do that?---That's right. Yes. And this is not something that we have been enforcing, but it's in this document.

I see. So it's a – another part of your documents that – I'm not sure how to put it – that is meaningless?---Well, I think over time as we have tried to, you know, raise the standards and, you know, these types of – so we are not applying – we are not applying any consequences to those.

So despite asking brokers to sign up, acknowledging that this is a volume requirement that they need to meet to maintain their accreditation, you say that that's not the situation that CBA is not in fact requiring brokers to do that?---We are not enforcing this, albeit that it's - - -

I see – I see. So there is a difference there?---We – we haven't – we haven't – we haven't traditionally been – been enforcing this, that's right.

THE COMMISSIONER: I'm sorry, Mr Huggins, you are dropping your voice. Repeat your last answer?---Sorry, we haven't – we haven't systemically been enforcing – enforcing this – this requirement.

The word "systemically" carries a lot of baggage, Mr Huggins?---Yes. I mean, I – yes, I don't want to - - -

You will have to unpack it for me at some point?---I don't want to suggest that we have never enforced it, because we are about to talk about some of the deaccreditation rules, but – but I have 4000 brokers who are accredited with me out of the 13 and a half thousand who are inactive or have very low volume. And therefore I don't want to sit here and suggest to the Commission that I'm – that I'm applying something like this, when I have got 4000 brokers who are inactive or writing very low volume.

MS ORR: Well - - -

THE COMMISSIONER: Mr Huggins, at some point I'm going to have to write a report about this. I'm going to have to record what I find about these sorts of things, I think. What you are telling me is there are bits of the document to which you are not giving effect?---Yes.

Or perhaps not giving effect systemically. What am I to make of it all, Mr Huggins? We have heard on a number of occasions this morning of, "This of the document we are not enforcing, that bit of the document we are not enforcing." What am I meant to make in all of this? Do I find any of this in your statement?---Well, in the statement we have been talking about how we are – we are in the process of changing the way in which we are accrediting the brokers, maintaining – maintaining the accreditation of brokers, you know, monitoring the head group. So we are just in a position of – we have – we are doing the work and have been doing the work of – of improving and – and – and therefore, you know, some of these documents haven't caught up with the work that we are doing. And as I mentioned some of it, you know, has been work that happened last year and has really been announced in the last several months. So the standard documentation which we have generated hasn't caught up to the fact that we have been doing a lot of this work to raise the – yes, the new accreditation standards, the ongoing accreditation standards, and we have been explicitly focused on trying to move to monitoring quality and taking out some of these volume parts.

Can I just see if I can capture a couple of points that, at least at the moment, I think I get from what you've told me. First you have told me, just after the break, the broker acts as an accreditation broker on behalf of CBA in the process of selling a home loan?---Yes.

In your eyes at least, the broker is the face of CBA?---Yes.

Is that right?---Yes.

And is acting on behalf of CBA?---Yes.

In connection with that you have been moving to a point where you expect all brokers, if they are to be accredited, must sell a certain amount of CBA product during certain periods?---No, we're not – we're not moving to that part. What we have – what we have moved to, and announced we are moving to, is that in line with the broker being face of the CBA, I believe that is coming with expectations from the customer that that broker is going to be able to have a good conversation about CBA products and processes and be able to meet that customer expectation. Where a broker doesn't write loans, doesn't have any activity, my ability to monitor how that broker is meeting that expectation is – falls apart. I can't – I can't work out whether someone has got a good quality application if I'm not seeing any volume from any application. So what we have moved to, and we have recently announced, is that for accredited brokers, people who are already accredited with us, if they – we will monitor them based on the quality metrics, which – you know, an example we saw before, a range of quality metrics. If you are not writing volume with us, then you are going to need to do some more training, and we will ask the broker to do a training on the regulatory environment and our products to give myself assurance that they can meet that customer expectation. Now, that is an evolution from the deaccreditation where, in the start of 2017, I made the decision based on, you know, my belief that brokers – that customers had an expectation of brokers, that I couldn't monitor it, and then some other work we did, which showed that my hypothesis that there would be lower quality showed true, that I would deaccredit brokers who were very inactive with us. And, yes, that resulted in us – in obviously quite a substantial reaction from the industry. We then consulted and worked with the industry at length to come up with what we've now put in place. So it's – we have intentionally now delinked the ongoing accreditation requirement from volume, but – but I expect brokers to still be able to meet the customer expectation. They can have a good conversation with customers about the CBA products and processes. So if I'm not seeing any activity which allows me to monitor them normally, then I will require some additional training to create the assurance that they can have that conversation with customers.

I won't delay you further, Mr Huggins. I will go back and read the transcript with great care. I should say to you that, at least at the moment, I have some difficulty understanding what you've just told me. That's my fault, not your fault. I need to go back and reread the transcript, but I must confess I don't have clear in my head exactly what you have just tried to convey to me. As I say, my fault, not yours?---Do you want me to try again? I'm happy to - - -

Well, Mr Scerri will have his chance later, perhaps.

MS ORR: There are a number of themes to that answer that you just gave, Mr Huggins, that I want to ask you some questions about when we come to the deaccreditation program - - -?---Sure.

- - - that you just referred to. But just before we move to that program, could I just direct your attention to some additional parts of the acknowledgment that the broker signs up to in this document. The acknowledgments include an acknowledgment that the broker will comply with terms and conditions. This is the top part. And the Commonwealth Bank's mortgage broker code of conduct. Do you see that?---Yes.

And could I show you the mortgage broker code of conduct which is exhibit DH 13. CBA.0507.0004.1646. Is this the current version of the mortgage broker code of conduct?---Yes.

And I direct your attention to the first paragraph:

> *We are committed to the highest standards of ethical behaviour at all times. The Commonwealth Bank's code of conduct clarifies the standards of behaviour that are expected of our accredited mortgage brokers in the performance of their duties.*

Now, what I want to ask you is what duties you are referring to or CBA is referring to there. They are duties to CBA?---Yes. They are duties in the provision of the mortgage.

To CBA?---To the – yes, to the CBA. And – and their duties to the customer as well.

Thank you. And then number 5 in the code of conduct:

> *I will adhere to the bank's instructions processes and policies and will not in any way exceed my authority.*

Can I ask you again what that is a reference to. What is the authority given by CBA to brokers?---Well, a broker is able to submit the application but they are not allowed to approve the application.

Okay?---So it's the authority to submit.

Okay. All right. And then I think we can leave that document and move to the topic that I think you have perhaps been ready to move to for some time now, Mr Huggins, which is the revocation or deaccreditation of large numbers of brokers by CBA in 2017. Can we start this way: I want to understand approximately how many CBA accreditation brokers there were at the start of 2017?---Approximately – at the start of 2017, approximately 12 and a half thousand, 13,000 brokers.

And early in 2017 CBA conducted a deaccreditation of brokers program. Is that right?---That's right. We deaccredited 710 brokers.

I'm sorry?---We deaccredited – we sent a deaccreditation notice to 710 brokers.

710 brokers, thank you. And prior to this deaccreditation program you tell us in your statement that the accreditation of brokers was revoked on three grounds only. This is paragraph 71 of your statement, Mr Huggins:

> *Accreditation could be revoked where CBA had identified that the broker had engaged in inappropriate activities such as by submitting false or fraudulent information in a home loan application, also if the head group identified that the broker had engaged in inappropriate activity of that kind, or if the broker or the head group informed CBA that the broker was resigning or otherwise leaving the industry.*

?---That's right.

So prior to the deaccreditation program, those were the circumstances that led to revocation or deaccreditation - - -?---That's right.

But the deaccreditation program early last year involves revocation on different grounds that you have already made reference to: brokers had their accreditation revoked because they were inactive or less active than other CBA accredited brokers; is that right?---Yes, that's right.

Now, by that I understand they were not submitting applications for CBA home loans or not submitting, in CBAs eyes, enough applications for home loans?---It was less – less about enough and more that they – they were not submitting those applications and that meant that I and the team were unable to monitor any sort of quality. And then we did some work around that which affirmed the view that the quality out of the broader group of brokers, who were – are not writing volume was lower than that of others.

I want to ask you about that. But can I put to you first the proposition that these inactive brokers in CBAs eyes were perhaps just submitting applications for home loans to other lenders. They were recommending to their customers that they take home loans with other banks, not CBA?---Sure. They – they could have been doing that. Again, our – our – there is a customer expectation, with CBA accreditation, that a broker is going to be able to credibly talk about CBA products and processes and policies. And whilst someone may still be sending loans to someone else in the business – sorry, someone else in the market, another lender, they still have to meet that customer expectation that a customer has when they see that that person is CBA accredited and indeed when the CBA brand is used to – in that broker's business or in their advertising.

Why do you assume, Mr Huggins, that brokers who are not regularly submitting home loan applications to CBA are not credibly talking about CBAs products? Why do you assume that. Why could they not be credibly talking about CBAs products but recommending other products to consumers or having customers choose other products?---I mean, as a – at an individual broker level you identify the challenge that – that I have, in that the way I would monitor a broker for their ability to have a great quality conversation is – is by how many times does it go back and forth between my credit officers? You know, how often is a broker putting in a loan with – with low expenses? What's the conversion rate of that loan? So those are the typical metrics that you would use for a broker. And when there is no loan, or there is no activity, those metrics don't work, because I don't have any – any activity by which I can assess the quality of that broker and I don't get any transparency around the loans clearly they are sending to other lenders. So then, on the basis of that, I ask my team to look at the group of brokers. Look at all of the brokers where there is inactivity and therefore see whether the hypothesis that there would be lower quality proves true. And the results of that work showed that there was a lower conversion rate, that there were more errors, that there was higher arrears, and that seemed to affirm the view that brokers who have less activity don't understand the CBA processes and policies as well as brokers who are writing more loans, and therefore they can't be meeting the – you know, they couldn't be meeting the customer expectation of being able to credibly talk about CBA products and policies. And from there I made the decision that for the least active ones we would move to deaccreditation, which we spoke about before.

Well, I want to put to you that you didn't deaccredit the 710 brokers because of their conversion rates, their errors or their arrears. You deaccredited them because they were not recommending enough CBA home loans to their customers?---That not right. That is not why we deaccredited those brokers. We deaccredited those brokers to raise the standards of the average broker that is accredited with the CBA, and I did not believe that brokers who were not writing any volume with CBA were going to meet the customer expectation, that – that someone who has a conversation with a CBA accreditation broker was going to be able to be current and have a really good conversation about a CBA product. That – you know, that seemed to be affirmed by the work that we had done and as I mentioned I have no other way of monitoring because there is no activity, and I don't get a view of the total activity in the market. So I don't know. And therefore I made the judgment that the right thing to do to improve quality, and meet the customer expectation, was to deaccredit the least active brokers in the business.

And you deaccredited them on the basis that they were the least active brokers, and that's what you told them when you wrote to them; do you agree with that?---That's right. That's the – that's right.

You said nothing to them about errors or lower conversion rates or arrears. You told them that they were being deaccredited for volume reasons, because they had been inactive?---That's right. And the reason I couldn't talk to an individual broker about their arrears rate or their quality was because they hadn't had any activity with me. So I don't know what your activity – I have no idea what your quality is, because - - -

How does it work then? It can't work both ways, Mr Huggins. On the one hand you were saying there were being revoked because of their lower conversion rates, their arrears, and errors?---I see.

And on the other hand you say you couldn't know what those things were?---So – so – so the way that I supported the – my own business judgment was to look at the full cohort. So I could look at a cohort. I could look at the 4000 or the 1000, 2000 brokers who weren't writing much and say, "Well, in aggregate, do I see a difference between those brokers who are active and inactive?" And I did see a difference between those who were conversation active and inactive and therefore on that basis I – I made the decision.

THE COMMISSIONER: And the differences you saw were conversion errors and arrears; is that right?---Yes, that's right.

Conversion and errors are matters concerning the bank, are they?---That's right.

Not concerning the customer?---No, that's right.

Arrears, yes, that a matter that concerns the customer, but it's also a matter that concerns the bank, isn't it?---Yes. The - - - –

And depends upon the quality of the credit assessment made on the bank on the data that received from the customer, doesn't it?---That's right.

So where does that connect with what you described as meeting customer expectations? They are all bank focused things, aren't they, Mr Huggins? Now, that's not a matter of criticism?---No. The one that the – the back and forth, where I'm seeing back and forth where you haven't provided the – you know, right information up front, you know, a loan is outside policy, you need to ask the customer for this information so that then goes back and forth. That isn't – that can be inferred as actually a person doesn't understand the CBA policies or products, and therefore may be having the wrong conversation with the customer. So if you see a loan coming in which is outside our policy or doesn't have the right documentation, per standard policy, that would infer that the broker doesn't understand and isn't having a great conversation with the customers. But they are inferences.

MS ORR: I – again, I want to put to you, Mr Huggins, to give you an opportunity to respond, that their inactivity reveals nothing to CBA about their familiarity with your processes and requirements. They could be very familiar with those processes and requirements, and choosing to recommend products other than CBA products to their customers?---Well, I have no way of knowing without activity.

That's right?---Without activity. And the work that we did when we brought it up to a cohort level showed that there were differences.

In knowledge of processes and requirements, as you refer to them in your statement, did your research or study show that?---It showed that there was more back and forth. It showed that – in things like expenses, you know, there were more errors. So because there were more errors then, yes, that inferred to me, in my judgment, that – that therefore there was enough information for me to make a business judgment which said, you know, that that person isn't meeting the customer expectations and is of a lower quality.

What proportion of that group that were deaccredited did you observe errors for?---I would have to go back. But, again, I would have to go and have a look at that group.

You don't say anything about that in your statement?---No, because the analysis we did was that the – was that the full group and then, you know, so having done that analysis, we then said, well let's – let's take a sub-segment of the 700 to then deaccredit. So I don't think we then repeated the same set of analysis on the subgroup of the 700.

And it wasn't originally intended to be 700 brokers that you deaccredited, was it, Mr Huggins. You originally wanted to deaccredit a much larger number of CBA brokers?---That's right. So the analysis that we had done showed that there was a much larger number, I believe it was two and a half to 3000 brokers who were inactive, and therefore, were not those that we believed were going to meet our standards. We started in a pilot of the 700 and then, based on that pilot, we got a lot of feedback from the market that actually people valued their accreditations with the CBA, and so we consulted widely with the industry, with the head groups, and we had a range of workshops with brokers to understand how could I deliver the objective, which is I have to get some sort of confirmation, some – something which tells me that this broker understands CBA policies and processes. How can I assure myself, as the person that responsible for these brokers within the business, and the experience they are giving customers, and that has led us to the – the ongoing broker accreditation program which we have announced. Which says, "You can keep your accreditation, if you don't write volume with the CBA. That fine. We understand it's valuable. But, if you don't – if we can't monitor you, using activity, then we are going to require you to do some more training on an ongoing basis to keep your – to keep yourself current."

Can I stop you there and ask why you didn't deal with the existing brokers in that way. Why didn't you explore this theory about errors and arrears and lower conversion rates by requiring them to do more training so that your theory could be tested? Why did you choose instead just to cut them?---Well, I think I have learned a lot from the original 700 which we deaccredited, and I think we have landed in a much better place now, which is that – you know, we won't deaccredit purely based on volume, but we will require to you do more training. So I think where we have landed is materially better. Why did we do the first 700? Well, I hadn't thought of that as a – as an approach. That came out of the consultation that we did. I mean, I wish I had thought of it. It would have been better. It is where we have landed. My – my business judgment at the time was I don't see how someone who hasn't written loans with the CBA can be meeting the customer expectations, and I made a decision to deaccredit the 700. I mean, I wish I had thought of a different approach that we have – we have since landed at, but that's not the way that it – that it worked.

You wanted to deaccredit about another 3000 brokers, didn't you, Mr Huggins?---At the time that was the number of inactive brokers who – who we had identified. And what I want to do is raise the quality of the brokers. And it remains the case that the inactive brokers that are currently with the CBA – I'm very happy for them to keep their CBA accreditation, but I need assurance that they understand CBA policies and processes and can have a great conversation with – with a customer. And I don't think that an unreasonable thing to be asking for people, particularly when they are using the brand of CBA, potentially, to attract customers into their business. Customers have an expectation that when they see the CBA brand, and they see CBA accreditation, that that going to have a certain quality. And – and I'm – I'm going to err on that side of making sure that quality exists.

I want to put to you, Mr Huggins, that you gave them no opportunity to provide you with the assurance that you sought?---That – yes. You're right. But that's a catch-22. I wasn't doing this to drive more volume through those brokers. So if I went out to them and said, "You need to prove to me that you've got quality, please write loans to the CBA", then - - -

I'm not talking about the second part, I'm talking about the first part only. "Prove to me that you've got quality. Prove to me that you understand CBAs processes." You are the one who made the link to do that by writing CBA loans?---Yes. I mean, I – I made the judgment that on the basis of the evidence we had that I needed to raise the quality and that decision is on me, I think. If I knew what I knew now, I would take a different approach. And after consultation with the industry that's the approach we put in place. But – but I didn't – I didn't – I didn't take that approach. And what I didn't want to do was give people notice and then suddenly someone says, "Well hang on, I'm going to start submitting loans to you now." So we didn't do that. We put in an appeals process in place instead, which 109 people used.

And why did you pull the pin on the extra 3000 that were you planning to revoke accreditation for?---Well, as I said before, we received a lot of feedback from brokers. You know, we – we got a lot of media attention and that media attention was going down a path of, "CBA is only doing this to encourage brokers to write more volume with them." And that's not what I was trying to do at all. And therefore I stopped it and said, "Well, the objective remains, so how do I achieve the objective?" And we worked with the industry to do that.

And you are referring there to the new broker accreditation program that is to be launched?---So there is a new accreditation program which has raised standards. We have also announced that for existing brokers we will monitor them against the same sort of quality metrics that we are monitoring head groups and others against, minimum living expenses, interest only owner-occupier, the conversion rates, the quality of the loan and customer feedback. So we will monitor existing brokers on that basis as well. Where people meet those quality metrics, that's fine. Where they don't or where we have insufficient activity to actually use those metrics then we will ask people to – to do some – some more online training, just to give myself some certainty that those people can deliver the quality of experience that the customer expects and – as rightfully, Commissioner, you identified before – and that the high quality for me. So, from a bank's perspective, I – I don't need to spend as much processing those loans, because there's not as much back and forth, which is expensive for me and a poor customer experience.

Could I show you some documents that aren't in your statement that I would like you to identify and to tender - - -?---Sure.

- - - Mr Huggins. The first is CBA.0508.0002.0004. So this is a letter from CBA dated 20 February 2017. Is this one of the deaccreditation letters that was sent to brokers?---Yes, it is.

And you will see that what the broker is told there in the third paragraph:

> *We have identified that you have not been active with Commonwealth Bank for some time. Accordingly, we have made the decision to resign your accreditation with the Commonwealth Bank in accordance with our agreement with your head group and have advised your head group of this decision.*

14 days notice commencing from the date of the letter, and:

> *The bank is going to exercise its right revoke your authority to act. You will no longer be age to submit home loan applications. Effective immediately, we will not accept any new home loan applications from you.*

So was this the first – the letter that went out in the first phase of deaccreditations?---Yes, this is the letter that went out. There were two phases.

I have a second letter as well, which is undated. And I can show you that one if it assists. The second letter is briefer than this letter. I'm not sure if that helps you?---This is – this is the letter that went out to brokers that were deaccredited, yes. There were a – there was a – there were two phases. I tend to think of them as the same. The first one had sort of 100 brokers, the second one had more. But they are effectively the same.

Yes. So you think this is the first phase?---This is the letter that – yes, I think so.

And you mentioned there was an appeal process available to brokers. Is there any mention of that appeal process in this letter?---So the appeal process was available through the relationship manager. So we asked people who wished to discuss the decision to contact their relationship manager and through that they could access the appeals process.

Yes. But nothing in this letter to suggest to them that there was a way of challenging the deaccreditation. Quite to the contrary:

Effective immediately, we are not accepting any new home loan applications from you.

?---Well, we encouraged them to have a discussion. We wanted to have a discussion with them and their relationship – with their relationship manager and that what we said in – in here.

I see. I tender that document, Commissioner.

THE COMMISSIONER: Yes. CBA.0508.0002.0004, draft deaccreditation letter, 20 February 2017, will be exhibit 1.31.

EXHIBIT #1.31 DRAFT DEACCREDITATION LETTER DATED 20/02/2017 (CBA.0508.0002.0004)

MS ORR: I'm not sure if you were here for the evidence of Mr Harris yesterday - - -?---I did see Mr Harris', yes, I was.

- - - Mr Huggins, but you would have seen that this is the form of letter that was sent to him?---Yes.

Now, could I show you next CBA.0508.0002.0001. This is the other style of letter that went to brokers?---Yes – yes.

Much briefer?---This is the – yes – this is the more standard revocation that would go for more BAU revocations.

BAU?---More business as usual. So if the revocation was - - -

Right?---Was, you know, as part of ongoing. As we mentioned before, there was - - -

Other grounds?---Other grounds, yes.

So was this letter used in the deaccreditation program?---I don't believe so.

No. Thank you. I will nonetheless tender that document, Commissioner

THE COMMISSIONER: Exhibit 1.32. CBA.0508.0002.0001. If I call it standard form notice of revocation of authority to act does that sufficiently capture the title?

EXHIBIT #1.32 STANDARD FORM NOTICE OF REVOCATION OF AUTHORITY TO ACT (CBA.0508.0002.0001)

MS ORR: Yes, I think so Commissioner.

You have given us a figure today, Mr Huggins, of the number of brokers that were deaccredited, which is 710?---That was the number of brokers that we – that we sent the letters out to, I believe, yes.

And is it fair to say it took you some time to be able to provide that figure to the Commission. You provided draft versions of your statement and a final version of your statement in which you were unable to say how many brokers in total had been deaccredited?---I think we were able to get to the numbers on the deaccreditation side, but at the BAU – the business as usual side of determining how many brokers were deaccredited was much more challenging for us. We – we keep in our systems a current list of all accredited brokers and, you know, that's our focus: on making sure that anyone who is currently accredited with us is current. And the Commission asked for us to go to a point in time back and we don't keep those points in time records. So we therefore had to reconstruct the data for the Commission and that required my team and a number of other people to go and do that manually. So that was quite manual and I apologise for how long it took. It's not something we would do in a normal course of business.

We now know. We now know the number, and your supplementary statement gave us that number. Was it any part of the decision to deaccredit these brokers – was any part of the thinking there aligned with this objective that I asked you questions about much earlier in your evidence of changing the proportions of the proprietary channel and the broking channel?---Not – not really. I mean, we – we certainly had discussions at the time around – because there was very little volume coming in, that it was – it was unlikely to have a – you know a huge impact on the business and also that part of our conversations at the time were – and continued to be a desire to build actually a very good, strong, broker proposition and that having – having fewer brokers, you know, may have meant you could focus your resources on – on those fewer brokers and provide a better level of service. But it wasn't directly linked to the proprietary side, sort of, directly.

Can I show you another document, Mr Huggins, which is again not in your statement. CBA.0513.0002.0069. Have you seen this document before, Mr Huggins?---Yes. Yes.

Could you explain what it is to the Commission?---This is a document which is produced by our communications team when there are sort of major events happening, and this looks like ..... mortgage broker review. So I think this would have been when the mortgage broker review was coming out. And it assesses – you know, discusses the issue and then assesses impacts on the bank.

Could I direct your attention to the second page of this document, at 0070. Reputational Impact Analysis. Do you see that section there?---Yes.

And can I direct you to the last two paragraphs:

Since the full year financial results Commonwealth Bank has come under pressure from equity analysts and shareholders to rebalance home loan flows in favour of our proprietary lenders, where we make a higher margin. Commonwealth Bank is introducing a number of initiatives to achieve this. For example, it is seeking to reduce the number of mortgage brokers that are accredited with us.

I'm sorry, you will need the next page:

It is seeking to reduce the number of mortgage brokers that are accredited with us, which are either inactive or providing very little business.

And do you accept that this is part of the thinking that sits behind the deaccreditation program, as this document records?---This was – this is not how we thought about the deaccreditation process. I think – you know, as I mentioned before, you know, we have – you know, we knew that we weren't getting a huge amount of business from these brokers, and therefore it wasn't going to have a material impact on the proportion coming through our proprietary channel. And our focus on the proprietary side had been to grow the number of lenders and investment in that space. So - - -

Nonetheless, it's consistent with the objective that I think you acknowledged earlier of rebalancing the home loan flow to the more profitable proprietary channel, rather than the broker channel?---No, that's right.

Yes?---I – I think – I don't think what's written here is – is correct that the way we would be able to achieve rebalancing the home loan flows was by – was by deaccrediting brokers and that wasn't something which was – you know, which was a objective in terms of rebalancing the flows. But, you know – but there was a broad objective to raise the proportion through proprietary, but this deaccreditation, we didn't think would have achieved an outcome of – of deaccrediting – of raising proportions.

I can't recall, did I – I don't think I have tendered that document yet Commissioner.

THE COMMISSIONER: No. Exhibit 1.33, CBA.0513.0002.0069, reputational impact brief, 10 March '17.

EXHIBIT #1.33 REPUTATIONAL IMPACT BRIEF DATED 10/03/2017 (CBA.0513.0002.0069)

MS ORR: Can I take you to a document in your statement, Mr Huggins, part of your exhibit DH14, which is a very large number of documents. It's a number of sets of minutes from third party broker governance forums. And the one I want to show you is from 27 April 2017. It's CBA.0507.00021.0051. I'm sorry, if you just give me a moment to find, in amongst all these minutes, the correct one. Right. Now, can I ask you to look at 0054 in this document and just show you the reference there to the 27 April ’17 update:

> *BK stated phase one and two was 700 brokers. Phase 3, 3000 brokers. Has been put on hold due to the changing environment in the broker space. The current focus is on developing higher standards for new brokers. The overall objective is only to accredit committed and quality brokers with the aim to reduce the flow of incoming new accreditations. Strategies being reviewed by legal and will be presented to Dan Huggins.*

?---Mmm.

Now, is that an accurate reflection of the situation in terms of the phase 3, 3000 brokers being put on hold?---It was put on hold, yes, both due to the changing environment and the – you know, what’s not – you know, as I mentioned before, the feedback we got from the industry and the media and then we went into a consultation with the industry about that, about our new accreditation, and also ongoing.

And you referred to the media attention that CBA got at that time, which you may have seen an email in the documents provided to you, an email from you in which you referred to the “media fallout”. Do you recall that?---Yes.

Yes. And that media fallout was a reason, if not the primary reason, for abandoning the move to deaccredit the further 3000 brokers?---The fallout I was referring to was that the narrative which had been picked up in the media was that we were doing this to try and drive volume, and through our other accredited brokers, which was an incorrect narrative.

Can I show one more document, Mr Huggins, which is also not in your statement. It’s CBA.0513.0002.0001. Now, this is another document in the same style as the previous one we looked at. Another reputational impact brief. Now, can I direct your attention to the second page of the document, which provides a timeline for the deaccreditation process; is that right?---Yes.

And we see there the way you selected the brokers who were to be in each phase of the deaccreditation?---Yes, at that time. I think it changed slightly from this document, but it’s approximately correct at that time.

THE COMMISSIONER: Sorry, Mr Huggins, you are dropping your voice again. Do you mind repeating your answer?---This was the criteria at the date of this document. I think it changed a little bit until we got to the final list of people.

MS ORR: So do we see there – I think you mentioned that the first phase – what you originally referred to as the first phase was 700, but you accepted that there were two phases?---That’s right.

And the first part of that was 100 brokers?---Yes.

And they were chosen on the basis that they had been accredited. We will need to go to the table below the part that is on the screen at the moment. The 100 brokers were chosen on the basis that they had been accredited in 2013 or prior; they have no book with CBA and have not settled a deal in FY16; no application submitted year to date. So that they were the criteria for identifying the first 100?---Yes.

And then the next 600 were identified on the basis that they had been accredited for more than 12 months, had no book with CBA, had not settled a deal FY16, and had not submitted an application year to date?---Yes.

So the only difference being the period for which they are been accredited?---Yes, that's right.

So that's how the 700 were selected. We see no reference in this document, do we, to selection on the basis of any matters you referred to before about errors or arrears or lower conversion rates?---So the – a couple of things. The – that wasn't the 700. So that there was the 100, which is correct, that was the first phase. But under the stage 1 there, I believe we ended up with fewer people in 600 – in that first bucket – and we ended up with a number of people out of the other two buckets. In terms of your second part of your question, there's no reference to that. There's not – that work had been done separately and then I had made the decision that we – we should being the deaccreditation. So this was the criteria upon which these groups of people were made. But the work that had been done was separate to this.

And we see a reference to stage 2, 2310. That the phase that ultimately went to about 3000 brokers, but was abandoned?---That's right.

Yes. I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 1.34. CBA.0513.0002.0001 reputational impact brief 11 April '17.

EXHIBIT #1.34 REPUTATIONAL IMPACT BRIEF DATED 11/04/2017 (CBA.0513.0002.0001)

MS ORR: Mr Huggins, how many Aussie brokers had their accreditation revoked by CBA as part of this program?---So no franchised brokers were included in this round of the program. So no one from Aussie or other franchises were in this – in this round.

And we've talked briefly about the appeal process. If – if a broker knew about the appeal process there was a requirement on them to submit information in support of their appeal; is that right?---That's right. They – they had a conversation with their relationship manager and then the relationship manager would write the appeal on their behalf.

Could I ask you to look at a document in your exhibit DH17 at 3816. I will ask you to look at the first page of that first, so you can familiarise yourself with the document?---Which – which page.

This is a document from 23 January relating to the accreditation review?---Yes.

And can I ask you then to go to 3816 in that document. I'm sorry, I haven't provided the doc ID. The doc ID is CBA.0001.0030.3813. Sorry, Mr Huggins, you and I know what we are talking about, but no one else does. So that's the front page of the document and can I ask you to go to 3816, which gives some information about what brokers were required to provide if they submitted an appeal. Now, one of the things that they had to tell CBA about, when they put their appeal in, third-last bullet point from the bottom, was the total funding figure and value with other lenders for FY16. Why did CBA want to know, as part of appeal process, about recommendations by the broker to other lenders?---Well, we wanted to know in general whether the broker was active in the industry or not.

And what would you do with that information as part of the appeal?---Well, that together with other information would – was used to determine whether it was appropriate to continue their accreditation. But we wanted to make sure that people were actually committed to the – to the industry and were active in it.

What would you have thought if the person providing the information revealed that they had been submitting significant amounts of loans for significant amounts of money to other lenders. How would that have factored into the decision on the appeal?---Well, that would have shown that they were active in the industry, but we didn't accept any appeals purely on the basis of volume - - -

This is volume to others, not volume to you?---Well, we didn't accept – we did not accept any appeal on the basis of volume alone, you know. So someone coming in and saying, "Well, please don't deaccredit me, I'm going to write you a lot more volume", was not a basis upon which we accepted an appeal.

I think that's a different point, Mr Huggins. I'm asking you: the person or body deciding the appeal, if the information provided showed that the particular broker had submitted a lot of loans to other lenders in FY16, would that have counted for or against their appeal?---Well, it would have counted for it, in that they were active in the end industry. But it wouldn't have been taken as the only factor.

I see. All right. How many brokers did appeal the revocation of their accreditation?---My understanding is 109 brokers.

And how many appeals were upheld?---23.

And on what basis were those appeals upheld?---There were a range of reasons, but there were some where the person had been – had been out for medical reasons or had been travelling. There were other reasons where brokers had recently been refocusing their business on consumer lending, but perhaps they had been focused on business lending. So there were a range of reasons.

What did you make of it when, as you have acknowledged happened, in the appeal process, CBA brokers said to you that they would promise to send more loans to CBA? What did that suggest to you about what brokers understood of why their accreditation had been revoked?---I mean, I don’t – I don’t recall thinking about that at the time, to be honest. I - - - –

Do you accept that the fact that people were promising to write more CBA loans shows the message that they were receiving as a result of the deaccreditation process, which was a message that they were being revoked because they had been submitting insufficient numbers of CBA loans?---Unfortunately, that was the narrative which was also in the media and in the industry press. So that was the narrative that had been – that had been picked up, which obviously – as we discussed – wasn’t the purpose or the objective, but that – it was the narrative that it was being picked up.

You heard the evidence yesterday of Mr Harris - - -?---Yes.

- - - in relation to the revocation of his accreditation. You are familiar with Mr Harris?---I have never met Mr Harris. The first time I saw him was yesterday. But I’m familiar with – with the case and in terms of preparing for today.

And you know that he spoke out to the media about the deaccreditation program after his accreditation was revoked?---I’m aware of that only through the media articles quoting him and his testimony yesterday.

Yes. And the media articles were drawn to your attention at the time, were they not?---Yes, they were.

And could I just show you a document which is CBA.0513.0002.0107. I’m sorry. I have that document now and I want to be careful about redactions in this document. Do you see from this document, Mr Huggins, that you were one of a number of people to whom an article quoting Mr Harris was sent on 24 February 2017?---Yes.

And you see your response, having received that article?---Yes.

Continuing:

> *Here is the Fairfax article. Let’s see if Mr Harris appeals!*

?---Yes.

I tender that document.

THE COMMISSIONER: Exhibit 1.35. CBA.0513.0002.0107, email Huggins to Vaswani, 24 February '17.

EXHIBIT #1.35 EMAIL HUGGINS TO VASWANI DATED 24/02/2017 (CBA.0513.0002.0107)

MS ORR: Why was Mr Harris' accreditation revoked, Mr Huggins?---Mr Harris fell into one of the previous categories that was identified where he had only written – funded one loan in the previous 12 month period. So he was captured in one of those broad segments, and was picked up to go into the – into that first group phase. Phase 2, I think it was .....

Were in any high arrears rates connected with his loans or previous loans he submitted to CBA?---Well, no. He didn't have a book with us, so he only had the one loan I believe. So you can't calculate the arrears.

Yes. So any problems with the loan that he submitted in that year prior to his deaccreditation?---There were actually two loans submitted. The first one loan was submitted in June 2015 and one in – I think it was August 2016. The 2016 loan, yes, did have a couple of problems. It was – it failed our original, sort of gate, to be accepted. It was missing, I believe, a statement, an OFID statement – which is a statement from another financial institution – which is required for that loan to progress through. So it went back to him. So had it to go back and forth and then the loan came in, was subsequently approved, and then later in the stage we discovered that on the customer on boarding form there was also an error. And I don't – I believe the product hadn't been selected and they needed to go back again and get that information. So there were some problems with – with that loan. And then the loan which was submitted in June 2015 was ultimately declined. That loan was a loan which was outside policy. So the 2015 loan again failed the original sort of check and then when it came back in it was outside CBA policy. The LVR was higher than allowed with CBA policy and it failed servicing. So that loan was – was declined.

And those things you've just mentioned had nothing to do with the deaccreditation of Mr Harris' deaccreditation, did they? He was selected because he fell within the 100 brokers who met the criteria for the first phase?---Right. But I think it provides a useful illustration of what we were trying to do, which was – I mean, coincidentally – and as I say we didn't go and look at that particular broker before he was deaccredited, but it does provide a useful insight into what – about why we undertook this, which was "We have got a loan in 2015 where a customer has had a conversation with a – with a broker and they have put an application in which was never going to be approved." It was outside policy, the LVR was too high, and it failed servicing. So there has been a conversation with a customer for a loan which was – which was never going to be approved. That is – that is precisely what I would like to avoid, and therefore why we are trying to get better assurance among our brokers to try and stop that from happening.

Did anyone - - -?---It doesn't need to be linked to volume, but it doesn't – I do need to assure myself that that doesn't happen.

Did anyone address those matters with Mr Harris?---I – I don't know that. I don't know that information. I mean, unlikely. There is 13 and a half thousand brokers and we are getting thousands of loan applications – applications in. So I'm unable to go and talk to every single broker about every single loan they put in that fails. And therefore I'm – I'm forced, you know, I have to put in mechanisms like the ones we have now put in place and the ones we had in place at the time to try and make reasonable business judgments about when certain groups of people are going to be able to meet the customer expectations and the business needs. And that was the judgment I made. And I think the example we have just talked about is a good one of that's not a great customer experience, that's not good for the Commonwealth Bank, that's not good for the customer, and so - - -

But no one raised that with Mr Harris and we see from the emails that you would have seen discussed in his evidence yesterday that your own people at CBA tried very hard to help him overturn the deaccreditation?---Well, they tried – I mean, Cameron, who is the state manager, suggested that he would put an appeal in. I mean, that appeal would have been assessed as with all of the other appeals. It didn't get to that point. But to your question before about no one discussed, as I said, there is 13 and a half thousand brokers. We are getting thousands of applications every day. I can't take every loan which gets declined like that, and therefore I have to put some other mechanisms in place, and to do that – and that's what I did with the deaccreditation, and based on the feedback that we got we have now, I think, moved to something which is better, which is that people can keep their accreditation, it's not linked to volume, but, "You've going to have to do some training so that I can be assured that you understand the CBA products and processes."

THE COMMISSIONER: Have you reduced the fail rate?---Pardon?

Have you reduced the fail rate? That is, the declining of proposal?---No, we haven't gone and done the deaccreditation of all of the large brokers. So - - -

Have you reduced the error rate?---I – I'm not sure the error rate has been – I would need to check whether that has come down.

Well, as far as your evidence presently goes, the changes you have made, you are not conscious of those changes affecting either of the purposes of the change, namely reducing fail rate and reducing error rate; is that right?---Well, on the 710 brokers that would be insufficient to move the entire bank's fail rate. But I would expect over time, based on the process that we have in place now for accredited brokers, that those – that those measures will absolutely decrease, as you – but it's going to take some time to flow through.

MS ORR: Just before we leave Mr Harris as a topic – yes, before we leave Mr Harris as a topic, Mr Huggins, I will show you another document which is CBA.0001.0100.5795. This is an email sent by Cameron Baseley, who you described as the state manager in Queensland, to other people within CBA, dealing with Mr Harris, explaining his business, referring to the issue in the middle of the page:

> *We notified Mark that he would be resigning his accreditation due to his low volume. I had already commenced an appeal for his accreditation, due to his history and potential. I was working with Beccy Raas at AFG to obtain some information to assist with this appeal. In the meantime, Mark has clearly been active in social and print media, broker news and SMH, advising journalists that CBA is resigning accreditation. I have been trying to book an appointment with Mark to go out and discuss with them directly, but as yet we have not finalised a date. Recommendation: Given Mark's activity in the press I am not now sure he is someone we want to honour an appeal for. I would like to speak directly with Mark and understand if he is keen to partner with CBA and will operate in line with our values. Therefore any appeals for accreditation from Mark should be parked.*

Have you seen that email before, Mr Huggins?---Yes, I have seen that email.

And it's true, isn't it, that CBA took a dim view of Mr Harris after he engaged with the media about the deaccreditation program?---I think we – we were uncomfortable, as I mentioned before, with the narrative which was in the press, which I believe Mr Harris was talking to, which suggested that this was all about us trying to raise volumes with other brokers which – which it wasn't about and, as is indicated here, we have been unable to meet with Mark to discuss that with him.

I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 1.36. CBA.001.0100.5795. Email Baseley to Boer, 24 February '17.

EXHIBIT #1.36 EMAIL BASELEY TO BOER DATED 24/02/2017 (CBA.001.0100.5795)

MS ORR: Now, Mr Huggins, the deaccreditation program followed a review that you have spoken about of brokers that was conducted in late 2016 and 2017 at CBA?---Yes.

Yes. And you oversaw that review?---Yes.

And as a result of that review CBA has announced changes that you have referred to already in your evidence to its broker accreditation program?---Yes.

There is currently a freeze on the accreditation of brokers which will shortly be lifted and a new broker accreditation program will be put in place?---That's right.

And a large purpose of those change that are being made is to ensure that CBA accredited brokers are experienced it in residential lending; is that right?---Yes, that's right.

Okay. Could I ask you to look at CBA.0001.0031.0121, which is your exhibit DH16. And this document was prepared for internal purposes to assist CBA people to field questions about the changes to the accreditation program; is that right?---Yes, that's right.

Can I ask you to look at 0125, and direct your attention to 3.3 and 3.4:

> *Does the potential candidate need to meet all criteria before they are able to submit an application for accreditation? Candidates must meet all of our criteria. There is only one instance where we will consider an exception, which is the minimum levels of residential lending experience. We will consider these exceptions based on head group nominations and the candidates' track record of delivering good outcomes as well as the training and mentoring they will receive.*

Down to 3.4, a reference again to that one exception, and the same basis for it. Now, what I want to ask you is how that fits with the driver of this new accreditation program being to ensure more experience to have this sort of exception in the program?---Well, the – the new accreditation program is designed to ensure that brokers are able – you know, to have a good conversation with customers about CBA products and therefore, you know, this is one of the requirements and whilst we allow an exception to that where there is a solid training and mentoring program around it, you know, we are still requiring brokers to have access to that experience and any other elements of the accreditation also fit into that. So we require a diploma, we require that a person is a direct member of an ACL, one of our approved ACLs, and also a member of the MFAA or the FBAA.

THE COMMISSIONER: Sorry, Mr Huggins, again you are dropping your voice?---Sorry, I'm not used to – so the – the – all of the changes that we have made to the accreditation are designed to make sure that a – that a customer is going to have a good experience with that broker and that the quality of brokers that are accredited with CBA is of the highest possible standard. And this requirement of two years minimum experience affirms that. We will make exceptions where there is an approved mentoring program with someone of experience, but the other elements of our accreditation program also reinforce the desire to have a very high quality broker who is able to have a very good conversation with a customer from day one.

I have one further topic to cover with you, Mr Huggins, but it can't be done within a few minutes, Commissioner.

THE COMMISSIONER: Then the only other matter of housekeeping, that I think may or may not be necessary, is I don't know that you have tendered the letter of Mr Narev to Sedgwick.

MS ORR: I have not.

THE COMMISSIONER: Do you intend to?

MS ORR: I do, Commissioner, and I can tender that now. It is the only one I have missed so far. It is CBA.0001.0038.0929. That document is both the letter from Mr Narev to Mr Sedgwick, dated 10 February 2017, and the annexed issues paper submission that I referred to.

THE COMMISSIONER: That will be exhibit 1.37. The document as you have just described it.

EXHIBIT #1.37 LETTER FROM MR NAREV TO MR SEDGWICK DATED 10/02/2017 AND THE ANNEXED ISSUES PAPER SUBMISSION DATED 10/02/2017 (CBA.0001.0038.0929)

THE COMMISSIONER: 2 o'clock, then.

ADJOURNED [12.58 pm]

RESUMED [2.00 pm]

THE COMMISSIONER: Yes, Ms Orr.

MS ORR: Mr Huggins, I would like to take you to paragraph 63 of your statement where you refer to controls that CBA has in place to ensure compliance by head groups and your aggregated mortgage brokers. Do you have that paragraph there?---Yes. I have that paragraph, yes.

And the controls that you list in that paragraph include a reference to a file review process that done by CBAs credit support and monitoring team. You refer to that in subparagraph (a)?---Yes.

How often do those occur?---So that – I think that referring to the credit and support team. So that occurs on a randomised basis across a statistically significant sample of the population. So it's hundreds of applications, but it's – you know, it is quite regularly across the population. But obviously that means that, you know, for any particular lender or broker, given it is a statistically significant sample across the population, that it may not be that frequently for a lender or a broker.

And the second control that you refer to here – this is control over your accredited mortgage brokers and head groups?---Yes.

Is a targeted review process?---Yes.

And that done by CBAs credit support and monitoring team and happens when CBA is notified of something that requires review; is that right?---That's right. So that's the same team and they will – where we have identified a broker – either we have been notified or where we have identified there may be cause to look at a specific broker they will, on a targeted basis, start pulling out applications and reviewing those.

And the third control you refer to, the third CBA control over its head groups and mortgage brokers, is the head group assurance program?---That's right.

And this is a program that requires the head group to comply with particular obligations and for its representatives and employees to comply with those obligations?---That's right. And that assurance program is linked to the document we looked at earlier, which has that sort of exhaustive list of things we go and look at with the head groups.

So this is about requiring the head group to do the right thing. It's not really a CBA control as such, it's requiring the head group?---No. So, as per that document we looked at before, CBA will go and look to make sure that the head group has, for example, the compliance documents, all those conflict of interest documents we were talking about before. So it's us auditing the head group.

And how regularly does that happen, that audit?---So we have recently started doing it and it will be once a year for the – for the main head groups is our – is our plan.

And when did you start doing it?---It was quite recently. It would have been last year we started doing it.

Is this one of the late last year changes?---The – it wouldn't have been – no, not December, I think sort of mid-year. I think the document we looked at before was sort of a May document and it was – it was created – we started doing them around that time as part of this process.

And how many of those have you done so far?---We have done three of them. I think there is a fourth underway now with us, and then our audit team had also done, I believe, three with Bankwest, but that was a different process. But we saw the outcomes from that, so that gave us some assurance over – over those head groups. But ourselves, I believe we've done three, and we've got a fourth going now.

And you refer also to a particular committee that the broker governance committee?---That’s right.

We looked at the – I think we looked at the minutes of one of those meetings before?---Yes, that’s right. So this is a – a committee which sits underneath the home loans sub risk committee and the intention is that we have a group of people who are meeting once a month, who are actually providing oversight and reviewing all of the things that should be going on in the business to make sure they are. So my – Simon Kwan, who leads my operations business, will be – he will talk to operations, and Bill Cantaris will talk about what has been happening in the BIR process, which is our broker investigations business. He will talk about deaccreditations and then there is what we call line 2, which is the business is me and then there is independent oversight, which is what we refer to as line 2. They also come in and report, and they are overseeing whether our accreditations are appropriate, whether that is all working. So we have both lines, and the intention of this committee is firstly to make sure that that’s happening, and then also if there are other decisions that need to be made around the broking business they would come to this committee. So when I referred before to changes to our accreditations model, then they would go into this committee first and then up through other approval stages.

Could I ask that you be shown a document, Mr Huggins, which is CBA.0508.0001.0029. Now, could you explain what this document is, Mr Huggins?---Sure. So this is an internal audit document. What we call line 3. So just to explain that, the business – as I mentioned before line 1, line 2 would be our normal internal risk function, and then the audit function is oversight across all of that. This is the – this is the summary report and then there will typically be an issues log that sits in behind this. This – the report is generated, you know, for a specific purpose in the business and, you know, we will assume that you understand, you know, the business and you have the context of what’s happening in the business. They don’t sort of go into all the details of the layers of control or anything like that. They kind of assume you understand that and then they will document their findings here and in the issues log.

And who are they?---Sorry, that’s the audit group, the independent audit team that works within CBA.

Yes. Now, this document relates to an internal audit of the CBA retail brokers; is that right?---Yes, that’s correct.

Within the home buying retail division, your division?---That’s right, yes.

And you are described in the third line of the document as the accountable executive?---That’s correct.

And this document is a document from towards the middle of last year, 16 August 2017?---That’s right. That when the document was written. I believe the review period for this was around May 2015, through until May 2017. So the review period was before, obviously, the document was written. It covers that two year period, and then the document was written on that date.

So in this report there is an assessment of various things in the retail brokers area?---Yes.

For the two years preceding the report; is that right?---For the specific areas, yes, that they have identified in the report. Yes, that's right.

So could you explain this report rating box to us, at the top?---Sure. So there is – there is three ratings which – which you can generally get, which will be satisfactory, marginal or unsatisfactory. Obviously, in this box, satisfactory is that things are going, you know, sort of perfectly well. If it's a marginal it's – there's opportunities for improvement and obviously if it's unsatisfactory then that, as it would suggest, would mean that there are, you know, more unsatisfactory findings.

So what does amber mean. You haven't referred to amber?---Sorry, so amber is the overall rating. Again, you can either have green, amber or red. Amber means, you know, generally that there are things to focus on. So when we look at this, this would show marginal and control environment, so there's areas that, you know, need to be improved in the control environment. Management awareness and actions is satisfactory. So that means that, like, management is aware of those gaps and has plans in place to resolve those or, indeed, they may already be solved, because this report is written after review period. And then amber, I mean if you have got any marginal on there you have going to get an amber. So the only way to get a sat on the overall report will be both to be satisfactory.

What are the available ratings for control environment? Marginal is the one given here?---Marginal is the middle, so you can have satisfactory, marginal or unsatisfactory.

I see. So marginal is somewhere between satisfactory and unsatisfactory?---Yes. It means there are things to improve.

Yes. So do I read this correctly as telling us that the last time this audit group looked into the broker's part, the business, the control environment was also rated marginal in 2014, management awareness and actions were also rated satisfactory, but the overall report rating was amber. As it in 2017?---That's right. I mean, the issues aren't necessarily the same. So when they look in the control environment in 2014, I haven't reviewed that report, but, you know, the environment changes in the couple of years that the reports are generated and what was – what made the report marginal in 2014 - - -

Might be different?---Might be quite different from what's made at marginal now.

In any event, the - - -?---But in - - -

- - - control environment hasn't moved up to satisfactory. It's still only marginal in 2017, perhaps for different reasons?---Right. So the control environment may have lifted into overall, but if the – you know, if the general view of audit is that needs to lift further, you can still be marginal.

And what are the consequences of a business area, such as the broker's business area, receiving an overall report rating from the independent auditors of amber?---Well, that would come into mine and my team's ratings. You know, links to management awareness and actions and then Matt Comyn, who is my manager ,would look at that and determine whether that should effect my KPIs or not. So my bonus at the end of the year.

Any other consequences apart from remuneration consequences?---Well, for the – for the leaders of the business it would – it would, you know, be remuneration. It also directs where we go and invest and certainly – and is the case in this – there was some things identified that resulted in us redirecting, you know, investment and management attention. So it may also result in – in management time and attention being redirected to roles and resources being redirected.

Yes, I see. So we see the audit conclusions on this page. The first is that there was a need to reprioritise some initiatives and develop new ones to give greater comfort over key tasks performed by both aggregators and brokers on CBAs behalf?---Yes.

If I could take you down to the next paragraph:

> *In addition, management needs to assess and determine whether aggregators and brokers are complying with the relevant key group policies they are contractually obliged to comply with.*

So the conclusion of the audit group is that there are issues – sorry, I have lost the page from the screen – there are issues with whether or not CBA is assessing and determining whether its head groups are behaving in a compliant way?---So as I mentioned before, the – the audit and the report is written, you know, for a specific purpose. Audit is going to look at the business and it's going to isolate specific parts of the business that need to be improved, and just focus on those. And then sort of ignore the broader context and layers that sit around that. So - - -

The role of the audit group is to identify the problems that need to be addressed, is it not?---It is. And they do that by looking in – for those problems and then they isolate them. So, you know, although there may be multiple layers of redundancy that exist in the system to ensure you are getting an overall good outcome, they are going to focus on a – you know, very specific part and say, "This part in isolation can be improved." And then they will – then they will report on that. They don't, you know, then – and that's appropriate. You know, I want them to identify where I can improve the business and that exactly what they do. But they don't talk in here about, you know, all of the other things that might be happening in the business to give ourselves assurance.

No. But what we see from this document is that they identify significant problems in relation to the monitoring of aggregators and brokers by CBA. This is in August 2017?---Yes. They identify some areas that need to be improved.

And as a result of that, the control environment is rated marginal only?---That's correct, yes.

Yes. So could we turn to the second page to look at some more specific findings of the audit group. The key themes from the audit are below. Do you see that reference, Mr Huggins, on the left-hand side of the page?---Yes.

The first is that:

> *Home buying do not have sufficient oversight of aggregators to confirm they are meeting key legislative requirements they are required to perform on behalf of the group.*

That was one of the findings of the audit group?---Right. So the way that audit is going to document its findings, as it does here, it's going to create the risk theme, which is what they talk about there. And then they are going to get into the details. So here they say, you know, the general theme is that we don't have sufficient oversight and then they get into the very specifics. So they talk about EDD, and we can talk about that in detail if you want, so they - - -

Well, let's talk about one of the details, which is that management relies on aggregators. That's CBA management - - -?---Yes.

- - - relies on aggregators to have a robust monitoring program to check that brokers comply with the National Consumer Credit card – Credit Code, I'm sorry?---Absolutely. That's right, yes

So why is that? Why is CBA relying on aggregators to do that when CBA has its own legislative obligations to do that?---So I don't rely on aggregators to meet my NCCP obligations. So, you know, where it pertains to responsible lending and my NCCP obligations I'm assuring myself, you know, from primary information that I'm lending responsibly and meeting my obligations. The broker, though, has its own obligations. The head groups have their own obligations under NCCP. And one of those we talked about before, for example, around disclosing commissions, or around doing a needs discovery exercise to ensure that the needs and objectives of the customer are appropriately understood and then, you know, some of that information is provided across to me. So I'm relying on, you know – on them to make sure they are meeting their NCCP obligations and then that what this is referring to. But I'm not relying on an aggregator or a broker to meet my NCCP obligations where it pertains to ensuring the loan which is written is appropriate for the customer.

So is the point here, the finding of the audit committee, that CBA is not doing enough to ensure that brokers and aggregators are meeting their legislative requirements?---That – that's right.

Yes?---And when you read the detail, it linked into the – again, that detail sort of five or 10 page document you had before, of how are we going to go and assess whether – whether those systems are appropriate, whether the compliance systems are appropriate, and it gives off another layer of certainty. So if an aggregator has a really, really great compliance program, and some of them do, then that – you know – gives me more confidence as well. It doesn't mean I stop doing my own assurance programs or the credit support and monitoring team, but it does give me another layer which – which is good for me. So - - -

But the overall findings of this document – there's a number of themes identified in here – the overall findings and the reason the retail brokers group was only given a marginal control rating is that:

> *CBA is not doing enough to monitor the activities of the head groups and the mortgage brokers who sit under those head groups.*

?---The – over the review period that was right. Obviously, we had started doing that work and it linked into it. But as I said, you know, there is – there is quite specific things in here which – it doesn't consider the – the full system that in place. But, yes, the audit identified improvement opportunities in the broking business and – and I'm fully supportive of those, and we have gone and taken action that was the point of the audit.

I will just show you briefly 0033, because we can see that an appendix to this document is a summary of the very high to medium audit issues?---Yes.

And the high audit issue is:

> *Risk exposure where the aggregators or third parties are not performing and monitoring activities. Has not been assessed by home buying.*

And that issue became an issue that you had responsibility for?---That's right. I think that issue had already been raised by us before, but – but I do have that as a high issue. I believe it was self-identified. And their findings link into that risk and, you know, that – that links, you know, again back to the work that we are doing, having identified this risk, to go and audit the head groups in detail to see whether this is happening. So it's absolutely a risk that we have identified in the business and doing work to – and done work to improve.

Can I just take to you appendix C?---Sure.

Which contains commercial insights for management's consideration. Is that a standard part of this sort of document?---Well, the way an audit will work, is they will – they will identify the issues and they will be documented in that issue log. They may have other observations which don't justify putting in a specific issue, which then requires a specific action. So these are sort of the – you know, "Look, we have seen this as well, you may want to consider it as management, but it's not a big enough issue for it to be made an issue." Otherwise it would have been put into the issue log.

I see. I see?---So this is observations of things for us to think about.

And the first one of those, the first dot point in row 1:

> *It is not industry practice for banks to complete assurance and hence aggregators do not have well-established processes for providing access to their people and deal files.*

Now, is that a reference to it not being industry practice for banks to complete assurance over head groups?---Yes, that's right. So it - - -

Yes. And why is it not industry practice for banks to complete assurance over the head groups through which the customers come to CBA?---Well, I think – and I can – from my perspective, you know, from the bank's perspective, I think we are assuring ourselves of the – of our obligations and making sure we are lending responsibly. I think historically we haven't extended that out to the other NCCP obligations of the – of the head groups, but that is starting to happen. As I mentioned, we have started doing it. The other thing that has happened is we are currently part of an industry initiative where PWC is performing this on behalf of a range of different banks, so we will end up with, you know, a industry once a year review of the head group, which can then go into ..... and we have put our approach into that, we have provided that to PWC, and they have themselves added a range of features, as have the other banks, to make sure that we get – at an industry level, you know – a really thorough annual review – at least annual review – of the head groups. So that – that work is happening. But – yes, and I guess part of this finding was seeing that and, you know, it is a good observation.

And how are we going to fix this problem that, because there hasn't historically been assurance by banks of head groups, that they don't have processes for providing access to their people and deal files, which is connected with another of the dot points, the last one:

> *As it is not industry practice for ACL holders to be subject to assurance, the aggregators sometimes encounter resistance from those brokers to provide documentation for review and Q&A.*

So you might well have your annual industry assurance of a head group, but what's happening to assure that that can be an effective process?---Yes. I mean, we are working closely with the head groups, and I have to say they have been very engaged and the ones we have spoken to so far – we haven't spoken to all of them – but the folks we have spoken to so far have been very engaged and they want this to improve too and certainly as we have had findings and gone back to them and said, “Look, here is where you can improve,” they have been really open to that. So it is a challenge, it’s a challenge for the head groups, but I would suggest – well, my experience with those head groups has been that they are keen to make this work and keep to see this type of thing happen at an industry level, so they can identify how they can improve, and those hurdles are for the head group to overcome. And they’re trying to overcome them.

And they become CBAs hurdles to overcome as well, don’t they?---Sure.

Given the customers deal with CBA through these mortgage brokers?---Of course. And as we suggest, as I mentioned earlier, you know, the CBA accreditation comes with some customer expectations that – I want to make sure they are met. So yes, they become my problem as well, and we are working closely with the head groups to make sure that they are resolved. But I have not yet – and I – I doubt this will happen, I hope it doesn’t – I have not yet had to pause or stop any activity because a head group has been resistant to CBA coming in. And we saw in the document before – and what is quite an intrusive process. We look through everything and that we – that is on that list. It’s quite extensive. So - - -

This is for the three you have done so far?---That’s right, the three we have done so far and then obviously we are now, at the industry level. So - - -

All right. I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 1.38. CBA.0508.001.0029 internal audit report 16 August 2017.

EXHIBIT #1.38 INTERNAL AUDIT REPORT DATED 16/08/2017 (CBA.0508.001.0029)

MS ORR: The last document I want to show you Mr Huggins is what I think you were referring to before is an “issues log”?---Yes.

It is CBA.0508.0001.0001. Am I right, is this an issues log of - - -?---Yes, that’s right.

- - - the style that you had described before?---Yes, that’s right. So this is the – got the summary, which is the one we just looked at, and then behind that there is the more detailed issue log which gets into the detail.

So this is the issues log for a different summary, because this is dated 5 September 2017?---No, it’s – it’s linked.

It's the same one?---It's the same one.

I see?---What will tend to happen is that, because management has to write management actions against this, audit will complete its findings, management will then write its responses.

I see?---And so it will tend to – it will tend to get finalised a little later.

I see. So these are companion documents?---They are companion documents, that's correct.

And the issues listed in here are the issues that underpinned the report findings?---That's right. Yes. So you will see the – you will see the titles, the issue titles here, are the same that are referred back to the previous one.

Okay. And, again, you are listed as the accountable executive for this?---That's right.

And the first issue is:

> *Risk exposure due to lack of management's oversight on aggregators and aggregators oversight on brokers have not been assessed by home buying.*

?---That's right.

And there's - - -?---So that links back to the same one we saw a second ago.

That's what we have been discussing?---Yes.

And the issue rating is high?---Yes.

And the impact is major?---Yes.

And the likelihood is likely. Could you explain those characterisations please?---Yes. So – so the way we look at an issue is – is, again, sort of an isolation of all of the layers of control. If that happened what would – what would happen? So the issue rating is defined by the impact and likelihood. So for an issue we say, you know, on a matrix – you know, here is the issues impact, if it were to happen, and here is its the likelihood. And most of the issues in the home buying business end up being high.

Yes?---Because it's a big business.

Yes?---Even if is a moderate likelihood the impact would be, you know, large. So you end up with high. So it's not linked necessary to the issue description, and here it's the overall issue that we are linking – linking into here, and then we get into the detail underneath.

And if we go to that detail, we see that:

> *The third party banking team have not confirmed if aggregators are meeting their responsibilities under the individual aggregator agreements. Third party banking did not exercise their rights to audit until recently.*

?---Yes, that's right.

And why – why is that?---So that what we were just referring to a second ago, when I took over the business, middle of 2015, which I took accountability for the broking business, the business hadn't been doing these audits recently into whether – whether the obligations of the contract we were talking about before have actually been met or whether, indeed, the – the compliance procedures that the head groups had were – were good ones. So - - -

So this is a recent development that this audit right is being exercised?---Yes.

And so far it has only being exercised in relation to three head groups?---So – yes, the – this document in September – at this stage I think we would have done three, but as I mentioned before, audit themselves had done three more with Bankwest and I think audit also have been in at Aussie. So across the – across the business, I believe we had covered seven at this stage, and – when this had been done. I think that's right. I'm not exactly sure whether, when this was written, whether we had done one – the timing is a bit – but that has been done now, definitely, but certainly the time this document had been written, we had only recently started to do those – those detailed audits, and before that we weren't doing them?

So could we look at some of the specific examples of what's going wrong here?---Yes.

The first being that:

> *There is a limited mechanism to confirm if the original customer identification information was sighted by third parties.*

Do you see there the audit group found 1361 instances of where the borrower, the broker, and the security property were in different states at the time of the application?---Yes.

And 332 where the borrower and the broker were in different countries at the time of the application?---Yes – yes.

And 2758 instances where the borrower and broker are from different states. Now, those are pretty obvious anomalies in the documentation, are they not?---Well, they – in this data analysis, yes, they come at when you do that data analysis. We – we didn't, at this time, have the – have that as a part of something we were picking up out of the application process. I think the other thing that is here is – and we were talking about it before with – our contracts haven't kept up with technology. So we refer in – and, you know, to face-to-face, which is what audits rightfully picked up here. They have said, "Well, some of your documents talk about face-to-face." We haven't updated those documents so, well, maybe someone has been talking on Skype or on FaceTime. So they might have met the obligation to have a personal conversation with the particular customer, but we can't tell it from this data and that rightfully is what audit has picked up and said, well, there is some data here which would suggest that face-to-face may not be happening. There may be other reasons. It may be that, at the time of application, someone was in a different country. But they may have had the interview with the customer before, you know, that person went away or same ..... but, look, the point remains our systems weren't set up to identify this, and - - -

You weren't even looking into this?---No, we weren't. We weren't. I mean, it's a good observation by audit, and it – you know, it doesn't suggest that the loan is inappropriate for the customer. But, you know, it was a good finding by audit and we've now – we are building up something called the Command Centre, which is utilising that data and is – is going to identify that in real time before the loans get funded, such that we can ask another question of – of the customer. So it's a good finding, you know, and – and it's helped improve the practices.

THE COMMISSIONER: It's a finding of a matter in respect of which the bank depended on what the broker told them?---Sorry, sir? Sorry, I missed that.

The bank depended on what the broker told it?---That's right. That's right. We depended on – yes, we depended on the broker.

In many respects, in respect of house loan applications, the bank depends on what the broker tells it?---That's right.

Yes. Go on.

MS ORR: Another example of that is the second issue on the next page, Mr Huggins, issue B:

> *Broker discussions with customers on products suitability and not validated by retail banking services to confirm the product meets the customer's intended purpose and desired customer outcome. Management relies on brokers to confirm product offered to the customer was not unsuitable at the time of the application and for in line changes.*

Now, under the National Credit Act, CBA is not permitted to rely on brokers to confirm that products are not unsuitable for the customer. CBA has its own statutory obligation to perform that assessment itself. Do you agree?---I mean, this is – this isn't well worded. We absolutely assure ourselves of our own NCCP obligations and make sure that the loan which is provided to customers as per the responsible lending obligations - - -

I want to put to you that that entirely inconsistent with what the audit group have found?---No. As I mentioned, I don't think it's well worded. I think what is – what is - - -

THE COMMISSIONER: You say the audit group got it wrong, do you?---No, I think what they are - - -

Well, what you are telling me, Mr Huggins?---What I'm saying is we are – we do not rely on the broker to do our assessments of the application and meet our responsible lending obligations. We will make those assessments based on primary documentation. But at this time we were not going back to the customer and asking them to confirm, once we had made that application, that everything we have seen was – was accurate. And that would have been - - -

Do you go back to the customer and ask them anything?---So - - -

Did you go back to the customer and ask them anything?---Not – not at this – not at this time. We do now, but at this time we were relying on the broker to provide an accurate application and then for us, under our responsible lending obligations, to look at primary source documents to make that assessment.

You are very quick to tell me that you thought this part of the audit report was poorly worded. Do you want to reflect on that answer and think again about whether there is some poor wording here, or is it simply the fact that at this time the bank did not verify what the broker told it: acted on what the broker told it. Now, that may be right, it may be wrong, but isn't that the fact?---Yes. Yes. The fact is that we – it says management relies on brokers to confirm the product offered to the customer was not unsuitable. That is – that is correct, at that time. So I would correct the statement for that piece and then obviously the other parts of us making our own inquiry would stand.

MS ORR: And could we just move to the second issue. There are many other limbs of this first issue that I won't take you to, Mr Huggins, but the second issue is at 0008. This was the risk exposure issue, issue 1. Issue 2 is:

> *Gaps in the monitoring process to prevent or detect adverse broker behaviour have not been addressed.*

Do you see that?---Yes – yes.

And do you see in the first paragraph:

> *Third party banking currently have 29 head groups with almost 13,000 active brokers submitting over 12,000 loan applications per month. Management do not have mechanisms and tools to proactively identify broker behaviours.*

?---That's correct.

Does that remain the case?---No. We – as I mentioned before we are building out the capabilities to identify specific broker behaviours in – on applications live. So we have some of those built, but we need to continue to build that out.

All right. There are other issues listed in this document, but could I just take you to the appendix, which is 0018. The appendix lists examples of adverse broker behaviours in connection with this particular issue that we've just referred to. Do you see there things such as the second observation, monthly living expenses less than household expenditure measure. 191,534 instances of that identified by the audit group?---Yes. So this is where audit – these documents, if viewed without context, can – or the understanding of the business can be misleading. And this certainly reads as though we have approved $191,000 less than HEM. That's not what happens. In – if someone were to – as is the case here for these loans, where someone has given monthly living expenses less than the household expenditure measure, then we ignore that information and we bring them up to the floor, which is the household expenditure measure. So what's – you know, that sort of assumed a knowledge on the part of people that they would know that our system would bring that up to the floor.

Why do you do that? When someone declaring their living expenses as less than HEM why do you bring it up to HEM?---Well, because our experience is that customers – we want – customers aren't that good at identifying their own household expenses as being our experience. And therefore we set a minimum floor which must be applied in the loan – that's linked to income and house size – to make sure that every loan that we approve has at least that floor. If a customer declares to us more than that amount, then we will take the higher number, but the people tend not to be very good at it.

So you assume their expenses are greater or lower than they have told you?---Greater.

Greater?---Greater. Yes. So we will always take the higher of the customer declared or HEM.

Yes?---So we will always – we will always raise. And as you can see here, you know, this is – it says 75 per cent are there. So a lot of customers are having it raised, and we ignore what the customer has told us where it's below our floor.

But what does that tell you, about 191,000 customers declaring less than HEM?---Yes. I mean, it – it's – it's a challenge that we are aware of, that customers aren't good at identifying it. So there advantage of work ongoing to try and – to try and improve that, that outcome. It is also worth – this is not the only – we are not talking about all customer expenditures. The way that the application works is we ask for other commitments. So other debts of the bank and then other commitments, school fees and so on. And then this is the household living expenditure part. So it's an important part, but it's – but it is one part. It doesn't include, you know, other mortgages or – all of those things are done separately.

Now, Mr Huggins, there are six pages of examples in appendix 1 of adverse broker behaviour?---Yes.

I will just show you the next page, so you can see the sorts of examples we have, but we see for example 83 instances identified by the audit group where a loan had been declined by a CBA branch and then accepted by another broker within a six month window. Is that a problem?---Well, it's a good observation that we should be looking at. It may not be a problem. The person may have applied for less money; they may have, you know, restructured the loan. So you don't know, from this analysis, as to whether it's a problem or not. But – but it's a good thing to look at and to ask another question, and this was very helpful for us and it's something that we have taken from audit when they did it; it was new when they did it. We've taken the way they were approaching this and we are building that into the business as usual part of the business. So it was – it was very helpful someone coming in who is not close to the business and just asking these sorts of questions about, "Well, you know you should ask a second question. It may be fine, but – but, you know, have a normal process by which you ask the second question." So that's what we have gone and done and are building out.

All of these examples are referable to the second issue identified by the audit group, which was that there were gaps in the monitoring process to prevent or detect adverse broker behaviour such as these things?---I think that – yes, that's right, yes.

Yes. I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 1.39. CBA.0508.0001.0001 issues logs September 2017.

EXHIBIT #1.39 ISSUES LOGS DATED SEPTEMBER 2017 (CBA.0508.0001.0001)

MS ORR: I have no further questions for Mr Huggins.

THE COMMISSIONER: Yes, thank you. Is any party other than the CBA who has leave to appear seek leave to cross-examine, Mr Huggins? And do you have leave to appear, sir?

MR MARTINEK: Commissioner, I actually applied this morning for leave to appear to examine.

THE COMMISSIONER: Well - - -

MR MARTINEK: And I have had no response and I have travelled down.

THE COMMISSIONER: I'm not surprised because the applications for leave to appear were due in quite some time ago. First, what is your name?

MR MARTINEK: James Martinek, your Honour.

THE COMMISSIONER: I'm terribly sorry, sir, could you spell your surname

MR MARTINEK: That's okay, Commissioner, it's actually M-a-r-t-i-n-e-k. I did send through a very brief summary and I have contacted the Commission over the last few days to have someone call me back. And I'm sure that they are fairly busy. It literally is a series of 10 questions in regards to broking and I - - -

THE COMMISSIONER: Yes. And how are these matters that affect you directly, sir?

MR MARTINEK: Your Honour, I have gone through a process that is current. And as of an email here, 6.1.2017, from the – I think Mr Kuselak is – and Mr Cohen is the chief risk officer for CBA, and it's really just in – in relation to one paragraph that was answered by Mr Kuselak who is the executive legal counsel for banking and technology in regards to a broker that was an ex-banker that then became a broker. And it's – it's a very simple series of questions. If your Honour would be able to just take five minutes to have a look and see it if it was suitable.

THE COMMISSIONER: Have you written them down?

MR MARTINEK: Yes.

THE COMMISSIONER: The questions. Perhaps if you would be good enough to hand them up.

MR MARTINEK: Yes. And the – all of these have been sent through, your Honour.

THE COMMISSIONER: Thank you very much.

MR MARTINEK: I have got copies for - - -

THE COMMISSIONER: Just a moment. Mr Martinek, I have looked at the questions to CBA that you have – I'm sorry, there are three pages of them, I have looked at two of them, not the third.

MR MARTINEK: I think it's really just the first 10, your Honour, in regards to payment family trusts and spouses.

THE COMMISSIONER: Yes. We have look already looked a little, and it may be that we will look a little further, at questions about disclosure of commissions that are paid and to whom they are to be paid.

MR MARTINEK: I suppose it's just – it is a current debate that has been going on with CBA.

THE COMMISSIONER: I understand.

MR MARTINEK: And I think if you look at paragraph 8, in particular, it negates nearly all of the answers that CBA have given.

THE COMMISSIONER: What I think I would suggest you do, Mr Martinek, if I may, is – if I return these documents to you – what I suggest you do you is you write down – and you should spend some time on this, I'm not suggesting you sort of go out the court door and write down in the next 10 minutes. I want you to take those papers, think about the issues that you raise, distil them – that is, refine them – as far as you can.

MR MARTINEK: Yes.

THE COMMISSIONER: Now, it is not an easy task.

MR MARTINEK: No.

THE COMMISSIONER: But we have all had to do it. Then what I suggest you do is go onto the website of the Commission and put it in, in the form of a submission. Now, all of the submissions that are being made on the web are in fact being read. I need that to be well understood. I suspect I'm probably breaching everything if I say I will keep an eye out for yours when it goes through, and have a look at it, but then I think we will decide what to do. So at the moment the answer to your question, may you ask Mr Huggins questions, is no. You may not. What I suggest you do – by all means stay here for the balance of the day, and as many days as you like, but go away, think about it, write it down, put it into the web form and then leave us to decide what we will do. Do you understand me?

MR MARTINEK: Very much Commissioner. Thank you very much for your time.

THE COMMISSIONER: Thank you very much, Mr Martinek. Any other application for leave to cross-examine? Yes, Mr Scerri.

<RE-EXAMINATION BY MR SCERRI [2.48 pm]

MR SCERRI: Thank you Commissioner.

Mr Huggins, what types of living expenses to customers typically underestimate?---Well, I mean, people tend to underestimate, you know, how much they spend going out, you know, for dinner. You know, they tend to forget, you know, the maintenance that happens on the car once a year, you know, so sort of infrequent things. They will tend to do a better job with things that are more frequent. So grocery bills, for example, things that are always happening people tend to do better. But infrequent expense items tend to be, you know, less well – you know, less well understood. We ask quite detailed questions, you know, so things like expenditure on pets and some of those things people – people may not naturally think about some of those things either, so they may not understand them.

Thank you.

THE COMMISSIONER: You ask those questions anyway?---Well, we break it down now - - -

Yes?--- - - - into 11 different categories.

And despite that people still come in underestimating, don't they?---Yes, they do.

Significantly underestimating?---It is hard to say. It's definitely under. The challenge is with something like HEM is that – you expect, by the way, it's created for some people to be below it. So it's certainly not as many - - -

Under HEM?---Yes. We do. We don't allow it, but the way HEM is created is you have got a basics, you take the survey which has – takes 50 per cent of – 50th percentile basics, so the median, and you add to that the 25th percentile discretionary. There are some households below that level, just because it's done on a survey basis and you've taken the median. So by definition some people will be below it but, you know, you wouldn't expect it to be – to be as much as it is.

A pretty modest lifestyle according to the Melbourne broker; is it not?---Yes.

Yes.

MR SCERRI: Mr Huggins, this morning you were asked questions about what would happen if the CBA were the first mover to go towards a fee-for-service as opposed to a commission basis. Do you recall that?---Yes.

And you said there would be an issue about conflict. What did you mean by that, sir?---Well, you would – you would create a conflict by doing that, which would mean that if you did have a – an existing CBA customer who likes the branch network, likes the app – you know, a range of reasons, and say, "I only want to go to CBA." The broker was would be conflicted if CBA was on a flat fee and everyone was on a – everyone else was on a commission structure today. The broker would probably want to send them to someone else.

So the conflict would be the broker's conflict?---Yes.

And to what extent - - -

THE COMMISSIONER: It is always the broker's conflict, isn't it? The conflict of interest with which we are concerned is only the broker's conflict, isn't it?---Yes, I think that's right.

The conflict between whatever duty it is that the broker owes to the client – query who the client is – and the interest the broker has, financial interest, in maximising income?---That's right.

MR SCERRI: But it's a different type of conflict, isn't it?---That – that conflict is a different conflict, yes.

Different to the existing one, which is what?---Well, the existing – the existing – the new conflict which is created is between brands, between different products. The existing conflict is one of – of loan size and pay down.

Yes.

THE COMMISSIONER: The existing conflict is between the interest of the broker in maximising income and the duty the broker owes the client?---That's right.

Is that right?---Yes, that's right. Therefore it's the same conflict, yes.

The flat fee circumstance, the conflict is between the broker maximising income by going to a – an upfront and trail commission payer, and whatever duty the broker owes the client?---That's right.

Same conflict.

MR SCERRI: That's correct, isn't it?---Yes.

It plays out in different ways?---Yes.

THE COMMISSIONER: Same conflict.

MR SCERRI: Same conflict plays out in different ways?---Yes.

Do you accept that?---Yes, that's right.

The – in relation to proportion, I think you called it, of business – the home lending that you get, CBA gets from brokers, what is that percentage?---It was 36 per cent of new flow coming – was coming through the broker channel.

Do you know how that compares with other major lenders?---It is between 10 and 20 per cent lower than other major lenders.

Percentage points or per cent?---Per cent. So other lenders are between 45 and 55 per cent broker. So we are the lowest of the majors by, you know, 10 to 20 percentage points.

When you were being asked questions about switching to a fee for service with brokers, you mentioned something called unintended consequences?---Yes.

What did you mean by that?---So there's a few different areas which – of that. So first is – and we spoke about it briefly – you may create other conflicts. So if you put a fee-for-service model in, and that was linked for example to loan complexities – so you had, you know, fee for service for one loan complexity or another loan complexity then, you know, it may encourage people to structure loans in more complex ways. So there's – there's – there's that. The second is that the other consideration, not a conflict, the other consideration is that brokers provide very good service to customers and to some segments of customers in particular. First home buyers, people with complex needs, and if you moved to a fee-for-service model then you may – you start to encourage people more to go towards volume than loan size. So therefore some of those segments that are currently benefitting from the service provided by a broker may not be able to access those services going forward. And then – I mean, finally you – you would need to make sure that broking remained a viable business for people, given that our research shows customers very much value that proposition. And there are some customers who are not willing or interested in going to our proprietary channels: they want to use a broker and that's why, you know, we are in broker: to help serve that segment of the customer base.

You said this morning that it is an objective of CBA to increase the proportion of loans to proprietary channel compared with the third party channel?---That's right.

And – but you've also said to Ms Orr that deaccreditation won't assist that. Why is that?---Well, deaccreditation, what I meant in my comments this morning was deaccreditation was not going to deliver that outcome. So – so the complete outcome. And that was because the numbers we are talking about are relatively small. So the amount of volume that we are getting out of the 710 brokers that we deaccredited, or indeed the larger pool, were relatively small. So that would be insufficient to achieve, you know, a large shift in the – in the proportion of business coming through proprietary. I think the other thing – our goal, the strategy is to have a strong and sustainable broker network where we are not achieving a mixed shift at – that proportional shift by just writing a whole lot less business and broking. That's not – that's not the way that we want to achieve that proportional shift. We want to grow – whilst sustaining and being able to continue to service customers in the broker channel, we want to grow into the proprietary channel to deliver that – that mixed shift. So it would be incorrect to say that the deaccreditation didn't help to some extent, if you went down that path. It would have helped a little bit, but it wasn't – it was not the – it would have been insufficient.

And, finally, the Commissioner asked you about the poles. Do you remember the poles?---Yes.

The left was the customer outcomes and the right – or vice versa – was profitability. What constraints are there on the bank to go towards the profitability end of the spectrum?---Well, the constraints are that we – we need to run the business for the – for the long term and our focus is on ensuring that we are to the – you know, running the business and – for the long term, and that requires customers to be satisfied with the bank and continue to maintain relationships with the bank. So we need to provide services to customers and experiences for customers which are – which are very – you know, which are very, very good in a competitive marketplace and therefore, you know, that provides a counterbalance to what you can do from a profit perspective. So you – you have to meet customer expectations. They are changing – there is a big focus on things like digital, and we have to spend a lot of money to keep up with customer expectations. So - - -

To what extent is the balance achieved by the competitive process?---Well, I mean, there is huge competitive pressure in this market. There is huge competitive pressure in home loans, which I can talk to most, and that means that you're – you're restricted in how far you can move away from the competitive offering that is in market at that point in time. People have choice. It's a competitive marketplace. And whilst, as I mentioned earlier in my statement – in my testimony, there are some customers that will go to the brand that they have always been with, but that's a small number of customers, and what we tend to see is that customers have choice and they make those choices and therefore if you are not delivering the right product and services and experiences for customers then they have plenty of options to go somewhere else and they do.

Thank you, Commissioner.

THE COMMISSIONER: Just before you sit down, Mr Scerri.

You recall being taken by Ms Orr to the bank's submission to the Sedgwick inquiry?---Yes.

And can I act on the basis that what was said in that submission remains the position of the bank?---It's the – the belief of the bank, yes, as – as it's being written. I guess the only reason I hesitate in answering your question is – and as we've talked about – position would imply that I'm going to go into market tomorrow and apply that and, you know, in that regard it's not. But I don't think that's what you refer to.

No?---Okay.

Anything arising out of that.

MR SCERRI: No, sir.

THE COMMISSIONER: Thank you, Mr Scerri. Ms Orr, is there anything?

MR SCERRI: May the witness be excused, your Honour.

THE COMMISSIONER: Yes.

Thank you Mr Huggins, you are excused from further attendance?---Thank you.

<THE WITNESS WITHDREW [3.00 pm]

THE COMMISSIONER: Ms Orr, wait until Mr Huggins - - -

MS ORR: Yes. I was going to suggest the next witness is associated with a different entity, with a different set of counsel, so perhaps if we could have a few minutes.

THE COMMISSIONER: You better have until five past 3, so that counsel can order their books and papers and trolleys, and etcetera. Thank you.

MS ORR: Thank you, Commissioner.

ADJOURNED [3.00 pm]

RESUMED [3.05 pm]

THE COMMISSIONER: Yes, Ms Orr.

MS ORR: The Commission pleases, the next witness is Ms Lynda Harris.

THE COMMISSIONER: Come into the witness box please, Ms Harris.

<LYNDA GAY HARRIS, AFFIRMED [3.05 pm]

<EXAMINATION-IN-CHIEF BY MS HOGAN-DORAN

THE COMMISSIONER: Thank you very much, Ms Harris. Do sit down. Yes, Ms Hogan-Doran.

MS D. HOGAN-DORAN: Ms Harris, could you please state your full name for the Commission?---Lynda Gay Harris.

And your business address?---225 George Street, Sydney.

And what position do you hold?---General manager, people and culture.

For which company?---For AHL Investments Proprietary Limited, known as Aussie.

All right. Do you have a copy of your summons?---I do.

And do you – you made a statement on 7 March 2018?---Yes – yes.

Do you have a copy of that with you?---I do.

And do you have a copy of the exhibits with you to that statement?---Yes, I do. Yes.

Are there any corrections that you wish to make to that statement?---There is one correction.

Where is that?---That paragraph 187.

That's on page 24 of your statement, paragraph 187?---Yes, that's right. So instead of it talking about a franchisee's eligibility, it actually should be a retail business consultant's eligibility.

THE COMMISSIONER: What word do you want to change in there?---So the word "franchisee", which is on the second line, third word in.

Yes?---That needs to be changed to "retail business consultant".

Yes. Thank you.

MS HOGAN-DORAN: Ms Harris, would you - - -

THE COMMISSIONER: If you would be good enough to make the amendment and initial it.

MS HOGAN-DORAN: That correction now having been made, is that statement true and correct to the best of your knowledge and belief?---It is, yes.

THE COMMISSIONER: Thank you. Do you produce the summons Ms Harris, that brought you here?---I do. Yes.

Yes. That will be exhibit 1.40, the summons to Ms Harris. Exhibit 1.41 will be the statement of Ms Harris dated 7 March '18 and the exhibits to it.

EXHIBIT #1.40 SUMMONS TO MS HARRIS

EXHIBIT #1.41 STATEMENT OF MS HARRIS WITH EXHIBITS DATED 07/03/2018

MS HOGAN-DORAN: If the Commission pleases.

THE COMMISSIONER: Yes. Ms Orr.

<CROSS-EXAMINATION BY MS ORR [3.08 pm]

MS ORR: Ms Harris, you have been put forward by Aussie Home Loans to give evidence to this Commission about misconduct by four former brokers at Aussie Home Loans?---I have.

And you said that your employer was AHL Investments; is that right?---That's right, yes.

What's the relationship between AHL investments and Aussie Home Loans?---Aussie Home Loans is part of AHL Investments.

Aussie Home Loans has two types of mortgage brokers; is that right?---That's right, yes.

And what – the first type is the Aussie retail brokers?---Yes. So we have brokers who either operate a store as a franchisee, or work for the franchisee in a store, and the definition of those is retail.

Yes. I see. And the other category is Aussie mobile brokers; is that right?---That's right, yes.

And can you explain the difference between those two?---So the mobile brokers tend to be single operators in their own business. And they will not have – normally have premises in which the customer can come, so they will go and see the customer. Whether that's their home or their office, or somewhere else, that's up to the customer.

In the early part of the statement that you have provided to the Commission, you mention first line and second line risk management at Aussie Home Loans?---Yes.

Can you describe what those are?---Sure. So first line risk management are roles that are directly interacting with the brokers. So they would be for instance the mobile business leaders, the retail business consultants. People on – in the state office or working directly with the brokers. Level 2 is the risk and compliance team. So they are centralised and they will be scanning files without that direct interaction unless there is an issue, in which case they will come and consult and guide.

And you are part of the second line risk management; is that right?---I'm not directly part of that, so the risk and compliance team sit under someone else. So my role is to be aware of what is happening with the business, but not necessarily direct those functions.

So you're not part of the first line or the second line risk and compliance functions?---No, not directly.

Right. In your statement you refer to the accreditation of brokers?---Yes.

What's the difference between the accreditation required by Aussie Home Loans and the accreditation required by a lender?---I can't tell you exactly what lenders do, but I can certainly talk to you about our process. So there is a rigorous recruitment process involving reference checking. There is a police and credit check that's conducted. There is an attestation that – in the process, that the candidate is asked to complete, which says that they haven't had any convictions and they haven't been banned from operating within our industry. They need to be – they need to be able to be a member of the MFAA and the Credit and Investments Ombudsman. So that's the process that they need to go through. In addition there is a four-week induction program and, importantly, someone will need to success – both successfully complete that four-week induction program and therefore qualify for a certificate IV in financial services, or – and they need to be able to demonstrate during that period the kind of behaviour and interpersonal skills and relationship skills which are necessary for them to represent our brand. So, you know, we look for integrity, honesty, someone that's able to show good judgment during the course of that. And that simply an additional factor. So a number of the other factors are also considered in that.

To be an accredited broker for Aussie Home Loans does a person also need to be accredited by lenders?---Yes, they do. Sorry, I should have said that. So with every lender on our panel.

Yes. And you mentioned membership of the MFAA. That's one of two industry associations for mortgage brokers; is that right?---It is. That's right, yes.

And why has Aussie chosen that one rather than the other one, which is the FBAA?---Yes. And it was quite a few years ago now, but – and at the time the MFAA was the only association which expelled brokers. So there was a level of frustration in Aussie that we would terminate a broker for doing the wrong thing, and they would go and work for someone else, so we actually applied to the ACCC for us to be able dictate that all of our brokers need to be a member of the MFAA, as opposed to the MFAA or the FBAA. We believed it was a more rigorous organisation.

You set out in your statement the things that brokers have to do to maintain their accreditation as well?---That's right, yes.

And one of those things is maintaining their accreditation with the panel lenders?---That's right.

But accreditation by panel lenders isn't a legal requirement. That's an internal Aussie Home Loans requirement; is that right?---Yes, that's right. So it's about the proposition for the customer. So we advertise a proposition. That proposition covers finding the loan, that is not unsuitable, from the full span of loans.

THE COMMISSIONER: Just a moment. I think my – see what ..... is producing feedback. At least we haven't got the taxi system cutting in on us yet. That which was lost is found. Thank you. Sorry. We might have to go back. The question was:

> *But accreditation by panel lenders isn't a legal requirement, but that's an internal Aussie Home Loans requirement; is that right?*

You began your answer:

> *Yes, that's right. So it's about the proposition for the customer. So we advertise a proposition. That proposition covers finding the loan that is not unsuitable from the – from the full span of loans.*

That's when I cut you off. Do you want to go on from there?---I don't want to go on much more than that. But it is just about – about making sure that we are able to look across the board.

MS ORR: Do Aussie brokers tell customers that they can only apply – that the customer can only apply for a loan with a lender on Aussie's panel?---The – an Aussie broker will tell the customer that they can only provide them with a loan on our panel. Our panel certainly provides loans to cover sort of 90, 95 per cent of home loans provided in the marketplace. But we don't have everyone on the panel, no.

And each Aussie retail broker and mobile broker is an authorised credit representative of Aussie; is that right?---Yes, that's right.

And you would understand that, in respect of its authorised representative brokers, Aussie has various obligations?---Yes.

Which include ensuring that it has adequate systems and procedures in place to monitor and supervise the brokers?---Yes.

And ensuring that the brokers are adequately trained and competent to engage in Aussie's credit activities?---That's right.

And these are requirements both under Aussie's credit licence and - - -?---Yes.

And under the National Credit Act; is that right?---That's right.

Now, could I just have brought up on the screen a particular legislative provision, which is section 47 of the National Credit Act. Are you familiar with that provision, Ms Harris?---I'm not familiar with the detail, but I understand what our responsibilities are.

It is RCD.0022.0001. I see. I'm looking for section 47 in that document. I thought I had the reference for it, but it seems not. I'm not sure if section 47 can be found within – it's not the whole Act there, as I understand it, so it shouldn't be too hard to find. But it's a legislative provision that I want to ask you some questions about, Ms Harris, that imposes obligations on credit providers and credit assistance providers, including Aussie Home Loans. And they include, as the first obligation, an obligation to ensure that the credit activities that are authorised by the licence are engaged in efficiently honestly and fairly. Are you familiar with that obligation?---Yes. I am.

And are you familiar with the obligation in section 47 to have adequate risk management systems?---I am, yes.

And the obligation imposed by section 47 to take reasonable steps to ensure that Aussie's representatives comply with the credit legislation?---Yes.

And Aussie has to have available adequate resources to engage in the credit activities authorised by its licence and to carry out supervisory arrangements; are you familiar with that obligation?---Yes. I am.

Now, have you ever seen the ASIC regulatory guide that provides some assistance to people such as Aussie about how to discharge those obligations?---I haven't looked at it in detail, no.

Yes. We have now section 47 on the screen. I've taken you through aspects of that provision already, and I think your evidence is that you are familiar with those obligations as they are imposed on Aussie Home Loans?---Yes.

And the ASIC regulatory guidance tells us that entities such as Aussie have to have measures or compliance measures to refer to processes, procedures or arrangements for ensuring that they comply with these obligations?---Yes.

Are you familiar with - - -?---I am familiar with that obligation, yes.

- - - that? Okay. Now, can I turn from talking to you about those obligations that are imposed on Aussie to talking to you about the conduct of the four brokers that your witness statement deals with?---Yes.

Conduct that I think we can – I can ask you at the outset, conduct that you would agree was not consistent with these conduct obligations imposed on Aussie Home Loans by this statutory regime?---I would agree.

Yes?---Yes.

So could we start with the first of those brokers whose name was Mr Shiv Sahay?---Yes.

And Aussie first became aware of misconduct by him on 8 August 2013, you tell us, in your statement?---That's right, yes.

And do you recall how Aussie became aware of misconduct by Mr Sahay?---I do. So Suncorp, as a lender, came to us with concerns about his loan.

So Suncorp contacted Aussie and told Aussie that it had made a decision to terminate Mr Sahay from its accreditation process; is that right?---That's right. That's right.

And I will show you a document, which is AHL.0002.0001.2421. This is an email chain, and could I ask that we bring up the second and third pages of the email chain, which are the first in time. We see there the email notification to Aussie from Suncorp on 8 August 2013?---I do.

So Mr Sahay is identified, Suncorp tells Aussie that:

> *An initial concern has been raised via one of our branches by particular clients. The customer told me that the loan was set up as an investment loan and the broker used rental income to increase the income. The borrower has advised me they are living in the property and said, "The broker just did it that way so they would get the loan."*

And as a consequence of being told that by those customers, Suncorp tells you that they have conducted a review of applications from that broker and that they have worked out they have concerns with seven other files that that broker was involved in?---That's right.

And on the basis of that, Suncorp tells you that their inclination is to terminate the broker's accreditation, but they will hold off until you have an opportunity to review – and they ask you to revert with the outcome of that review at the earliest possible opportunity?---Yes.

And the response from Aussie, if we can pull up the first and second pages next to each other, same day:

> *Appreciate the call and heads up. Aussie takes these matters very seriously. We are grateful that you have allowed us time to conduct our internal review or audit before commencing your preferred course of action. We will keep you in the loop with the progress of our investigation, the outcomes, and resulting course of action. We need to discuss John's email as a matter of urgency.*

This all happens on 8 August. And the first thing I want to put to you is that therefore we see, from these documents that this misconduct – which we will come to in more detail – was not detected by Aussie. Aussie found out about it when a lender reported concerns of a particular customer?---Yes. I agree with that.

Yes. So Aussie's systems neither prevented the misconduct from occurring or detected the misconduct?---In this particular instance, yes, you're right. Yes.

So the following day, 9 August 2013, Aussie conducted a review of the loan files for Mr Sahay; is that right?---That's right, yes.

And, later that day, Aussie terminated its contract with Mr Sahay's company?---That's right.

Is that correct? And that night Aussie sent emails to various Aussie panel lenders advising that it had terminated its contract with Mr Sahay's company?---That's right.

Now, could I show you one of those letters. It's an email. So AHL.0002.0001.2463. We have – we have blacked out entirely, it seems, who the email has gone to. But you have seen these emails Ms Harris, and you know that these are emails that went to various lenders?---To the best of my knowledge they would have gone to various lenders, yes.

Yes. And the lender is told no more than:

> *Aussie recently terminated its contract with Shiv Sahay's company. In accordance with our obligations, we request that you review all loan applications that are pending settlement and settled loans that were submitted by Shiv Sahay and take all necessary action to carefully manage the loan applications and settled loans.*

?---Yes.

Now, in your statement you explained that a communication like this went out to, in your words, "various lenders". Did these letters go out to all of the lenders on the panel that had accredited Mr Sahay?---The process was for a letter to go out to every member on the panel.

And the letter says nothing to the lender about why Mr Sahay has been terminated by Aussie?---The letter doesn't, but there is – there is an arrangement with the lenders so that if we do not say "no adverse circumstances", then they will understand that there is a reason why the person has been terminated. Secondly, the fact that we tell them – alert them to the fact that they should be reviewing loans written by that person is further – is further evidence to them that there is a problem.

Well, why doesn't Aussie tell the lender what the problem is? What the nature of the problem is?---I can't answer that at the time, and this was back in 2013. I believe it was a legal advice to not specifically say. And I can't give you the rationale, because I'm not a lawyer. It was certainly the case then, and I think it was around – if we were to say fraud, you know, that that some people have a different definition of what we would have termed fraud. I think it was around that. But that – I can't categorically tell you.

So what's the lender meant to look for in their review. How do they know what to look for?---The lender would immediately look for any issues in the loan application and if the loan application on the surface looked okay then they would always look at the supporting documents. And, in the case of Mr Sahay, it was the supporting documents in particular where there were concerns.

So your evidence is that there was an arrangement whereby there was, in essence, some sort of code between Aussie and the lenders whereby if the words "no adverse circumstances" were not used in the communication the lender was to understand that there was some form of adverse circumstances that you would not provide any information of?---So in those situations – that wouldn't have been in the letter but it is very – we are very, very willing to help and so what you would normally find is that the lenders would be contacting someone like Mr McKenzie and asking him for more details about why this happened so that they were more targeted in their search.

Well, I want to put to you that it's not in Aussie's interest to tell the lenders has happened because Aussie's trail commission might be terminated by the lenders if Aussie tells the lenders that loans have been fraudulently obtained?---That is actually not the case. So Aussie communicates with the lenders. We know that if there are any loans that are deemed to be fraudulent in any way then the trail commission will stop on those. The – the lender has the right cease payment of that. That's acknowledged by us.

Well, I will show you some documents as we go, but I want to suggest to you that Aussie works very hard to get to an end point where the lender does not cease the trail commissions in these circumstances?---Yes. I – I don't agree with that, but perhaps you can show me something that will change my mind.

Yes. Well, let's work through the documents?---Yes.

This review that was conducted by Aussie, that led to the termination of Mr Sahay, was conducted over the course of a single day. That's right? The notification from Suncorp comes on 8 August, the review is on 9 August, and by 6 pm, 6.16 that night, the letters are going out to the lenders?---That's right in this case. They normally take longer than that, but in this case it was an efficient process, and that's primarily driven by the fact that Suncorp came to us and said they were going to – they didn't come to us and say, "We've got some concerns about these files, can you please review." They came and said, "We are seriously considering termination". So the process then was far more urgent, far more speedy, because we needed to ensure that we also supported the concept that the broker had – had conducted himself in a way that was completely and utterly unacceptable.

Yes. Well, I will put to you that the review must have revealed very, very quickly that there were grave issues with the loans that were being submitted by Mr Sahay?---The review very quickly showed that the supporting documentation was fraudulent, yes.

Yes. And that had not been picked up by Aussie?---No.

How long had Mr Sahay been an Aussie broker at this time?---He had been an Aussie broker for about 20 – 18, 20 months, I believe.

Yes. So the review that Aussie does takes a day and then Aussie asks the lenders by this communication to conduct their own review?---Yes.

So rather than conducting a thorough review at Aussie's end, Aussie relies on the lenders to do that; is that right?---So after the – they all – we also asked them to look both at any current loans and also settled loans, which we don't necessarily have access to after settlement.

Yes. So it's restricted. The review that you are suggesting they undertake is restricted to pending settlement and settled loans?---And settled loans.

And settled loans?---Yes.

But how is the lender going to do that? They don't have access to the broker's computer, the broker's files or emails; all of that sits with you at Aussie, doesn't it?---It does. Once the application, though, is submitted on behalf of the customer, then the application goes through a system called Apply Online and is actually with the lenders. So the lender would have had access. In this case, Suncorp would have had access to those loans.

I just want to go back to something that you said earlier, Ms Harris. You said that Mr Sahay had been with Aussie for 20 months. Could I ask that you be shown a document, ASIC.0011.0006.0017?---Sorry. In my statement it says 14 November 2011 to 6 August 2013. So - - -

What paragraph you are reading from there, Ms Harris?---I'm reading – I'm reading the first – that's the first question. So broker misconduct events, Shiv Sahay:

> *How and when Aussie first became aware of the fraudulent conduct, including falsification of home loan documents between 14 November and 6 August.*

Sorry, then I misread that. I can't tell you how long he had been with us for. My apologies.

Well, the document I'm taking you to, is the Aussie contract with Mr Sahay's company and if we turn within that document to 0039?---That's the date. So you are right, he had been with us since 19.06.09. Well, that was when this agreement was signed.

Yes. So that suggests - - -?---Sorry, can you hear me.

So it had been about four years that he had been a broker with you?---Yes. My apologies, yes.

Not 20 months?---Yes, my apologies. That's right.

Okay. There was – after these letters were sent out to the lenders, an incident reported – an incident report created by Aussie about Mr Sahay; is that right?---Yes. That went to the ERC. Yes.

THE COMMISSIONER: Went to?---The executive risk committee.

Thank you.

MS ORR: And that document, I think is AHL.0002.0001.2409. Is that right, Ms Harris? Is that the incident report that was report that was prepared?---Yes, it was. Yes.

Could – could we have the first and second page displayed on the screen, please. You will see that this report is dated 3 September 2013?---Yes.

And the risk incident details report that the initial contact was from Suncorp and there had been further investigation from Suncorp and then a formal notification of termination of the lender's accreditation on 9 August?---Yes.

Aussie's agreement with the broker was terminated on 9 August following a high level review undertaken by risk and sales operations. Do you then see the section headed Controls that Did Not Work or Were Not in Place?---Yes, I do.

Continuing:

> *This issue is difficult to identify purely from the documents retained by Aussie. Random reviews of loan files for this broker have been undertaken and have not identified any irregularities of a similar nature. From 1 July 2012, nine files have been reviewed for this broker with three fails and six passes. The last five files reviewed passed.*

Now, the last five were fine, but there had been three fails in file reviews prior to that time. What happened as a result of those three fails on the file reviews?---So fail doesn't – doesn't mean fraudulent. Fail means the broker had not completed all responsibilities under responsible lending. So in those case when someone – when there is a review of a file and the person hasn't passed, so in the categories now it's considered a C or a D, then immediately that information is passed back to the mobile business leader, in this case, because he was part of the mobile channel. And the mobile business leader needs to sit down with the broker and go through what the concerns are. So they are given a report by the compliance team and they sit and go through the concerns.

You see the impact section below that, Ms Harris? Three types of impact. The first is financial. There is a positive financial impact, because no trail is payable – which must mean, it seems to me – no trail is payable by Aussie to Mr Sahay on a loan book of approximately $70 million?---That what it says, yes.

Yes. So that means Aussie is going to continue to benefit from Mr Sahay's loan book after his termination?---So the logic that we – for that is we will continue to look after the customer. So if he is terminated we will continue to have the processes and systems in order to ensure that the customer's ongoing needs, post settlement, are looked after.

And you will keep taking the trail commissions for that?---We keep taking the trail commission for that, yes.

But there is also - - -?---For looking after the customer, yes.

There is also a negative financial impact because there is a loss of a broker who was settling approximately $30 million of loans per year?---Yes.

Reputation:

> *Minimal impact with Suncorp expressing appreciation on the rapid response to the issue raised.*

That reflects the fact that within 24 hours after being notified of their position on this, Aussie terminated; is that right?---Yes, that's right.

And regulatory:

> *The assessment is that the prompt action taken should minimise any regulatory impact.*

?---Yes. On the basis that we acted promptly to take the broker out of the business.

And then over the page - - -

THE COMMISSIONER: Sorry, just before you depart from that section, you spoke of Aussie continuing to earn its trail commission for looking after the customer's needs after settlement. What would those needs be?---They vary from a customer wanting to change perhaps from a fixed rate – sorry, a variable to a fixed. So, depending on what was happening with the interest rates, a customer might want to do a variation. So they want to renovate the house, and they will do a variation to the loan, those kind of things. As the customer's needs change.

If you had made – if the customer made a new transaction, that would be a new event for a new commission, wouldn't it?---If that's what the best outcome for the customer was, but that would – that's certainly not the goal. The goal is to look after whatever the customer is wanting.

I – I'm not grasping, I think, sufficiently what kinds of need the customer has after settlement for the remaining – it's a 30 year loan – 29 years, that the trail commission will continue to accrue?---In theory.

Yes?---If a customer is not being looked after and things happen in the marketplace, that will trigger them to ask questions. So, you know, what we would like is that they contact their broker, if they are asking questions, and the broker contacts the customer on a regular basis just to check whether there are any of those questions. Sometimes customers aren't thinking of their interest rate, and if there is changes with the RBA – and changes happen – then there is reason to trigger the customer into saying, "Are you still happy with what – with the loan that you are on?" It is simply a question to ask the customer.

Thank you. Yes, Ms Orr.

MS ORR: Do you see number 4, Ms Harris, remediation and action plans. And (a) is remedial action description. This is to address the impact, including estimated completion dates and action owner. And what we see in response to that is:

> *The broker has had his agreement with Aussie cancelled.*

That – that's the entirety of the remedial action taken by Aussie?---That's – according to that form, yes.

Yes?---Yes.

And I will show you some documents, but I'm going to put to that you Aussie didn't contact any of Mr Sahay's customers to advise them of what had been detected in relation to Mr Sahay's conduct?---You are saying we didn't contact any of thinks pending customers?

Any of his pending or former customers?---I have read correspondence with pending customers who - - -

Correspondence from Aussie or from the lender?---No, from customers and phone calls to the mobile business leader, and the mobile business leader feeding that into us with questions about - - -

You will have to direct me to those documents, Ms Harris?---They were documents, I don't have them here, but I can certainly provide those documents.

And you hadn't referred to that in your statement, have you?---No. I haven't, no.

The only contact with Mr Sahay's customers occurs when two of Mr Sahay's customers contact Aussie; is that right?---Two of them contacted Aussie; yes, they did.

And I will take you to each of those instances?---Yes.

But I want to put to you that, other than those two instances initiated by the customer, there were no discussions between Aussie and Mr Sahay's customers about the fraud that had been detected, and whether it might impact on any of them?---I – I know that we reallocated every customer that was pending to another broker so that the broker – the next broker could help them through.

Yes?---I know that we had a mobile business leader who was managing the process, and who was liaising with the customers about the process. I can't tell you whether they specifically said that Mr Sahay had committed fraud. They would have said that Mr Sahay had left and we wanted to look after them and someone else would be given to them as their broker.

And why weren't they told that Mr Sahay had committed fraud?---I don't know. And, my personal opinion, we should be open about that.

And you're not, are you? It's still the case today that when these sorts of things happen Aussie does not contact customers to inform them that the broker who they dealt with has been found to have engaged in fraud?---I – what I can't guarantee to you is what verbal conversations are being had. I can't – and certainly in writing, you're right, the letters to the lenders. That has clearly been evidenced. I don't know what verbal conversations are being had.

I'm not talking with the lenders now. I'm talking with the customers?---With the customers. Yes, no, I understand, with the customers.

The customers aren't told, are they, Ms Harris?---I can't tell you one way or the other, I'm sorry. I would like to; I don't know.

Well, in this instance with Mr Sahay, on 17 September there was a communication from one of Mr Sahay's customers to Aussie, wasn't there?---There was.

Yes?---Yes.

Now, could I show you a document which is – I think it's AHL.0002.0001.4786. Now, do you see here this is an email – an internal email between two members of Aussie and perhaps if we can have the second page on the screen. It will assist.

Melanie Tomkins is asking Melissa Goode to put in an email the conversation she had with Shiv's previous client and what she said happened when she was contacted by the bank. Then we see the email in response from Melissa Goode, explaining what her customer with – her contact with the customer was. She says to Melanie Tomkins:

> *She contacted me at 11.30 am on 18 September advising that CBA had contacted her and wanted to discuss a statement that was used to support her home loan with Bankwest. The person told her that it was – that it was if she was found to have known about this incorrect statement that she could be charged with serious offences. She was confused about what they were relating to, and she wanted to go into the bank today to see what they were referring to. She was under the impression that they had made some sort of mistake as she had given a CBA statement with an amount of 25,000 and didn't understand what the 39,000 was that they referred to.*
>
> *She was extremely stressed about the person making threats about being charged and possibly jailed. She asked what paperwork I had. When I accessed the file I had, I contacted her to confirm the figures I had on the statement copy, and she advised that it was correct, and that was the statement she had given to Shiv. She then said that, "The bank must have it wrong, because the statement I have is correct." It was left that she was going to try to go into a CBA branch today. She has not contacted me again today. I know it isn't the best timing, with what has happened, but will this affect the commissions paid on the file? As Simon advised, it was transferred to me and would take effect post settlement.*

So this records a communication from a customer who has been contacted by CBA, contacted by CBA because Bankwest was one of the lenders involved who was looking into Mr Sahay's conduct; is that right?---That's right.

And she is calling Aussie distressed about that contact?---Yes.

Wanting to know why this discrepancy exists between the $25,000 on her statement and $39,000 that's on the CBA paperwork. Now, the response of this particular individual at Aussie was, at least in part, to find out whether this contact affected the commission, the trailing commission, that they were going to be taking over from Mr Sahay on the loan. Do you agree?---That's what that states, yes.

Yes. I will tender that document, Commissioner.

THE COMMISSIONER: We have had a number of documents referred to.

MS ORR: I did – I have missed a number. I could do them all now, if that is convenient.

THE COMMISSIONER: Well, if we go back to AHL.0002.0001.2421 email McKenzie to MacDonald, 8 August 2013, that will be exhibit 1.42. AHL.0002.0001.2463 email from McKenzie, 9 August 2013, that would be exhibit 1.43. Then I think it is the current one, is it? Or is there an intermediate one?

EXHIBIT #1.42 EMAIL FROM McKENZIE TO MacDONALD DATED 08/08/2013 (AHL.0002.0001.2421)

EXHIBIT #1.43 EMAIL FROM McKENZIE DATED 09/08/2013 (AHL.0002.0001.2463)

MS ORR: I'm sorry, Commissioner, I have a list of five.

THE COMMISSIONER: I have not been paying strict attention, have I, Ms Orr. I'm about to be marked down.

MS ORR: No, I'm sorry. I wasn't paying attention then. You are doing much better than me. I'm sorry, could I just read the doc IDs for my five. 0002.0001.2421. 0003.0001.2463.

THE COMMISSIONER: Those two are respectively exhibits 1.42 and 1.43.

MS ORR: Then ASIC.0001.00006.00017.

THE COMMISSIONER: Exhibit 1.44. What do I describe it as?

MS ORR: That was the extract from the NCCPA, Commissioner. Section 47. I'm not sure that I need to tender that. If you would like me to, can.

THE COMMISSIONER: I can think of nothing I would like more, Ms Orr, than that you not tender - - -

MS ORR: Thank you.

THE COMMISSIONER: - - - the National Credit Act, but - - -

MS HOGAN-DORAN: Commissioner, I think that that actual code was the contract with Mr Sahay.

THE COMMISSIONER: I think the ASIC was the –

MS HOGAN-DORAN: Yes.

MS ORR: Thank you. Thank you.

THE COMMISSIONER: It had to come to this, Ms Orr, that we get tangled in our documents. We have survived thus far.

MS ORR: That doc ID I just gave you, I do wish to tender. That was Mr Sahay's loan contract with Aussie Home Loans.

THE COMMISSIONER: Exhibit 1.44, ASIC.0011.0006.0017 is contract of Sahay. Yes.

EXHIBIT #1.44 CONTRACT OF SHIV SAHAY (ASIC.0011.0006.0017)

MS ORR: I'm corrected. I said loan contract, it is not a loan contract, Commissioner.

THE COMMISSIONER: No.

MS ORR: Then AHL.0002.0001.2409.

THE COMMISSIONER: Which is which?

MS ORR: We are all at sea.

MS HOGAN-DORAN: That's the incident report.

MS ORR: That was the incident report. Thank you very much to my learned friend.

THE COMMISSIONER: I'm glad someone is paying attention. I'm obviously not sufficiently. Exhibit 1.45, AHL.0002.0001.2409, incident report.

EXHIBIT #1.45 INCIDENT REPORT (AHL.0002.0001.2409)

MS ORR: And the final document, which was the email from Melissa Good to Melanie Tomkins.

THE COMMISSIONER: 19 September 2013, AHL.0002.0001.4786 will be exhibit 1.46. I think the ledger is squared.

EXHIBIT #1.46 EMAIL FROM MELISSA GOOD TO MELANIE TOMKINS DATED 19/09/2013 (AHL.0002.0001.4786)

MS ORR: Thank you very much, Commissioner.

THE COMMISSIONER: Yes.

MS ORR: Now, that communication from the customer on 18 September that's reflected in the email I just took you to?---Yes.

There is another exchange of emails internally about this customer communication, which I will take you to. This email chain starts at AHL.0002.0001.4701, and could I take you to the first email in the chain, which is on 4706. Again, an email between Melissa Goode and Melanie Tomkins. This is an email that relates to the same customer contact:

> *Hi Mel, as per my voice message tonight, please find attached requested documents. I have confirmed with the customer that the statement that I have a copy of is the one she provided to Shiv. You will note that the CBA statement shows a balance of 25,000 but on the funds to complete and Shiv's comments it notes that there is an amount of 40,000. CBA have told the customer that the statement showed an amount of 39,000. The customer is under the impression that CBA have made a mistake with their figures or statement, and is going in tomorrow to try to get copies and discuss. I am not sure what to advise the customer, as she thinks CBA have made an error. Not sure if you want to give her a call tomorrow before she goes into the branch to find out what has been done.*

Now, why didn't Melissa Goode tell this customer, who called in distress, in fear of imprisonment, what had occurred: that Mr Sahay had engaged in fraud by changing the figures from the $25,000 on the statement to the $39,000, when she well knew that that was what had occurred?---I can't tell you why it wasn't done. It was obviously the process back then. I think that I don't agree with that process, and I think there needs to be open communication with customers.

But there was not open communication with this customer, was there?---In this particular case, I agree.

Now, there are – in this email chain that I will tender – some further discussions internally about how to deal with this, but they relate to communicating with Bankwest about why Bankwest has gone to the customer first about this, rather than gone to Aussie Home Loans. Have you seen this email chain before?---Yes.

Yes. I will tender that email chain, Commissioner, which is AHL.0002.00014701.

THE COMMISSIONER: Email to McKenzie and accompanying emails will be exhibit 1.47.

EXHIBIT #1.47 EMAIL TO McKENZIE AND ACCOMPANYING EMAILS (AHL.0002.00014701)

MS ORR: Now, before we move on to further conduct by Aussie in relation to this event, there is a document that we have that shows what Bankwest was doing in relation to this event and I will – I will take you to that. AHL.0002.0001.4780. Now, this is an email from 17 September from a person at Bankwest to a person at Aussie:

We found some possible problems on this broker's deals. There is a strong likelihood of falsified bank statements, although we are continuing our review.

This, of course, is the day prior to the contact from the customer on 18 September 2013. And if we turn to the next page we will see a document that was annexed to that email. This is 5070. 0001.0001.5070. Thank you. So this is a document recording some investigative work done by Bankwest once it became aware of these issues. There was an audit conducted by Bankwest that revealed 10 alleged fraudulent mortgage applications. Under the heading Audit Information:

Audit was conducted from data produced on a report by CBA fraud analytics from deals submitted in the last six months.

And it's CBA because Bankwest is affiliated with CBA.

There were 16 deals submitted during this period and audit conducted on the first two deals revealed falsified OFI bank statements with inflated savings.

Now, precisely what the customer contacted Aussie about.

Employment details for these applications were correct. It was decided the audit would continue with all applications during this period, which had provided OFI –

OFI is other financial institution; is that right?---Yes.

Who:

…had provided OFI bank statements and/or in the current pipeline.

So the audit statistics are deals fully audited, 11, fraud located, 10. Only one assessed to be okay to proceed. And Mr Sahay had submitted 131 loans to Bankwest. And we see – yes, on the following page, that this report that was provided to Aussie gives a summary of the 10 identified fraudulent loans. So this was provided to Aussie on 17 September; is that correct?---I believe so, yes.

Yes. As I said, on the day prior to the communication from the customer, who was also contacted by CBA?---Yes.

I tender that document, Commissioner.

THE COMMISSIONER: That's exhibit 1.48. AHL.0001.0001.5070. Bankwest broker investigation, 17 September 2013.

EXHIBIT #1.48 BANKWEST BROKER INVESTIGATION DATED 17/09/2013 (AHL.0001.0001.5070)

MS ORR: There's two separate documents, I'm told, there. So I will need to tender both, Commissioner. 47 - - -

THE COMMISSIONER: The email as well.

MS ORR: Yes. 4780 is the email. And - - -

THE COMMISSIONER: Yes.

MS ORR: And 5070 is the broker investigation report

THE COMMISSIONER: Exhibit 1.49, AHL.0002.0001.4780, email Rakhit to McKenzie, 17 September '13.

EXHIBIT #1.49 EMAIL FROM RAKHIT TO McKENZIE DATED 17/09/2013 (AHL.0002.0001.4780)

MS ORR: Now, I want to take to you the action plan that Aussie came up with to deal with this situation, Ms Harris. But I – I see the time Commissioner. Would – I can continue to that document or I have a number of further questions.

THE COMMISSIONER: How long do you need to – how long do you need altogether with this witness? Is there any realistic prospect of finishing her evidence tonight?

MS ORR: No, there is not, Commissioner.

THE COMMISSIONER: No. Well let's get to a point where you think there is a convenient interruption in the flow.

MS ORR: I think in that case I would like to take Ms Harris to the action plan and we can stop of after that. So the action plan was circulated on 27 September 2013. Do you understand that Ms Harris?---Mmm.

And that action plan is at AHL.0002.0001.4772. So the misconduct was notified to Aussie on 8 August 2013. This action plan is circulated on 27 September 2013 by

Rob Klenner. Could you explain who Rob Klenner is?---Rob Klenner at the time managed our relationships with our lenders.

And Mr Klenner circulated this action plan to a number of people within Aussie who included Melanie Tomkins, who seems to have been the broker who took over Mr Sahay's loans; is that right?---So Melanie Tomkins was the mobile business leader who coordinated.

I see?---So he was part of her team, so she was responsible.

So we see that Mr Klenner tells everyone that:

> *Due to recent developments we thought it worthwhile to outline the list actions that have already been undertaken and proposed actions to deal with the matter.*

I want to direct you to 1(c), Loan Pipeline:

> *Oversee these loans to ensure that lenders are not applying any bias by way of association to Shiv Sahay to the borrowers or lodging brokers. Client interactions, credit assessment and commission.*

What do you understand that to mean, Ms Harris. What bias was Mr Klenner worried about?---Sorry. That – can – I will just take a minute.

Yes?---I take it to be – and it's my interpretation –that if there are existing loans that are actually bona fide loans with valid documentation to support them, that the customer not be disadvantaged by the fact that Mr Sahay had been – had conducted – had been fraudulent in other loan applications.

I see. And the second action item relates to the Bankwest portfolio, and their letter of termination. And we see there 2(c):

> *Once we have this information, assess our next steps in relation to cessation of trail on the total Shiv Sahay portfolio.*

Now, this is a topic that comes up again in subsequent communications?---Yes.

But I want to put to you this is the first indication in these documents that Aussie is trying very hard to avoid the cessation of the trail commissions from the Bankwest business?---Aussie is asking the question, yes, about whether the trail commission on the total book would be removed. It's asking the question, yes.

Yes. And then risk mitigation is the final action item, number 5:

> *Once we have worked through the previous steps we will convene a working group.*

This is after we have worked out things like trail commission:

> *…we will convene a working group with key internal stakeholders, items to be discussed include review actions and outcomes, including sales compliance review of linked brokers, establish a position and strategy to deal with future eventualities, namely borrower default and the resulting process. The approach lenders may take – Bankwest and Suncorp are the priorities there – and involvement or advice to third parties: industry bodies, PI providers, regulatory agencies and law enforcement.*

So the very final list on the action item was to consider the involvement or advice to regulatory agencies and law enforcement; is that right?---That's right. Yes.

And ASIC was not notified by Aussie Home Loans of Mr Sahay's conduct, were they?---They weren't in this instance, no.

No?---We have notified them of other instances and you would be aware of that.

Why did Aussie Home Loans not notify ASIC of this misconduct of Mr Sahay?---I can't answer that. I can't give you reasons.

And as for law enforcement, Aussie Home Loans did not make any report to the police about Mr Sahay's conduct?---No, we didn't. No.

And why did Aussie Home Loans not make any such report?---So the reports are normally made by the lenders, because they are the ones that have the – the credit decision making, and they are ones with the expertise to determine exactly what the conduct is being diagnosed as or defined as.

I tender that document Commissioner.

THE COMMISSIONER: Exhibit 1.50. AHL.0002.0001.4772. Action plan email Klenner to Symond and others, 27 September, '13.

EXHIBIT #1.50 ACTION PLAN EMAIL FROM KLENNER TO SYMOND AND OTHERS DATED 13/09/2013

MS ORR: Just before I leave that document, one last question, if the Commissioner wouldn't mind. There's nothing in this action plan about notifying any customer of Mr Sahay of this conduct, is there?---No, there is not.

Thank you. I will continue my questions tomorrow.

THE COMMISSIONER: Yes. Thank you. Ms Harris, I will have to ask you to be back here in time to begin at 09.45 tomorrow. And we will adjourn until 9.45 tomorrow.

<THE WITNESS WITHDREW [4.04 pm]

MATTER ADJOURNED at 4.04 pm UNTIL FRIDAY, 16 MARCH 2018

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