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TRANSCRIPT OF PROCEEDINGS

O/N H-959649

THE HONOURABLE K. HAYNE AC QC, Commissioner

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

SYDNEY

9.45 AM, WEDNESDAY, 21 NOVEMBER 2018

Continued from 20.11.18

DAY 62

MS R. ORR QC and MR M. HODGE QC appear with MR M. COSTELLO, MS E. DIAS, MR A. DINELLI, MR T. FARHALL, MR M. HOSKING and MS S. ZELEZNIKOW as Counsel Assisting
MR S.G. FINCH SC appears with MS Z. HILLMAN and MR P. KULEVSKI for CBA
MR J. SHEAHAN QC appears with MS P. NESKOVCIN QC for Westpac

<CATHERINE BRIGHID LIVINGSTONE, ON FORMER OATH [9.45 am]

<CROSS-EXAMINATION BY MS ORR

THE COMMISSIONER: Yes, Ms Orr.

MS ORR: Ms Livingstone, yesterday I asked you some - - -?---Sorry, Ms Orr, sorry, I have just wondered, I had the opportunity to reflect overnight on my responses yesterday, and I feel I need to add to my response to the December '16 audit committee, and also my recollections of meetings between October and December 2016 - - -

Have you - - -?--- - - - If that would be possible.

Before you explain your reflections, have you been assisted in those reflections - - -?---No, I have not, no.

Okay. Before you give them, to be clear, we provided you, to review last night, copies of minutes for each of three board meetings, one held on 10 and 11 October 2016, one held on 8 November '16 and another held on 5 and 6 December 2016?---Yes.

Did you review those minutes?---Yes, I did.

And they did not assist you?---They did, to some extent, but that's why I would like to - - -

Yes, thank you?--- - - - add to my responses. So to the best of my recollection, it was at the October board meeting that I challenged management in relation to the AML/CTF reports, and the details in the regulatory report, and sought an understanding of AUSTRAC's perspective. I did not receive a satisfactory answer to my challenge, because it did not accord with my understanding of AUSTRAC. That response served to confirm the concern that I had been developing, based on my experience as a non-executive director, that management, at that time, did not have the capacity to respond to what was, clearly, an escalating, significant and serious systemic control challenge. Management did not have the capacity, either because they couldn't or they wouldn't. Later, at that same meeting, and following what was the surprise and sudden decision of the former chairman, that he wanted to resign from 31 December that year, I agreed to take on the role of chair of CBA. In making that decision, I understood very clearly that the degree of diligence that would be required from me would be greater than anything I had undertaken to date in my career, and that it would take years. So turning to your question about the December audit committee meeting, and, yes, you are correct, and as I agreed yesterday, I could have called for more detailed reports. My judgment as a director at that time was further questioning of that detail would serve little purpose at that time, because it would simply elicit further unsatisfactory answers. What was clear to me was that neither management nor internal audit could articulate the problem they were trying to solve, let alone identify the root cause of that problem. And, unfortunately, that judgment was borne out by subsequent events. So in response to your very appropriate question as to what did I do, what did I do in response to the AUSTRAC 167 notices, the AML red audits, the ASIC fees for no service report, the APRA OP risk review, the APRA IT services review, and the largest no vote ever recorded at that point in time against a remuneration report in Australia – in our November '16 AGM. So what did I do? What I did, from 1 January 2017, is put my reputation on the line, take up the role of chair of CBA, and its responsibilities, but, more importantly, its accountability for leading the fundamental change that had to be made in the way CBA operates. It's in that capacity as chair and with that accountability that I appear before the Royal Commission today. And I do understand, from your opening statement, that you want to focus on what can be done to prevent the instances of misconduct which have come before the Commission. And I absolutely share that intent and we touched yesterday on some of the actions I and we have taken at CBA. But I can assure you that the focus on changing the way CBA operates is central to what the board and the senior management team have on their agenda.

You heard from my opening, Ms Livingstone, that part of fixing these things going forward is understanding why things went wrong in the past. And I was exploring with you the board's role in relation to CBAs failings in the past?---That's correct. And I would endorse, and have publicly and at the Royal Commission, accepted all of the observations and recommendations in the APRA prudential inquiry. That is the most complete analysis of what went wrong and why things happened.

Well, it's one analysis of it. We're conducting another, Ms Livingstone. And if I may, I would like to continue asking you some questions. The three documents that you reviewed overnight for those three board meetings in October, November and December of 2006, I want to take you to each of those briefly, starting with the October minutes. They are CBA.1004.0160.1335. Now, this is one of the documents you reviewed overnight, Ms Livingstone, the minutes of the board for the meeting on 10 and 11 October 2016? These are the minutes, Ms Livingstone?---Yes, they are.

And if we turn to the last page, 1351, we see that these minutes were signed by the chair, Mr Turner. The signature has been redacted but you know that that is Mr Turner's signature there?---I presume it is, yes.

And they were recorded in the minute book. We see that there?---Yes.

And immediately above this part of the minutes we see that in a director private session, the directors met privately and discussed chairman succession which included a presentation by you?---That's correct.

And what did that presentation involve, Ms Livingstone?---That presentation involved my view on how I would conduct the board if I were invited to be chair and what I saw as had to happen in CBA to address the various issues that we've been through today and yesterday.

Were you the only candidate to succeed Mr Turner as chair?---At that point I was, yes.

Now, if we turn to page 8 in the minutes, which is 1342, we see a reference towards the bottom of the page to a regulatory report being considered at this meeting?---That – that - - -

This is a regulatory - - -?---It's not coming up on my screen.

Perhaps if we could have the entirety of the section under Regulatory Report on the screen. Now, this is the meeting at which you say today you challenged management. Is that right?---To the best – to the best of my recollection, it was this meeting.

Yes. And what - - -?---Sorry, I - - -

What allowed you – I'm sorry, Ms Livingstone, what allowed you overnight to come to the certainty that this was the meeting at which you challenged?---Because I went through my recollection. I know the circumstances of the particular boardroom. It could not have been the November meeting because we were in Perth. And my recollection of the timing of my challenge versus the – the discussion on when I would become chair was – it was coincident.

This will come up on the screen, Ms Livingstone, but you reviewed this document overnight, and I will read the relevant portion to you under the heading Regulatory Report:

> *Cassandra Williams and Gary Dingley presented the regulatory report. Matters discussed included ASIC notices received during the period, CommSec fines and APRAs activities including the upcoming review of ES which will focus on IT strategy and infrastructure resiliency. It was noted that the group had responded to the AUSTRAC statutory notices and there had been no further correspondence to date.*

?---I am familiar with the section.

The final line is:

> *The board discussed and noted the report.*

We now have it on the screen, Ms Livingstone.

So you see that there is no reference to any director challenging management about the content of that report?---I note that there isn't but that does not mean that I didn't. In fact, I did, and I received a response.

There's no reference to management providing any assurances to you about the reasons why CBA was receiving these statutory notices from AUSTRAC?---It is not, necessarily, the case that the minutes record every single conversation that occurs during the board - - -

Well - - -?--- - - - but I can assure you, Ms Orr, I asked the question and I received the response.

Should they, Ms Livingstone? This is the official record of the minutes of a meeting of the board of CBA at which very significant matters were discussed. If you challenged the regulatory report and were provided with assurances by management in response to that challenge, should they appear in this official record of that meeting?---Ms Orr, it's not possible for minutes to record every single question in a board meeting, and most of the questions are, in fact, very serious questions. That is the purpose of the board meeting.

Well, is that satisfactory, Ms Livingstone? CBA has a statutory obligation under the Corporations Act to keep minute books. You're aware of that?---I am.

And the minute books must record proceedings and resolutions of meetings of directors?---And in this case, they do, but they don't record every single question that a director asks.

Well, do you accept that they don't record a very significant exchange that you say occurred at this meeting but which we have no record of?---I do accept that, but I am also aware that I am giving evidence under oath.

Yes. And I am asking you about the adequacy of these minutes, Ms Livingstone?---In terms of reflecting that particular exchange, no, they do not reflect that exchange. But that exchange did occur. As did many other exchanges during the meeting which would not be reflected verbatim in the minutes.

And is that good enough, Ms Livingstone?---Well, the minutes of the meeting already run to now – we have actually expanded our minute taking and the minute taking is significantly improved. But they do actually run to about 30 pages.

About how many pages?---About 30 pages.

Which minutes run to about 30 pages?---The minutes that we currently take.

Right?---For board meetings. As I said, we have improved, since I took over at chair we have improved our minute taking.

And these minutes run to about 17 pages. You've seen that?---Yes, I have.

And do you understand that a failure to comply with the requirements in relation to the keeping of minutes under section 251A of the Corporations Act is an offence?---I am. But these are the minutes of the meeting and I - - -

And - - -?---I assert again that I asked the question and received the response.

Yes. And you can offer no explanation for why that is not reported in these minutes?---The explanation is that the minutes don't usually record verbatim what is discussed at the board meeting.

And I'm not expecting the minutes to record verbatim what was discussed, Ms Livingstone. The keeping of accurate minutes of the board of an organisation like CBA is very important because those minutes are the evidence of the matters that are discussed in the meeting?---I understand that, Ms Orr.

Is it CBAs practice at each meeting of the board to put a resolution to adopt the minutes of the previous meeting?---Yes, it is.

And that occurred in relation to these minutes?---It would have, yes.

Yes. All right. I tender those minutes, Commissioner.

THE COMMISSIONER: CBA October board – October '16, is it?

MS ORR: Yes, it is, Commissioner.

THE COMMISSIONER: CBA October 2016 board minutes CBA.1004.0160.1335, exhibit 7.33.

EXHIBIT #7.33 CBA OCTOBER 2016 BOARD MINUTES (CBA.1004.0160.1335)

MS ORR: Now, for completeness, Ms Livingstone, I would like you to identify – and I will tender the minutes of the board meetings on 8 November and 5 and 6 December. I understand from your evidence this morning that you don't assert that you challenged management in either of those meetings about AUSTRAC?---I may have in terms of the conversation around the regulatory report but the particular exchange that I am recalling, where I received assurances from management which I did not feel comfortable with, and from senior management, not middle management, is that particular meeting that we just discussed.

All right. Could I ask you to identify CBA.1004.0160.1446, the minutes of the meeting on 8 November 2016. There we have them, Ms Livingstone. These are the minutes of the meeting held in Perth on 8 November 2016?---Yes, that's correct.

I will tender those minutes, Commissioner.

THE COMMISSIONER: CBA November '16 board minutes, CBA.1004.0160.1446, exhibit 7.34.

EXHIBIT #7.34 CBA NOVEMBER '16 BOARD MINUTES (CBA.1004.0160.1446)

MS ORR: And it was following this meeting, Ms Livingstone, that the board resolved to appoint you as chair. Is that right?---No, that's not correct. I think it was resolved by circular resolution after the previous meeting.

All right?---And I think you will see on the bottom of that page there was a 12 October circular resolution.

I see. I see. So we see recorded in these minutes the resolution from 12 October to appoint you as chair?---That's correct.

Thank you. All right. Could I ask you to identify CBA.1004.0160.1319. These are the minutes of the meeting of the board on 5 and 6 December - - -?---That's correct.

- - - 2016?---Yes.

And you've reviewed these minutes as well?---That's correct.

In these minutes, as with the previous two minutes, there's no record of any challenge by any of the directors to management about the AUSTRAC matters?---No, other than – if I could see the section on the regulatory report, please.

Yes, 1325 to 1326?---If I could see the full section, thank you. It's recorded there the board did discuss and note the regulatory report.

Yes. And what I asked you, Ms Livingstone, is whether there was any record in these minutes or the previous set of minutes of any challenge by a member of the board to management about their handling of the AUSTRAC matters?---Not as noted in the minutes, no.

Thank you. I will tender that document, Commissioner.

THE COMMISSIONER: CBA December '16 board minutes, CBA.1004.0160.1319, exhibit 7.35.

EXHIBIT #7.35 CBA DECEMBER ’16 BOARD MINUTES (CBA.1004.0160.1319)

MS ORR: Ms Livingstone, I understood you to say in your answer before that you didn’t seek any of the red audit reports in relation to the AUSTRAC matters because you didn’t think there was any point to doing that. Is that right?---There was no point, at that point, at that time, to drilling down into further detail because management could not respond. They could not articulate the problem, nor the root cause. At that time – so that is towards the end of 2016, and I was going to take up the role of chair from 1 January ’17, my intention was from January ’17, when I was in the role of chair, that I would be in a position to take action.

So you had a significant lack of faith not only in management but in the audit team as well. You weren’t interested in the detail of their audit report about the failings?---I did not say that I was not interested. I said that the audit report – neither the auditor nor management could articulate what the problem was and hence what the root cause was. They could identify the symptoms.

How do you know that, Ms Livingstone, when you didn’t ask for the audit report. You don’t know how the audit team articulated the nature of the problems?---I did know from the discussion that we had at the board meeting and their responses.

Well - - -?---Sorry, the audit committee meeting.

The best way of understanding that would have been to review the audit report, wouldn’t it?---No, I think the best way is actually to interrogate the people who write the reports to see whether they have the understanding rather than what is actually written in the reports.

And we see no reflection of any interrogation to that effect in any of these discussions?---That doesn’t mean it didn’t happen.

I see. Now, I want to move on from these documents, Ms Livingstone, and return to the topic that we were discussing yesterday which was cultural change at CBA?---Yes.

Do you accept that part of the necessary cultural change at CBA is an improvement in CBAs relationships with regulators?---Yes, I do, and we have been, as you know, resetting our relationship with regulators.

And not long after you became chair of the board, you requested a meeting with Mr Medcraft who was then the chair of ASIC?---I think – actually, it went – because Mr Medcraft was handing over to Mr Shipton, and so the meeting, I think - - -

After you became chair of the board?---I – no, no, sorry, I’ve got the wrong – yes. No, no, sorry, I did request a meeting with Mr Medcraft, sorry.

Why did you do that? Why did you request a meeting with the chair of ASIC after you became chair of the board?---I requested a meeting with the chairs of all of the regulators that we deal with regularly. So AUSTRAC, ASIC, and APRA.

Why, Ms Livingstone?---Because I think it's very important that the chair, on behalf of the board, has a direct relationship with the regulator so that the regulator can hear from the chair and the chair can hear from – directly from the regulator what the regulator's views and concerns are.

So important to have a direct relationship so you can hear from each other. Is that right?---That's correct.

And what do you envisage that the chair of ASIC should hear from you as the chair of CBA?---Well, as you can – we've discussed, in terms of the matters that were on foot, the chair of ASIC would want to know what the board is doing about those matters and how the board is working with management to address those matters.

Matters that are on foot. What do you mean by that?---The matters on foot with ASIC or with any regulator.

Do you mean matters that are under investigation by ASIC?---No, not necessarily. No, no. Matters that are of – of concern or industry-wide matters. So, for example, in my first meeting with Mr Medcraft, we discussed the role of proxy advisers, as an example.

Did you have a set of things that you wanted to discuss with Mr Medcraft in preparation for that meeting with him?---A chair when you go to meet a regulator is always provided with a briefing note so that you're aware of background.

What did you hope to achieve from that meeting with Mr Medcraft?---It was an introductory meeting in the context of my coming into the role as chair. So it was a courtesy in the first instance, and to discuss matters that he might have on his mind.

And what did he tell you he had on his mind?---I think the – if I recall, my notes from that meeting, they would be the relationship between ASIC and CBA, and the concerns, as we've heard, that it was not always as cooperative as it should have been. And I'm paraphrasing here but it was legalistic and defensive.

Anything else that he had on his mind that he shared with you in that meeting?---I can't – I can't recall specifically.

Now, not long after Mr Shipton became the chair of ASIC earlier this year you had a meeting with him, too?---Yes, I did.

And what was the purpose of that meeting?---Again, that was courtesy, because he was just coming into the role. So I met with him to introduce myself as chair, and we had very good discussion in terms of his perspectives on markets and market integrity, and we discussed the importance for financial services in having more exposure to other industries and understanding what other industries, the approaches they took to operational risk, in particular, and he was interested in my experience from implantable medical devices in that regard.

Were there other things that you raised with him?---I think it was – it was more along the lines, because we – we discussed the importance of a cooperative relationship and the fact that it was a mutual responsibility between regulators and the organisations in the financial services sector to ensure that there was trust in the sector.

Do you have regular meetings with the chair of ASIC, Ms Livingstone?---Probably – well, definitely the board meets once a year, and I make it a practice to meet one on one with the chair of a regulator once a year, if that hasn't already happened in the course of the year.

And do you ever discuss investigations that are underway in those meetings?---No, not usually, because they don't want to discuss investigations specifically.

What about any enforcement action that has been taken? Do you discuss that in those meetings?---Only after the event, usually. So, for example, with APRA, one – we might discuss the – the progress on the enforceable undertaking, in terms of the remedial action plan or the remuneration consequences, for example.

So you have regular meetings with APRA, too?---Yes, I do.

And what do you discuss in your meetings with the prudential regulator?---A whole range of matters, ranging from the views on culture, on remuneration, very specifically we have an annual chairs meeting which is chair of board, audit committee and risk committee. And, for example, the targeted review that has been mentioned here at the Commission. We had a chairs meeting and discussed that in detail. With Mr Byres, of course, I have kept him informed as we've gone through the process of looking for a new CEO. And then the – the eventual appointment of a new CEO. I also, in accordance with the BEAR regime will advise Mr Byres if we're considering appointing a new director after we've put that director through a fit and proper process. There's a 14 day period, so I will personally contact Mr Byres when we put in that submission.

Now, the board of CBA met with Mr Byres in February this year?---That's correct.

And following that meeting you wrote Mr Byres a letter?---Yes, I did.

I would like to show you that letter, which is APRA.0061.0001.2508. This is the letter that you sent to Mr Byres on 16 February this year, Ms Livingstone?---That's correct.

And in the first paragraph you said:

Thank you again for the frank and valuable discussion with the CBA board on 5 February 2018. Having reflected with the board on the matters raised, I thought it would be useful to follow up with our thoughts on and give an indication of CBAs approach to those matters.

?---Yes.

And you went on to say:

The board acknowledges and shares your desire that CBA take a leadership position in the industry to promote higher responsible lending standards. We recognise the influence of CBAs significant market position in home lending and other sectors.

That was what you said to Mr Byres?---Yes.

So what changes is CBA planning to make to promote responsible lending?---That – that particular comment came out of the macro-prudential requirements at that time but we also discussed the targeted review and the progress on the implementation of the recommendations of the targeted review.

I understand that, Ms Livingstone. But I'm referring to the sentence here where you said:

The board acknowledges and shares your desire that CBA take a leadership position in the industry to promote higher responsible lending standards.

What are you planning to do in your industry-leading position to promote higher responsible lending standards?---Well, as you probably – as you probably know from the evidence of Mr Comyn, one of the main things that we have done is improve the detail that we receive on borrowers' expenditure patterns, and we've increased the number of elements that we put in to that analysis from a single line to 11 items. We have also increased our analysis of other financial institution potential borrowings by customers. We've invested $100 million in our home lending platform. We have increased the analysis through what we call our command centre to identify patterns within our home lending process. This is part of operational risk control and we've improved our analysis of customer outflows to identify any unusual outflows that might not have been declared by customers. We have also reduced and are reducing our reliance on HEM. In fact, I wrote to Mr Byres on 29 October this year indicating that we would bring our reliance on HEM down to below 60 per cent by December this year. So they're some of the actions we're taking to ensure that we are actually reflecting what's expected of us in terms of a leadership position.

Well, why didn't you take a leadership position on those changes earlier?---We have been taking a leadership position since that time. I think Mr Comyn had reflected the point in his evidence that it was disappointing that the targeted review had to identify matters which we had not self-identified, but the review having identified them, we have acted on them expeditiously.

In the next paragraph of this letter you refer to Mr Comyn as the incoming CEO – I will just wait till it comes on to the screen. Do you need that blown up or can you read the paragraph starting with:

> *More is needed with us.*

?---Here it is. Yes.

Continuing:

> *Mr Comyn as the incoming CEO will arrange to meet you to discuss ways in which CBA can increase its leadership role in the industry.*

Do you see that?---Yes, I do.

Now, Ms Livingstone, given its history and its position in the market, do you think that CBA has a responsibility to lead the industry in making changes that are the right thing to do, even where there might be a first mover disadvantage?---I think this – this issue was canvassed with Mr – Mr Comyn and in the context of a first mover disadvantage – and if you're referring to mortgage brokers in particular - - -

I'm not. I'm referring to this statement in this letter. And I'm interested in your views, not Mr Comyn's views, Ms Livingstone?---Certainly. So the – to the extent that a first mover would actually affect the industry as a whole, and the standards in the industry as a whole, yes, it would be appropriate for us to take it. To the extent that we might take action and there be no impact on the industry as a whole, then I think we would question and would want to work with the regulator.

Are there other areas apart from responsible lending standards where you think it's appropriate for CBA to take the lead?---I – I think in everything we do, we should be seen to have leadership standards.

Within the industry?---And more broadly.

What do you mean by "more broadly", Ms Livingstone?---Well, for example, our corporate governance standards. We have taken a particular lead – and you might have seen from our annual report that in terms of our disclosures under the taskforce for climate-related financial disclosures we have taken a lead there. We have taken a lead in our approach to disclosure matters generally. So that's what I mean by corporate governance.

Are you doing enough to take the lead in the industry as CBA?---We can always do more. But we're doing as much as we can as fast as we can.

A few pages over in this letter at 2510, you said to Mr Byres, in the paragraph above the heading CBA Perspective:

Finally, as noted at our meeting a prerequisite for the effectiveness of governance is a strong working relationship between board and management. The board has a duty to inquire and interrogate; management has a duty to inform and disclose, and these two aspects must result in a meeting of the minds. This contextual aspect of governance is receiving explicit attention.

That was what you said to Mr Byres?---That's correct.

And reflecting on the period prior to the prudential inquiry, do you think that the board failed in its duty to inquire and interrogate?---I think it's – it is correct to say that there was not enough challenge and that would be through inquiring and interrogating of particular matters.

Yes. So the board did fail in its duty to inquire and interrogate?---It didn't adequately address the duty, yes.

And do you think that management failed in its duty to inform and disclose?---Yes. I think that's correct.

And how is this aspect of governance, as you describe it, now receiving explicit attention at CBA?---Because it relates to the relationship between the chair and the CEO. And that's a very important relationship and a continuous conversation between the two. So that management can alert the chair as to matters which might be useful to inform the board and more serious matters to disclose. And similarly, the chair can inform through the CEO what the board considers important matters where it would like to inquire and more serious matters where it would like to interrogate. And that is the process by which the agenda for the meetings is determined, and the matters on the agenda, and the time allocated to those matters in the agenda.

Now, if we go back one page, finally, in this letter to 2509, you said to Mr Byres under the heading Frameworks:

Your challenge to us that the answer to effective board oversight is not simply a matter of directors meeting for longer and working harder, was most apposite. As you observed, what is needed are frameworks that enable directors to form a view of current risk issues and to anticipate emerging issues.

And underneath that you listed a number of frameworks. And the first in that list of frameworks, the first dot point is the remuneration framework. Do you see that, Ms Livingstone?---That's correct.

And you described the remuneration framework as being:

Crucial across multiple dimensions.

And you said it was:

It was receiving intense scrutiny from the board.

?---That's correct.

What did you mean when you said the operation of the remuneration framework was crucial across multiple dimensions?---Because we discussed the dimensions of governance and looking at the – effectively starting with the OECD definition of governance, governance is about direction, control and people. And remuneration frameworks operate across direction. So that is long-term remuneration, control, that is short-term remuneration, and people generally, which is making sure that they are appropriately paid, and that the remuneration framework applies consequences, both negative and positive.

Do you agree that poorly designed remuneration structures can be a driver of misconduct and of poor risk management?---If they're poorly designed, and even if they're well designed but not accompanied by other frameworks, being checks and balances, they may still have inherent risks.

And do you think that by contrast, well designed remuneration structures can be a useful tool to promote good risk management and reduce the risk of misconduct?---I do.

I will tender this letter, Commissioner.

THE COMMISSIONER: Letter Livingstone to Byres 16 February 2018, APRA.0061.0001.2508, exhibit 7.36.

EXHIBIT #7.36 LETTER LIVINGSTONE TO BYRES DATED 16/02/2018 (APRA.0061.0001.2508)

MS ORR: Now, Ms Livingstone, that brings me to the next topic that I want to ask you about, which is your role as a member of the remuneration committee. And you said earlier – you said yesterday that the remuneration committee oversees the bank's remuneration policy?---Yes.

And it makes recommendations to the board about the remuneration of the CEO and the senior executives each year?---Yes.

Now, I asked Mr Comyn about some of the decisions that CBA has made about the way it remunerates the bulk of its employees. What I want to ask you about are the decisions that the board makes about the way it remunerates the organisation's executives?---Yes.

And, in particular, I want to ask you about the decisions that the remuneration committee made and the board made about the remuneration of those executives in the 2016, '17 and '18 financial years?---Yes.

Now, before I do that, I just want to make sure that I understand in general terms how executives are remunerated at CBA. And Mr Comyn explained to us that most of CBAs employees have two components to their remuneration. They have fixed remuneration and they have variable remuneration. That's broadly true for executives as well?---That's correct.

But at CBA, the most senior executives, the CEO and the group executives, receive two different types of variable remuneration: short-term variable remuneration and long-term variable remuneration. Is that right?---That's correct.

Now, it might assist if I bring up a copy of CBAs remuneration report from this year which sets some of this out. If we could bring up RCD.0021.0028.0196. This is the 2018 annual report for CBA. And could we turn to 0300 in the remuneration report. About halfway down the page we see the three different components of group executive remuneration. On the left, we see under FR, fixed remuneration. Perhaps if we could bring that part of the document up. I'm sorry, if we could bring up the full table there. With FR, STVR – thank you. So on the left we have fixed remuneration. In the middle we have short-term variable remuneration, which is, essentially, an annual bonus?---We don't regard it as a bonus. The variable remuneration is actually a part of total remuneration.

Okay. And at the end of each year, the board determines how much each executive will receive as their short-term variable remuneration?---Yes, it does.

And that can range, we see from this, between zero and 150 per cent of the fixed remuneration?---That's correct.

And half of that, we see from this, is paid in cash straightaway?---Yes.

And the other half is paid in shares?---That's correct.

But the shares are not paid immediately?---No, they're deferred for two years.

Yes?---Over one and two years.

So the executive gets half of the shares one year later and the other half two years later?---That's correct.

Why does CBA do that?---The deferral mechanism is important, as you know, for ensuring that the short-term variable remuneration – and it applies in the long-term variable remuneration – has been awarded in relation to circumstances that are fully understood. So if matters come to light subsequently, the deferred remuneration can be reduced or forfeited completely.

Now, before I move to the third component, the long-term variable remuneration, I just want to put some propositions to you in broad terms to understand how the board makes decisions about how much short-term variable remuneration each executive receives. As I understand it, but correct me if I'm wrong about this, the chief risk officer reports to the risk committee about any risk issues that might affect the remuneration of executives?---That's correct.

And that information is also provided to the remuneration committee?---It's provided to the remuneration committee, and it's done on the basis of a detailed risk scorecard for the individual.

It is, at this stage. It hasn't always been done that way?---No, it hasn't. And as you know, we have been improving remuneration framework every year from '17, '18 and we continue to work on our framework.

So the chief risk officer reports about risk issues and the CEO also reports to the remuneration committee about executive performance?---It does and the audit committee also reports about control issues - - -

Yes?--- - - - that have arisen in the executives area but those control issues are also picked up on the risk scorecard under one of the four quadrants which relates to issues and incidents.

The CEO makes a recommendation to the remuneration committee about the executive remuneration outcomes?---Yes, he does.

And having received information about the risk issues that might affect the remuneration, and about the performance of the executives, and the audit matters that you've identified, the remuneration committee then makes a recommendation to the board about whether the remuneration of each executive – about how much remuneration of each executive should be provided?---That's correct.

So they decide whether they should receive their short-term variable remuneration, and, if so, in what amount?---That's correct.

And the board then makes the final decision about how each executive should be remunerated, including whether they get that short-term variable remuneration?---Yes. They do. And the – the board reserves its right in relation to the deferred remuneration to exercise discretion at a future date, if necessary.

Then if we come back to the third component in the right-hand column, that's long-term variable remuneration?---That's correct.

At the end of each year, each executive is allocated a certain number of reward rights?---Well, it's actually at the – at the beginning of the – the new year.

I see. And four years later, depending on certain criteria, which I will come back to, the board makes a decision about whether those reward rights vest, that is, whether they're converted into shares?---That's correct.

Now, if we could go back so that we can look at what appears under this table and blow up the part entitled CEO and Group Executive Remuneration Mix. We see references there to target short-term variable remuneration and maximum short-term variable remuneration. Could you explain those concepts, Ms Livingstone?---The target is, as you can see there, defined as 100 per cent of fixed remuneration. And the maximum is, obviously, the 150 per cent.

And if we look at the target diagram, we can see that 26 per cent is fixed remuneration, which they're guaranteed to receive each year?---That's correct.

And a total of 26 per cent is short-term variable remuneration, and the board decides how much of that they will get?---That's correct.

And 48 per cent is long-term variable remuneration, which they might get four years later, depending on whether they've met the criteria?---That's right, because that is actually on that table included at its maximum value, which is 180 per cent of fixed REM.

Ms Livingstone, why does CBA pay its executives any variable remuneration. Why not just pay them an appropriate salary?---The total remuneration, which is split between fixed and variable, has very specific purposes attached to the variable part. They start with the ability to have a – what we call a balanced scorecard, which indicates very clearly to executives that we expect balanced outcomes across financial outcomes, customer outcomes, people and strategy. The second thing it does is through that scorecard enables us to highlight priorities, as we have done for the FY19 year. As you know, in the score cards, APRA required us to give priority to the remedial action plan and all senior executives have a 30 per cent element in their scorecard for that. The third thing it enables us to do is to ensure alignment with the risk management framework which is why we have those risk scorecards as a modifier to remuneration. It also enables us to discriminate between executives who might be at the same fixed remuneration level but have different levels of performance, because, as you might know, internal equity in terms of remuneration, is as important to employees as benchmarking to market. Perceived lack of internal equity has a very damaging effect. Finally, we need the short-term remuneration and the long-term, in terms of its deferred part, to deliver consequences where that's necessary.

Now, I want to ask you, Ms Livingstone, why you can't achieve those objectives with an appropriate fixed salary and a consequence management framework and a promotion and reward framework. You talked about achieving balanced outcomes, highlighting priorities, ensuring alignment with the risk management framework. Why can't you achieve those objectives in the way I've suggested?---Because a one – a one element, fixed remuneration, does not give you the discrimination that having a variable component does. So, for example, we might have three executives who are on the same fixed remuneration and you will see from the remuneration report that they generally are on a similar level for similar responsibility. But to the extent that their performance differs, some perform better than others, we want to be able to reflect that in remuneration. If it were one fixed sum we could not do that.

Do you - - -?---And the – sorry, the elements of promotion and those other factors are very important mechanisms as well, and they are part of the framework but they work in conjunction with the remuneration system.

Do you think there's a perception among executives that unless they do something wrong, they should get their short-term variable remuneration, that is, they should get it for doing their jobs?---I would argue, if you look at the results for FY17 and FY18, no executive in CBA would think that they would get their short-term variable remuneration just for doing their job.

Well, I said unless they do something wrong, because the consequences that you imposed, particularly in FY17 were as a result of them doing something wrong, weren't they, Ms Livingstone?---That's correct, but if you look at FY18, there are – the question of someone doing something wrong or not doing something adequately gets reflected in the short-term variable remuneration. So they don't have to do something wrong to have a consequence in their remuneration.

Do you think the purpose of variable remuneration has changed over time?---I think we have made it very explicit in our framework, in terms of the – the balance scorecard risk side as well as the consequence side. But I do think – and we are struggling with this – we are currently looking at our remuneration framework as we evolve it still further – what the appropriate approach to short-term and long-term is, whether you can have the one element, but we've seen in the market that there are issues with these so-called hybrid remuneration schemes. They have unintended consequences. They have some good features but they have unintended consequences as well. So we are actually consulting quite widely and getting advice and looking internationally at the experience as to how you could have one of these hybrid schemes that enables you to defer remuneration so that you can apply discretion years after the remuneration is awarded, and – and you would know from the FSB supplementary principles from 2015 and the PRA from 2016, and APRAs 2018 report that the concept of deferral is something that's supported by most regulatory authorities. So how to best achieve that deferral without front-end loading, if you like, with an emphasis on the short term, but also make sure that it is sufficiently meaningful to executives that they – they value it. And one of the problems with long-term variable remuneration, because it often doesn't vest, is that executives don't attribute value to it, in which case it is valueless both to the board and to the executive.

You say that you are considering these things, consulting, working through the best way to deal with these issues. Are you aware of the changes that NAB is making in its remuneration framework?---We have been looking at NAB and we have been looking at ANZ. But – as part of – the mix that we are considering.

And what are your views about their remuneration frameworks? Do they achieve the things you are trying to achieve?---Well, I – I don't necessarily want to be critical of others, but we think there are potentially unintended consequences in the mix, and the other issue for us is maintaining consistency and stability in the remuneration framework because that is also important to employees if they think it's going to change every year.

What are the unintended consequences that you say are in the mix?---There's potentially too much focus – or could be, depending on how you design it, on rewarding outcomes in the current year. So that – that has the risk of rewarding short-term performance, and distracting from focus on the longer term. That – that's a – that's our biggest conundrum at the moment, how you can be sure that you're adequately keeping focus on the long term, while also have the intensity of focus on the short term. It's getting that mix.

In circumstances where, as you've acknowledged, long-term variable remuneration frequently doesn't vest and is, therefore, not valued by executives?---In the structure that we have at the moment. Now, another structure is that you award performance rights in one year and they stay on foot over a – a long-term deferral. It could be five, it could be seven, it could be 10 years. And there's no performance hurdle involved other than the effluxion of time and the exercise of discretion if circumstances change but absent that the executive would get them at the end of the period. That's one model. Another model is to have a hurdle at the beginning and a retest hurdle at the end. To executives that could be seen as a double jeopardy. So there's a hurdle at the beginning but then they don't value because they don't know what the hurdle at the end is going to be like which is the situation that we have with our long-term variable remuneration. As you would know from the FY15 plan that just vested, 75 per cent of it did not vest because the financial outcomes were not achieved. So the overall vesting was around 24 per cent. In other years it has been 20 per cent, other years 67 per cent.

I will come back to the vesting long-term variable remuneration. Could I for now tender the 2018 annual report.

THE COMMISSIONER: CBA 2018 annual report, RCD.0021.0028.0196, exhibit 7.37.

EXHIBIT #7.37 CBA 2018 ANNUAL REPORT (RCD.0021.0028.0196)

MS ORR: Now, Ms Livingstone, you've told us that you became a member of the remuneration committee in January last year when you became chair of the board?---That's correct.

And CBAs financial year runs from 1 July to 30 June?---Correct.

And that means that you joined the remuneration committee halfway through the 2017 financial year?---Correct.

But you were on the board at the end of the 2016 financial year?---I was.

And you were, therefore, on the board when it approved the remuneration outcomes for CBA executives for the 2016 financial year?---Yes.

Now, CBA released its 2016 remuneration report in August 2016?---Yes.

And by that time, the ASIC and APRA investigations into CBAs life insurance business were ongoing following the media reports about CommInsure in March 2016?---That's correct.

And by this time, CBA was aware of a number of other issues that became public over the course of the following year. Do you agree with that?---Yes, I do.

And they included the anti-money laundering and counter-terrorism financing issues?---Yes.

They included the charging of fees to customers for a service that hadn't been provided?---That's correct.

And they included the mis-selling of credit card insurance which I asked Mr Comyn about?---Yes.

But those failings weren't yet known to the public at the time that the remuneration report was released in August 2016?---Yes.

Now, could I take you to that remuneration report, which is RCD.0021.0028.0001. Now, the remuneration report for 2016 begins at 0049 in this document. The chair of the remuneration committee that year was David Higgins, Ms Livingstone?---That's correct.

And we see on this page his message on the front of the remuneration report?---Yes.

And do you see in the first column, about halfway down, there's a reference to the concerns raised in the media about CommInsure. Do you see that reference?---That's correct.

But there's no reference to any of the other issues that I've identified that were known to the bank, nothing about the failings in relation to anti-money laundering measures, nothing about charging fees for no service, nothing about mis-selling consumer credit card insurance?---That's correct.

Now, I want to take you to some of the documents that show how those matters were taken into account in determining how much money would be paid to CBA executives that year. Now, you said earlier that one of the matters that's taken into account in that process is the chief risk officer's views about risk issues?---Yes, but, Ms Orr, can I just make a – an overall comment in relation to the outcomes for 2016?

Well, I want to take you through the sequence of those outcomes and how they were arrived at, Ms Livingstone. Could we do that, and if you need to make some observations at the end of that process, I'm happy for you to do that but I want to do this by showing you the documents that record each of the stages?---Which will show that it was inadequate.

Yes?---Yes.

All right. Well, we will accept at the outset that it was inadequate. And can I show you the documents to understand the process that led to it being significantly inadequate. Do you agree with that characterisation - - -?---I do.

- - - Ms Livingstone?---I do.

All right?---And my fellow directors would also agree with that.

All right. Well, let's look at how that played out, Ms Livingstone. Can I ask you to look at – I will tender this annual report, Commissioner.

THE COMMISSIONER: CBA annual report 2016, RCD.0021.0028.0001, exhibit 7.38.

EXHIBIT #7.38 CBA ANNUAL REPORT 2016 (RCD.0021.0028.0001)

MS ORR: Could we turn to CBA.1004.0041.1992. So this is the agenda for the meeting of the remuneration committee on 5 August 2016?---Yes.

And you weren't present at that meeting, Ms Livingstone, but you've reviewed this document in preparing to give evidence?---Yes, I think I have.

And at the meeting, the remuneration committee considered a paper called Risk Considerations for CEO and Group Executive Remuneration. That's at 1997. We see that that was a paper prepared by Mr Cohen, the group chief risk officer, and Ms Linklater, the executive general manager of performance and reward?---Yes.

And its purpose, as described in 1.1, was to:

> *Provide support to the risk committee concerning the risk behaviours demonstrated by the CEO and the group executives in the 12 months to 30 June 2016.*

?---Yes.

Do you see that? And under Background Facts at 3.2, the report said:

> *The risk committee advises the board's remuneration committee on the appropriate risk factors that warrant consideration when assessing the performance of executives.*

?---Yes.

Was there anything more to the process of advising the remuneration committee on the risk factors that warranted consideration for executive remuneration, other than this paper being considered by the remuneration committee?---At that time, I think this was the only paper that was considered.

And the first attachment to this paper is at 1998. That's a letter from Mr Cohen to the risk committee. Mr Cohen said:

> *This letter is provided as input into the assessment of the recommended STI outcome for the CEO and group executives. It supports the risk committee's comments to the remuneration committee about any risk matters of concern, including risk behaviours, which require consideration in determining the following.*

And that's all referable to the short-term variable remuneration. Second paragraph:

> *In summary, for the financial year ended 30 June 2016, I do not believe there to be any risk issues or risk behaviours that would suggest STI awards should be modified from that recommended based on other achievements or results. However, as always, there may need to be adjustments, yet to be determined for FY2016 due to potentially sub-par compliance and other matters currently under investigation. One such matter is the CommInsure issue, which although still under investigation, the risk committee may wish to consider separately in light of the reputational impact to the group.*

That was the letter from the chief risk officer to the chair of the risk committee?---Yes. That's correct.

And the second attachment to Mr Cohen's paper was a table which commences at 1999. This is a table setting out the matters considered by the risk and remuneration review committee. It's a five-page long table?---Yes.

And it sets out a large list of risk matters?---Yes, it does.

Each of which we see has an identified loss amount attached to it?---Yes.

And a business unit attached to it?---Yes.

And a brief comment about the nature of the risk matter?---Yes.

And a date on which the risk matter was closed?---That's correct.

But no information about how serious each particular risk matter was?---No, other than the loss amount.

No information about which executive or executives were accountable for each risk matter?---No, other than signalling the actual division or business unit.

The business unit. Nothing about how each risk matter reflected a particular executive's handling of risk issues?---No.

Do you think this information was adequate for the remuneration committee to make a decision about the impact of risk on remuneration outcomes for its executives?---I think the – the use of this information and the conclusions that the remuneration committee came to at that time, in terms of remuneration consequences, were inadequate.

Do you agree that this information was inadequate information to provide?---It was important information but not sufficient.

So I think you agree that it was inadequate?---I do.

And if we look at this page, 1999, we see that the list included, about halfway down the page, an entry for ineffective provision of ongoing service, with a loss amount of $114.9 million?---That's correct.

Can you see that?---Yes.

Is that a reference to the fees for no service failings?---Yes, it is.

And we see that that issue is described as closed in July 2015?---Yes.

But we saw from the documents I took you to yesterday that this was still a red audit issue in December 2016?---That's correct.

So it hadn't been resolved by July 2015?---No, it hadn't.

And the table also includes at 2001, again about halfway down the page, a reference to the AUSTRAC intelligent deposit machines threshold transaction reports issue. Do you see that?---Yes, I do.

That's part of what led to the AUSTRAC proceeding the following year?---That's correct.

And that issue was described as "under consideration" and not closed?---Yes.

Now, I've just picked out two issues from the five pages of risk issues that Mr Cohen identified, but despite all of those issues we see that Mr Cohen did not believe that there were any risk issues or risk behaviours that would suggest that short-term incentive awards should be modified in any way, for any of the executives connected with these risk issues?---That was his conclusion, yes.

Now, I will tender that document.

THE COMMISSIONER: Remuneration committee papers 5 August '16, CBA.1004.0041.1992, exhibit 7.39.

EXHIBIT #7.39 REMUNERATION COMMITTEE PAPERS DATED 05/08/2016 (CBA.1004.0041.1992)

MS ORR: Now, if we turn to the minutes of the 5 August 2016 meeting we can see how the remuneration committee dealt with that report. That is CBA.1004.0139.0004. Now, if we could have that page and the following page on the screen together. Have you reviewed these minutes of the meeting of the remuneration committee on 5 August, Ms Livingstone?---Yes, I believe I have.

And you've seen from the minutes that the chair of the risk committee supported Mr Cohen's assessment?---Yes.

But he noted that there were issues that might affect remuneration outcomes in the future?---That's correct.

Was it CBAs approach at this time to wait until a risk had eventuated publicly before imposing any sort of consequence for failing to manage that risk?---I don't believe that was the intention, but it might be the impression created.

It was the outcome, was it not?---It – well, I can't – I can't speak for what happened before I joined, and maybe there were consequences that were not linked to a positive – sorry, a media event. So I can't confirm that that was the case, but, certainly - - -

But this was a process that you were part of because you were on the board when these recommendations were presented to the board?---I was not on the remuneration committee.

No, but we will come to the ultimate stage which was the board, and you were on the board when the ultimate decision was made?---Yes, but I had only been on the board for two meetings prior to this, and I was not at the June meeting.

But you were on the board when the ultimate decision was made?---Yes, correct.

You were part of that decision?---Yes.

Yes. Now, some of the risks in Mr Cohen's table had existed for a very long period of time, hadn't they?---Yes.

And particular managers and business units had failed to mitigate those risks over a long period of time?---That is the evidence, yes.

And wasn't that failure in itself something that warranted an adverse remuneration outcome?---I would agree with that, and as I've said, Ms Orr, the process around the remuneration outcomes for 2016 was patently inadequate.

I will tender this document, Commissioner.

THE COMMISSIONER: Remuneration committee minutes of meeting, 5 August '16, CBA.1004.0139.0004, exhibit 7.40.

EXHIBIT #7.40 REMUNERATION COMMITTEE MINUTES OF MEETING, 5 AUGUST '16 (CBA.1004.0139.0004)

MS ORR: So subject to the risk committee accepting Mr Cohen's assessment the remuneration committee didn't seek any further input from the risk committee, did it?---Well, I was not at the remuneration committee meeting so I don't know.

But you have reviewed these documents?---Yes, I have but I don't know what other conversations might have occurred.

Do the documents suggest that anything further was sought?---No, they don't.

No. Do you think that was appropriate?---No, I don't because if you look at our process now we also include, obviously, the reference from the audit committee.

All right. So three days after this meeting on 5 August 2016, the remuneration committee considered the CEOs recommendations about the performance of the group executives, and whether based on their performance they should receive their short-term variable remuneration?---That's correct.

And at that meeting, on 8 August 2016, the committee considered the recommendation from the chair also about the performance of the CEO?---That's correct.

And whether based on his performance, he should receive short-term variable remuneration and how much he should get?---Yes.

Now, if we turn to CBA.1004.0041.1929. We see the agenda for the remuneration committee on 8 August 2016. And if we look at the agenda for that meeting we can see that item 4A was the outcomes for the group executives and item 5A was the outcome for the CEO?---That's correct.

And that 10 minutes was allowed for presentation of papers on each of these topics and discussion on those points?---Yes.

And if we turn to the paper for item 4A at 1966. We see from the first paragraph that this paper provided:

> *...recommendations for the committee's consideration regarding performance and short term incentive outcomes for the group executives and Rob De Luca to enable the committee to make a recommendation to the board.*

Do you see that?---Yes, I do.

And at 1968, if we turn to the last page of the paper, we can see that it was prepared by Mr Narev who was then the CEO?---That's correct.

So the CEO made recommendations to the remuneration committee about the remuneration of the group executives and the remuneration committee considered those recommendations and then made a recommendation to the board?---Yes.

And if we turn back to the second page at 1967, we can see where Mr Narev addressed the issue of risk insofar as it related to executive performance. Mr Narev said:

> *Risk is a key factor in considering short-term performance. Each executive has a risk and reputation KPI as a gate opener in his or her scorecard. The financial KPIs also incorporate a risk adjustment measure through the use of PACC, as PACC takes into account not just the profit achieved but also the risk that was taken to achieve it. Executives are also required to comply with risk appetite statements. STI awards are adjusted downwards where material risk issues occur. Several risk-related matters impacted financial performance for the year (for example, remediations). I have not adjusted business unit level KPIs for those matters. Weaknesses in the operational risk framework and*

some aspects of issues management have been reflected in the performance assessments for some group executives. I will provide some commentary on this at the meeting. Risk is also managed through the compulsory 50 per cent deferral of executives' STI outcomes for a period of 12 months and delivery of one-third of their total target remuneration after a four-year period. Under the group's remuneration policy, the board has discretion to make adjustments to deferred remuneration in various circumstances. Adjustments can include partial reductions or complete forfeiture of deferred STI awards. I am not aware of any reasons why deferred STI should not be paid in full to all relevant executives.

That was Mr Narev's recommendation?---Yes, it was.

And if we turn to attachment A at 1969, we see how the recommendation was recorded for each of the group executives. Mr Narev recommended that all of the group executives receive a rating of fully met for their risk gate opener?---Yes.

Is that correct? He recommended that none of them have their short-term incentive adjusted for risk matters, a zero per cent risk adjustment for each of them?---That's correct.

And apart from Mr De Luca who was on a different sort of scheme, he recommended that each of them receive more than 100 per cent of their target short-term incentive?---That's correct.

All right. I will tender that document, Commissioner. Would you like to reflect on those recommendations before we move to how they were received.

THE COMMISSIONER: Before we get to that, remuneration committee papers 8 August '16, CBA.1004.0041.1929, exhibit 7.41.

EXHIBIT #7.41 REMUNERATION COMMITTEE PAPERS DATED 08/08/2016 (CBA.1004.0041.1929)

THE COMMISSIONER: Now, your question was?

MS ORR: I'm sorry, Commissioner. I jumped the gun.

I was interested in whether at this stage before I move to how these recommendations were received, whether you would like to reflect on the recommendations made by the CEO?---Well, I think, as I've indicated, that there are individuals here for whom the level of award was not appropriate, in light of the risk matters which, as you've pointed out, were on foot in the group at the time. Subsequently, one executive's STI award was reduced downwards, but even that reduction was patently inadequate for what was going on at the time.

How many of these executives do you think should have had a risk adjustment recommended by the CEO?---Well, I would probably say, based on what – what I have – what I have known, I would say most of them.

And what would you regard as an appropriate risk adjustment for the CEO to have recommended, based on what you know?---Well, in some instances, I – probably 100 per cent reduction, which is the approach that, as you know, we've taken subsequently.

All right. Can I ask you to look at the minutes for the remuneration committee meeting on 8 August 2016, CBA.1004.0121.3481. Now, you weren't at this meeting of the remuneration committee but you have reviewed these documents?---It hasn't come up on the screen yet.

I understand that. It will come up. But have you reviewed that document in the material you've reviewed prior to giving evidence?---I think I will have, yes.

And on the first page of this minutes of the meeting of the remuneration committee on 8 August 2016, we can see that the committee continued its consideration of Mr Cohen's letter in relation to risk outcomes, and it accepted that letter. Do you see that?---Yes, I do.

And over the page at 3482, the committee noted the matters set out in the attachment to that letter, which I took you to earlier?---Yes.

But otherwise said nothing about the risk related issues?---That's correct.

And then at 3483, we can see where item 4A was dealt with, which was the discussion of the short-term incentive outcomes for the group executives. Do you see that, Ms Livingstone?---Yes, I do.

The CEO presented his paper discussing with the committee the rationale for his recommendations:

> *Subject to reducing the percentage of STI target payable to the group executive wealth management to 95 per cent, the committee resolved to endorse for board approval the CEOs assessment of the relevant executives' performance and the CEOs recommended FY16 short-term incentive outcomes for the executives.*

?---That's correct.

So the committee resolved to recommend that the percentage of the target payable to the group executive for wealth be reduced to 95 per cent, but otherwise accepted Mr Narev's recommendations?---That's correct.

Do you know why the remuneration committee decided to recommend reducing that one executive's amount by five per cent?---My understanding is to reflect the CommInsure issue.

A five per cent reduction?---As I've indicated, that is patently inadequate and my board colleagues would recognise that today.

Do you think the remuneration committee had adequate information to make a proper assessment of the risk behaviour of the group executives?---The information, as I have said already, could have been more comprehensive.

Do you think the remuneration committee did enough to challenge the CEOs recommendations about the short-term variable remuneration for his group executives?---The record would suggest not.

Was 10 minutes long enough for the committee to meaningfully engage with the CEO about his recommendations?---No.

And were the recommendations of the remuneration committee appropriate, in your view?---On reflection, no, they weren't.

And the remuneration committee ought to have rejected the CEOs recommendations?---Or it ought to have challenged.

Should it have challenged and then rejected?---Well, challenged and then determined alternative outcomes.

I see. I tender that document, Commissioner.

THE COMMISSIONER: Remuneration committee minutes 8 August '16, CBA.1004.0121.3481, exhibit 7.42.

EXHIBIT #7.42 REMUNERATION COMMITTEE MINUTES 8 AUGUST '16 (CBA.1004.0121.3481)

MS ORR: Could we go back to CBA.1004.0041.1929, which is the agenda for the remuneration committee meeting on 8 August. What I want to do is look at the attached papers for item 5A which is about the CEOs remuneration. And the paper for that item is at 1972. And this paper, when it comes up on the screen, set out a recommendation to the committee from David Turner who was then chair of the board about Mr Narev's remuneration?---That's correct.

And we see at 1972 that the assessment of the CEOs performance is conducted at a closed meeting of the non-executive directors in October of each year?---That's correct. That was the case at the time, yes.

You wouldn’t have participated in the October 2015 assessment, but you participated in more recent assessments of the CEOs performance?---That’s correct. Well, I’ve done the assessment.

Yes. Now, at 1973 we see the scorecard outcomes for Mr Narev. Do you see that?---I do.

There’s no particular risk item in Mr Narev’s scorecard?---No.

But like the other executives, he had to meet a risk gate opener?---Yes.

And the board had a discretion to reduce his variable remuneration for risk-related reasons. Is that right?---That’s correct.

And we see in paragraph 5.7 how the CommInsure issues were reflected in Mr Narev’s assessment:

> *The group’s reputation has suffered this year in relation to CommInsure. Ian has self-assessed this portion of the scorecard which represents 10 per cent of the total at 50 per cent. But for these issues, Ian’s performance would have been on target and assessed at 100 per cent.*

?---Yes.

See that? But the chair of the board did not otherwise recommend that Mr Narev’s remuneration be reduced for risk-related reasons?---That’s correct.

He recommended at 1974 that Mr Narev receive 108 per cent of his target bonus?---That’s correct.

That was a recommendation that he receive short-term variable remuneration for this financial year of $2.862 million?---That’s correct.

For this year, in which there were ongoing investigations into CBAs life insurance business, known problems with anti-money laundering compliance, it was known that customers had been charged fees for no service, and it was known that consumer credit insurance had been mis-sold?---That’s correct.

Do you agree that they were all things – that was the context for this recommendation by the chair of the board for Mr Narev to receive a short-term variable award of $2.862 million?---I do.

Do you have any reflections on that recommendation, Ms Livingstone?---As I’ve indicated, we have all reflected on these outcomes, and would regard them as inappropriate. Perhaps I will repeat that: that we’ve all reflected on these outcomes, and would regard them as inappropriate.

Regard them as inappropriate. This was the period within which you, yourself, had no faith in management in their dealings with you about the AUSTRAC issues, or in the audit dealings?---I was coming to that view. As I said earlier today, I firmed up on that view by the October meeting.

I see?---But I recognised at the time that I didn't have the detailed knowledge that my colleagues had.

Now - - -

THE COMMISSIONER: Could we go behind the answer just a little, Ms Livingstone. Scorecards present an aura of mathematical precision to the calculation, do they not?---I agree, Commissioner.

I never intended that to elicit any amusement. And going through this process we see a high degree of specificity and a high degree of detail at various stages. Is that right?---That's correct.

Does the degree of specificity and detail that is applied in truth serve to mask the lack of critical judgment about what really matters?---I think that's – Commissioner, that's correct, in – certainly at this point, in terms of how the scorecard framework is applied. That's not the case now, in terms of the discussion which accompanies the scorecard, both in terms of input from the other committees as well as the substance of the scorecard. It is one element. At this point, it was the – virtually the only element.

Well, the masking that was occurring at this time was a masking of what were the criteria that should have led to an outcome that you would regard as proper. Is that right?---That's correct.

That is to say, the scorecard and the various steps that were taken were masking or failing to identify, or not identifying properly, criteria of importance. Do you accept that?---I – I do, and that's why we now have a much more comprehensive assessment on using our risk scorecard before we even get to the financial scorecard.

Ultimately, someone in the organisation, and ultimately, I think, it has to be the board, has to stand back and look at what is proposed and make a judgment about the sufficiency and correctness of the result that is proposed. Is that right?---That is correct, and that is what the board did in FY17 and, again, in FY18. The process of coming to the outcomes for individual executives was an iterative discussion with the CEO after having considered the risk scorecard and the KPI scorecard. So the board exercised quite a degree of inquiry on individuals, and the outcomes were varied as a result.

But in the end, is the board in a position where it can determine whether particular very senior members of the leadership team have or have not performed at, below or above what is required of them?---I think we – we are now much better informed in that regard, and I think we have to take into account a number of factors, including our – well, our observations on their performance during the year when they've come before the board, the observations in terms of the matters that have come before the audit committee and the way they've responded to those, and also the – the risk committee. So the outcome is based on an observation over a year, as much as on documentation at the end of the year. But I think the board is in a position to form a view about the performance of individual senior executives.

And ultimately, the question can be reduced to do scorecards give an appearance of precision to what ultimately has to be a matter of judgment?---If scorecards were used on their own, that would be the case. But because we combine them with other elements, that appearance of precision is mitigated.

Yes. Yes, Ms Orr.

MS ORR: The remuneration committee accepted the chair's recommendation about the remuneration of the CEO?---Yes, it did.

As did the board?---Yes, it did.

And the board accepted the remuneration committee's recommendations about the remuneration of the group executives?---Yes, subject to that one adjustment.

The adjustment that the remuneration committee recommended - - -?---Yes.

- - - of five per cent?---Yes.

Now, I want to ask you about the same decision-making process in the 2017 financial year but before I do that, I want to deal with one other aspect of the 2016 remuneration report. At CBAs annual general meeting, CBAs shareholders have the opportunity to vote to adopt the remuneration report?---That's correct.

And in 2016, 50.91 per cent of the votes were against the remuneration report?---That's correct, as I referred to earlier this morning.

And that was partly the result of the remuneration decisions that I've just asked you questions about?---That was one of the contributing factors. It was more than remuneration, but in terms of the remuneration report, the outcomes particularly in relation to the group executive for wealth were an issue, but very specifically, the proposals in relation to the changes to the long-term variable remuneration, shareholders, both retail and institutional, found unacceptable because it appeared to make it easier for executives to receive long-term variable REM, the way it was restructured.

I want to ask you about those changes, those proposed changes which you say were a contributing factor to the vote on your remuneration report that year. If we go back to the 2016 annual report and the message from the chair of the remuneration committee, RCD.0021.0028.0001. At 0049. We see, when it comes up on the screen, Ms Livingstone, an explanation in the message from the chair of the remuneration committee for the proposed changes under the heading Remuneration Changes?---Yes.

We see that here the remuneration report foreshadowed changes to executive remuneration for the 2017 financial year. And the first bullet point under this heading recorded that:

> *The scorecards for executives were to be amended to include an assessment of exemplary leadership and exceptional personal demonstration of CBAs vision and values.*

?---Yes.

And the second dot point recorded that "The GLRP" which was the Group Leadership Reward Plan was going to change?---That's correct.

And that's the long-term variable remuneration plan?---Yes.

And the criteria for getting your long-term variable remuneration were going to change in that the criteria for assessing eligibility were going to be amended to include a new measure, a new people and community measure, weighted at 25 per cent?---That's correct.

Now, if we turn over a few pages to 0056 and 0057, we can see from those pages, when they come up on the screen, how the long-term variable remuneration scheme was structured in the 2016 financial year prior to the proposed changes?---Yes. Yes.

And executives were granted a certain number of reward rights?---That's correct.

And at the end of that four year performance period, there was, as we discussed earlier, a determination about whether the rights would vest?---Yes.

And if they vested, the executives received one share for each right?---That's correct.

And whether the rights vested depended at this time on two performance hurdles, the first was a total shareholder return hurdle?---That's correct.

And that determined whether 75 per cent of the rights would vest?---Yes.

Can you explain how the total shareholder return hurdle works, Ms Livingstone?---Yes. It takes into account both the movement in the share price and the dividends over the period. And it's – it's relative to – as I think it describes over the page – it's relative to a peer group of the ASX20, excluding the bank and resource companies. So it's a relative performance.

It compares CBAs total shareholder return over the four-year performance period - - -?---That's correct.

- - - to the total shareholder return of the 20 largest ASX listed companies?---That's right.

And - - -?---Excluding resources.

Excluding resources. And there's an assessment made of which percentile CBA is in - - -?---That's - - -

- - - within those 20 companies excluding resources?---That's correct.

Now, the second hurdle in addition to the total shareholder return hurdle was a customer satisfaction hurdle?---That's right.

And that determined whether the remaining 25 per cent of the rights would be vested?---Yes.

And how did that hurdle work, the customer satisfaction hurdle?---It – it worked in relation to the outcome of surveys by external parties like Roy Morgan, and whether CBA retained its number one position in relation to customer satisfaction.

So on 30 June 2016, the four-year performance period ended for reward rights that had been granted in 2012?---That's correct.

And we see from this page that only 20.31 per cent of those reward rights vested?---That's correct.

None of the reward rights vested against the total shareholder return hurdle?---Yes.

And of the remaining 25 per cent that depended on the customer satisfaction hurdle, just under 90 per cent vested?---That's correct.

And that gave the total that you referred to earlier of about 20 per cent - - -?---Yes.

- - - of the total award vesting. If we turn to 0058 we can see what the plan was to change this. The board wanted to change the length of the performance period?---That's correct.

And reduce the share of the award that was attributable to the total shareholder return hurdle from 75 per cent down to 50 per cent?---That's correct.

And you wanted to add a new people and community hurdle which would determine whether that 25 per cent that you had removed from the TSR hurdle would vest?---Yes, that's correct.

And that hurdle was explained on this page as:

> *...measuring long-term progress in the areas of diversity and inclusion, sustainability and culture. And aiming to strengthen the group's culture by further aligning the executive reward framework with the group's vision and values.*

?---That's correct.

Why was that hurdle sought to be introduced, Ms Livingstone?---Again, my understanding was that the view of the board was that there should be more of a non-financial emphasis in the long-term variable remuneration, and the – the view that the commitment to community and sustainability and diversity were elements which underpinned the long-term value creation for the company.

And did you support these changes to the long-term variable remuneration framework?---Well, they were represented as being supported by shareholders and, in fact, that shareholders would view these very favourably, so on the basis of that, yes, I was part of the decision of the board to approve the remuneration report. As we know, in the event, shareholders were not supportive - - -

Yes?--- - - - of this.

And I will come to that. But before we come to the reaction, were these measures that you thought were a good idea?---The – the inherent complexity of having multiple testing points is not a good design feature. I am – I was and continue to be supportive of having non-financial measures in the long-term remuneration plan, and, as you know, we continue to do so.

Did you support the idea that one of the ways to achieve cultural change was to make a component of executives' long-term variable remuneration dependent on long-term cultural change?---In principle, yes, as long as you can, through the design feature, be clear as to how you expect that to be achieved.

Now, more than half of the votes were against the remuneration report - - -?---That's correct.

- - - which contained these changes. And that meant that if more than 25 per cent of the votes were against the 2017 remuneration report at the next AGM, there would be a spill of all the board positions?---That's correct.

And you and the rest of the directors, in that event, would have had to stand for re-election to the board?---That's correct.

That's called the two strikes rule?---Yes, it is.

Now, following the first strike for this remuneration report at the 2016 AGM, you met with investors to discuss their position?---Once I came into the chair role, yes.

And were the investors that you met with concerned by the first topic that I dealt with, which was the lack of consequences for CBA executives for risk and reputational issues?---They were. They were concerned about a number of matters which we laid out in our 2017 report, including the lack of transparency in the remuneration report, the lack of transparency around the exercise of board discretion, the lack of variability in outcomes for senior executive remuneration, and, as we've just discussed, the proposed structure, which, in the event, was never implemented, of the long-term variable - - -

Were the investors concerned in the reduction on the reliance shareholder return hurdle?---It – it varied, but in general, yes, partly because they were concerned about the – the way the board would exercise its discretion in relation to the other elements.

Do you think that the – the two strikes rule is an impediment to the boards of financial services entities adjusting their remuneration policies in a way that prioritises or encourages positive outcomes for stakeholders other than the shareholders?---Well, I think the outcome that we achieved as a result of the work that we undertook from January 2017 through to June 2017 suggests that you can actually convince shareholders that appropriate non-financial measures can be included in the long-term variable remuneration plan. The easiest thing for us to do would have been just to take them out and revert to the previous plan. But I and my colleagues felt that having those non-financial measures in there, and the ones that we subsequently designed – so the trust and reputation, and employee engagement – were actually crucial to delivering long-term value to the company, but long-term value to stakeholders. So we – I went round investors, and several of them multiple times, to convince them that we wanted to retain those elements, those non-financial elements in our long-term variable reward plan, and, as I have said, that was consistent with the FSB supplementary guidance and the PRA guidance. It – it did take some effort to convince some shareholders, but I felt the principle of the point was worth – was worth pressing.

So you had to work very hard to convince shareholders of this ahead of the next vote on your next remuneration report?---Well, we actually wanted to be ready to implement the different – because we were not just dealing with a restructuring of this, we were dealing with the restructuring of the whole executive remuneration framework, beyond, necessarily, what shareholders might have been concerned about, because for the reasons that you've laid out, clearly, the framework at that time was ineffective and not fit for purpose. And so we were redesigning the whole framework and we wanted it to be ready for implementation from 1 July 2017. So we had to finalise it well in advance of putting anything to shareholders.

Do you think that the operation of the two strikes rule should be restricted or qualified in any way to better enable financial services entities to adjust their remuneration policies to benefit stakeholders other than shareholders?---Well, I think, Ms Orr, what we're observing, in fact, is the two strikes rule and the vote against the remuneration report is actually being used for purposes beyond remuneration. So institutional shareholders may use that vote to register dissatisfaction with other elements, not related to remuneration. And I think this is – this is causing a distortion and compromising, I think, the ability of the two strikes rule to work effectively.

What are the other things that you think shareholders are sending a message about other than remuneration in their voting?---Shareholders might not be happy with the board but the particular directors with whom they're unhappy might not be up for election that year. I experienced an instance where a shareholder voted against all resolutions, including the remuneration report, because they didn't agree with the director who was actually going up for election, a new director that year. That's not at CBA, that's another company. So that, to me, was an inappropriate use of the vote on the remuneration report. Certainly vote against the director but don't vote against both. We saw in the vote for our remuneration report this year a number of abstentions by shareholders, not because they had concerns with the remuneration, but they had broader issues about whether the action that we were taking to give effect to change, whether those actions were being effective, and they used an abstention from the remuneration report vote as a mechanism for that. And it's important to – to know that usually about somewhere around 40 to 45 per cent of shareholders vote, which means that any shareholder who votes, effectively, you can double their shareholding because of the impact that that vote has in the total. So where you have people abstaining from the remuneration report, even though they agree with it, it could, if the vote were close, actually cause a strike or a second strike, which may not have been intended but it's just the way the arithmetic works. So I think to come to your point on the two strikes rule, I certainly think having the advisory vote on the remuneration report is good. And, yes, if – if there are two strikes, that's helpful. At least you have an opportunity to come back again. But I think, as I say, the fact that it is being used for purposes other than a view on remuneration is compromising its effectiveness.

So after the 2016 strike you had to make a number of changes to your remuneration arrangements. And I want to ask you about some of those changes. They're summarised on the first two pages of the 2017 remuneration report that I will take you to now. That's RCD.0021.0002.2483. And if we bring up 2548 and 2549. We see a section of the remuneration report that you will see is headed:

> *Board response to concerns raised in relation to the FY16 remuneration report.*

?---That's correct.

And the first item in the response is the short-term remuneration outcomes for the 2017 financial year, which I want to come back to. But underneath that, the report referred to a number of changes that were going to take effect from the 2018 financial year?---Yes. So from 1 July '17.

Yes. And the first was an increased weighting on financial and quantitative measures in the short-term remuneration scorecard for executives?---That's correct.

Why did the board decide to introduce that change?---Well, we introduced that change because shareholders were, I think, rightly critical of the application of board discretion, and they wanted to see more quantitative measures. So not just financial but more quantitative measures across the elements of the scorecards. As you know, as part of the evolution of our framework, for the following year we have reduced the weighting of financial measures in all score cards.

Well, over the course of this year the Commission has heard evidence about how an excessive weight on financial measures in employee scorecards can increase the risk of misconduct or conduct that falls below community standards. In making this change to increase the weighting on financial and quantitative measures, did CBA consider that increasing the weighting for its executives for financial measures could have that effect?---No, we didn't. We didn't explicitly consider whether this would provide an incentive for misconduct. But in – in coming to this, as I say, subsequently, we have taken the weighting of the financial measures back down to 30 per cent, so - - -

My question was not about whether it provided an incentive for misconduct. It's about whether you considered the risk that this change would give rise to misconduct?---We didn't. We didn't explicitly.

The next change was improved rigour of non-financial measures?---That's correct.

Do you see that?---Yes.

And this is about increased quantitative – quantitative measurement of non-financial measures and the introduction of the net promotor score customer targets?---That's correct.

The net promotor score is a quantitative measure that's introduced to measure a non-financial matter, customer satisfaction. Is that right?---It doesn't measure customer satisfaction. It measures the proportion of customer advocates versus detractors. So the intent of the net promotor score is to pick up those customers who are not advocates for your products.

So is that a measure of customer satisfaction, essentially?---It's – it's not the same as a – a customer satisfaction measure per se, because it's intended to mix the positive with the negative.

I see?---So that's why it's called a net promotor score.

And it's a quantitative measure?---Yes, it is, based on surveys.

Do you think that quantitative measures are a better way to measure non-financial matters than qualitative measurements?---Well, in fact, as you know, we've taken that particular measure in the scorecards for the current year includes NPS, but also includes customer outcomes, such as customer complaints. So that is the non-quantitative side that you're referring to.

But you've retained the quantitative side and added some qualitative elements?---That's correct.

And another change that we see here was the removal of the proposed people and community measure that I asked you about before?---Yes.

And why was that removed?---It was replaced with a trust and reputation measure and an employee engagement measure, which we thought were better and more specific indicators of those elements which lead to long-term value creation.

I see. So at the bottom of the page – if, perhaps, we could blow up the section under comprehensive review of LTVR measures, we see that the document records that:

> *After conducting a review of long-term variable remuneration performance measures, the board decided to keep the total shareholder return hurdle.*

?---That's correct.

And to continue to have 75 per cent of the long-term remuneration dependent on satisfying that hurdle?---Yes, that's correct.

And the customer satisfaction hurdle was replaced with the two new performance measures that you've mentioned?---Yes.

The trust and reputation hurdle for 12.5 per cent and the employee engagement hurdle for 12.5 per cent?---Yes.

Now, I want to ask you a bit more about the use of the total shareholder return hurdle at CBA. We've seen that for the reward rights granted in the '2016 and '17 years, 75 per cent of the long-term incentive depends on CBA meeting the total shareholder return hurdle?---That's correct.

And that had been true for many years before the 2016 financial year?---Yes.

And it remained true for reward rights granted this year, in the 2018 financial year?---That's correct.

And you've explained how that hurdle needs to be met. Is it subject to any risk-related adjustment by the board?---Not – not that measure, but the overall achievement of the LTVR - - -

The reward rights?--- - - - either before or at the point of vesting is subject to a risk assessment.

I see. So that's the point at which the risk-related assessment by the board enters the picture?---That's correct.

And for 2017 and 2018 financial years there was also a positive TSR gateway. What does that mean?---That means that to receive the trust and reputation employee engagement score outcomes, the overall outcomes for shareholders could not be negative.

I see. So CBAs long-term variable remuneration framework places significant emphasis on this one measure, this total shareholder return measure. Do you agree with that?---It does.

And in April this year, APRA released a paper that you referred to earlier in your evidence called Remuneration Practices at Large Financial Institutions?---That's correct.

Are you aware of what that paper says about use of the total shareholder return hurdle?---Yes. And there are – there are a lot of competing views on the appropriate, if you like, financial element to put into a long-term variable remuneration framework.

But are you aware of the views expressed by APRA - - -?---Yes.

- - - on the use of the total shareholder return hurdle?---I understand that it's not – it's not favoured as – as a measure.

It's not favoured, did you say?---Yes.

APRA has expressed concern about an excessive focus on return measures such as total shareholder return, hasn't it?---Yes, it has.

And those concerns have been expressed also by the PRA, the Prudential Regulation Authority in the UK?---Yes.

The PRA said that:

> *Performance measures like total shareholder return are not suitably adjusted for long-term risk factors, and may incentivise highly leveraged activities.*

Are you familiar with that statement?---I am, but, again, I would say that the – the outcomes and the vesting, and the – that's the point at which the board exercises discretion, and if there have been adverse outcomes, then the LTVR doesn't vest.

So the APRA information paper was released in April this year before you released your most recent remuneration report?---That’s correct.

And as a result of that APRA paper did you reduce your reliance on total shareholder return?---No, we haven’t, but as I’ve said, we are undergoing another whole review of the remuneration framework and the working of the short-term and the long-term variable remuneration.

Do you think it’s appropriate to have such a large proportion of the long-term incentive for your group executives depend on a purely financial matter?---I think as reflected in our structure at the moment, we do think that that is – it’s a measure we can use. It’s not EPS and it’s not ROE, which are directly, if you like, influenceable by management. The total shareholder return relies on market influence, not just what the company does. So it does have a degree of reflection of external perception and external views. It is not – it is far from a perfect measure. And that’s, again, why we’re going through another review to see if there’s a better framework. And, in fact, we’re consulting with the PRA next month on this.

Consulting with the PRA on what?---On their views on remuneration frameworks.

And why are you consulting with the PRA, the UK prudential authority?---Well, as part of getting an international perspective. We can observe what’s happening in our market but we will also get an international perspective.

But – but - - -?---And we have to meet with the PRA in any event because we have employees in the UK.

But you know what the local prudential authority’s perspective on this is from the document produced by APRA in April this year?---We do. And we’re having regard to that perspective. But, as I say, we’re trying to look at effectively what a comprehensive redesign could be that doesn’t have, as I said earlier, the unintended consequences.

Which unintended consequences are you referring to there, Ms Livingstone?---I’m referring back to whether you have the design of a system which unduly weights the short-term, if you like masquerading as a long-term plan.

I see. All right. Now, if we can just go back to the document on the screen. The final change that was mentioned there as part of the response of the board to the concerns raised for the FY16 remuneration report is at 2549. If we could go to 2549 and blow up the section headed Enhanced Risk and Remuneration Governance. I want to ask you about this set of changes and then turn to the decisions of the remuneration committee and the board about short-term variable incentives in the 2017 financial year pursuant to this new remuneration governance. The changes to the governance were proposed in about April 2017?---That’s correct.

By that time you were the chair of the board?---That’s correct.

And you were a member of the remuneration committee?---Yes.

Could I take you to CBA – I'm sorry, I think I need to tender this document before I move away from it, the 2017 annual report.

THE COMMISSIONER: CBA annual report 2017, CBA.0021.0002.2483, exhibit 7.43.

EXHIBIT #7.43 CBA ANNUAL REPORT 2017 (CBA.0021.0002.2483)

MS ORR: Could we now look at CBA.1004.0041.2374, which is a paper prepared for the remuneration committee by David Abusah, executive general manager, performance and reward from 10 April last year. Now, this paper proposed a number of changes to executive remuneration processes in light of the strike on the 2016 remuneration report?---Yes. In light of the strike and also looking at enhancements that we could do, notwithstanding the strike.

Now, if we turn to – I'm sorry, the first page of the paper is at 2419. I will just bring that up to show you. You are familiar with this paper, Ms Livingstone?---If I could just have a moment to review it. Yes.

And if we turn to 2422, which is attachment A to the paper, we see a summary of the risk adjustments that CBA had made to executive remuneration in the past. We see here that from the 2011 financial year to the time of this paper there were only seven instances involving five executives where an executive's short-term remuneration was reduced as a result of a risk issue?---Yes.

And with one exception, they involved reductions of 20 per cent or less?---That's correct.

And in each case, the reason for the reduction, as explained in this document, was damage to CBAs reputation?---Yes. Well, there's – there's the misconduct one as well.

Was that a reputational problem?---Again, that's before I joined the board, so I can't comment on whether the primacy was misconduct or reputation.

And the others you agree all relate to reputational damage?---I think from the – again, I was not on the board at the time but the – the document refers to the particular issue. So, for example, in advice and also the public scrutiny.

Yes. Well, we see in every entry, other than the misconduct activities entry that you referred to, either the use of reputational risk, reputational damage, or intense public scrutiny?---It was one of the factors that would have obviously gone into the consideration, but I was not there at the time.

From the 2011 financial year, CBA had never reduced an executive's short-term remuneration as a result of a risk-related issue that had not yet been made public?---Based on this evidence, no.

Do you think that sends the right message to CBAs employees?---If you draw that conclusion, no, it doesn't.

What message do you think it sends?---Well, clearly, that there will only be consequence if there is a public event, a media event.

If it's found out. If the public learns of the problem?---That would be the inference, yes.

You accept that's the inference from what you see on this page?---I do.

One of the changes that was proposed at this time was to introduce a new executive risk scorecard. You referred to that earlier - - -?---That's correct.

- - - in your evidence. Can you explain that scorecard?---So it has – it assesses the individual on a number of elements. One is the risk culture and leadership.

And I will just ask you to pause for a minute because it might assist you if I bring it on to the screen at the time?---Thank you.

2424. And it might assist us to understand your explanation?---So, as you can see, it has the – the four quadrants. So the one I just referred to, the risk culture, and leadership. Then risk strategy, risk appetite, risk and control environment, and incidents and issues.

And before this scorecard was introduced, did CBA have any formal framework for the assessment of an executive's risk performance?---Not – not in this way. And not - - -

In any way?---Well, there was – if you call the chief risk officer's assessment a framework, that was the only framework, but this is very specific, individual assessment, which, as you can see, also includes a self-assessment which gives a guide as to the culture mindset of the individual.

All right. I will tender that document, Commissioner.

THE COMMISSIONER: Remuneration committee papers 10 April '17 CBA.1004.0041.2374, exhibit 7.44.

EXHIBIT #7.44 REMUNERATION COMMITTEE PAPERS DATED 10/04/2017 (CBA.1004.0041.2374)

MS ORR: The remuneration committee recommended the changes in this paper to the board?---That's correct.

And the board adopted those changes?---Yes.

And they were applied in determining executive remuneration in the 2017 financial year?---They were.

And the remuneration committee met in June 2017 and discussed the risk-related adjustments that should be made for the 2017 financial year?---Yes.

And by that time, CBAs fees for no service conduct had been made public?---Yes.

And CBA had entered into an enforceable undertaking in relation to its foreign exchange trading?---Yes.

And ASICs investigations into CBAs life insurance business had mostly concluded, apart from an ongoing investigation by ASIC into whether CBAs advertising was misleading - - -?---Yes.

- - - to consumers. So those things had occurred. And at a meeting in July 2017, the remuneration committee considered the CEOs recommendations for the remuneration of his executives?---Yes.

Could I ask you to look at CBA.1004.0041.2546. This is the agenda for the meeting of the remuneration committee on that date?---Yes.

And item 7 was the discussion of group executive remuneration. And that was scheduled for a 15 minute discussion?---Yes.

And if we turn to the paper for item 7 at 2652. We see that the CEO said in the first paragraph:

> *At its June meeting, the committee received my initial high level recommendations on FY17 performance and remuneration outcomes for current and former group executives. The initial recommendations did not yet include adjustments for risk and reputation issues, and this is an area in which the committee provided specific guidance.*

Do you see that?---That's correct.

And over the page, we see at 2653 to 2654 a discussion of the recommended adjustments. So for the 2017 financial year we see in paragraph 3.5 that the CEO recommended a 10 per cent reduction for all group executives for long outstanding items. Do you see that?---Yes, that's correct.

A further 10 per cent reduction for certain group executives, including Mr Comyn for control weaknesses relating to anti-money laundering and counter-terrorism financing regulation?---That's correct.

A further 20 per cent reduction for the group executive for wealth management as a result of the fees for no service issue?---That's correct.

And a further 25 per cent reduction for the group executive responsible for enterprise services as a result of weaknesses in controls and effectiveness?---Yes.

And if we turn over the page to 2655, we see that in contrast to the previous year all of the group executives received a rating of partially met rather than fully met for risk?---That's correct.

And they each received a downwards risk adjustment to their short term variable remuneration of between 10 and 35 per cent?---That's correct.

Now, I will tender that document, Commissioner.

THE COMMISSIONER: Remuneration committee papers 11 July '17, CBA.1004.0041.2546, exhibit 7.45.

EXHIBIT #7.45 REMUNERATION COMMITTEE PAPERS DATED 11/07/2017 (CBA.1004.0041.2546)

MS ORR: At the July meeting the remuneration committee broadly approved these remuneration outcomes?---Yes, we did.

And you were present at that meeting?---Yes, I was.

Now, I want to come to what happened in August in a moment, but reflecting on what happened at that meeting of the remuneration committee in July last year, do you think that those remuneration outcomes for the group executives were appropriate?---I think in hindsight, we could have done a greater risk adjustment on several executives, including to zero.

And who would you have reduced to zero? Who should you have reduced to zero?---This is awkward in terms of individuals.

So some but not all?---Some but not all. No, certainly not all.

The CEO. We will come to the CEO separately. Perhaps I will do that in order. I am just trying to understand if there's a way that you can identify categories of individuals within here who you think ought to have been reduced down to zero?---Probably the ones with the high risk adjustments.

I see. I see. So with the risk adjustments of 20 per cent or more?---Well, certainly the – the 30 per cent or more.

30 per cent or more?---Yes.

Only those ones?---In terms of going through to zero?

Yes?---Yes.

And do you think that you should have reduced further others?---So I would go back to the – the – the 10 per cent factor that was in there for the AML. And the board had said to the CEO that their – while we were understanding – and this is before the proceedings obviously had been lodged.

Yes?---But while we were understanding more about the significance of those issues – and this comes to the action that we were taking to understand the detail in our control environment around AML/CTF getting to root cause – that there should be a factor in there for that, almost as a marker, but recognising that when we did get to root cause and have a better – a fuller appreciation of the level of our financial crimes compliance, there would be a further adjustment.

So do you think reflecting on it, that the 10 per cent across the board reduction for the anti-money laundering issues was inadequate?---In the light of subsequent events, it was clearly inadequate, which is why we then made the further adjustment.

In light of the proceeding being brought against CBA. They're the further events that you're referring to?---And in terms of what we then became aware of, which we would have become aware of as we sought root cause and what the issues were, but we were partly through the process when AUSTRAC lodged its proceedings, we became aware of matters that we had not known at the time. So had we known those issues, the adjustment would have been greater, and in the event it was 100 per cent.

But you did know that there had been consecutive red-rated audit reports in this area for multiple years?---We did. But we also knew that a great deal of work had happened and you take the 400 million that had been invested in the systems, but, again, the ability to articulate the problem and get to the root cause was still not well developed. So, yes, there are red audits, but there was the – the offset of all the work that was going on.

All right?---So it wasn't a situation that nothing was being done about the AML/CTF Act compliance. A great deal was going on.

But the problems had not been fixed and they were longstanding problems, weren't they?---But – that's what I'm saying. The articulation of the problem was not clear. So certain aspects were fixed and then other aspects would appear, which meant that there wasn't a complete understanding of what the problem was. The root cause analysis was only just being done and we were having various groups, consultants help us with the understanding of root cause.

And that hampered the board's ability to give appropriate remuneration consequences, didn't it?---The fact that we didn't know what the scale of the issue was, yes, it did, but we were signalling that there will be consequences. So it wasn't a situation that there couldn't be consequences until we found out more. There was an element in the risk adjustment which said there will be consequences, but we need to understand the situation a lot better first.

The proposed risk adjustment for the CEO, Mr Narev, for this year, was about the same as what we see here, wasn't it? It was a reduction of 20 per cent?---Yes, it was.

And do you think that was appropriate?---The – so in an absolute sense – and, again, with hindsight, it should have been more.

What should it have been?---Well, in hindsight, it should have been zero, which is where it ended up.

Right?---But I would say that one of the aspects in all of executive remuneration, which is – it's an explanation. It's not, in any way, an excuse. But the fact that all of these remuneration elements are disclosed under the KMP disclosure requirements means that they carry not just a financial impact but a reputational impact. And at this level, executives are very cognisant of the reputational impact as much as of the financial. So if you want to deliver a message to an executive, that reputational impact dimension is also important.

That's why it's very important to use the powers that you have to send consequences via remuneration reductions, isn't it?---Absolutely. And so if you're asking me about the CEO, at that time, to get anything less than 100 per cent was unheard of, and to get down to 83 per cent was – was effectively an adjustment that was considered very significant on his part. So for – for – in that sense, that was a very major message being delivered to him, that the variable pay is truly variable, and it will be below 100 per cent.

But do you accept that the matters that I took you to at the start of these questions about the events in this financial year warranted a very significant consequence for the CEO and a very strong message?---Well, what I'm saying, Ms Orr, is that a very strong message was delivered, but I also accept that the financial consequences and the adjustment should have been greater.

Yes. Well, a 20 per cent reduction in your variable remuneration is not a very strong message in a year where fees for no service, enforceable undertakings about your foreign exchange trading, your life insurance business being under investigation, things of that nature, the AML problems - - -?---I – I accept that.

All right. Thank you. Now, a few weeks after this meeting on 11 July, on 3 August AUSTRAC commenced the civil penalty proceeding against CBA?---That's correct.

And a few days after AUSTRAC commenced that civil penalty proceeding, on 7 August, the remuneration committee had its next meeting?---That's correct.

Could I take you to CBA.1004.0121.3528. You were present at that meeting of the remuneration committee, Ms Livingstone?---Yes, I was.

Do you remember this meeting?---Vividly.

Now, the first page of the minutes at 3528 records that the non-executive directors met in private and discussed the risk and reputational matters affecting the group and the related considerations for the executive remuneration outcomes in FY17, including for the chief executive officer. They then record that Mr Narev joined the meeting after that discussion. Now, I want to ask you about your recollection of that private discussion of the non-executive directors in Mr Narev's absence a few days after AUSTRAC commenced its civil penalty proceedings against CBA?---So the – the discussion – and as you can see, all directors were there – was to determine, in the light of what had happened, what the remuneration consequences should be, and how they should be delivered through the remuneration framework, whether they should be delivered through short-term variable REM or long-term variable REM, and what quantum. And also I proposed that all directors take a 20 per cent penalty on their fees. So I put that to the meeting as well.

That was your idea?---Yes, it was.

That the non-executive directors take a 20 per cent cut on their fees?---Yes.

What about the CEO? What was the discussion about the remuneration consequences for him?---So where – we had quite a debate as to the best mechanism to use to deliver the consequences, and in the end, the board determined that reducing the current year short-term variable REM to zero was the appropriate consequence, given that at that time we were not fully aware of all the matters that were covered in the proceedings. So the view was that we should leave the long-term variable REM on foot in terms of the deferred REM, so that if there was a need for consequences further down the line, we would still have that option to exercise discretion then.

Did anyone argue for immediate consequences in relation to long-term remuneration?---There was a mix of views. Some people – in fact, I felt – my own view at the time was we should consider a mix of short-term and long-term. We had a good discussion, which is why you have a board and you have the diversity of views, and the outcome of that discussion was that the immediate consequence would be delivered through a zero short-term variable REM rather than adjusting deferred long-term variable REM on foot.

And did anyone argue against a 100 per cent reduction to the short-term variable remuneration?---No, it was a unanimous decision.

And you were persuaded in that discussion that there should be no long-term variable remuneration consequences at this time?---At that time, yes. For the purposes of enabling subsequent board discretion.

And what about the other group executives? What did you discuss about consequences for them?---It was – the discussion covered all the CEO and all group executives.

And did anyone suggest to the contrary in terms of reducing their short-term variable remuneration to zero?---Well, that was the discussion that we would reduce everyone to zero.

There was no separation between the CEO and the group executives?---No. Zero was zero.

I see. I see. The minutes record that Mr Narev then joined the meeting and the directors continued to discuss the outcomes on group executives' remuneration that it would recommend to the board. What do you recall of that discussion after Mr Narev joined the meeting?---Well, the discussion was basically informing Mr Narev of what the outcome of the board's decision was – well, the remuneration committee, but, clearly, it was going to be the board's decision as well.

And after that, the remuneration risk review report was tabled. Do you see that towards - - -?---Yes, yes.

- - - the bottom of the page?---Yes.

And the minutes record, if we could have both this page and the following page on the screen, that the committee noted that:

> *All directors had participated in a fulsome discussion on the risk and reputation matters affecting executive remuneration outcomes for FY17 earlier in the meeting. It was further noted that the committee had considered the key risk matters identified in attachment 1 to the paper –*

Which I took you to earlier:

> *... as well as the impact on group's reputation of the AUSTRAC legal proceedings and accountability for those matters.*

?---That's correct.

Now, I want to look at what the committee decided. If we go to 3530 and bring up 3530 and 3531. We see that the committee decided to recommend to the board, as you've described, a reduction in the short-term bonus for all group executives, including certain former group executives to zero, to forfeit all of the deferred amount of the former chief risk officer's short-term variable remuneration for the 2016 financial year, to reduce the amount of that same former chief risk officer's long-term remuneration, and to reduce the short-term remuneration for the CEO to zero?---That's correct.

What did you decide about how the decisions of the remuneration committee that are recorded in this document would be communicated within the organisation?---So in – in the first instance, Ian was asked to inform the group executives that that was the board's decision. And I subsequently met with the ExCo to explain the board's decision. I wasn't in a position to meet with ExCo immediately, because, as you may know, I was summoned to Canberra by the Treasurer.

How did the group executives react when they were told that they had lost the entirety of their short-term variable remuneration?---It varied. Some were immediately accepting. Some were angry. And others felt that because it had affected the whole group, including people who hadn't been there for very long, that – that it wasn't – it wasn't fair. But the – the point of the board taking this view was to emphasise the importance of – to emphasise the importance of collective accountability and that ExCo was a collective leadership group and not to distinguish between individuals.

And how did the CEO react to the decision about his short-term variable remuneration?---He recognised that it was appropriate.

All right. I don't think I've tendered this document, Commissioner.

THE COMMISSIONER: Remuneration committee paper 7 August '17 CBA.1004.0121.3528, exhibit 7.46.

EXHIBIT #7.46 REMUNERATION COMMITTEE PAPER DATED 07/08/2017 (CBA.1004.0121.3528)

MS ORR: Ms Livingstone, after this decision, APRA announced that it would conduct the prudential review into the CBA?---That's correct.

In May this year APRA released the report of that prudential review?---Yes.

And that inquiry was highly critical of CBAs remuneration practices. Do you accept that?---Yes.

It criticised CBAs reactive approach to applying risk adjustments to variable remuneration?---That's correct.

It criticised the remuneration committee's reliance on the performance assessments of the CEO and the advice provided by the chief risk officer?---Yes.

And it said that the remuneration committee did little to challenge those assessments by seeking further information?---That was their conclusion, yes.

And do you agree with that conclusion?---I think the – in terms of the FY17 outcomes which were pre the AUSTRAC, we did – we did challenge significantly the actual outcomes. And as you would have seen, the difference between the June and July outcomes as recommended by the CEO there was a significant reduction.

The - - -?---Which came from the challenge from the board.

The prudential inquiry made a number of recommendations in relation to the remuneration framework at CBA?---That's correct.

And I want to ask you about a few of those. The third part of what is recommendation 25 in the report was that:

> *... in support of the effective application of the remuneration framework, CBA, with due regard for confidentiality concerns, communicate the impact of both good and poor risk outcomes on remuneration across the group to reinforce the link between accountability and consequence.*

You recall that recommendation - - -?---I do.

- - - Ms Livingstone?---I do.

And did CBA do that with the most recent set of remuneration outcomes for the 2018 financial year?---Yes, it – it has, and the board received the proposal as to how that would be communicated and communicated over a period. So there was a – a communication strategy, if you like, in relation to that.

So how did you communicate that?---Through – through employee meetings and also with HR actually describing how the process had worked. And also in employee communications or written communications. So there were a number of ways in which that was communicated. What – what we will do is then, effectively, do a review of that to see how that – how effective that communication has been. And one of the other recommendations is more generally to – for the remuneration committee to understand how effective the remuneration framework actually is, because at the moment we rely, really, on, if you like, anecdotal data points. So – so customer complaints. We – the risk behaviours and analysis that internal audit does, misconduct reporting. So, as I say, they're somewhat anecdotal, and we need a more analytical approach, which is what's being worked on at the moment, and we hope to look at that in the first quarter of next year. And that point on, effectiveness was raised by the PRA as well, and by the FSB. So having a more analytical approach to understanding the effectiveness of individual frameworks, not just the senior executive framework, is part of the work of the remuneration committee going forward.

Did you communicate the most recent set of remuneration outcomes across the group?---The – the communication plan that we – that was brought to the committee certainly envisaged that that would be the case.

And did it happen?---Well, it happened, but I – what I'm saying is we haven't – the committee hasn't actually assessed as to whether it has been effective at this point.

Why are you unsure whether it's effective?---Well, you always check when there has been a communication as to whether the communication has been effectively received. And if you – in our – in our framework, the STVR – STVR outcomes for the broader group are only delivered in mid to late September, and it's part of the delivery there. So people will understand why they got the particular outcomes they did.

Do you think it's important for everyone within CBA – not just the people affected by these remuneration outcomes – to understand what remuneration outcomes the board has imposed on the executives?---Well, they see that publicly. They see it in the REM report.

Do they see it in any further communication internally, or do they have to rely on the annual report?---Well, it's a fairly – it's a very public document.

Of course. But should CBA explain this to its employees before publishing the annual report?---Well, the – the report comes out coincident, really, with the decision and the results.

So that is the mechanism through which you say your employees learn of the remuneration consequences that the board has imposed on the executives?---On the senior executives.

I see. Now, you said earlier that for executives the reputational consequences of remuneration adjustments are very important?---They're personally important, yes.

And earning more than your target short-term variable remuneration is a quantifiable indication of good performance. Is that right?---It's actually relative to your peers, as distinct from the absolute.

And having your short-term variable remuneration reduced for risk-related reasons is a quantifiable indication that you've done something wrong?---It – as I said earlier, it may be that you haven't done something right as well.

What's the difference, Ms Livingstone?---Well, the difference is that you didn't take action that would have enhanced the risk environment but it may not be something that you have done wrong to detriment of – so it may not be a – if you take the misconduct construct, it may not be misconduct, but you haven't met the expectations of the level of behaviour that you might – that the board might have had or the senior executives might have had.

Is that really a distinction of substance, Ms Livingstone?---I think it is.

Do you accept that having your short-term variable remuneration reduced for risk-related reasons might affect your prospects of advancement within CBA?---It might, but given that the – that the process is applied across the organisation and much more rigorously now, it's expected that there will be an outcome more often than not in terms of the rigour with which it's applied. So it's not an unusual event any more that you will have an adjustment for risk outcomes.

It's not an unusual event that group executives within CBA have an adjustment for risk related outcomes?---That's correct. If you look at the – the risk scorecard that we looked at, if you have incidents in your area, if you go outside of risk appetite, if you haven't demonstrated the appropriate risk culture and leadership, or if the controls in your environment as assessed by an audit report have an adverse audit outcome - - -

Does that concern you as the board – as the chair of the board of CBA that it's not an unusual outcome for adjustments to be made to your executives because of failings in relation to risk culture or risk leadership or because of other risk incidents?---No, it doesn't surprise me because in an organisation such as CBA, you would expect the inspection of all of these matters to be at the detailed level where it is picking up as many of the matters as possible. It is – it is not my expectation that the CBA environment will be perfect.

Do you agree that it's a powerful way to reinforce the consequences of good and poor risk behaviour to make the consequences of that behaviour public?---Yes. And – and for the group executives they are very public.

Because of the remuneration report. Is that what you say?---Yes.

Well, can we look at the 2018 remuneration report at RCD.0021.0028.0196. And if we turn to 0295 and 0296, we see on those pages that CBA set out the remuneration consequences that flowed from the prudential inquiry. Do you see that towards the bottom of the left-hand side?---Yes, I do.

And the document records there – perhaps if we could blow that up – that the CEO and all group executives had their short-term variable remuneration for the 2018 financial year reduced by 20 per cent?---That's correct.

And that Mr Comyn offered to forgo all of his short-term variable remuneration?---Yes.

And the document records that the board decided that Mr Narev would not receive any of his short-term variable remuneration for the 2018 financial year, or any of his unvested long-term variable remuneration?---That’s correct.

And then over at 0296 at the top of the page, the document records that the board also forfeited the unvested long-term variable remuneration for David Craig, the former CFO?---That’s correct.

And the former chief risk officer?---That’s correct.

And it forfeited a portion of all unvested deferred short-term variable remuneration for former executive general managers and general managers?---That’s correct.

And the document also referred there to the 20 per cent fee reduction for the board that you explained earlier?---That’s correct.

But there were further remuneration consequences, weren’t there, Ms Livingstone?---For – are you talking about for the APRA report specifically? The APRA - - -

Well, I want to ask you about the board’s request that the former chair return 40 per cent of the fees that he earned in his final year at CBA?---That’s correct.

Why did the board request the former chair to return those fees?---Because the – the board felt that it was appropriate as chair that he also effectively participate in the reduction that we had all taken for effectively what was described in the APRA report.

So why didn’t you make that clear in the remuneration report?---Because the – the chair – the former chair did not agree to return any of his fees.

So although the board requested that the former chair return those fees, that request was not acceded to?---That’s correct.

Do you think it was important for you to publish that the board had made that request of the former CEO – I’m sorry, of the former chair, I apologise?---Well, I suppose I didn’t consider at the time including it, and maybe I should have but - - -

Well, could I ask you to consider now whether that’s a message that you think should be sent publicly, that you made a decision as a board to request the former chair to return 40 per cent of his fees?---In – in retrospect, yes, perhaps we should have made that public.

Have you spoken with Mr Turner about the findings of the prudential inquiry?---I have not directly. He has communicated with one of my board colleagues.

Were there additional – I'm sorry, he has communicated with one of your colleagues, did you say?---Yes.

And what has he communicated through one of your colleagues?---He communicated that – and I'm paraphrasing because I obviously didn't have the direct conversation – that he didn't recognise in the APRA report the CBA board that he knew.

I'm sorry, could you say that again? I didn't hear that?---That he didn't recognise in the APRA report the CBA board that he knew.

I see?---But I am paraphrasing.

Yes. Were there further risk-related remuneration consequences in the 2018 financial year beyond those imposed for the prudential inquiry?---There – there were on – on individual group executives, yes.

Are they disclosed in the remuneration report?---Well, you can see them through the STVR outcomes for individual executives.

Well, what can you see through the STVR outcomes?---You can see those who got zero.

And what about those who had a reduction which was something other than 100 per cent? Are you able to understand that from the information that's published in the remuneration report?---Yes, you can see the – you can see the per cent that they actually received.

Can you see the reasons for those reductions in the remuneration report - - -?---No, you don't.

- - - Ms Livingstone?---No, you don't see the individual reasons in the remuneration report.

Should you be able to see those reasons?---There is probably an argument for making it clear to readers of the annual report why the adjustments were made, yes.

Well, can you see that the adjustments that have been made were made for risk-related reasons or are you left not knowing whether it was a risk-related reduction or some other failure to meet a financial target style of reduction?---You can see from the – the scorecard for the CEO what the outcomes would likely to have been. There are small variations across scorecards but you can see from the shape of the CEOs scorecard outcome what the outcomes in terms of financial outcomes would be for the group executives. So that you can see in the CEO outcomes that the financial outcome for the scorecard was zero.

But what do you see for the group executives. Do you see that they received risk-related reductions to their variable remuneration?---You can't see specifically what they were for, but the – the executive scorecards match the shape of the CEOs scorecards. So you can look at the CEOs scorecard and understand reduction there would be for financial measures.

So you have to extrapolate from the CEOs scorecard across to the dollar sums that are reported - - -?---No, the – the percentages are there as well.

Well, could we just look at what is in the remuneration report. 0297?---Sorry, could I just go back to – could I just go back to the previous page?

Yes. The previous page was 0295 and 0296?---So the – yes, so, sorry, that's – so you will see under the STVR outcomes - - -

Yes?--- - - - paragraph - - -

Yes?--- - - - that it does actually describe, I accept in general terms, the adjustment to the scorecards for the APRA inquiry - - -

Yes?--- - - - findings in the current year. Yes, for the APRA prudential inquiry report's findings?---And it does then talk about further negative adjustments were made to reflect the individual accountability for other risk and reputation matters, so - - -

And it doesn't tell you what those - - -?---No.

- - - individual outcomes were and it doesn't tell you anything about remuneration outcomes, risk-related remuneration outcomes beyond those responsive to the prudential inquiry?---Not – not in percentage terms, but if you go to the schedule, that shows the individual - - -

Yes. 0297?---No, the schedule that shows the percentages of STVR outcome.

0304. Perhaps if we could have both of those on the screen, 0297 and 0304?---So - - -

Is that – is it the right-hand - - -?---It is the right-hand side.

- - - side that you are referring to?---Can I swap them over, otherwise I - - -

Perhaps if we can just blow up the table on the right-hand side, if that would assist you?---So you can see the percentages of STVR versus target.

Yes. Yes. We can see that, Ms Livingstone. What I want to understand is why you don't tell the public how much of that reduction is related to risk adjustments, poor behaviour?---So I accept that that is not obvious and that is something that, perhaps, we should consider for next year's report.

You say it's not obvious. It's not able to be worked out from the information that you provide in the annual report, is it?---Not easily. You would have to cross-reference to the CEOs scorecard outcomes.

I'm sorry, but I don't understand how you say that could be done?---So under the – under the CEOs scorecard, you would know the proportion that had not effectively been achieved because the financials hadn't been achieved.

Yes?---So as a per cent of – of target, you could see, for example, 50 per cent has not been achieved.

By who?---By the CEO.

And how does that help you understand the risk-related adjustments for the individual group executives?---Because the individual – the individual executives would also have a similar adjustment for not having achieved financial outcomes.

Well, how do we know that, Ms Livingstone? How does the reader of your annual report know that?---I accept that they – they probably wouldn't know that.

So going forward, should you disclose in your annual reports the risk-related adjustments that are made to the remuneration outcomes for your group executives?---Yes. We should – I agree. We should disclose them in more detail. We have, as you've pointed out, we've disclosed what we've done for the APRA adjustment, but I agree, there would probably be merit in more detail on an individual basis as to what the risk-adjusted outcomes were.

Because that sends a powerful message that you, as chair of the board, are able to send about the way your organisation responds to misconduct. Do you agree with that?---I do agree with that.

All right. Now, I want to ask you about another recommendation of the prudential inquiry.

THE COMMISSIONER: Just while that's – while you are turning to that, can I go back a stage and just see if I can put this into a framework, Ms Livingstone. There are, I think, three steps in these remuneration issues: (1) what are you assessing; (2) over what time; (3) how do you apply consequences. Do you agree that that's the - - -?---Yes.

- - - broadest elements of the framework?---Yes, Commissioner.

What are you assessing? That subdivides or may be subdivided into two issues, may it not; what the employee has done or not done, and second, how the employee has done it during the course of whatever the relevant period is?---Yes.

Metrics take you so far. They're particularly apt to determine what you've – what an employee has done if you are measuring financial consequences. Do you accept that?---Yes, Commissioner.

Beyond that, beyond financial consequences, whether that's sales, ROE, whatever financial metric you employ, there is a difficulty about measurement, isn't there, in assessing what an employee has done?---That's – that's right. I mean, we – we do try and identify the factors on an employee-by-employee basis, but there is a subjective element.

And it becomes even harder to apply numbers when you're assessing how the employee has done it?---That's correct.

Now, the simple example is it doesn't capture readily the employee who, for perfectly good reasons, says to a customer, "Look, I could sell you this but you really don't need this. Therefore, don't make any change to your financial arrangements." That employee may have acted perfectly properly, perfectly soundly, and it's a bit hard to measure that, isn't it?---That's – that's true.

It's a trivial example but important to the customer. Over what term. All right, we seem determined on annual reviews. Application of consequences. Again, you divide it in two, don't you; application of consequences as individual message to the employee. But there is also, is there not, a demonstration to the whole organisation of what the organisation values and what it deprecates. Is that right?---Correct.

Now, the last passage of questioning about what we can see in the annual report, etcetera, can I just turn it slightly. How does what appears in the annual report help to convey to the whole of the organisation what it is that the board is saying to the senior leadership team about what is valued, what is not valued, what is deprecated, what will be condemned?---Well, I – I accept that it's at a very high level because it turns out – or it turns on individuals looking at the percentage of STVR achieved, but not why.

And isn't that message of why an important message to send down through the organisation, the senior leadership team has been docked X per cent, Y dollars, whatever it is, because what this organisation values is this, and what it will condemn is that. Now, you say communication to staff is something to look at. It's a one-page document, isn't it? A fairly simply – not simply written; it's a document that's written simply, which is a radically different task. It's a document that should be available to the most junior teller, isn't it?---Yes. Under – I accept that's – that's correct.

And it's not?---No, not – not in those – I was going to say simple terms but not simple terms but not in those precise terms.

Yes. Yes, Ms Orr.

MS ORR: Just finally on remuneration, Ms Livingstone, I want to ask you about recommendation 26 made by the prudential inquiry. The final part of that recommendation is for CBA to:

> *... update its remuneration framework and practices to include the potential for an upside for sound risk management and collective risk adjustments to promote collective accountability.*

Now, we've heard a bit from you about how CBA has applied collective risk adjustments to reflect collective accountability. What I want to ask you about is how you think you're going to implement an upside for sound risk management in your remuneration framework?---So we have already implemented it. The CEO has a discretionary pool, and can receive recommendations from throughout the organisation, and at the CEO discretion make awards out of that pool for positive risk behaviours.

And what are the sorts of positive risk behaviours that will lead to a recommendation of a disbursement from that pool?---Well, they would – they would vary but it could be, for example, someone in a branch who detects a particular activity on the part of a customer which should be considered for anti-money laundering, which may not be an obvious activity but they may have – if I go back to the situational awareness comment that I made yesterday, they might have declared – they might have manifested very good situational awareness about that, or it could be someone who called out a concern on a particular product, and the benefit of that product for customers or the way customers were perceiving that product. So it could be a range of factors.

And do you provide information to your employees about the sorts of factors that will lead to a recommendation that the CEO make a disbursement from that pool?---I don't know specifically whether we have, more broadly in the organisation, I can't answer that question.

So you've set up the pool but you don't know whether you've told people about what they need to do to be eligible for a disbursement?---I don't know, but it may have been the case.

Do you know whether any disbursements from that pool have been made to date?---I understand they have but we haven't received the – the feedback analysis on that. But I believe that they have been.

You believe that there have been some disbursements?---I think so. I think I'm aware the pool has actually been used but I don't know the – the remuneration committee hasn't received the analysis back yet.

And can you say anything about the sorts of behaviours that have led - - -?---No.

- - - to disbursements?---No, I can't.

I see. All right. Now - - -

THE COMMISSIONER: Well, is the more radical idea to look at STVR and treat it as something that is marked up or marked down? At the moment STVR is regarded as something to mark down, is it not?---It is from the 100 per cent. The mark-up is between 100 and 150, if – if that were considered appropriate.

Yes.

MS ORR: The final topic I want to ask you about, Ms Livingstone, is your role as chair of the nominations committee. And one of the functions of the board is to appoint the CEO?---That's correct.

And the nominations committee assists the board in fulfilling that function?---It does.

And in your speech at this year's annual general meeting, you described the appointment of Mr Comyn as:

> *... the most important of the actions the board has taken to prevent the failings of judgment, leadership systems and processes in recent years.*

?---That's correct.

Why is it the most important of those actions, Ms Livingstone?---Because the – the CEO is responsible for the management of the whole organisation. So it's the CEO who, across the board, in terms of their – their character, the way they work, what they think is important, how they get their work done, all of those elements, they will set the tone for the organisation.

And at the time he was appointed as CEO, Mr Comyn was the group executive responsible for retail banking services?---That's correct.

And that was the division that was responsible for a number of failings within CBA, including the anti-money laundering failings?---As part of the collective accountability for that, yes.

And the home lending issues that I have discussed with Mr Comyn yesterday?---Yes.

The mis-selling of consumer credit insurance that I asked Mr Comyn about?---Yes. And you heard his responses, but yes.

I did hear his responses. Thank you. And the board was aware of all of those issues at the time that it chose Mr Comyn for the job?---Yes, it was.

And I want to ask you about the sort of message that you think it sent to others within CBA and to the broader community to promote the person who was in charge of the division in which all of those issues occurred?---The – the board made its decision, and I think this is important, on a number of bases. As you probably know, we had criteria against which we assessed individuals, but in relation specifically to Mr Comyn, the board understood his perspective in terms of customers and his better customer outcomes project. It understood what he had been doing in that division in terms of the risk management implementation. So he understood controls. He led a team and the team highly respected him. But the biggest issue for us, as I have said, is the way he stepped up at the time the AUSTRAC proceedings were lodged. So he took full accountability, including for areas that were not part of his responsibility. In fact, for me, the most telling thing was after the proceedings had been lodged, and I met individually with each group executive, and variously they came in either not having informed themselves or blaming other people, or – Mr Comyn came in and the first thing he did was apologise. He apologised to me, apologised to the board for what had happened, and his failings in that. He then applied himself with extraordinary diligence to understand what had gone wrong, what he could have done better, what he should have done. And I think he, and we, have learnt the hardest possible lesson in the most public way. And for us to have an executive who recognised that, who knows the bank, who knows what has to be done, who spent 20 years in the bank, has a commitment above and beyond, for us to have someone like that leading the bank is an extraordinary opportunity for us, because what he will do for the bank as part of working with his team, his new team, and with the board, the renewed board, will enable us to do what I said at the outset that I was tasked to do, and have the accountability to do, which is to change the way CBA operates in a very fundamental way.

Well, I would be grateful if you would consider and answer my question, Ms Livingstone, which was not about why you appointed Mr Comyn. My question was about the message that you think it sent to others, to others within CBA and the broader community to promote the person who was in charge of the division in which these issues all arose. That's what I would like you to consider and respond to?---So my response for the internal response was overwhelmingly positive because of the respect the organisation has for Matt, his transparency, his personal – personal ethics and his character, and his ability to admit mistakes. Externally, if I speak to investors, if I speak to people who have seen Matt now since he has become CEO, again, there is almost universal praise for Matt.

I - - -?---And his choice as CEO. So if you are asking me what's the reaction, what's the message it sends.

No, I am not asking you – I will try one more time, Ms Livingstone. I am asking you about the sort of message that your appointment of Mr Comyn sent – I said both within CBA and to the broader community – what message was sent by promoting the person who was leading the division in which these issues occurred. I'm not asking about the reaction or the reasons for your appointment. Whether you as the chairman of the board considered the message that that was sending?---We did. We considered for weeks. The easy answer for us would have been to appoint an external person. To find an external person globally at that level who has not been involved in some regulatory event is almost impossible. And I don't mean that as a joke. So the message that it actually sent inside the organisation is one that these issues are unacceptable and we're determined to fix them. That was the message it sent.

And what about the external message?---Well, the – the external message, in my view, was the same, in terms of what – the feedback I have had, that here is someone who is committed to dealing with the issues that have arisen. And I think – I would hope that you've seen that in his evidence over the last two days.

In June this year, Ms Livingstone, CBA announced that its chief risk officer, David Cohen, would become the deputy CEO to Mr Comyn, and that Nigel Williams would replace Mr Cohen as chief risk officer?---That's correct.

What do you think are the most important qualities for your chief risk officer?---The most important qualities are, first, to be steeped in experience in risk management, in financial services, and also to have a presence and, if you like, the skills to make sure that the voice of risk is very loud in the organisation.

In your experience, is there a view among boards that risk and compliance executives don't make suitable candidates for leading the organisation as a whole?---No, I don't think that that's – that that's a generalisation that we would make.

Well, do you think that there's value in appointing executives who have risk and compliance experience?---Well, yes.

Yes?---I mean, certainly.

And do you do that – do your group executives have risk and compliance experience?---Well, the – the chief risk officer is - - -

I'm sorry, I'm not referring to the risk officer. I'm talking about the leaders of your business units, your group executives. Do you require them to spend time in a risk and compliance role?---Not – not specifically. But - - -

Do you see value in doing that, so that risk and compliance is built into the way they approach their task?---Yes. There's value if – if accompanied by the right skills for the other role that they – they may hold.

The prudential inquiry observed that CBA was largely aware of the challenges that it faced and that it wasn't until 2017, in the face of external pressures, that it developed the momentum to address them. You're familiar with that finding of the prudential inquiry?---Yes.

And you appear to accept that the task that CBA faces going forward is a very difficult one?---I do.

And do you believe that it will take many years to complete?---I believe it will take years, but there will be stages within those years.

And how can we be confident that CBA won't lose the momentum that it has developed, and in five or 10 years' time, settle back into the complacent attitude that both you and Mr Comyn have referred to?---That is a key question that is on our minds because we can put a lot of effort now into fixing, as you say, but is that – is that going to be durable, is it going to be sustainable when current management moves on, current board moves on. So I would – I would say – and, yes, it was extreme circumstances, but the APRA prudential inquiry, being an intense overview – or not overview, but inspection – over that six-month period, that is the best thing that could have happened to CBA, because it has enabled us to really develop momentum around the change program that we have. So there is a question, I think, as to whether at some appropriate period or interval that such an inquiry might be conducted on an ongoing basis, because having seen the benefit to CBA of the external view, and that intense concentrated view across the whole organisation at one time, it certainly revealed more matters than we would have perhaps been aware of, and being independent it's indisputable.

What do you want the board to be doing differently by this time next year?---Having to spend less time on compliance issues because there are fewer compliance issues, would be one – one of the important aspects.

And what about in five years' time. What do you want the board to be doing differently then?---I think we will be a very different organisation. If you – I mean, strategically we will be different as we progress the – the simplification strategy. But it would be good if the board had far better analytics so that it could characterise the organisation on a continuous basis, and be able to detect patterns much more easily. So management to be able to do this and report to the board across all – all aspects of the organisation, and the hope would be with – with good data and data analytics that that's possible.

And in your mind, how will CBA – stepping away from the board, how will CBA be different by this time next year?---By this time next year, we will have, I think, progressed our remedial action plan and we will have more stable processes. We will have better integrated systems. And we will have a policy environment where, probably not all, but most people, progressively, will understand their role and their duties and obligations in that role.

And on that slightly longer term horizon, what do you want for CBA in five years' time? What is the CBA that you're striving to achieve five years from now?---Well, the CBA – and hopefully in less than five years – is one that customers trust and the community trusts, and that we're delivering the products that really fit our purpose, which is for the financial wellbeing of – of our customers.

I have no further questions, Commissioner.

THE COMMISSIONER: Ms Orr. Mr Finch.

MR FINCH: No re-examination, Commissioner.

THE COMMISSIONER: Thank you very much, Ms Livingstone. You may step down?---Thank you, Commissioner.

<THE WITNESS WITHDREW [1.01 pm]

MS ORR: Commissioner, just before we adjourn, there was a further statement provided by a representative of CBA that I would like to tender. That is the statement of David Abusah, A-b-u-s-a-h, dated 2 November 2018, CBA.9000.0123.1000.

THE COMMISSIONER: That statement will become exhibit 7.47.

EXHIBIT #7.47 STATEMENT OF DAVID ABUSAH DATED 02/11/2018 (CBA.9000.0123.1000_

MS ORR: Thank you, Commissioner.

THE COMMISSIONER: Thank you. 2 pm.

MS ORR: Thank you, Commissioner.

THE COMMISSIONER: 2 pm.

ADJOURNED [1.02 pm]

RESUMED [2.00 pm]

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Commissioner, the next witness is Mr Hartzer. Just before Mr Hartzer begins, can I just indicate we received a witness statement from Mr Tollman, the general manager of reward performance and employee relations at Westpac. And that statement dealt with questions regarding remuneration and incentives for senior executives of Westpac. So I tender the statement of Mr Brett Mark Tollman dated 6 November 2018 with document ID WBC.900.001.1216 and its exhibits.

THE COMMISSIONER: That statement and its exhibits become exhibit 7.48.

EXHIBIT #7.48 STATEMENT OF MR BRETT MARK TOLLMAN AND EXHIBITS DATED 06/11/2018 (WBC.900.001.1216)

MR HODGE: Thank you, Commissioner.

<BRIAN CHARLES HARTZER, SWORN [2.01 pm]

<EXAMINATION-IN-CHIEF BY MR SHEAHAN

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

MR SHEAHAN: Thank you, sir. Your full name is Brian Charles Hartzer?---It is.

And your address is 275 Kent Street, Sydney, New South Wales?---Yes.

You're by occupation the managing director and chief executive officer of Westpac Banking Corporation?---I am.

You are attending here in response to a summons?---That's correct.

Do you have the summons there with you?---I do.

I tender the summons, Commissioner.

THE COMMISSIONER: Exhibit 7.49, the summons to Mr Hartzer.

EXHIBIT #7.49 SUMMONS TO MR HARTZER

MR SHEAHAN: And you have prepared one statement for the purposes of this Commission?---Yes, I have.

Dated 16 November 2018?---Yes.

Are its contents true and correct?---They are.

Commissioner, I tender that statement, the ID for which is WBC.900.001.1259.

THE COMMISSIONER: That statement becomes exhibit 7.50.

EXHIBIT #7.50 STATEMENT OF MR HARTZER DATED 16/11/2018 (WBC.900.001.1259)

MR SHEAHAN: Thank you, Commissioner.

THE COMMISSIONER: Thank you, Mr Sheahan. Yes, Mr Hodge.

<CROSS-EXAMINATION BY MR HODGE [2.02 pm]

MR HODGE: Thank you, Commissioner. Mr Hartzer, you were appointed the managing director and CEO of Westpac in February of 2015?---Yes, Mr Hodge.

And between June 2012 and February 2015 you were the CEO of Westpac's Australian financial services division?---That's correct.

And before joining Westpac, you were the CEO for retail, wealth at Ulster Bank at the Royal Bank of Scotland for three years?---Yes.

And before that you were at ANZ for 10 years?---I was.

And at ANZ, you held a variety of roles, including being CEO of Australia and Global Segment Lead for retail and wealth?---Yes.

And then before that, you had spent 10 years as a financial services consultant in the United States and Australia?---That's right.

What I want to do – or the first topic I want to deal with is Westpac's approach to conduct and compliance risk, and in order to explore that topic with you, I want to deal with two case studies that came out of round 1 of the hearings and about which you have given a statement – or you have addressed in the statement that has been tendered. The first case study is the credit card limit increases case study. And, broadly, that case study concerned unsolicited credit card limit increase offers being sent to selected Westpac customers?---That's right.

And you have identified two types of conduct that were involved in the subject matter that formed the case study?---Yes.

And the first type of conduct that you've identified was the actual granting of credit limit increases to some existing customers without making fresh inquiries about their income and employment status?---Yes.

And that's what you term in your witness statement the "offer conduct"?---Yes.

And the second type of conduct relates to how Westpac engaged with ASIC?---Correct.

And you've termed that conduct in your witness statement the "ASIC engagement conduct"?---Yes.

And the way in which that second type of conduct comes about is that on 12 September 2012 ASIC had written to the Australian Bankers' Association setting out its views as to how the responsible lending requirements in relation to credit limit increases or how the responsible lending obligations applied to credit limit increases?---Yes.

And Westpac considered the points that were made by ASIC in September of 2012 but decided not to make any change to its process?---That's right.

And you have said in your statement that the issue that arose in relation to that second type of conduct arose due to a difference of opinion as to Westpac's obligations?---Yes.

That is, Westpac believed that there wasn't any problem under the responsible lending obligations with how it was dealing with credit limit increases?---That's correct.

But that was different from the view that ASIC had?---That's right.

And then in your view, there was a further issue, which is that Westpac didn't actually communicate with ASIC about the difference of view?---Correct.

It just continued on with making the credit limit increase offers in the way that it had been doing?---Yes. It considered the – the views – came to the view that what we were still doing was okay, and – and didn't then communicate that properly with ASIC.

What you say in your statement is that insufficient weight was given by Westpac to ASICs views?---Yes.

And was it the case that insufficient weight was also given to the view of Westpac's risk and regulatory affairs teams?---I don't think I would characterise it that way.

I see. It wasn't just ASIC that held the view that there was a problem with the way in which Westpac was dealing with credit limit increase offers and the responsible lending obligations?---Well, there were certainly concerns from the regulatory team based on ASICs position.

Well, the view of the risk and regulatory affairs team was that Westpac could not do nothing about ASICs views?---Yes.

And the view was that there needed to be some change made to the process?---That was one of the views that was put forward, yes.

And the view was that the change would be beneficial to customer experience?---Potentially. Not necessarily.

I'm sorry, are you disagreeing that the view was that there could be – that there would be an improvement to customer experience or are you just saying - - -?---Sorry.

- - - as a matter of objective fact?---Maybe if you could just restate the question so I answer properly.

Maybe it will help if we just go to the document that I think you are referring to. This is WBC.099.001.2070. Commissioner, this was a document that was already tendered in round 1 of the hearings. It's exhibit 1.164.12. So this is a chain of emails you've looked at before, which is an internal chain of emails between the product and risk teams?---This looks like a email within the risk team. So it's from someone in risk to someone else in risk.

I see. And then if we go over to page .2072. We see at the bottom of the page an email from Mark Stewart, who is the senior product risk manager, talking about how to address ASICs expectations?---Yes.

And he explains that there's a couple of different ways that things could be done and describes options 1 and 2 as:

> *...the most change intensive but likely to provide a better business outcome and customer experience.*

Do you see that?---Yes.

Now, the view of the product team was that Westpac should do nothing until ASIC made a formal request?---I believe I've seen that somewhere but perhaps you could remind me by showing me that statement.

If we go to page 2071 of that document. So if you look at the bottom of the page, you will see an email which says:

What do you want me to do with this one? The product view is to not do anything unless ASIC makes a formal request.

?---I see that.

That's the statement that you're thinking of as well, I assume?---It is. I think there's a bit more context to this conversation, however.

When you say you think that, what do you mean by that, Mr Hartzer?---I'm just looking at the dates on this email. They were in October and my recollection is that product – the risk teams did do more action after this.

Ultimately, the risk and the product teams had a discussion and the decision was made in December not to change the process?---Yes.

And it's fair to say, isn't it, that the changes that would have been required in order to adapt the processes so as to be consistent with ASICs guidance would have been unfavourable to Westpac's profits?---Possibly.

Well, that is – it's obvious, isn't it, it would cost money in order to change the processes?---That is true.

And that would, therefore, negatively affect the profit?---Yes.

And the view that ultimately ended up prevailing was that of the product team to do nothing at that time?---I don't think that's how I would characterise it. My recollection is that it was a joint discussion between risk and product.

Well, the risk view that had been expressed was that a change should be made. The product view that had been expressed was that a change should not be made. And ultimately, it was agreed that no change would be made?---My point is, I don't think you've shown the basis on which the ultimate decision was made, which I think was a joint decision.

I see. You're saying ultimately risk didn't – it wasn't made over a recorded objection from risk?---Correct.

Risk and product got together and decided not to change the process?---That's right.

All right. And ASIC then discovered, in 2014, that Westpac had not changed its process?---I'm not sure if that's an accurate characterisation of it. My understanding is ASIC was aware, through conversations along the way, but clearly they did an intervention later that suggested if – even if they were aware, they weren't fully aware. So – sorry, that sounds a little complicated, but I accept the basic premise that ASIC intervened at the date that you talked about to say that they wanted the change.

You accept that in 2014 ASIC intervened in order to say it wanted a change?---Yes.

But you were disagreeing with the proposition that ASIC intervened in 2014 because it had discovered that you hadn't changed?---Yes. It's the characterisation of "they discovered it". I'm just not sure that's strictly accurate.

Do you think that they knew from back in 2012 that you hadn't changed your process?---I think that's possible.

And what is the basis upon which you say you think that's possible?---Just my recollection of conversations with some of the people involved. And I believe I've seen a document that mentions that ASIC was aware of the processes that we were following.

From 2012?---I believe so.

I see?---I can't recall the exact document but I saw it at one point in – in my review.

I see. You make a statement in your – in your statement that you understood that Westpac had continued to engage with ASIC about this?---That's my understanding.

And is the basis of the statement that you think that Westpac had continued to engage with ASIC these recollections that you've just spoken about now?---Yes.

And so you think ASIC knew in 2012 that Westpac hadn't changed its process, but then did nothing about it until 2014?---That – that's possible, but I – I'm not sure.

It doesn't make any sense, does it, that ASIC would know in 2012 that you weren't following what it had said was the legal obligations but then waited until 2014 to say anything?---I understand the premise of your question. I'm not sure that that totally follows logically.

You know that ASIC considered Westpac – once it became fully aware of Westpac's position, that ASIC considered Westpac to be an outlier?---In – in which respect?

That is, that its position to continue to offer credit card limit increases in a way that wasn't consistent with ASICs view was different from the position that had been taken by all of the other banks?---Yes.

Okay. And that is, you understood everyone else in the industry had accepted ASICs position?---Effectively, yes.

And you're aware that ASICs view was that the fact that Westpac – or the business was able to overrule the regulatory affairs or compliance team within Westpac was indicative of poor culture and a weakness in independent control functions?---I'm aware that's a perception. I don't accept the premise that risk was overruled.

I see. You think that, ultimately, risk agreed to the decision as well?---Yes.

And assuming that's the case, does that suggest an even bigger problem within Westpac as at 2012?---No, I don't think so.

It's not a problem that risk would internally, as you've pointed out in these emails, have formed the view that it ought to act in accordance with ASICs view and that it was a better customer experience to do so, but then shifted its view after discussions with product?---Well, you're talking about different people within risk. I – sorry, can you maybe just rephrase the question.

Do you think it is a problem that risk had internally formed a view that it should change and alter its position to accord with what ASIC wanted, but then after a discussion with product it changed that position?---Strictly, to the answer to your question, no, because I don't think that's – so I do think there is absolutely an issue in the way we handled this with ASIC and today we would handle it very differently. So I'm not meaning to argue that point. But I'm just struggling with the suggestion that there was an overruling in this. And – and you can have different points of view within risk.

We're accepting, I think, in this – this series of questions your proposition, which is it wasn't an overruling?---Okay.

That risk initially held a view and then it changed its view after speaking with product. The question I'm asking you is: is that in itself a problem?---You're talking about different parts of risk in this discussion, and I – I don't know that the credit risk team actually changed their mind per se. I think they held that same view. So - - -

Go on, Mr Hartzer. Sorry, I don't want to interrupt you?---I'm not sure that I – I'm not sure that I have an issue with the – the basic fact that you can have a disagreement within risk.

I see. So now, just so we understand, your view is there is actually a disagreement within risk about whether the process should be changed?---That's what it appears to me from those emails.

From these emails that we just looked at?---You showed me an email from the regulatory risk team.

Yes?---And I'm referring to the fact that we had the credit risk team who had a different view of what was required.

Sorry, is the credit risk view that you're talking about something that's expressed in these emails?---There is reference to it in – mention in one of the – the risk people that are there.

But you - - -?---I was – I guess in that one, I was referring to something you referred to, which was about the – the decision that was made in December.

Step back from this and think about it in this way, Mr Hartzer: risk within Westpac ultimately agreed to a position that made Westpac an outlier compared to the other banks?---Yes.

Do you regard that as a problem with your risk function?---Not in itself.

And why not?---Because I think the issue is having formed a different view we should have engaged differently with ASIC. But that doesn't mean we have to always agree with all the other banks.

That doesn't mean – I'm sorry, what was that?---We don't have to agree with all the other banks all the time.

Or the regulator?---No, with the regulator we need to work it through and that, in my mind, is where we went wrong in this one.

But, again, if you – when you think about the effectiveness of the risk function within Westpac, does it tell you anything about the effectiveness of that function that the regulator has expressed a view that every other bank, every other major bank, has switched to accept that view, but that Westpac has not?---It concerns me that we didn't engage with the regulator when that point of view was pointed out, and that, to me, is where we clearly went wrong in this case.

We will circle back to that in a moment. You have said in your statement that Westpac failed to sufficiently recognise the importance of resolving any difference of opinion with ASIC at the time?---Yes.

And what do you mean by that? How was the difference of opinion to be resolved?---Well, it was obvious, for the reasons you've articulated, that a letter sent to the ABA highlighted the position that ASIC had although it wasn't expressed as a firm position that this is what you must do. Nevertheless, having made a decision that was clearly counter to the view ASIC had expressed, we should have been proactive in going to ASIC, talking about the differences, seeing if we could resolve them, explaining why we thought our position was correct, and in this case, if ASIC had been firm in its views, we should have, in my view, acquiesced.

I see. So the problem was, in your view, not testing how firm ASIC was in its views?---In effect.

And if you had tested ASICs views and found that it probably wasn't going to take any enforcement action, it wouldn't have been a problem from your perspective to just continue?---Our position was that the process we were following was meeting the responsible lending obligations. It was explicitly designed to do that. But I think it's very clear that we should have paid more attention to ASICs interpretation and guidance on that matter as to how we should have implemented those regulations.

You say in your statement that more senior leaders were not involved in the decision, and that Westpac's processes for escalating risk and regulatory issues to more senior leaders were not fully developed at that time?---Yes.

And do you mean by this that you think that more senior leaders would have taken a different approach?---Yes, I do.

And how senior do you think it needed to rise before there would have been a different approach?---Well, I think today we would take a different approach before it got to more senior levels, frankly, because we've changed the process. But I would certainly expect that a – a business unit executive who was aware that ASIC had a profoundly different view on how we should undertake a basic activity would have had the responsibility to intervene and make a different decision.

Is it a problem, do you think – no, I withdraw that. Let me go back a step. There was a steering group that this was brought up to?---I'm not sure if I would describe it that. There was a meeting between the product manager and the senior credit person.

I will just show you a document. If we bring up WBC.050.097.6212. So this is the minutes and action items from the Sustainable Banking Credit Cards Program Steering Committee?---Yes.

And if we go over to page 2 of that document, at .6213, you see the open action item, which is about risk and product have reviewed the current CLI letter strategy?---Yes.

So when you say you're not sure whether you would describe it as a steering committee, is this – this is a steering committee, isn't it?---It is. I – I see what you're saying. My point was that I believe that decision which is what's recorded in the minutes there had been taken before this meeting. And this meeting is recording that, is my understanding.

Well, what happened was it came to the steering committee initially and then it was sent away for product and risk to attempt to resolve their differences of views. Is that right?---I'm not sure if that's the exact process. I don't know.

You know it was reported back up to the steering committee?---Yes.

And is the steering committee, in your view, not senior enough to have appreciated the issue?---In this case, the way we would run it would be different today.

Do the people who are described here, do they not constitute people who are more senior leaders, in your view?---Would you mind going back a slide.

Yes. If we go back a page, to the first page, .6212?---This looks like a – a committee within the product management area. And so it would not have the level of seniority we would put to a disagreement with the regulator today.

I see. If there was a disagreement between the regulator and Westpac today, it would go up - - -?---Yes.

- - - to a much more senior level?---Yes.

And your point is you would then expect that at that more senior level they would reach out to engage with ASIC about the difference of view?---Yes.

And to test how firm ASIC was in its view?---Yes.

And even assuming that Westpac's processes at the time were not fully developed, would you not have expected that even just at this level that the managers and executives of Westpac would have shown a greater degree of respect for the view of the regulator?---In hindsight, yes.

And would you have expected that they would only act in opposition to those views if they had received some sort of sign-off from Westpac's internal or external lawyers and senior executives?---Probably, yes. It would depend on the matter.

And when you've reflected then on this case study, has it told you anything about Westpac's culture, at least at the time, that managers and employees at this level would simply act in defiance of ASICs views without taking it to more senior executives and without seeking internal or external legal clearance?---I think there was clearly a deficiency in understanding the seriousness with which regulatory disagreements needed to be dealt with. There needed to be clearer ownership within the first line business management for the fact that they were accountable for making sure they met their compliance requirements. And I think the combination of those things today would lead to a very different engagement with ASIC.

Well, it would lead to an engagement with ASIC, is your point, isn't it?---In detail on this one, yes.

I'm sorry, I missed that last part. Did you say in the detail of this one?---Yes.

When ASIC commenced looking into Westpac's credit limit increase processes in 2014, Westpac suspended making any bank-initiated limit increase offers?---Yes.

And just so I can make sure I have understood this, what had happened, as we understand it, is that ASIC had conducted a follow-up with Westpac about 15 months after it sent its 2012 letter. And at that stage then became aware that ASIC was not – I'm sorry, that Westpac was not following the guidance that ASIC had given?---Yes.

And ASICs view was that Westpac refused to change its practices until faced with the threat of legal action?---I understand that to be ASICs view, yes.

And that was consistent – or that is consistent with the approach of the product team that we see recorded in that email from risk, which is to do nothing until ASIC formally approached Westpac?---In effect, yes.

And it must be the case that Westpac was, therefore, content to continue offering credit limit increases, notwithstanding that difference of internal views about the appropriateness of doing so unless or until ASIC intervened?---I wouldn't describe that as being the senior philosophy we would have taken to an issue like that. Our goal would be to – to be compliant. But I – I definitely accept that that was the effect of the – the lack of engagement with ASIC.

I want to come back to that in a moment that your goal was to be compliant. But before we get to that, let's just work through the last part of this. One of the reasons that Westpac continued with the process as it was was to obtain the profits from the limit increase program?---That would be one of the reasons.

And that's what Mr Malcolm of Westpac accepted in round 1?---Yes.

Are you aware of that?---Roughly.

And we understand Westpac's estimate of the profits it made on its credit limit increase program from around this time was about $23 million?---I've seen that, yes.

And Westpac has now made a number of changes to its systems and processes since all of this occurred?---Yes.

And in March 2015, Westpac finalised changes to its credit limit increase processes, and that meant that then it was – or then it came in line with what ASIC wanted?---Yes.

And that fixed the compliance problem?---Yes.

And that's, therefore, fixing the first type of conduct that you've identified the offer conduct?---That's right.

But I think the point – I get the sense that the point that you're trying to make is you don't necessarily even now accept that ASICs view was right?---Right in terms of what?

In terms of the application of the responsible lending obligations to credit limit increase offers?---Well, it – it sort of – we – we can have disagreements. It's kind of moot because credit limit increase offers have ceased altogether.

Yes. So I think by saying that you're saying you don't need to accept it any more because whether it's right or wrong any more because it just doesn't matter?---I haven't spent a lot of time thinking about it because we stopped doing it.

Okay. In terms of Westpac's dealings with ASIC you point to a number of measures which in your opinion mean that Westpac would deal with the matter differently if it occurred today?---Definitely.

And the first is increased accountability in the first line of defence?---Yes.

And I think that's what you might have been referring to a moment ago. How would that affect this type of issue?---We like to talk about risk as having – a risk framework being three lines of defence. The business itself, the first line, the risk department and the audit function. I think on some of these matters historically – and there's an irony in this – we had centralised a lot of engagement with regulators in order to make sure that we had covered these issues. That had the unintended consequence of making, in some cases, businesses feel that they weren't on the hook for the compliance and that the risk department would tell them what they could and couldn't do. What we've clarified is that the first line actually needs to take ownership and accountability for their compliance obligations, and that risk is part of that chain but the first line can't devolve that responsibility to the risk department.

I am not sure whether you've answered the question that I asked, which is how is it that the increased accountability in the first line of defence would affect the outcome of this issue?---I'm sorry. So it – by – what I was getting at was that the first line now understands much more clearly that they are on the hook for thinking these things through, and that they, therefore, in this situation, would think much more seriously about putting themselves in the position that was counter to a regulator's view.

I see. And how is it that you've brought about the change that the first line, that is, the business, is more concerned with regulators' views?---So we've done that through a variety of means. The – we've updated and clarified many of the risk frameworks internally to make that clear. We've changed our operating policies and processes around risk management, reporting of issues. We've made the front line people being the ones that have to front discussions, for example, with the board on risk matters that relate to their area. We've made it much more explicit in the way we measure people. We've made the consequences much more explicit, and so on. We've also beefed up the regulatory team who deals with the regulators, put better processes in place to engage with them on a regular basis. I would venture to say everyone internally is now very clear that the views of the regulators and their compliance obligations must be observed.

But that's something you think wasn't clear, at least as at 2012?---Not sufficiently.

And is clear now?---Yes.

And do you have a view as to what the tipping point was?---Well, this particular incident was an important contributor to that.

I see. So effectively from 2015 you've put real effort into trying to have the bank respect the views of the regulator?---I'm not sure I would put it quite like that but certainly from 2015 we put a lot more effort into understanding and clarifying the policies and procedures on these issues.

And so that seems to suggest, just taking the first point, that a problem that you diagnose that led to this conduct was that in 2012 the business wasn't – the business function wasn't sufficiently accountable for how it responded to the regulators' views?---It wasn't clearly enough – it certainly wasn't clear enough on its accountability for that.

And now you think it is accountable for that?---Yes.

And then you say the second of the enhancements as to the second line of defence, which includes the establishment of a dedicated regulatory governance and assurance function reporting to the chief risk officer?---Yes.

And how, in practice, would that team be engaged on an issue like credit limit increases if they were permitted today?---Well, there's an ongoing dialogue with the regulators to understand what issues are on their mind. They monitor incidents and questions that come up from the businesses, and engage frequently with the businesses. We also have an extensive proactive process looking through each of our products and business areas for issues that might be an issue, and then that team gets engaged in – in looking at those issues and coordinating with regulators.

Again, just, if you can, trying to answer my question. If this specific issue arose today, that is, ASIC expressed a view to the ABA which passed it on to its members that responsible lending obligations required particular processes in relation to credit limit increases, how would this expanded regulatory team be engaged?---They would – how would they be engaged - - -

Yes?--- - - - in that process?

In the issue, that's right?---So they would be directly speaking with the regulators. They might frequently coordinate meetings between the business leaders and the regulators themselves, which is something we're doing a lot more of so that that feedback goes direct. They would then be keeping track of that issue and making sure that it was on the agenda for our various risk forums so that senior people had visibility on it and they would coordinate the process of looking to and responding to the regulators' views.

The third way in which you say things have been changed to address the issue is the expansion of management reporting about regulatory matters?---Yes.

And you say that expansion of management reporting involved strengthening the focus on regulatory matters in divisional committees that ultimately report to the board risk and compliance committee?---Yes.

And what does that mean, exactly?---Each of our businesses now have dedicated committees where they review risk issues. One of the clear agenda items around that is anything to do with various regulators. Those get reviewed at various levels through the company and then cascaded up into the executive risk meeting which I chair, along with the chief risk officer, and then ultimately those go to the board. We also have dedicated regulatory reporting to the board now which picks up matters across the company.

So this seems to involve a more developed – a more developed sense of identifying regulatory matters at a lower level down in the company, and then pushing them up all the way to the top. Is that the idea?---That's part of it, yes.

And the risk and compliance committee is responsible for overseeing the identification, management and reporting of risks?---And the closure out of those issues, yes.

Banking is a very heavily regulated industry?---It is.

And regulation and regulatory action can present material risks to Westpac's operations?---Yes.

But in 2012 there was no dedicated regulatory reporting in place?---Regulatory reporting happened in risk reporting but it wasn't broken out as a separate agenda item necessarily. It usually sat within operating risk reports or – or other general risk reports. So we – it – the subtlety is pulling it altogether and giving it a particular focus.

By having a separate agenda item?---That's right.

So I don't want to be unfair about this but is the third point that you raise about expansion of management reporting about regulatory matters, that is there will now be a separate agenda item at these committees – divisional committees about risk?---That's an element of it, yes.

And that's how Westpac has strengthened the focus on regulatory matters in divisional risk committees?---Yes.

And when was that separate agenda item introduced?---I can't recall exactly. It would have been over the last couple of years.

And is the idea then that that separate agenda item will contribute to a culture where regulatory issues are taken seriously?---Yes.

Again, stepping back to the case study, given that the letter was written to the ABA, wouldn't you have expected that senior leaders within the bank would have been aware of it?---In hindsight, that seems obvious but not necessarily. It – the ABA doesn't function, necessarily, as a structured response to regulators. So typically there's more direct engagement with the regulator on – on issues.

But ASIC has written to the ABA. The ABA has passed the letter on to all of the members?---Yes.

Have you looked at why it is that senior executives within the business weren't aware of the letter?---Not on – on that particular matter, no.

Why is it that you would expect this type of issue, that is, an issue where ASIC has written to the ABA to express a particular view about how the responsible lending obligations apply, and the response of Westpac to that letter would be one that would have to percolate up through the management ranks rather than being one that would be dealt with by senior executives being aware of it and stepping in?---I agree that that letter should have gotten more visibility. And it may have done. I just don't know. But what I would say is that the ABA is not typically the channel by which the regulator deals with the banks on particular matters. That is what I was trying to express before. So a serious regulatory matter would tend to be more of a direct discussion with the regulator.

One way or the other, though, you know in this case the letter went to the ABA and it was distributed to all of the banks?---Yes.

Every other bank changed its processes. Westpac didn't. You agree?---I don't know if those are causal, but yes.

Sorry, you don't know whether the other banks changed their process because of - - -?---Because of the ABA letter.

- - - the ASICs letter. You think they might have simply independently formed the view that what they were doing was unlawful?---No, I am saying there may have been other engagement between the regulator and those entities.

I see. And you know that the letter made its way into the – further down the management chain at Westpac?---Yes.

But you haven't looked into why it is that nobody at a more senior level stepped in?---Not on that particular matter, no.

And if you haven't looked into that, does that suggest that you haven't necessarily fully investigated and understood what the problem was within Westpac at the time?---I don't think so. I think that the steps that we've taken to strengthen the attention and the resourcing and the focus on regulatory matters would address that issue in any event.

The fourth matter that you point to is an increase in regular engagement between ASIC and Westpac?---Yes.

And, in particular, you pointed to the fact that you have an annual meeting with the chair of ASIC and there are meetings between other senior leaders in the bank with ASIC?---Yes.

And are those meetings a recent development?---It has been evolving.

How long have you been having an annual meeting with the chairman of ASIC?---Certainly since I've been CEO, I have.

Since 2015?---Yes. And I would say, although I couldn't say for sure, that the same would have been happening with my predecessor.

And the credit limit increase offer issue, is that one that you would have expected to have been raised at one of these meetings?---Quite potentially.

A meeting with you?---I'm sure if that – if there were an issue like that today, yes.

That is, if ASIC knew that Westpac wasn't acting in accordance with its guidance, you expect that is an issue that would be raised with you at the meeting?---Yes. Although I expect I would have heard about it by now, given the process we now have.

But in order for ASIC to be raising that at a meeting with you, it would be necessary for ASIC to first be aware of the position that Westpac had taken?---Yes.

And your point about the problems that needed to be addressed was that no one had thought in the first place to engage with ASIC in order to tell them - - -?---Yes.

- - - that there was a difference of view?---Yes.

So it seems unlikely, doesn't it, that the meetings between you and the chairman would be something that would address this particular problem?---Well, if there were an ongoing issue I would expect him to raise it with me.

Once ASIC was aware of it?---Certainly.

And the fifth matter you point to is that there are a range of measures designed to improve Westpac's compliance culture?---Yes.

And those measures include town hall meetings, a new performance development framework and an initiative called Our Compass to communicate Westpac's culture and set clear expectations for employees?---Yes.

And why do you think that those measures will be effective?---Well, I think it's – on their own they're not sufficient, but I think that it's – it's a mechanism we've used to communicate much more directly with our people the importance of compliance, meeting the code of conduct, having an open relationship with regulators, logging issues when they arise, and the like.

How will the effectiveness of those measures be assessed?---We look at it through a number of lenses. Staff surveys are an example. We explicitly ask people about whether they feel comfortable to speak up, whether they feel issues will be addressed. We have whistleblower tools that we keep track of and a very important tool we call Juno which is our compliance incident management tool that every staff member has access to to log incidents where they think there might be an issue.

So this credit limit increase offers issue is that one that you would now expect would be logged through Juno?---Yes.

And logged by risk?---By whomever comes across it as an issue first.

Your belief is things have changed enough that now within your bank it would be understood that there is an issue with going directly against the view that ASIC has expressed about the law?---Absolutely.

But that at the time, for whatever reason, that wasn't the case?---Yes.

And you say in your statement that no consequences were taken against managers or executives on the basis of the conduct specific to this case study?---That's right.

And that includes the way Westpac engaged with ASIC?---That's right.

And you say that you consider it appropriate that specific adverse consequences were not applied to individuals in relation to that conduct?---Yes.

And we understand there's no record of remuneration consequences even having been considered in respect of those individuals?---Yes.

You agree there's no record of that - - -?---I agree.

- - - having been considered. Would you have expected that there would be a record of consideration?---In this case, no. And the reason is that we considered this issue as not being an issue warranting – warranting a consequence because of the history of it as I've described to you. Therefore, it wasn't considered for a consequence. If it happened today, the situation would be different.

Well, you don't know whether it was considered for a consequence or not?---Well, I remember this – I vaguely remember the discussion coming up but the conclusion as – as in my evidence was that this wasn't an issue that individuals needed to bear consequences on.

You recall this coming up in 2015 or earlier?---'15, roughly.

After you were the CEO?---I suppose it must have been technically at the end of 2015 I was CEO. But that issue wouldn't have necessarily been on my agenda.

Well, you recall a discussion where this came up. At what level was it coming up?---So I – what I'm trying to refer to is as we worked through the issue with ASIC and – and made the decision to change the practice around CLIs, we had a discussion – I don't remember the specifics of when that happened but it would have been around the time we made the decision to change the process – that there were learnings out of the event but it wasn't that someone had done the wrong thing. And, therefore, it didn't flow through into remuneration that year.

Were you involved in dealing with ASIC in order to change the process?---I don't believe I specifically was, no.

But you recall having been involved in some discussion about what the learnings were and whether there should be remuneration consequences?---Yes.

And do you remember – was that part of a particular committee that you were on?---I don't know.

Do you remember who raised the issue with you?---Not specifically.

Do you know why there's no record of this consideration?---Which consideration?

The consideration of whether there should be remuneration consequences?---Well, again, it's consistent with my recollection of the event that there was a discussion about whether there was some specific harm that had been done to – by an individual, and I – my recollection is our learnings from it was no. Therefore, it doesn't surprise me that there isn't a document about it in REM time.

I'm having a little bit of trouble pinning down exactly what the evidence is that you're giving. Are you saying that you recall having participated in a discussion about whether there should be remuneration consequences for anyone arising from this issue?---Not – it wasn't discussed like that, would be my general recollection.

So what – what is it that you're recalling?---What I'm recalling is that the issue of what are the learnings out of the CLI experience, and did somebody do the wrong thing here and – which implicitly, I guess, suggests was there REM – that would come later. We concluded there wasn't a specific error by an individual and, therefore, we – we took the learnings around process and we moved on. And so, therefore, I wouldn't expect it to come back up at REM time which would have been in September/October.

I see. You say in your statement that you consider it appropriate that no consequences followed from Westpac's behaviour in engaging with ASIC because the primary cause of the conduct was the way in which Westpac's broader systems and culture addressed regulatory issues. That's paragraph 26 subparagraph (b) of Mr Hartzer's statement.

THE COMMISSIONER: Page 1265.

MR HODGE: Thank you, Commissioner.

You see that at the bottom of the page there, Mr Hartzer?---Yes.

And that statement that your understanding is that the primary cause of the conduct was the way in which Westpac's broader systems and culture addressed regulatory issues. Is that a conclusion or a learning you recall also having come to in 2015?---In effect, yes.

And it appears as if the point you are making is that the cause of the way in which Westpac interacted with ASIC was Westpac's culture at the time?---I'm referring to the combination of processes and expectations that we discussed earlier in that statement.

Well, the processes are that it wasn't being percolated up from lower down up to higher up?---That's part of it, yes.

And the culture is that there wasn't an appreciation of the significance of respecting the view of the regulator?---Particularly in the first line, yes.

And then when you're explaining that this is why it wouldn't be appropriate to take action against any managers or executives, that rather suggests that you're saying it wouldn't be fair to punish specific individuals involved in the decision-making and interaction with the regulator because they were acting within their authority in accordance with the culture of Westpac?---In effect, yes.

And does that seem problematic to you, if you want to change the culture of the bank, don't you need to apply remuneration consequences to employees who act in a way that you don't want them to act?---Yes. Although I think we also have a – an obligation on ourselves as a company to make expectations very clear upfront, and I think that's part of the issue here.

Is your point, it wasn't clear at the time to employees that there was an expectation that they would respect the view of the regulator and, therefore, it's unfair to apply remuneration consequences to - - -?---I wouldn't say it in such a sweeping way.

But isn't that the essence of what you're getting at?---I'm – not exactly.

So when you say that the expectations weren't clear, what are the expectations that weren't clear?---Well, as we discussed before, the expectations on the first line about their accountability for making sure that the compliance goals were met, and that they understood the expectations of the regulators as opposed to them relying on the risk department to tell them what they could or couldn't do.

I'm not sure I understand the second part of that. There has never been any suggestion, is there, that anyone was in any doubt within Westpac about what ASIC expected?---Well, no, the expectations were there, but as – as we've discussed earlier, there was a genuinely held view that the – that the regulations were different, and ASICs view is not necessarily the same as the interpretation of – of the law.

So can we – can we set aside the idea of whether the business needed to understand ASICs expectations, because they understood what ASICs expectations were, didn't they?---Yes.

So the issue is they didn't understand that Westpac's expectation was that the business would act in accordance with the view of the regulator?---In effect, yes.

And so the point that you're making is because Westpac had not sufficiently communicated that expectation to its business, therefore, remuneration consequences ought not flow?---That's an element of it, yes.

Does it seem strange to you – again, just stepping back – that Westpac needs to communicate to its employees that it expects them to comply with the views of the regulator?---Well, I think it's important that we make that very, very clear.

I'm just struggling with the idea that you would, therefore, apply no remuneration consequences, because you don't think you had sufficiently communicated to employees within the business that they needed to comply with the views of the regulator?---Well, this situation had a number of aspects to it, and we took all those things into account. It wasn't obvious to us that someone had acted in bad faith or not followed their responsibilities, and, therefore, we didn't see it as an issue where REM implications should happen. But, again, that – I'm not defending that practice. We've changed that practice. And – and we would deal with it very differently today.

Again, I just need to pick you up on that. When you say "we didn't think that it was necessary for remuneration consequences to follow", can we be clear about this: there wasn't any consideration given to remuneration consequences following?---Well, that would have flowed if we had decided that someone had done the wrong thing.

And so is it the case that today you think there would be remuneration consequences?---Yes.

And why is that?---Because the expectations are much clearer. We would manage the process quite differently and someone who made those same judgments in our current framework would know or certainly be found to be going against the practices that we set today.

Can we move then to understand what that practice is and how this relates to risk appetite. Westpac maintains a risk appetite statement?---Yes, we do.

And Westpac has no appetite for compliance risk?---Correct.

That is, it has no appetite to breach legal obligations or - - -?---Correct.

- - - regulatory requirements?---Correct.

And the risk appetite statement identifies key risks and the amount of risk that Westpac is willing to accept?---Yes.

And it doesn't identify that Westpac has any appetite for risking a breach of the law?---That's right.

And does it, therefore, follow that Westpac has no appetite for risking a breach of the law?---Essentially, yes.

And has that always been the case?---I think in principle, yes. Although I think we've documented that better in recent times.

Do you think that at some earlier point in time there was some uncertainty within Westpac as to whether there was an appetite for risking a breach of the law?---No, I don't think that's true.

And Westpac also has no appetite for failure to design and monitor its policies, products and services to support fair, clear and suitable outcomes for its customers?---I'm sorry, would you mind repeating that?

I will bring that up. Can we bring up WBC.120.001.0420 at .0449.

THE COMMISSIONER: Can we have the numbers again.

MR HODGE: Yes, Commissioner. It's WBC.120.001.0420. And the page is .0449. So this is the segment of Westpac's group risk appetite statement dealing with conduct risk?---Yes.

And we see the risk appetite statement there?---Yes.

And the second sentence says:

> *We have no appetite for failure to design and monitor our policies, products and services to support fair, clear and suitable outcomes for our customers.*

?---Yes.

Continuing:

This includes conduct that undermines market integrity and inappropriate sales and distribution practices.

?---Yes.

And has that appetite for conduct risk changed at all?---This is – well, do you mean at a philosophical level or do you mean specifically in – in terms of these documents?

Well, let's take it in turn. First, at a philosophical level has it changed?---No.

And then in terms of the documents has it changed?---Yes.

In what way has it changed?---Well, conduct risk as a theme is relatively new as a area of practice in banks globally and banks including us are continuing to try to get better at figuring out how you define and measure against conduct risk appetites. And so this document that you're looking at here is part of an evolution – it's sort of where we are today but we continue to look for other measures we can use to make the measurement of conduct risk more objective.

Is the development that you're talking about the ways in which you try to measure these things?---Yes.

And come up with dashboard measures, and things like that?---That's right.

But it's – so far as you have been involved with Westpac, it has always been the case that Westpac has no appetite for failing to design and monitor its policies, products and services to support fair, clear and suitable outcomes for its customers?---As far as I know, that's right.

And that's conduct risk, and just so I can be clear, that issue we were talking about in terms of legal obligations and breaching the law and regulatory requirements, that's what's referred to as compliance risk?---Yes.

And in your view, was making offers of credit card limit increases to some existing customers without making fresh inquiries about their income and employment status a failure to design and monitor Westpac's policies, products and services to support fair, clear and suitable outcomes for its customers?---Not necessarily, no.

Why is that?---Well, as I said, the – the design of the process was very explicitly designed to try to meet the responsible lending legislation. We had, in the end, a difference of opinion with ASIC as to what specific measures were required. So I would describe it in a sense is we ended up with a compliance risk and then in that sense it's a risk that we wouldn't take today.

Well, that's – that's compliance risk and we will come back to that in a moment. But in terms of conduct risk, do you think that there was a conduct risk involved with this conduct of making the offers without making inquiries as to employment status and income?---The design of the system was very much to meet the responsible lending obligations which implies meeting the conduct obligations that you refer to.

In your view, the – meeting the responsible lending obligations is equivalent to addressing the conduct risk and having appropriate systems and policies?---In this case, I think so.

And it must follow, mustn't it, that you thought that there was some conduct risk involved with the conduct, because you changed the process in 2014?---Again, I would probably put that one under compliance risk rather than conduct risk.

Okay. Well, then, let's take it as a compliance risk matter. You have the view of the regulator in 2012 as to how the law applies. You agree?---Yes.

And Westpac is – makes the decision not to act in accordance with that view?---Yes.

Your position today, Westpac's position for some years, is that there was a reasonable basis for its interpretation of the law?---Yes.

And you make the point in your statement that when it comes to matters of the – things like the application of the responsible lending obligations, there can be differences of opinion as to how the law applies?---Yes.

Or what the law is and how it applies?---Yes.

And what I'm trying to understand is if you have a situation where ASIC says, "This is our view of the law", and Westpac has a different view of the law, that must, nevertheless, seem to carry with it the risk for Westpac that it will contravene the law?---Yes.

And Westpac, as you understand it, has philosophically never had an appetite for risking a contravention of the law?---Yes, that's my understanding.

I'm sorry?---That's my understanding.

So in practical terms, what does it say about how meaningful any of this is when you write down, "We have no appetite for risking a contravention of the law" if, in fact, even in the face of a letter from the regulator, you risk a contravention of the law?---Well, you're talking about a letter from the regulator in 2012. The process we're looking at today is very different and today we wouldn't do it like that.

But your appetite for compliance risk hasn't changed?---The process of managing compliance risk was not as robust as it should have been.

I see. So it's – the change is not about the appetite for risk, the change is just about the way in which compliance risk gets managed?---I suppose that's right.

And those changes then are limited to the things that you've spoken about, which are there's now separate risk reporting within divisional committee – or a separate agenda item for risk reporting within divisional committees; you've tried to encourage your first line to understand what's going on; you've improved your second line. I think is that – and you engage with the regulator?---We have new systems, we have a new engagement processes with regulators, we have new operating management processes that look at these things through our various committees.

And is the point of all of that that you think, therefore, today somebody would recognise that there was a compliance risk involved in continuing with this?---Absolutely.

And, therefore, it wouldn't occur?---Correct.

Isn't the problem with the – the strength of that belief that you know in 2012 that risk recognised that there was a problem?---I don't understand your question.

Well, it's not the case that no one recognised in 2012 within Westpac that there was a compliance risk involved in Westpac continuing with the way it was acting?---That's correct.

It was recognised?---In some parts of risk, yes.

So the solution then is to just hope that the processes will mean that that recognition will expand out further?---I don't think that's what I said.

Do you think that the product team didn't recognise the risk of not complying with the law?---Yes.

You think they didn't understand it?---I don't – I don't – I don't know what was in their head but they clearly didn't appreciate the importance of treating it as seriously as they should have.

And so if a similar situation arose today, the point at which Westpac would change its practices would be – what?---After a more thorough discussion with the regulator which would have happened much sooner.

So not as soon as it's aware of what the regulator's view is?---Well, you can have genuine disagreements, which is the point I make in my statement. Sometimes they might form a view. We might have other facts that they're not aware of. The proper process is to engage, to share our views, explain our rationale, let them consider it. But if they – you know, if after that process we still don't agree, then overwhelmingly we would default to their view.

I see. And in your view then, that fits with this idea of an appetite for no compliance risk?---Yes.

Can we move then to the second case study which concerns car loans. I'm sorry, I tender the group risk appetite statement, Commissioner.

THE COMMISSIONER: Group risk appetite statement WBC.120.001.0420, exhibit 7.51.

EXHIBIT #7.51 GROUP RISK APPETITE STATEMENT (WBC.120.001.0420)

MR HODGE: Thank you, Commissioner.

I will just ask you something else before we do that. Have you spoken to the people from product who had the view in 2012 that they should continue with the conduct?---No, they no longer work for us.

Nobody involved in product works there any more?---Well, there might have been junior people but the senior people do not work for us any more.

I see. So it has not been possible for you to understand why exactly they took the view that they took?---No.

Okay. Would that be something that you would be interested in, in terms of trying to understand what the problem was?---At one level, yes, but, frankly, I feel we've made enough changes that it wouldn't happen again, so that would be a matter of academic interest.

I see. And if we switch then to the second case study, which is about car loans. And that was a case study that involved flex commissions and reliance on dealers?---I'm – I'm not sure if that's a flex commission – can you be more specific which case study you're referring to?

Yes, the case study involving the loan that was made to Nalini Thiruvangadam and that that was an inappropriate loan mad by the Bank of Melbourne?---Yes.

And wasn't there a flex commission involved in that loan?---I can't recall. There may have been.

I see.

THE COMMISSIONER: Not to my recollection, Mr Hodge.

MR HODGE: Sorry?

THE COMMISSIONER: Not to my recollection.

MR HODGE: You don't - - -

THE COMMISSIONER: Perhaps I'm wrong.

MR HODGE: I'm sorry, Commissioner.

THE COMMISSIONER: Not to my recollection.

MR HODGE: And - - -

THE COMMISSIONER: It's a long time ago. There has been a bit happen since then.

MR HODGE: And what I want to do is to look at two aspects of the car loan issue. The first is to just understand some aspects of Westpac's approach to flex commissions. And so to do that, I just want to make sure we've understood some things about the market. At the last time that this issue was addressed with Westpac, which was in round 1, the overwhelming majority of car loans on issue by Westpac were initiated by dealers?---Yes.

And is that still the case?---Yes, it is.

And Westpac is a very significant participant in the car loan market?---Yes.

The number of car loans on issue by Westpac by or through dealers in 2017 was well into multiple hundreds of thousands?---That sounds right.

And the quantum of car loans on issue by Westpac was in the million – was in the multiple billions of dollars?---Yes.

And Westpac was typically number 1 or number 2 in the market for auto finance through dealer intermediaries?---Yes.

And at the time of the hearings, Westpac was heavily committed to the motor vehicle dealership model and physical point of sale model?---Yes.

And is that still the case?---Yes.

Now, the case study involved entering into a loan with Bank of Melbourne in July 2012?---Yes.

And the loan is one the Bank of Melbourne acknowledged should not have been approved?---Yes.

And Westpac has acknowledged that its processes in relation to the approval of the loan were deficient?---Yes.

And the loan was considered by two credit officers?---I'm – I don't know that off the top of my head, I'm afraid.

I think that's some evidence that Mr Godkin gave. In any event, you're aware that it was ultimately subject to manual approval?---Yes.

And that's because the credit score is automatically generated, and if it falls below a certain threshold it is referred to the credit team for a manual assessment?---Yes.

And Westpac has acknowledged that it breached obligations imposed under the NCCP Act?---Yes.

And that included failure to take reasonable steps to verify the financial situation of the borrower?---Yes.

And Westpac has also acknowledged that the loan was unsuitable?---Yes.

Now, I think you've identified that the loan was made for broadly two reasons. One, because of the dealer's conduct in preparing the loan application and, two, because of Westpac's approval processes?---Yes.

And one of the issues with the approval process was that the application listed no expenses?---That's right.

And Westpac's systems allowed a loan application to list no expenses and still be approved?---Yes.

And the consequence then is the system permitted a situation where a loan could be made where Westpac had no idea what the borrower's expenses were?---Yes, although there's a subtlety to that.

And what's that subtlety?---That there was a default in the event that the expenses were below something it was called at the time the Henderson Poverty Index it would default to that as the assumed expenses for the loan.

I see. And there was also an independent failure by Westpac to properly assess the application?---Yes.

And it was not, you say in your statement, sufficiently verified?---Correct.

Commissioner, I just note the time. Is that a convenient time to take a five minute break.

THE COMMISSIONER: Yes. If we come back at, say, 20 past 3.

MS ORR: Thank you, Commissioner.

THE COMMISSIONER: Yes.

ADJOURNED **[3.15 pm]**

RESUMED **[3.21 pm]**

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner.

Now, you were asked a number of questions, Mr Hartzer, in order to try to understand your view as to why it is that the – that the problems arose in relation to this particular loan?---Sorry, were - - -

In relation to this loan that was made by the Bank of Melbourne, you were asked a number of questions - - -?---Yes.

- - - to try to understand your view as to why those problems arose?---Yes.

And, therefore, what Westpac had done to fix it?---Yes.

And in your statement you say that you have not identified any internal reward or remuneration issues that contributed to the decision by Westpac to approve the loan?---That's right.

And can we take it from that you're referring there to Westpac staff as opposed to the dealer business manager?---That's right.

And you say that Westpac employees responsible for approving loans such as those made in this case are not incentivised to approve loans?---That's right.

So does it follow, therefore, that the – whatever the failing is is simply a failing to have adequately applied the responsible lending obligations?---Yes.

And does that suggest, then, the possibility that the problem, at least at the time, was an inadequate culture for respecting the responsible lending obligations?---I don't think that follows.

So what, then, is the possible explanation for why there was this failure to follow the responsible lending obligations?---Well, I can't speak for the dealer themselves, but - - -

We're not talking about the dealer. We're just talking about the employees of Westpac?---I just wanted to clarify that. So for our employees, the credit officer has clearly made a mistake here.

From your perspective, it's just some mistake that was made?---That's what it looks like to me.

I see. And have you considered whether there might be cultural factors that contributed to the conduct?---We've considered it, but it's not obvious that that's an issue here.

When you consider the two case studies from round 1, the credit card limit increase offers and the car loan, both of which involve Westpac taking a particular approach to the responsible lending obligations, does that suggest anything to you about the culture within Westpac in relation to responsible lending?---No, I think they're different issues. Each of them.

I see. And in your statement you say in relation to the dealer, that the dealer didn't follow Westpac's policies and procedures?---That's right.

And you say that the reasons for the dealer business manager's failure to follow the correct procedures in relation to the particular loan are not clear?---I'm sorry, could you just say that again?

You say in your statement at paragraph 33, the reason for the dealer business manager's failure to follow the correct procedures in relation to the particular loan are not clear?---Yes.

And have you considered what the possible explanations are?---Yes.

And what are the possible explanations that you've identified?---Well, certainly, the pursuit of a commission on the car is one. Another is from reading the story, it was a very sad story of a woman who was really desperate to get a car, and he may have been just really trying to get her a car. So, you know, that – that could have been part of it.

And when – you're obviously very experienced, Mr Hartzer, in relation to finance. When you have to choose between those two possibilities, one of which is doing something in order to make a profit and get the commission, and the other of which is engaging in some sort of fraud or misrepresentation to Westpac out of the goodness of the dealer's heart, which one do you think is more likely?---I couldn't say. I'm not a car dealer.

Does it seem to you that when Westpac is coming to design its systems and be involved with car dealers, which are its principal source of making auto finance, that it needs to actually think about things from the perspective of the car dealer?---It – it certainly – yes.

So can I suggest the rather flippant answer which is you're not a car dealer, rather ignores the position that you're in, which is that you are dependent upon car dealers in order to make these loans for your profit?---Just – I want to make sure I understand your question.

You gave an answer before, I want to suggest to you was a flippant answer which is you're not a car dealer?---You asked me why the person made the decision they made.

Yes?---And that's my response to that.

Don't you need to think about why car dealers are doing things if you are the one who is remunerating them and you are dependent upon them in order to generate business for you?---We – sorry, we absolutely have an obligation to think about the controls that need to be in place for car dealers in this position, given that they are representing us in – in providing that finance, and we've made a number of improvements to those controls since that time to address that issue.

Westpac has acknowledged that the flex commission model of remuneration carries the risk that some dealers may prefer their own interests to the interests of consumers?---Yes.

And Mr Godkin accepted that flex commissions create the risk of a conflict of interest between dealers and customers?---Yes.

And Westpac itself accepted that in a submission that it made to ASIC in 2016?---Yes.

And it, therefore, sought or submitted to ASIC that ASIC ought to ban flex commissions?---Yes.

And that was because, from Westpac's perspective, flex commissions were not in the interests of consumers?---They – they created the potential for risk to bad outcomes for consumers, yes.

Flex commissions were only in the interests, can I suggest, of dealers and Westpac?---Yes.

They were in the interests of dealers because dealers could make more money by flexing up the commission?---Yes.

And they were in the interests of Westpac because they were an incentive for the dealer to deliver business to Westpac?---Yes.

And Westpac understood all of this in 2016 because it set it out in its letter to ASIC?---Yes.

But it decided not to abandon flex commissions itself?---Yes, although we did put caps in.

And it also submitted to – it also submitted to ASIC that rather than moving immediately to ban flex commissions that it supported a transition period of about 18 months?---Yes.

And it made a particular point, which was that Westpac was different from its smaller competitors. It would take it longer to change its systems over?---That's right.

And that would seem to mean, therefore, that what Westpac was asking for was a ban but a ban over a period of time that best suited Westpac. Do you agree?---That's one way to interpret it.

Is there another way to interpret it?---Yes. We were trying to be operationally practical. We had some very old clunky car finance systems that were difficult to change. And we had existing contracts on foot with dealers that would need to be worked through.

And the reason that Westpac didn't want to simply move itself to give up flex commissions was because it didn't want to be the first mover in the industry?---We didn't think that making – being the first mover would actually achieve the elimination of flex commissions, because we didn't think the others would change, if they weren't required to.

But it would mean that you no longer would be paying flex commissions?---Yes and we felt that that would mean we were no longer effectively in the business.

And it would mean that you would no longer be incentivising dealers to have a conflict of interest between themselves and the customer?---Yes.

And it would mean that you would remove the possibility of these poor customer outcomes?---In that case, yes.

And did Westpac consider how flex commissions fitted with its risk appetite?---Yes.

If there's – there's an obvious conduct risk involved with flex commissions. Do you agree?---Philosophically, yes.

And Westpac says it has no appetite for conduct risk?---In effect, yes.

But, nevertheless, it kept paying flex commissions?---Yes.

Because to stop paying flex commissions would be to give up its auto finance business?---Yes.

And so, again, if we think through that statement in the Westpac group risk appetite that Westpac has no risk for conduct, how meaningful is that, then, when considered against flex commissions?---Well, as – as you pointed out – as you pointed out in the article – the letter that we put to ASIC, we felt that it was a practice that should be banned by ASIC. And – but we recognised that if we did it unilaterally, that would have the effect of us leaving the business, but would not change the outcomes for customers. And, therefore, we felt that a – a constructive way to deal with it was to make our view plain that it should stop, to be supportive of that, and to advocate with ASIC for it to stop. So it was not suggesting that we were prepared to endure it forever, it was that we thought a good way forward was to make the practice stop with an intervention from the regulator.

Well, let's just try to tease that out a little bit. If you stopped paying flex commissions, then you would cease having this conduct risk?---That is true.

And you say that you have no appetite for conduct risk?---Yes.

And what I'm trying to understand is, is that actually a meaningful statement if your answer is, "Well, we do have some appetite for conduct risk if the consequence of giving up all of that conduct risk is that we're going to lose our auto finance business"?---I understand your – where – what you're getting at. The way that I would think about it is if we thought that there was not a pathway to eliminating that risk, then we would make that decision, but we saw the possibility through intervention with the regulator to eliminate the practice and, thereby, eliminate the risk.

And so if ASIC had further delayed implementing the ban on flex commissions what would you have done?---It depends on the situation. That's hypothetical. I don't know.

And I'm – what I'm trying to then understand is whether – when you write down on a piece of paper, "We have no appetite for conduct risk", that is something that then is always – the application of it is always going to depend upon the particular judgments made within the business?---Around timeframe and how we achieve that goal, yes.

It surely can't have come as a recent revelation in 2016 that there was this potential poor customer outcomes in relation to flex commissions?---I think we started focusing on it as an issue around that time, actually.

ASIC had already put out for consultations about flex commissions, hadn't it?---That's – it was around – I'm sorry, I'm a little hazy on the exact dates but my recollection is around the time ASIC put that inquiry around we had started to look at that as an issue as well.

All right. And do you think that the fact that flex commissions needed to be banned despite industry participants knowing that it was harmful to consumers suggests that there is a problem with the intermediated market?---Do you mean in terms of car dealers?

Yes?---Yes.

And what is the problem?---Well, there's clearly a continuation of a practice that puts some customers at risk of bad outcomes.

That is, if they get flex commissions they put customers at risk of bad outcomes?---Yes.

But just step back more generally. What does it tell you about the intermediated market and whether or not car dealers should be in a position to be making loans?---Well, the convenience of being able to access finance when you're at a dealer is something that a lot of customers value, and it's an important part of the economics for car dealers. I'm not sure if I take the opposite proposition, which is that there was no finance available at car dealers, I'm not sure that necessarily delivers a great outcome in terms of competition in the car market.

In terms of competition in the car market, did you say?---Yes.

I see. Now, generally speaking, in considering car loans, Westpac relies heavily on information provided by dealers about a borrower's expenses and liabilities?---Yes.

And Westpac relied heavily on dealers to ensure that it complied with its responsible lending obligations?---Yes.

But whether or not the dealer acted appropriately, Westpac always has had ways to ensure that the loan application was adequate?---Yes.

And do you think that Westpac placed too much reliance on others to help it discharge its responsible lending obligations?---I think the practices were not as strictly enforced as they should have been, and we have taken steps to improve the controls and the systems to make that work better.

Westpac has, I think, supported a change to the point of sale exemption?---I am not 100 per cent sure on that.

Or is it a – it may be that it's ambiguous. If we bring up RCD.0010.0001.0282. This is Westpac's round 1 submissions in relation to auto finance. And if we go to paragraph 83.

THE COMMISSIONER: Page?

MR HODGE: 0301.

THE WITNESS: I'm sorry, what paragraph?

MR HODGE: Paragraph 83?---Yes.

You see Westpac notes that:

> *Any changes to the point of sale exemption would represent a major shift to the industry. While Westpac sees benefits to the consumer in this removal, any consideration of this reform should take into account the impact to all stakeholders.*

?---Yes.

And perhaps this might be the ambiguity. I think I've incorrectly inferred that because Westpac sees a benefit to consumers, it would, therefore, support the reform?---Right.

But that's not right?---Now you lost me.

That is, you're not – Westpac sees the benefit but it doesn't necessarily support the reform?---Correct.

It's - - -?---It's saying it's hard. We're saying it's hard.

I see. And that's because of the impact to all stakeholders?---Yes.

And - - -?---Particularly the dealers.

And so what is the major shift that would occur in the industry if you removed the point of sale exemption?---You would essentially require the dealers to become authorised credit providers. That would be a significant cost to the dealers. We suspect that many dealers wouldn't be able to make that an economically viable proposition. And so it could have quite a flow-on consequence into the structure of the dealer market. And also, potentially, the cost of finance and the cost of cars.

I see. And so Westpac's position is although this might benefit consumers in terms of the removal of the point of sale exemption, it doesn't necessarily follow that there should be the change?---Right.

Because of the further consequences it's uncertain about?---That's right.

What would be the consequences for Westpac if the point of sale exemption was removed?---Well, in some respects, it would reduce our risk. It would certainly reduce the conduct risk that we've been talking about before. And it would – it would potentially put more obligations on the car dealer to perform some of the processes relative to the controls that we have to have in place now.

Does it seem odd to you that you would be paying commissions to people in respect of these loans and that they wouldn't have to be subject to the obligations that would apply but for the point of sale exemption?---I'm – I'm struggling to follow that question, sorry.

That is – well, you're paying commissions to people in order to facilitate these loans?---Yes.

Does it seem odd to you that they should receive those commissions without being subject to the obligations that they would be under but for the point of sale exemption?---Not necessarily.

And why is that?---Because it depends on what their specific responsibilities are and what other controls are put in place around that.

When the auto finance dealer is engaged in trying to facilitate this loan, are they acting for Westpac?---Well, in some respects, yes.

Are they the agent of Westpac?---Yes, I suppose they are from a finance point of view.

Are they also acting for the customer?---Well, they're providing a service to the customer that is around the convenience of being able to finance the car on – on site, essentially. They're not acting as a broker.

I see. Thank you. I want to move to another - - -

THE COMMISSIONER: Yes.

MR HODGE: - - - topic, Commissioner. And we're going to move to financial advice. Now, Westpac has a very significant wealth advice business?---Yes, we do.

And that business is conducted through BT?---Yes.

BT is a division of Westpac and directly employs financial advisers?---It does.

And it also – Westpac also owns two advice licensees who licence authorised representatives?---That's correct.

One is called Securitor and the other is Magnitude?---That's right.

And there are two issues that have been endemic across the large financial advice businesses. One is poor or non-compliant advice and the other is fees for no service?---Yes.

And I want to deal with each with you. As you're aware, many of the largescale financial advice businesses have undertaken or are undertaking remediation programs because of inappropriate financial advice being given to customers?---Yes.

And speaking generally, do you agree that inappropriate advice given by advisers will usually be caused by one or more of the following: first, inadequate training or experience?---Yes.

Second, the adviser acting out of self-interest rather than in the client's best interests?---Yes.

Third, inadequate supervision?---Yes.

Fourth, the deliberate circumvention of policies and procedures?---Yes.

And fifth, deficiencies in consequence management systems?---Yes.

Are there any other significant causes that you can think of?---Not that I can think of.

And Westpac's advice business and advice licensees has also recognised that inappropriate advice has been given by their advisers?---In some cases, yes.

And Westpac is currently undertaking remediation for clients who received inappropriate advice?---Yes, we are.

And Westpac has provisioned $47 million for that remediation as at 27 September 2018?---Yes.

Now, Westpac has made a number of significant changes to its wealth business to address the issue of inappropriate advice?---We have.

It has sought to improve its control systems?---Very much so.

It has been working to improve its control processes for some time now with respect to monitoring and training of advisers?---Yes.

And, nevertheless, the level of risk that BT is exposed to due to its processes and conduct of advisers is currently outside of its risk appetite?---That's right.

And how long has that been the case for?---For a while now. I don't – I couldn't tell you exactly how many years.

And BT has been monitoring its risk acceptance relating to the provision of inappropriate advice to clients?---Yes.

And that's referred to within BT as risk 24?---Yes, that sounds right.

And risk 24 relates to incomplete, inadequate or inappropriate provision of advice and implementation of financial plans for clients?---Yes.

Now, I might bring up, just so we can understand where things are at, a memorandum from 30 October 2018. That's WBC.557.005.2528. This is a memorandum to the BTFG risk review committee?---Yes.

Do you sit on the BTFG risk review committee, Mr - - -?---No, I don't.

Okay. But you've seen this document in the course of preparing to give evidence?---Yes, I have.

And if we look at the bottom of the page, we see in the beginning of the last paragraph:

> *In respect of risk 24, while several key control enhancements have been implemented, including updated policies, processes and training, over the year and in the most recent quarter current audit fail rates indicate that ongoing enhancement and embedment is required.*

?---Yes.

And then if we go over the page to page .2529 and we look at the bottom third of the page we see:

> *A number of ongoing factors and recent developments continue to impact these residual risk ratings, including the control environment relating to risk 21 and 24 was rated as "unsatisfactory".*

?---Yes.

And in the second bullet point:

> *In November 2017 our file audit process was strengthened to reflect ASICs new higher expectations. Outcomes from recent file audits using those higher standards are showing results at a level that does not indicate a sufficiently robust control environment to comply with ASICs expectations.*

Can you see that, Mr Hartzer?---I do.

And then further on, you see in the next bullet point:

> *The compliance audit pass rates were 61 per cent for BTFA and 60 per cent for BTGL after applying the higher best interests and record keeping requirements introduced to the compliance audit program.*

?---Yes.

And BTFA are the BT-employed financial advisers?---That's right.

And BTGL is the BT group licensees?---That's right.

So that's effectively where the authorised representatives lie within BTGL. Is that right?---That's right.

All right. And then if we go over to page .2534, we see the sign-off from the second line Risk Management Opinion?---Yes.

And it explains the present situation in relation to risk and then in the third paragraph says:

> *On this basis, it is not inappropriate for these risks to continue to be risk accepted.*

?---Yes.

What does it mean to say that it is not inappropriate to continue to accept risks that are outside of Westpac's risk appetite?---What that means is that the risk team is comfortable that the extra controls that are in place to minimise the impact of a potential – one of these risks manifesting are currently sufficient, and that the program of – that's in place to close out those risk issues is robust and tracking against its – its goals.

That is, ultimately, this program will pull the behaviour or conduct back within risk appetite?---Yes.

And the development of this program began – or had been ongoing since 2015?---In varying degrees, yes.

And various changes have been made over time?---Yes.

And even with those changes, BT and Deloitte have both found that even today more design improvements are required?---Yes.

And one of the changes that has been made by Westpac is to take steps to align adviser remuneration with customer interest?---That's right.

And it has done that by linking fixed pay and variable rewards to the advisers' capability, education and seniority?---Yes.

And also by introducing a new balance scorecard with 80 per cent non-financial metrics to determine variable reward?---That's right.

And we will come back to that. And it has also removed life insurance commissions for the scorecards?---Yes.

And there have been some other changes made which are to enhance regional manager supervision?---Yes.

And consequence management systems?---Yes.

And as you've explained, Westpac has increased its first line of defence?---Yes.

And it has taken various steps to try to prevent circumvention by advisers of policies and procedures?---Yes.

And it has also made a change of ceasing grandfathered commissions as at 1 October 2018?---That's right.

All of these changes, do they all relate to the employed advisers within BTFA rather than the authorised representatives within BTGL?---There are some nuances for BTGL but essentially the approach is designed to be consistent across the piece.

I see. You haven't eliminated grandfathered commissions for BTGL?---Where we have the ability to do that, we have. In some cases, we are essentially a pass-through to the advisers who have their own contract separately.

I see?---So those we don't have the ability to turn off yet.

And the effect of the elimination of grandfathered commissions represents $14 million of cash earnings in the first half of 2018?---That sounds about right.

And the effect of turning off the grandfathered commissions altogether is expected to cost Westpac about $40 million per year?---That's right.

Now, I think what you're saying about grandfathered commissions with authorised representatives is where Westpac considers it is contractually able to turn off commissions it has done so?---Yes.

And was that also as of 1 October 2018?---It's the same decision, yes.

Sorry, that is for BTFA it happened as at 1 October 2018?---Yes.

It's the same thing for those BTGL advisers where you can?---I am not 100 per cent sure on this but I think the BTGL ones would be operating under a different system.

I see?---They would have different arrangements so they wouldn't be covered.

And Westpac presumably has turned off these commissions because it recognises that it is in its clients' interests to remove grandfathered commissions?---Yes.

When did Westpac first recognise this?---We started talking about it probably about a year ago, maybe nine – where are we, November – beginning of this year roughly, I think we first started talking about it.

And, again, just so I understand, you're saying that's the first time you started talking about the possibility of turning them off?---Yes.

If you just think back to my question about when you first recognised that it was in customers' interests to turn it off, was that at the same time or an earlier time?---Well, we had always been of the view that grandfathered commissions would go away as advisers renewed their advice. So we thought it would naturally fall away, and that we wouldn't have to intervene. It was in January this year when we began having the discussion about, in fact, we should act. It wasn't coming down in the way we expected it to.

Surely, it was apparent, at least from the time of FOFA, that commissions were not in the interests of clients?---I'm not sure I would say it like that.

Isn't that the reason why FOFA was brought in, because it is not in the interests of clients for there to be this conflict between the interests of an adviser and the interests of the client?---It was to manage the risks. I'm just – it was the way you phrased that as a broader statement. A commission is not necessarily against the interest of customer but the issue was that with the – the structure of product commissions that was in place at the time, created the risk of – of advisers not acting in customers' interests. So I'm basically agreeing with you. It's just a subtlety in the way you said it.

I see. And – so if you're basically agreeing with me, perhaps, then, you can answer this: why is it that Westpac didn't turn off grandfathered commissions at least for its own financial advisers in 2013?---Well, it was part of the transitional arrangements that those advisers had as part of their revenue, these previous arrangements, and so we thought that that would naturally flow off in the same way that it would across the industry.

That is your own employed financial advisers were receiving the commissions?---Yes.

But you've changed – you've now changed how they're paid?---Yes.

Is there some reason why you couldn't change how they were paid in 2013?---I don't know.

So, again, just thinking back to my question, can you think of a reason why you wouldn't have just made the change in 2013?---There was an industry practice at the time. It was part of the transitional arrangements. And, as I said earlier, we expected the process to naturally flow off as – as advisers renewed their statements of advice with their clients.

I tender that document, Commissioner.

THE COMMISSIONER: Memorandum to BTFG risk review committee, 30 November – is it October – 30 October '18, WBC.557.005.2528, exhibit 7.52.

EXHIBIT #7.52 MEMORANDUM TO BTFG RISK REVIEW COMMITTEE DATED 30/10/2018 (WBC.557.005.2528)

MR HODGE: Now, another recent change that has been made by Westpac is to cease the provision of personal advice by BTs virtual advice team?---Yes.

And that was a team that provided personal advice by phone or video conference?---That's right.

And the reason for ceasing that was because the results of file audits were unacceptable?---I can't recall exactly why we made that decision.

All right. Given that poor advice has been a significant issue within BT, have you drawn any conclusions about the approach of the leaders of that business over a number of years?---Well, I would say that my observation is that the leaders of BT have been very clear that the industry needed to change and evolve, as relates to financial advice and had been making a number of changes over time to try to make the business more sustainable.

Well, many of the problems with inappropriate advice had been apparent for many years?---Yes.

And to the extent that the problems weren't apparent, they were certainly foreseeable?---In some respects, yes.

And what I'm trying to understand then is do you have a problem, as the CEO, with the leadership of the senior leaders within BT over a number of years, given that all of these problems persisted within BT?---I'm certainly disappointed.

And have you done something as a consequence of that disappointment?---Yes.

And what is that?---Well, it has been a series of things. There have been – it has taken up much more of my personal time and intervention. We've devoted substantial investment/resources to systems improvements, control improvements. We've made changes in – in people and there have been consequences for a number of people.

And remuneration consequences?---Yes.

For the senior leaders?---Yes.

And when has that occurred?---It occurred, in some respects, for particular people over the last couple of years. Last year there were some consequences and this year the consequences were significant.

I see. And does that mean a reduction in the variable remuneration that they were paid?---Yes.

Do you think that a customer who uses a financial adviser owned by a major bank like Westpac is entitled to assume that they will get high quality advice?---Yes.

And do you have a view as to whether it is possible for a bank to operate a large scale financial advice business in a way that delivers compliant high quality advice?---I do.

And what is your view?---My view is that, yes, we can, and yes we should. However, the economics of doing that are getting very difficult.

And why are the economics getting very difficult?---Well, advice is inherently a challenging issue to monitor because you're talking about a subjective conversation between two people at some point. Investing inevitably has a level of subjectivity around it which can mean that with the best will in the world results don't necessarily come out the way you expect them to. The standards of documentation and proof that we're now, as a general industry, expected to meet are very, very high, and so the cost of training, hindsighting, storing documents, auditing and the like is very, very high relative to the revenue associated with providing that advice.

If you step away from the industry as a whole and just think about BT and Westpac, presumably, from your perspective, Westpac has always wanted to provide its financial advice clients with high quality advice?---Yes.

And, surely, in order to do that, it needs to have record keeping that keeps records of what advice is provided?---Yes.

And when it's provided?---Yes.

And that's obvious, isn't it? It has been obvious – it's not just obvious this year, it is always obvious that if you want to have adequate high quality advice, you have to keep a record of it?---Yes.

And yet, one of the fundamental problems that Westpac faces is that it doesn't have good records of what advice was provided?---Historically, that's true.

And it doesn't have good records in relation to its own employed advisers?---In some cases, that's true.

And it has terrible records in relation to the advice provided by the authorised representatives?---Those representatives hold their files.

And Westpac has great difficulties – and we will come to this in a moment – with being able to access those files?---Yes.

And if it was concerned, say, back in 2013 with making sure that its authorised representatives were providing high quality advice, why would it not have implemented good quality record keeping at that time?---We did.

So you think you do have adequate records from when?---So we – I don't remember exactly when but it was around that time I recall because it was shortly after I started with Westpac. We signed off on a significant investment in systems to try to digitise all the files. So historically part of – the point you were getting at or what I was referring to was that the files were manual, paper files spread around lots of different locations. So we invested in a major system to digitise all of those files which would then make it easier for us to access them and audit them centrally.

Are you speaking there about the authorised representatives through BTGL or are you speaking about the employed financial advisers?---The employed financial advisers.

Okay. If we think though about the authorised representatives through BTGL, presumably Westpac would also like those financial advisers to provide high quality advice?---Yes.

Did it implement any system in 2013 for trying to centralise and keep records of that advice?---No.

And how do you reconcile that, that is, not having implemented such systems, with the proposition that Westpac has always wanted to make sure that it is providing high quality advice?---Well, the relationship between Westpac and the advice – the authorised reps is slightly different. They operate, essentially, their own businesses in a way and so they're responsible for maintaining their files. And so at the time we put the system in, it was viewed as – going to be difficult to get all the advise – those reps to agree to use that system. More recently, we have started the project – I don't know off the top of my head where we're up to – to roll that same system out to the authorised reps as well.

Now, just thinking this through, what is the value to Westpac or BT of owning advice licensees?---Well, I would say that that has changed over time. The general notion was to be able to build scale on our operating platforms, and to provide – to make it easier for us to provide advice to customers, and over time, part of our notion is that by providing systems that make it convenient for people to manage their banking and their investments all in one place, that that would help make us a more attractive bank for people to be with.

There's a few different ideas there. Let's just tease them out. The last idea seemed to be to make it more attractive for customers to be with Westpac?---Yes.

And that means that, I take it, that it would be more likely that a customer would have other banking products with Westpac if it was also receiving financial advice from Westpac?---Yes.

And was that a point of significance in relation to the authorised representatives or only in relation to the employed financial advisers?---It's potentially both although it's less so for the authorised reps.

But potentially both in the sense that both might potentially operate as a distribution network for Westpac of its other banking products?---Well, yes.

And then – that was the third idea. The second idea I think you mentioned was providing high quality advice to your clients?---Yes.

That, can I suggest, can't have been a particularly significant point, because you weren't keeping records in order to be able to check whether high quality advice was being provided?---Well, we were relying on the reps to provide that advice and to keep the records.

But it – if you're not – if that is – if Westpac isn't keeping records, and monitoring the advice, then it's not taking any steps to assure itself that high quality advice is being provided?---Well, there were controls around – and audits of the dealer groups and they had to meet certain standards. So they weren't – not anyone could just become an authorised rep.

Again, though, just coming back to my question. If Westpac isn't keeping records of this advice and checking the advice itself, then it suggests that its principal concern isn't about the quality of that advice?---I'm not sure that totally follows.

All right. The first reason was to build scale?---Yes.

And I think you referred to building scale with Westpac's platforms?---Yes.

And also, presumably, Westpac's – at that time the wealth products that it was manufacturing?---At the time, and I don't want to divert your question but the authorised reps came a bit out of history from before my time, and the market has moved on a bit. So the role that the reps played and strategically has probably shifted a bit over time.

Is what you're getting at that historically the role of authorised representatives was to function as a distribution network for wealth products?---I suspect that's true. That's – it's before my time.

Surely you've turned your mind to the question of why it is that you own a whole lot of authorised representatives – why it is you own advice licensees and have a whole lot of authorised representatives?---Yes, I just – I just think I should qualify because I wasn't there as to what exactly the strategic choices were. That seems logical.

Is there some other explanation you can think of for why these wealth management companies would have authorised representatives?---They might have seen it as a profitable business to invest in.

I see. Is the efficiency benefit, though, for a wealth management company of owning both product manufacturer and advice licensee that you can use the advice licensee to distribute your products?---That was certainly a big part of the rationale when those businesses were put together.

And that's why authorised representatives were paid commissions?---Yes.

Because they were distributors for the products?---Yes.

And now Westpac's position has, at least in relation to product manufacture, changed?---Yes.

And it sold off BTIM?---Yes.

That's BT Investment Management?---That's right.

And BTIM was the product manufacturer?---Yes.

Does it still own the platform somewhere within the BT Group as owned by Westpac?---Yes.

And does it see the platform as a product that is also distributed through its advisers?---The role of platforms has changed. We see it more as an administrative service. So definitionally and in a way, yes, but we don't view it as manufacturing an asset management product. We see it as the provision of a service.

And is it fair to say that one of the things that you recognise is that there is an inherent conflict between owning the product manufacturer and owning the advice licensee?---I would say there's a potential for conflict. I personally think it can be managed. However, I concluded that – and we concluded that in the case of BTIM it – well, it's probably not a question you've asked me but we decided it made sense to get rid of it.

And just – just so we understand your view that it can be managed, does that mean if you have a sufficient number of controls in place then it ought to be possible to avoid the adviser acting in the interests of the customer – I'm sorry, acting in the interests of the product manufacturer rather than the customer?---Yes.

But in order to implement those controls, it would be very expensive?---There can be a variety of reasons why you might not want to do it, but cost could be one of them.

Well, when you identified the reasons why you would prefer to sell BTIM rather than implement those controls, what were the reasons?---At the end of the day, the real reason that I came to the conclusion we should get rid of it was that even if we put the – all the conflict of interest controls in place, the fact that we were having an adviser offer a product branded BT to the customer, the customer would still perceive there was a conflict of interest, and I came to a conclusion that managing the perception of that conflict was too difficult, and that it would be cleaner for us to be able to say that we really want an open architecture approach where the adviser can give you whatever product makes sense for you if people weren't going, "But don't you own BTIM?" That was – that was it at the end of the day.

I see. We will return to that possibly not this afternoon, possibly tomorrow morning, Mr Hartzer. I want to just move now to fees for no service and then we will come back to how this fits with vertical integration. Fees for no service is a problem that has affected essentially the entire financial advice industry?---Yes.

And the conduct was the subject of ASICs report 499?---Yes.

And, as you know, I'm sure, the conduct is now well known and has been explored through a number of case studies in this Royal Commission?---Yes.

And ASIC first wrote to Westpac in early 2016 to say it was conducting an investigation into the charging of fees for providing financial advice or services where no advice or services had been provided?---Yes.

And Westpac accepts that both its employed financial advisers and its authorised representatives have charged fees for no service?---In some cases, yes.

And you identify in your statement that the causes of that fees for no service conduct were, I think as you identify it, roughly five: first, deficient systems?---Yes.

That is deficient systems to oversee and monitor whether advisers were providing services?---Yes.

Second, deficient systems for record keeping, to ensure that an annual review is actually provided?---Yes.

Third, deficient systems in terms of ensuring that a client was allocated to an adviser where they had an ongoing service fee contract?---Yes.

And those clients who weren't allocated to an adviser are referred to as orphan clients?---Yes.

That is Westpac didn't have adequate systems for ensuring it didn't have orphan clients?---Yes.

Fourth, inadvertent conduct by some advisers?---Yes.

Which we assume means they inadvertently didn't provide the services they were charging for?---Yes.

And fifth, deliberate conduct by some advisers?---Yes.

And that means they deliberately didn't provide the services that they were charging for?---Yes.

And you say in your statement that at the time that ASIC first corresponded with Westpac in 2016, Westpac understood the issue was likely limited to a small number of problem advisers?---Yes, we did.

And is it the case that Westpac now accepts that belief was wrong?---Yes.

And since the concerns were first raised in 2016, the scale of that fees for no service problem, it has become apparent, has expanded significantly?---Yes.

And Westpac didn't, though, undertake a more expansive review after learning of the concerns in 2016?---Well, we gradually – we did. But it's a problem that grew in our awareness over time and so the response scaled up over time.

Its initial response was to review a small number of problem advisers?---Yes.

And now it is engaged or hoping to be engaged in a much wider scale review?---Yes.

And Westpac is presently remediating customers who were charged fees but received no service during the period 1 July 2018 to 31 December 2015?---That's right.

I'm sorry, 2008 to 2015. For Westpac's salaried advisers, Westpac's estimate is that the total ongoing service fees charged between 2008 and 2018 were $647 million?---That sounds about right.

And on 27 September 2018, Westpac provisioned a further $93 million for remediation of ongoing advice fees for salaried advisers?---That's right.

And across 2017 and 2018, the total amount provisioned in relation to Westpac's salaried financial advisers for fees for no service is $117 million?---Yes.

And we think we've understood that the $93 million provisioned in September is included within that $117 million across both periods?---Yes, it is.

The $93 million also includes some provision for inappropriate advice, or do you think that's only fees for no service?---No, I think that's separate.

All right. And Westpac has so far paid about $10.75 million to customers for fees for no service?---Sounds about right.

And that's 6657 customers?---Yes.

And approximately 25,000 customers remain to be remediated?---Yes.

So the expectation is they will collectively be paid about $106 million?---Yes.

And all of these numbers that we're talking about are just for Westpac's employed financial advisers?---That's right.

That's BTFA?---That's right.

And you say in your statement that Westpac commenced work in November 2017 to identify clients of employed financial advisers who may have charged fees for no service?---Yes.

And it commenced remediation payments in December 2017?---That's right.

And it would seem to follow, therefore, that the payments started being made almost two years after ASIC had first identified the problem in January of 2016 to Westpac?---I'm not sure that's strictly correct. I think there were payments for some of the – the poor advisers that we were already looking at that would have happened sooner.

I see. And Westpac expects to complete the remediation for its employed financial advisers by April of 2019?---Yes.

And that will be more than three years since learning of the issues about fees for no service?---In the first instance, yes.

When you say "in the first instance", that's because you expect there's going to keep being remediation after April 2019?---No, because, as you pointed out, when we started, we thought this was a narrower issue.

I see. And it seems, when you sort of work through the timeline, that it's possible that for some of these customers, by the time they are remediated, the fees that they are being remediated for relate to fees that they were charged as long as 11 years ago?---That's correct.

And presumably, it's possible that the remediation may take even longer if Westpac's remediation processes identifies any other records as being missing?---I suppose that's possible.

And is it fair to say the complexity of Westpac's own customer management and billing systems have contributed to the problem?---Yes.

And the systems have added to the time it takes to remediate the customers?---Yes.

But also, they've made it difficult to identify the customers that should be remediated?---In some cases, yes.

And that's one of the reasons – or that is the reason why Westpac is remediating customers on a benefit of the doubt basis?---Yes.

That is, Westpac will remediate a client unless it can prove that the service was provided?---Yes. It's a little more subtle than that, but broadly, yes.

Westpac has not yet provisioned for the fees attributable to the authorised representatives of its dealer groups?---That's right.

And Westpac currently estimates that during the period 2008 to 2018 authorised representatives of Westpac received approximately $991 million in ongoing advice fees?---Yes.

And the review of the dealer groups then that will need to be done relates to those two advice licensees, Securitor and Magnitude?---Yes.

And it will have to relate to ongoing services provided by approximately 1660 planners of those advice licensees?---That sounds about right.

Now, can you explain to the Commissioner what the fundamental problem is that Westpac faces in trying to undertake remediation for its advice licensees?---Yes. There are several issues there. Briefly, they are that the advice licensees have different contractual arrangements that vary quite a lot among the different groups. So establishing a fact base is difficult. You have customers and advisers who no longer are operating under the licence in the time period that need to be found and identified. And in some of those cases, getting hold of the records is particularly difficult. The other element that has contributed to the timeframe here is an ongoing conversation with ASIC on this issue. As you pointed out, this is an industry-wide challenge. And a number of different organisations have the same issue. So ASIC has been keen that there be a consistent approach across the industry to resolving it. And we've been in discussions with ASIC and one of the other banks that they've asked us to work with to try to settle a methodology for doing it thoroughly.

So let me see if I've – or can accurately articulate the problems. The first problem is because of the wide variety in contractual arrangements, you don't have a standardised way of knowing what was contracted for?---Yes.

The second problem is because of incomplete records or missing records or not having access to records, you don't know who was supposed to receive the services?---Yes.

The third problem is because you don't have accurate records or any records, you don't know whether the services were provided?---Yes.

And the fourth problem is because some of these representatives are no longer with you or they're – if they are with you, they're resistant to handing over information or they've moved on to other organisations, you don't have ready access to be able to obtain the information that you need to be able to prove that you provided the services?---Yes.

And so then that leads to the problem which is if you were to simply adopt the same approach for your employed financial advisers and carry that over to the authorised representatives, the amount of remediation that would need to be made could be very, very, very significant?---It's not quite that simple.

It's not that simple?---No. In – in that it's – there are a couple – in the first cohort of the salaried planners, there are actually a variety of different segments in that and that the payment for no file, if we were to use that phrase, applies to a sub-segment, not the whole. So it's not necessarily apples and apples in the way you just described it.

But the remediation method in relation to the employed advisers, as if you don't have a record of having provided the service, you refund the fees to them?---Yes, but we go through a bit of a process to get to that cohort.

To see whether you have a record of it or not?---Yes. And we need to go through – my point is we need to go through other steps first with the aligned advisers before we would come to that application of that same process.

Before you come to advocate for that same process, did you say?---Before we would come to apply that same process. So there are steps precedent that we would go through.

But is one of the significant reasons that your rough estimate of the value of ongoing fees taken by those authorised representatives over a 10 year period is almost a billion dollars?---I'm not really sure what you're getting at.

If you thought that there was only $10 million of fees that had been taken by those authorised representatives over the period of 10 years, you wouldn't be going through this level of agony to decide whether to remediate or not?---Possibly. I accept that that's – that could be a part contributor, but we still have to get hold of the files on the customers and have a basis for making a payment rather than just using no data at all.

But you still need to at least identify who the customers are?---Yes, and what was charged and – so there's still a process to be gone through. It's not quite that simple.

When you – when you think about that, when you think about the fact that you have these authorised representatives operating under your licences where you don't know what they contracted to provide, you don't know who they contracted to provide it to and you don't know whether it was provided, does that tell you anything about whether you were ever really very interested in providing high quality advice?---I – I don't think it – I don't think the suggestion that you seem to be making follows directly.

Westpac had a total of 1046 practices operating under its licence during the period 2009 to 2015?---I'm not familiar with that number but I accept that.

Well, I will bring up the document if that would help?---No, that's okay. I will – I will accept that.

Well, I might leave that until tomorrow morning, Commissioner, and tender that document then. Now, are you aware that about half of the practices that were operating under Westpac's licence have ceased to be authorised representatives of Westpac and are no longer with Westpac?---I wasn't aware of that exact number but I'm – I accept the basis of that.

You were aware that it was a significant number - - -?---Yes.

- - - that had ceased. And you referred to the idea of a – of an – there being an industry problem. Does Westpac have some proposal of an industry solution?---To what?

To fees for no service?---Well - - -

And remediating the authorised representative clients?---So we're working through a process with ASIC now on that remediation, and we're doing some sampling of files and advisers, and the authorised reps to try to dimension the issue, and identify the subtleties of what it will take to do the remediation properly. So we're working that through in conjunction with ASIC.

Are you aware of Westpac having suggested to ASIC that some sort of industry solution was required?---I don't know if we were the first ones to make that suggestion. I think that has been generally recognised.

All right. You're aware that there's some sort of discussion about a potential - - -?---Yes.

- - - industry solution. And what is that potential industry solution?---It's about a – as I understand it, because I think it's still being worked through, is that there would be a common methodology for contacting customers, what the basis of evidence would be, how much information you need to gather, what to do when you couldn't contact the customer or when you couldn't contact the adviser, what the approach would be.

And this is a common approach for all of the bank businesses that have authorised representatives?---Yes, although I would have thought it would extend beyond the bank-owned businesses as well.

At least?---It's a common issue.

At least extend to AMP?---Yes, but I don't see why it wouldn't be extended more broadly.

All right. And so the idea then is that there would somehow be facilitated by ASIC some common way of trying to pay back to Australian consumers who had been charged fees for service by authorised representatives over the course of a decade all of this money?---Yes.

And however much that is, it's beyond what has been provisioned by Westpac already?---Well, in that we haven't provided for that, yes.

And do you know whether any of the other big five have provisioned for it?---I don't.

All right. Commissioner, is that a convenient time - - -

THE COMMISSIONER: Just before we break, can I just understand, Mr Hartzer, are all the ongoing advice fees that we are concerned with in the case of advice licensees and authorised reps ongoing advice fees that were paid through the advice licensee? Did the money come into the advice licensee and go out from the advice licensee?---I believe so, Commissioner.

Yes.

MR HODGE: Thank you, Commissioner. 9.45 will be - - -

THE COMMISSIONER: 9.45. Is that possible for you, Mr Hartzer? 9.45 tomorrow then.

MR HODGE: Thank you, Commissioner.

<THE WITNESS WITHDREW [4.28 pm]

MATTER ADJOURNED at 4.28 pm UNTIL THURSDAY, 22 NOVEMBER 2018

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