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TRANSCRIPT OF PROCEEDINGS

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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, THURSDAY, 22 NOVEMBER 2018

Continued from 21.11.18

DAY 63

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 J. SHEAHAN QC appears with MS P. NESKOVICIN QC for Westpac
MR G. RICH SC appears with MR E. GISONDA for Macquarie
MR P. COLLINSON QC appears with MR L. HOGAN for ASIC

<CROSS-EXAMINATION BY MR HODGE

5

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner.

10

Mr Hartzler, yesterday I asked you a question – or I said to you Westpac had a total of 1046 practices operating under its licence during the period 2009 to 2015. And I think your response was, “I am not familiar with that number but I accept that”, and I then promised that I would tender a document. So I just want to show that to you and then tender that. Can we bring up WBC.558.002.0030. Now, just take a moment, if you would. Is that a document you’ve had a look at before in the course of preparing to give evidence?---I don’t recall seeing this one, I’m afraid.

15

I see. Is this – this appears to be a meeting between – is it Mr Cooper of Westpac and Peter Kell of ASIC. Would that be correct?---It doesn’t say, but that’s very plausible.

20

All right. And then - - -?---It does say “Peter” on there, doesn’t it? I would assume that’s probably right.

25

All right. And Mr Cooper’s role within the BT Financial Group is what?---He’s the chief executive of BT.

If we go over the page to page .0031, you will see there’s a heading which is OAS-dealer groups and then the third bullet point down begins:

30

To understand the industry-wide challenge.

?---Yes.

35

And then you will see in the first bullet point under the third bullet point:

Over the period 2009 to 2015, we had a total of 1046 practices operating under our licence.

40

?---Yes.

And then the other things that are set out there reflect, I think, the things that more generally you’re aware of and that we were speaking about yesterday, which are just the challenges that your institution but also the other – the other institutions within the big five face in relation to their authorised representatives?---That’s right.

45

I tender that document, Commissioner.

THE COMMISSIONER: If I call it notes of meeting between BT and ASIC of what date?

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MR HODGE: 1 June 2018.

THE COMMISSIONER: WBC.558.002.0030, exhibit 7.53.

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EXHIBIT #7.53 NOTES OF MEETING BETWEEN BT AND ASIC DATED 01/06/2018 (WBC.558.002.0030)

15 MR HODGE: Thank you, Commissioner. Now, Mr Hartzler, we were speaking yesterday about some of the challenges in relation to delivering ongoing advice services, and the management of ensuring that those services are delivered and that high quality services are delivered. You will recall that?---Yes.

20 And one of the things that Westpac did in January of this year was to undertake an ongoing advice service and consequence management thematic review?---That's right.

And that was in relation to its employed advisers?---That's right.

25

And that review found that 50 per cent of the samples tested had no appropriate supporting documentation on file to match the review status recorded in the fee disclosure statement and ongoing advice delivery report?---That's possible. You might need to show me which report you're referring to.

30

I will bring that up. Can we bring up WBC.557.012.0001. And this is the report from the second line of defence in relation – or from BT Risk which is the second line of defence in relation to this thematic review?---Yes.

35 And if you look about halfway down the page you will see:

Our review noted the following findings.

And there's then a second bullet point which is:

40

Ongoing advice service process.

?---Yes.

45 And you see the first bullet point under the second bullet point is:

50 per cent of the samples tested had no appropriate supporting documentation on file to match the review status recorded in the FDS and ongoing advice delivery report.

5 ?---Yes.

And then what it also found – I think we might just need to pull out to be able to see this – could we – thank you – is that there was a lack of CM policy application by the business where advisers admitted to or were found to be non-compliant or breached the Westpac code of conduct?---Yes.

And CM policy is consequence management policy?---Yes, it is.

All right. And that, then, was the situation, even within the employed advice business, as at January of this year?---Yes.

And so since that point, Westpac has been taking steps to address both of those findings?---Yes, we have.

20 And I will come to those steps in a moment. What I want to ask you to consider and help us with first is why do you think it had reached the point that these problems, very significant problems, persisted all the way until the beginning of this year before active steps were being taken to address them?---Well, I think one of the bits of background to this is there had been an overreliance on the fact that customers had 25 – were opting in to an advice relationship every two years. So every two years customers were signing a contract saying, “I want an ongoing advice relationship and I’m agreeing to this set of fees.” And then every year we were providing a fee disclosure statement that reminded customers what they were paying and what they were entitled to. So I think the business, and perhaps the planners themselves, were 30 overly reliant on that as being sufficient to demonstrate that they were providing the service that customers were paying for. And – and that clearly was insufficient. They were not taking the steps they needed to do to load the files up into the system. And I just – if I might just make one point of clarification here. This is a testing of 35 whether those appropriate files are loaded into the system. It doesn’t necessarily follow that those files don’t exist.

Yes. I understand. Your point is it might have – it might well be that there is a file that an employed adviser has kept but then not followed the process to load into the system?---Potentially.

40 And, therefore, Westpac doesn’t have this centralised record of showing the advice having been provided?---Not immediately, yes.

And doesn’t have a centralised record showing that even, for example, the fee disclosure statements having been issued?---Potentially. I’m not – actually, I’m not sure on that one. I think they’re generated centrally.

Okay. Now, your explanation as to why you think that that had persisted up until January of 2018 was, as I understood it, that the business was over-reliant upon the fact that customers would need to opt in every two years in order to continue their services?---That's part of it, yes.

5

Well, is there another – apart from that reliance on that fact, is there another part of the explanation you want - - -?---The other part that I mentioned a moment ago is that each customer was getting a statement every single year telling them what fees they were paying and what services they were entitled to.

10

I understand. Now, those two things, being required to opt in every two years and receiving a fee disclosure statement every year, those are requirements that were imposed by FOFA when it came in?---Yes.

15

But the application of FOFA is limited to clients that began the ongoing fee arrangement after FOFA commenced?---That's true. Although when FOFA came in, we made the decision to issue fee disclosure statements to all customers, regardless of whether they were opting into a new arrangement or not.

20

You did that back in 2013?---Yes, we did.

But only for your employed advisers?---I believe that was done for all customers, actually.

25

You think your authorised representatives also had that requirement?---Yes, I do.

And - - -?---As distinct from the two-year opt-in.

30

And you – I'm sorry, as distinct from the two-year opt-in. What do you mean by that?---Well, we were talking about two different types of control.

I'm sorry, you're – let's just break this down into the two constituent parts. There are two different requirements. One is that you have to provide a fee disclosure statement every year?---Yes.

35

The other is that you have to have the client opt in every two years to continue the ongoing fee arrangement?---That's right.

40

As to the first one, the providing a fee disclosure statement every year, you think that Westpac expanded that when FOFA came in to everybody, not just post FOFA clients?---I'm sure we did for the salaried planners. I'm pretty sure we did for the aligned planners as well.

45

In relation to the ongoing fee opt-ins every two years, do you think that you expanded it – expanded that also to all clients as at the time that FOFA came into operation?---No. But we did bring it in a couple of years later for the aligned planners.

All right. So if we just, again, make sure we understand what occurred. FOFA comes in in 2013. At that time, in accordance with FOFA for new clients commencing ongoing fee agreements after FOFA, Westpac required an opt-in as it had to under the legislation?---Yes.

5

And then you think a couple of years after that, it expanded the requirement to have an opt-in every two years to clients that were pre-FOFA clients but were clients of employed advisers?---Yes.

10 But it hasn't yet expanded that requirement to pre-FOFA clients who are clients of authorised reps?---I am not sure.

Okay. And your point, then, is insofar as it expanded it out for its employed advisers, that is, the two-year opt-in, that, therefore, created the impression that that was sufficient for the purposes of making sure that ongoing advice was provided?---I think there was an over-reliance on that as one of the controls, yes.

And that then would pass the responsibility, effectively, on to the client, that is, the client would, in filling out the form, would need to be satisfied that they had actually received the advice?---I suppose that's implicit.

20

Rather than Westpac exercising the control over its own employed advisers?---Well, we still needed to keep the records. I accept that. There is a subtlety, though, just in the way you phrased that about getting the advice, which is the nature of these ongoing advice relationships can vary. So sometimes they constitute a full new financial plan being done as a one-off. Sometimes it's about an ongoing dialogue with the customer and the customers get value from being able to ring up and have an interaction with the adviser.

25

I just want to make sure I've understood that. You're distinguishing between one-off advice and the benefit of being able to have an ongoing interaction?---The point I'm making is that the ongoing advice relationship is not about merely the transaction of a full financial plan and a new statement of advice being done. For some customers, they see value in the, if you like, think of it as a retainer relationship with the adviser that they can ring up and discuss things with or the adviser rings them when something happens that they should consider.

35

All right. We might return in a moment to the – well, we will return in a moment to the value of an ongoing advice relationship. One of the things that Westpac has done in relation to its employed advisers – and you explain this at paragraph 65 of your statement which we might bring up, and that's the statement itself is WBC.900.001.1259 and the relevant page is page 18, .1276. Commissioner, that's coming up. Can I tender the last document which is WBC.557.012.0001, which is the report from the second line of defence risk dated 23 January 2018.

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THE COMMISSIONER: That document with that ID will become exhibit 7.54.

**EXHIBIT #7.54 REPORT FROM THE SECOND LINE OF DEFENCE RISK
DATED 23/01/2018 (WBC.557.012.0001)**

5 MR HODGE: Thank you, Commissioner.

What you're setting out here, Mr Hartzer, are the process changes that Westpac has implemented in order to try to improve risk management procedures?---Yes.

10 And you identify a number. The first is, in subparagraph (a), what you call:

Training and communications with financial advisers.

And you say that:

15

In 2017, Westpac developed a mandatory ongoing advice training program for employed financial advisers.

?---Yes.

20

And then in subparagraph (b), which will come up in a moment, you then talk about a:

Revised process and procedure for ongoing advice arrangements.

25

?---Yes.

And you explain that there were some changes. If we go over the page and bring up (i), you see:

30

All clients of Westpac's employed financial advisers are required to opt in to receiving ongoing advice at least once every two years.

?---Yes.

35

Now, we had read that as being a purposeful statement in the sense that you didn't say that all clients of employed financial advisers and authorised representatives were required to opt in at least once every two years. Are we reading that correctly?---Sorry, can you say that again, please?

40

That is, there's a reason why you say – why you limit the requirement to opt in every two years to the employed financial advisers rather than all financial advisers?---Yes, just to be specific.

45 Specific. And, again, I just want to be clear about this. We were – I was asking you some questions a moment ago about whether the requirement of an opt-in every two years applies to only the clients of employed advisers or all clients of both Westpac's

employed advisers and authorised representatives?---So my understanding is that we did the opt-in for all clients regardless of whether they were pre or post FOFA from the beginning for the salaried planners.

5 Yes?---And then a couple of years later we extended that requirement to the BTGL aligned planners. That's – that's my recollection.

Do you say that somewhere in your statement?---I don't – I don't see that here.

10 Can I suggest, if we bring up footnote 6 on that page, you see it says:

BTFG has gone beyond FOFA obligations in relation to BTFA advisers and applied the biennial opt-in requirement to all clients rather than clients who commenced their arrangements after 1 July 2013.

15

?---Yes.

And just taking that statement in parts, but in reverse, 1 July 2013 is the commencement date of FOFA?---Yes.

20

And BTFG – I'm sorry, BTFA advisers are the employed advisers?---That's right.

And BTFG is the complete financial group?---Correct.

25 And just looking at that footnote, do you still say that you think, in fact, the footnote is wrong and BTFG has extended it to all clients regardless of whether they're clients of BTGL or BTFA?---I don't think the footnote is wrong. I don't think it's fully comprehensive.

30 So you think that at some point in time there was an extension to BTGL and you just didn't record it in your statement?---That's my recollection, yes.

And when do you think it happened?---I think it happened two years ago. Maybe three.

35

And just, again, so we can try to make sure we've understood where your evidence is now, my recollection of what you've said this morning is that when FOFA commenced on 1 July 2013, BTFG extended the requirement to give a fee disclosure statement every 12 months to all clients?---That's my understanding.

40

Regardless of whether they were clients of the – of BTFA or BTGL?---That's my understanding.

45 And then you had said a couple of years after that you thought that BTFG had extended the biennial opt-in requirement to all BTFA clients?---No, no, that – BTF – sorry, I know it's confusing. BTFA started at FOFA.

I think initially, remember we had discussion you said - - -?---I understand what you're trying to distinguish. I'm happy to try to step back for you if you like.

5 You distinguished between when the two obligations were extended. I'm a bit concerned as to whether some of this is things that you're just saying without really being certain about?---Well - - -

10 Why don't you just tell us exactly what you remember now?---I'm doing my best to tell you what I recall. There were a lot of different dates and changes, and this is one – there's one element of this I'm not 100 per cent certain on. So the BTFA – if I say back to you what you just said – BTFA which is our salaried advisers, from the start of FOFA we issued fee disclosure statements to all customers and started the opt in process for all customers regardless of whether it was pre or post-FOFA service arrangements. The fee disclosure statement, my understanding is, applied to BTGL
15 customers as well from the start of FOFA. And then my understanding is that a couple of years later, we imposed the two-year opt-in for all BTGL customers because they would have had to do the post-FOFA ones anyway. My understanding is a couple of years ago we then extended and asked them to do the two-year opt-in for people who had pre-FOFA arrangements as well.

20 All right?---That's the subtlety and that's the one date I'm not sure of.

25 Assuming for the moment that that's the case, does it follow that, therefore, Westpac has – Westpac supports the idea of removing the limitation on the application of FOFA to fee disclosure statements and – and biennial opt-ins?---Yes.

30 That is, it thinks that all financial advice clients who are receiving ongoing advice, regardless of when they entered into those arrangements, should have to opt in at least every two years?---Yes.

And also should receive a fee disclosure statement every year?---Definitely.

35 All right. And is there a reason why Westpac thinks that clients shouldn't be required to opt in every year?---Just administrative burden, in short. Not sure that it would add a lot of extra value. I don't profoundly object to it. I just think that it would be an extra administrative exercise that clients wouldn't necessarily welcome, that would add cost that would ultimately be borne by customers and which would distract time that planners could be spending with their clients giving them advice.

40 Well, let's just see if we can take apart some of those things. Presumably, as you explained before, the issuing of the biennial opt-in is done centrally rather than being done individually by the planner?---I believe that's right but it would generally involve the planner contacting the customer to talk through their arrangements.

45 All right. Now, I'm struggling with the idea that it would somehow be a distraction for the planner from working for the client to have to call up the client and actually talk through with the client what the client's needs were and whether they still

needed an ongoing fee agreement?---Well, some of these clients are being spoken to on a regular basis by their advisers anyway. So they would view it as an unnecessary administrative burden. The advisers have a – in some cases, reasonably sizeable portfolio and – of customers they would have to ring. So I'm just saying it – you know, if you spend time doing that you're not spending time doing something else.

Presumably, though, you need to be contacting your clients anyway and talking with them about what their needs are?---In some cases. It – largely, yes, but it depends on the nature of the relationship with that adviser and their client.

But it must be every case. That's the entire point of having an ongoing fee agreement is that you are receiving ongoing advice and there's an ongoing monitoring of your needs?---Well, different clients view it differently. Some clients do want an active set of meetings frequently. Some clients view it, as I mentioned earlier, as a bit of a retainer relationship where they can ring up and bounce things off their adviser when they want to, and sometimes they're quite happy not to do that for quite a long time, but still like to know that the adviser is there. I know people like that.

You know people who what?---I know people who pay for an advice relationship and they are quite happy about the fact that it's at their discretion to ring up the adviser and talk to them.

I'm going to ask you this and not facetiously, these are very wealthy people you are speaking about?---Relatively speaking, that would be true, yes.

And can I suggest to you that's quite an important point, because the subset of clients that need to have an ongoing advice relationship and are in a position where they're happy to just leave somebody to monitor their no doubt very substantial investments, are going to be very wealthy clients?---It depends on your definition but broadly, I would say yes.

All right. Now, we will return in a moment to that. So accepting your point that there might be some clients that don't apparently – or would find it burdensome to be told once a year rather than once every two years what they were agreeing to receive, the other point that you raised was that it would involve some significant – or it would involve some additional cost?---Yes.

And that's a cost that would ultimately be passed on to the clients?---In effect, yes.

But as it is, Westpac already issues every year a fee disclosure statement?---Yes.

Issues every two years an opt-in requirement?---Yes.

Is making changes to actually attempt to ensure that it's providing ongoing advice throughout a year?---Yes.

It surely cannot be a meaningful additional cost to require a client to confirm once a year rather than once every two years that they want the service and agree to pay the price for the service?---I understand your point. But the nature of that conversation is probably a longer conversation about what sort of relationship the customer wants, what sort of needs they want. It's not just a binary are you happy to tick a box and send the form back. And so if you think about the number of conversations and outbound calls that an adviser needs to make and the follow-up that's required to make sure that the document comes in, and all those sorts of things, it adds up over time. So I'm not saying I have a profound objection to it. I'm just saying I think our judgment is, two years is okay, given that there's also an annual disclosure statement.

Well, one of the problems with two years being okay, as you've identified, is that you have a significant fees for no service problem that you're having to get to grips with this year?---Yes.

And one of the ways that you might control the fees for no service problem is by the opt-in?---Well, we would say that the opt-in is already happening. The issue where we have the difficulty is on then making sure that the records of the actual advice to meet the standard that has been agreed with ASIC are sufficient.

But your proposition earlier was one of them is not the best control but one of the ways in which you can control the fees for no service issue is by at least requiring the client to confirm that they want the service and they're happy to keep paying for the service and, by implication, that they received the service they had been paying for in the past?---I think the point I was making was that was a perception. I was saying I thought that might have been a perception of the advisers themselves as to what – why they were covered in that respect. But we've clearly seen, in terms of what we've agreed with ASIC, that a higher standard is required than that.

It might well be the case and certainly the case that a higher standard is required than that but, nevertheless, surely getting client consent every year to continuing to pay for services and agree to what those services are is a way of making sure the client gets what they pay for?---It's a contributor, yes, but it doesn't meet the ASIC standard alone.

Do you regard financial advisers as a profession?---I think it should be. I think it's moving in that direction. And I think more reform would be helpful to make that happen.

All right. Can you think of other professional services where it is regarded as too burdensome to ask clients each year if they still agree to pay for and receive an ongoing service?---I don't know.

I'm sorry?---I don't know.

Does that mean you can't think of one?---I haven't thought about it. I haven't thought about it.

Does it seem to you that fundamental to the nature of a profession is if you're providing a service to a client you will agree on exactly what that service is and agree on how much you're going to charge for that service?---Yes.

5 And that in any other profession, it would be very surprising to hear a member of the profession say, "It's too burdensome to have to have that confirmed even on a yearly basis"?---I don't know.

You don't have a view about that?---I haven't thought about it.

10

But you do have a view that changes are needed in order to professionalise
- - -?---Yes.

- - - the industry?---Further. Yes.

15

And do you have a view about how Westpac can encourage the professionalisation of the industry?---Well, we've continued, I think, in our submission, we – to the interim report we made some statements about things that we're supportive of. We would continue to advocate with ASIC for improvements in that, and with the other
20 industry bodies.

So one of the things that Westpac supports is individual licensing of advisers?---We do.

25 And another thing that Westpac supports is the establishment of a single independent central registration body capable of assessing qualifications?---We do.

And that would also be a body that would have the power to impose conditions or consequences in the event of a failure to comply with professional standards?---Yes.

30

And so in that sense, it would become – it would make planners like other professions, the lawyers have the Legal Services Commission, or the Admissions Board, doctors have various medical boards that have to supervise them and ensure that they comply with professional standards?---Yes.

35

And that's what Westpac wants?---Yes.

And Westpac also supports increasing personal responsibility of advisers because of the significant responsibility associated with providing financial advice and the
40 potential ramifications for clients where advice goes wrong?---Yes, we do.

And do you think that as it is, Westpac and BTs consequence management frameworks and other controls that it has in place to manage conduct risk are sufficient to ensure that the necessary level of rigour and standards are brought for
45 the provision of financial advice?---I think they are. But I would clarify and accept that at the moment it's catching errors and fixing them and we have more work to do to make sure things are done right the first time.

5 I want to try to understand something about the way in which the professionalisation of financial planners relates to fees for no service. You agreed yesterday and you say in your statement that some of the reasons – or at least one of the reasons why the fees for no service conduct occurred was that advisers chose not to provide the services?---In some cases.

10 And you've added the qualification "in some cases". You don't know what proportion of the cases are cases where the adviser has simply chosen not to provide the service?---No, I don't.

15 And that's because the review that has been undertaken to date of Westpac's employed advisers hasn't been focused or hasn't attempted to identify whether it's a deliberate choice or not?---Well, where we found planners who have clearly not met their obligations and – or have given bad advice you can draw some inferences about that, and there – there would be some of the examples. But more broadly, it – in the end, sometimes it's difficult unless you were to sit down and interview every individual to know what was going on in their head and whether it was inadvertent or intentional.

20 And in the case of the BTGL advisers, that is the authorised representatives, Westpac is at a much earlier stage in terms of trying to figure out what has happened?---Yes, we are.

25 And we talked about yesterday the fact that you've identified – you've made an estimate that about \$991 million was taken in for ongoing advice over 11 years by those BTGL advisers?---That was the total amount but we don't know how much of that is at risk if – if much at all.

30 You gave a notification to ASIC on 27 June 2018, a breach notification, in relation to the two advice licensees?---Yes.

And that notification was built off – or took into account a report that Deloitte had prepared for you in relation to BTGL?---That was a contributor to it, yes.

35 And Deloitte had observed in its report that there were no controls monitoring the fee disclosure statement activity and limited controls monitoring delivery of ongoing advice services?---Yes.

40 And you just are in the process of developing a pilot for remediation of ongoing service fee conduct in relation to Securitor and Magnitude?---That's right.

And I think that was – the pilot was certainly being developed as at the end of October of this year?---Yes.

45 Has it been rolled out yet?---I believe it's underway now.

I see. And the consequence of all of that is that you just don't know to what extent the failure to provide advice within your advice licensees was deliberate?---That's correct.

5 And - - -?---We also – if I can just clarify, there's a presumption in that statement, we don't yet know the extent to which advice wasn't provided either.

10 That's right. You neither – well, you don't know the extent to which advice was provided. You don't know where it wasn't provided. Whether that was deliberate or inadvertent?---Yes.

And it may be difficult to distinguish between deliberate and inadvertent, in any event?---Yes.

15 And what that may reflect, can I suggest, is a cultural issue within financial advice which is that pre-FOFA and in the past, financial advisers weren't professionals, weren't offering advice, they were, effectively, a distribution mechanism for wealth management products?---I think that's largely true, and I would observe that
20 financial advice evolved over the last 20 years, starting very much in the way you characterise it as a distribution channel, and gradually transitioning into more of a profession.

25 And that change is relatively fundamental because for a long time financial advisers were receiving ongoing commissions in relation to the financial products that they were acting as the distribution mechanism for?---Yes.

30 And what then happened was that, particularly with the advent of FOFA, they were, by legislation, no longer permitted to be a distribution mechanism?---That's a good way to characterise it, yes.

They were being forcibly transformed into a profession?---Yes.

35 To provide advice to customers?---I think it was – the subtlety I would say I think it was already moving in that direction but FOFA formalised that.

The writing had been on the wall for a few years?---Yes, indeed.

40 And the discussion about whether or not – I'm sorry, I withdraw that. The concerns about the commissions being paid to financial advisers had been known for some time?---Yes.

And the possibility of legislative reform had been foreshadowed since probably about 2010?---I wasn't in the country then, so I don't remember.

45 All right. And at least one institution had moved, in about 2010, to try to switch new arrangements from being commission arrangements over to advice arrangements, but you're not aware of that?---I'm not – I don't know.

5 All right. In any event, can I suggest what all of this – what the fees for no service problem suggests is that the switch from commissions to ongoing advice, which was intended to be a profound shift in the nature of the relationship between the adviser and the client, didn't actually result in that profound shift?---I think that's too broad a statement.

That is, you think in some cases it did result in the shift?---Yes.

10 And in – I'm sorry, go on?---I think in the vast majority of cases, my sense is that the financial advisers are trying to do the right thing. But, clearly, there are cases where that hasn't happened or people haven't gotten the memo about the shift that – that you describe.

15 Well, you are – your institution is, effectively, going to refund around 20 per cent of the ongoing advice fees that it took in over a 10 year period to customers?---I'm not sure if the number is quite that high but - - -

20 Sorry, from the employed advisers?---I don't know if the number is quite that high but that order of magnitude.

I think from memory, and I might be wrong, about 600-something million dollars in total ongoing advice fees that were taken in over about 10 or 11 years and you presently are provisioned to refund \$117 million?---I'm happy to accept your – your rough number, yes.

25 And in the case of the authorised representatives, you just don't know?---That's right. One subtlety I should just draw out, though, as we discussed in the past, in some cases the refunds don't necessarily reflect the person not getting the advice, it's that the file isn't there.

30 Yes, you don't know whether the advice was provided?---Right. I'm just making – just the subtlety of the way you put it.

35 It could have been provided, is your point, it's just nobody kept any record of it?---Not sufficient records, yes.

40 And I wonder, then if you can then consider this: if financial advisers are now going to be truly professionalised, what role do they have within a bank like yours?---Well, that is an issue of ongoing discussion. One subtlety I would say is, as we've seen, the systems that are required to demonstrate compliance and record keeping, the controls around that are substantial. And I would make the point that an institution like Westpac has the resources to invest in those systems and to sort things out when they do go wrong. So the counterfactual, if you like, of them not being in institutions and being out on their own means you either have to have large independent
45 companies, or you have a fragmentation of the industry and then in that case you don't necessarily have the resources to invest in the controls to give the clients the – the comfort level that ultimately we all seek.

I've seen this explanation that you've given before. I'm not sure I entirely understand it. So can we just try to reduce it down to its essence. Your point is it's possible for an institution like Westpac, if it chose to do so, to invest a lot of money in developing systems in order to ensure compliance?---Yes.

5

And whether it chose to do that or not is a matter that, no doubt, Westpac has to think about?---Yes.

10 And one of the problems is that the more you invest in having to actually achieve compliance, the more expensive advice will become?---Yes.

15 And what that suggests is that, in the past, for a long time in the past, that nobody has been paying the true cost of advice of high quality compliant advice?---You could – I suppose you could draw that conclusion. I would have to think about that more.

20 And isn't one possibility as to where all of this goes that it's recognised that for most Australians, they don't need an ongoing advice relationship with a financial adviser?---Possibly. I'm not sure most Australians have one. But there's a reasonable portion of Australians that would see value in that.

25 And if they see the value in it, then, presumably, they see the value based on what the actual cost is of receiving high quality compliant advice?---Yes. And, of course, it follows then that the higher you put the cost, the fewer people will see the value.

30 But the cost in this case is something where we're talking about what it actually takes in order to deliver quality advice to people?---Yes.

35 It's an odd proposition to say, well, you can afford advice, it's just it won't be very good quality advice?---Yes. I guess the – the subtlety here, though, is, of course, the psychology that people may choose not to engage with their retirement planning and they may end up much worse off in the future. So they might make a short-term decision based on a cost that they see and say, "Well, I don't want to do that at all." And then in the long run, they might end up worse off.

40 I just wonder, again, if you think about the majority of people – and, again, not very wealthy people who want to just leave a financial adviser to manage their wealth but most ordinary people who are receiving a wage and have children and buy a house, and they want to pay off their mortgage, and their retirement is going to be provided for by their superannuation. You agree?---Well, you've actually raised a couple of different issues in there.

45 All right. You think about this then: just in terms of retirement, for most people their retirement is going to be provided for by their superannuation?---Most people believe that. I'm not sure that's always correct.

The system that we have in Australia is intended to work on the basis that most people's retirement will be provided for by their superannuation?---Yes.

And the development of the MySuper product was one that was intended to provide for a simple, low cost way that would be suitable for most Australians?---I think it's intended as a backstop for people who don't want to get more involved in thinking about their future. And so, yes, it provides an important product for – for many
5 Australians. But it is – it is a backstop and on its own for a large number of Australians, a simple MySuper product is not going to be sufficient to give them the retirement that – that they might think they're going to have.

That's your view that for most Australians a simple MySuper product - - -?---I don't
10 know if it's most. We're talking about portions here.

Is that something that Westpac has thought about?---A bit, yes.

And is that something that you have a view about, about whether or not a MySuper
15 product is suitable for most Australians?---I think the MySuper product is suitable and I think it plays a really important role. I think, though, there are a lot of people who think that just because they have a MySuper product their retirement is sorted out, and I'm saying I don't think that's always true.

It may be also that we're being insufficiently specific about it. It may depend who
20 has issued you with your MySuper product?---Yes. Although the concept of MySuper is to put a quality standard around that which we're very supportive of.

And in terms of, then, the benefit of an ongoing fee arrangement to somebody who
25 comes into a Westpac branch, is that something that Westpac tries to put a value on?---I'm sorry, can you just say that again?

Well, people come into a Westpac branch and, as I understand it, your view is you
30 need to have financial planners available so that if they come in they could enter into an ongoing arrangement?---For some people but I'm not suggesting that a financial planning arrangement is appropriate for everybody, by any means.

Does Westpac have a process or any position as to for how many people an ongoing
35 fee arrangement is appropriate?---Not a specific number, no.

Does it have any way of evaluating the value of an ongoing fee arrangement to
customers?---Not in a quantitative sense that I can point to, no.

Do you know how advisers within Westpac assess whether clients need an ongoing
40 service?---At a high level I have a view on it, but I don't know if we have a specific exact framework for that or not.

Well, you – you have a policy. I can show you it if that would help. Can we bring
45 up WBC.119.001.0011. So this is the policy – and this is for your employed advisers?---Yes.

In relation to ongoing advice services. And if we go to page .0012. And you see, at the very top of the page, 2.2, Key Points?---Yes.

Continuing:

5

You should only offer to provide an OASA when (i) you are satisfied that you are able to discharge your obligations under the OASA; (ii) it is in the client's interests to have an OASA; and (iii) it is appropriate to their needs and expectations.

10

?---Yes.

And beyond this policy, are you aware of any other guidance that Westpac has as to whether an OASA is appropriate for a client?---Not specifically, but I would assume that that's part of the training for the financial advisers.

15

Are you aware of how Westpac evaluates whether or not clients who have gone into an OASA should have gone into an OASA?---Well, my understanding is that would be part of the pre-vet process that we go through and the quality assurance process we go through when we look at the files, the statements of advice.

20

Do you know whether Westpac has performed any analysis to try to determine what the characteristics are of customers in a general way for whom an ongoing advice service agreement is appropriate?---No, I don't.

25

Does that seem surprising to you?---I'm not saying it hasn't happened. I'm just saying I'm not aware of it.

30

You just don't know?---No, I just don't know.

I just wonder when you're forming a judgment about whether it makes sense for Westpac to continue with a financial planning business, whether, necessarily, part of that is trying to figure out how many of our customers actually genuinely need to have an ongoing advice agreement?---Yes. That – that forms a part of it, certainly.

35

And when you say “that forms a part of it, certainly”, is it something then that you've taken into account thus far in your thinking?---Well, I – I've said publicly recently that we're thinking through how we make advice available to different segments of customers, and implicit in that statement is that we have to look at the different segments and understand where that sort of an advice relationship makes sense for them, as well as for us.

40

All right. Nobody thus far has come to you and shown you an analysis of what sort of – what the characteristics are of your customers that actually require OASAs?---Not specifically, no.

45

When you say “not specifically” - - -?---Well, we generally have a conversation about the fact that advisers tend to be more suitable for more affluent customers who are more actively engaged in their investments, have more complex needs, and so there’s a general understanding that, in any event, financial advice is likely to be targeted at the – at the upper end of our customer base.

And if a customer comes into a Westpac branch, would you expect that, ordinarily, they would be directed towards a financial planner within the branch?---Not unless they expressed needs that suggested they had a more complex requirement, or had that interest.

Does it seem very likely that the people with the level of affluence for whom an ongoing advice arrangement are appropriate is likely to be coming into a branch to talk to somebody on the front desk about where they can see a financial adviser?---Many of them do, not the front desk per se if you’re talking about the tellers, but many of our customers have personal bankers who look after their needs and in the course of those discussions, issues would come up where they would say, “Really, you know, it sounds like you should talk to an adviser.”

I see. I want to now move to a more general topic in relation to the bank assurance model.

THE COMMISSIONER: Are you putting in this service policy, Mr Hodge?

MR HODGE: Yes, Commissioner, thank you. I tender that.

THE COMMISSIONER: Westpac ongoing advice service policy WBC.119.001.0011, exhibit 7.55.

30

**EXHIBIT #7.55 WESTPAC ONGOING ADVICE SERVICE POLICY
(WBC.119.001.0011)**

MR HODGE: Thank you. Does Westpac aspire to increase the share of its customers’ wallets?---Yes.

And is one aspect of that that Westpac aspires to increase the number of its products that are held by each of its customers?---That follows, yes.

40

Now, there’s traditional banking products, things like mortgages, credit cards, lines of credit, everyday transaction accounts, deposit accounts, all those sorts of ordinary banking products. Presumably, those are one type of product that Westpac aspires to have its clients acquire more of?---Yes.

45

And there are then other types of products that, over time, Westpac, like the other big four, has moved into, which are wealth management products and financial advice and insurance?---Yes.

5 In terms of where the point that you have reached, as I've understood what you've said yesterday and, to an extent, this morning, Westpac has recognised that there is a potential for conflict or the potential for the perception of conflict between both owning and operating the wealth product manufacturer and owning and operating the advice business?---Yes.

10

And it has made the decision that in order to address that potential for conflict, or perception of the potential for conflict, that it will – or it has exited from the manufacture of wealth products?---Asset management products, yes.

15 And that has involved the divestment of BTIM?---Yes, although we've done that in several steps, but yes.

And you've commented already about your thinking at the moment about your advice business, and that that's something you're thinking through?---Yes.

20

And then in relation to insurance, what's Westpac's view about whether it ought to stay in insurance?---Well, it depends which aspect. So many of the times when a customer needs insurance correspond with when they're doing something related to their banking. So we would like to be able to offer good value insurance products to customers at those times. The extent to which we want to manufacture that product itself depends on the product category.

25

So in relation to home insurance, that's something where you're comfortable that you can do it well?---At this point in time, yes.

30

But in relation to some other insurance products, life insurance?---Life insurance we still manufacture.

I see?---Auto insurance we don't.

35

Is it important, do you think, that banks do more than their traditional role of accepting deposits and offering finance?---I think possibly, and I'm happy to explain the rationale for that, if you like.

40 Yes, please?---So the way we think about this business is that banking is ultimately an annuity business, the value comes from having long-term relationships with customers, and that that is – it's best thought of as a service business rather than a product business. And so we grow the value of the company over time by encouraging people to deal with us for the full range of their needs over their
45 lifetime. And that's what we're trying to do. And – and so in thinking that through we want to be able to support them at different times of their life, and as people go through their lives, the nature of what they need changes. They develop often very

good relationships with our bankers, who they come to, want to talk to when they're making big decisions in their life. And so our view is that if we can do a good job of helping people over time, then that will lead to them doing more with us. But it's not about selling a particular product at a particular time, it's about building a
5 relationship where they come to us over the years and – and continue to come back when they need something else.

Ultimately, you generate profit by having more customers acquiring more products over a period of time from you of a higher value?---Yes.

10 Do you think that - - -?---If I can just clarify that, but the value can – can go up and down for an individual relationship over time. It's not just add more products, more products. It's what does the customer need at that point in their life. The value is in the duration of the relationship.

15 Because – and I think one of the points you're getting at is you – when we talk about this idea of aspiring for a share of a customer's wallet, what you don't want is somebody after five years switching from Westpac and going over to one of your competitors?---Correct.

20 You don't want to lose the, effectively, the profit from that customer?---Correct.

Understandably - - -?---Yes.

25 - - - because you are a profit-making business?---Yes.

And do you think that from the consumer's perspective, the way in which Australian banks have gone into wealth management has been a success?---I think at a high level, clearly not.

30 And what does that suggest to you about the bank assurance model?---I don't think banks fully thought through how the model needed to evolve to be consistent with being part of a service business that focuses on long-term relationships.

35 Is it the case, do you think, that the movement into wealth management assumed a capacity on the part of banks to provide compliant financial products and financial advice – I'm sorry, not financial products, I will say wealth management products and financial advice when, in reality, the expertise of most banks is only in providing compliant deposit accounts and loans?---That's one way to look at it. I – I think
40 banks just under – underestimated how – how different the models were and how the model needed to evolve to be consistent with the way banks should run themselves.

And is that a way of saying that in trying to seek this growth outside of their traditional areas, what the – or what the largest of Australia's banks failed to recognise was the subtleties of some of these other markets?---Yes. I mean, insurance, for example, traditionally was – you referred previously to the commission model and the – that they were distributors. Over – through the nineties

and the early 2000s, the insurance brokers started calling themselves financial planners. I think banks made assumption about the way that they went about that business, thought that it would sit neatly within the framework of banking, and clearly underestimated how much change was – was going to be required to make that work.

Do you think that, to return to something we've touched on a number of times, that high quality financial advice is ever going to be something that is affordable for ordinary Australians?---I think, potentially, if it's done through technology.

Could you just explain what you mean by that?---So there are a number of developments around the world in what's sometimes colloquially referred to as robo advice which is where a customer essentially self-serves by putting in their information, taking tests around their risk appetite, their understanding of finance, and then the system, based on what they've put in, says, "Well, given what you've told us, here's what the system would suggest." And then it's up to the customer to decide whether they want to go ahead with that. I think developments in that regard are going to become more available and – and be more scalable for ordinary people.

That, though, then is something very different from this model of a professionalised financial advice service?---Yes.

We're talking about now professional financial advisers potentially competing in the future with, effectively, computers and algorithms?---Well, I think it will be different – horses for courses. Different approaches for different segments.

If Westpac is not manufacturing wealth management products, what is the financial proposition for Westpac shareholders in continuing to have an advice function?---It's more challenged.

That seems like a very understated answer, perhaps deliberately. You mean it's difficult to identify exactly what the purpose is of holding an advice business if you're not manufacturing the investment management?---Well, it's more challenging, in the sense that we – we genuinely do have a large number of customers who are very happy with their advisers. We have a large number of customers who do – it's not all customers by any means but we do have a significant number of customers who do look to us as a trusted source of – of advice, and we would like to be able to help them with that. So to just walk away from it entirely to a certain extent is to abandon our customers in – in an important respect. Not for all. I'm not suggesting for all but we do have those customers. So we have to work through what's the right approach for the different groups of customers that we have.

I understand. If I can take a few parts of that. One point is there's a certain segment, presumably quite a small segment, but nevertheless a segment of your customer base who values the financial advice that they're being provided with?---Yes.

And if you were to give up all financial advice, then the question would be what happens to those particular customers?---Yes.

5 But, more generally, the reason that no longer manufacturing products makes it more
challenging to continue with a financial advice business is because the advice
business wasn't about providing advice, it was about distributing products?---That's
a – no, not exactly. So we were quite happy, prior to some of the things that we've
gone through in the last couple of years. The decision to get out of, for example,
10 BTIM did not, therefore, imply that we needed to get out of advice. It has been the
rising cost of advice that has – has created the challenge of that. The advice, though,
in itself, was never designed to be a massively profitable exercise. But it was
important, as a – as a service to customers, and going back to my earlier point about
wanting to help people through their lives, we felt it was an important thing to be
able to offer to our customers to help keep them in the family, if you like.

15 Well, again, I don't want to traverse over old ground, but I think the two points
you're making are – three points you're making are (1) there are customers who
benefit from having this service?---Yes.

20 (2) when you owned the actual product or manufacturing the products, then having
an advice business was, although not itself particularly profitable, a useful
distribution mechanism for that – for those products?---Yes.

25 And (3) the big change then that has happened over the course of the last two years is
that there's suddenly a real urgency and significance placed on delivering high
quality compliant advice, and that means the cost of providing the advice has gone
up?---Yes. The only subtlety I would take with that point is it's about the
verification that the quality of the advice has happened, not necessarily suggesting
that the advice itself was poor.

30 I understand. Now, in your statement you make a point which is that conflicts arise
both within and outside vertically integrated financial institutions?---Yes.

35 And you then list various measures that financial institutions may put in place to
manage those conflicts?---Yes.

40 Would it not be simpler to simply avoid those conflicts in the first place?---That is an
option in some cases, but most businesses have the potential for conflict of interest at
some level or another. An independent financial planning industry with a tied
distribution arrangement for a manufacturer has a conflict. You know, there are –
you can have conflicts in lots of different businesses.

45 I'm sorry, an independent advice licensee, did you say - - -?---I'm saying in – if you
have a standalone advice business, for example, that does a distribution arrangement
with an insurance company, there's a potential conflict in that. So I'm just making
the point that the – the organisational structure itself does not create the conflict, nor
does it protect against the potential for conflicts.

Yes. It's always possible that you could enter into an arrangement if you're an independent advice licensee that could put you in conflict?---Yes.

5 But presumably, if you professionalise advice licensees and they operate like other independent professional services, organisations, then they won't be entering into arrangements that would put them in conflict?---You would hope so but I'm – I think that that isn't necessarily a guarantee that you're not going to still have conflicts.

10 Well, typically, there's a reason why we don't want doctors entering into agreements with pharmaceutical companies - - -?---Right.

- - - to distribute their drugs. Your point is the same thing would apply to financial advisers?---Yes.

15 And so that's something that you think would go along with the professionalisation of the industry?---Yes.

20 And also something that you would think would go along with at least the FOFA bans on commissions?---Yes.

And, in fact, it's difficult – perhaps with the exception of insurance carve-outs, it's difficult to see, isn't it, how those sorts of distribution agreements could be permitted under FOFA?---I agree.

25 All right. So your point then is there is, really, no reason, if you've professionalised advice licensees to allow them to enter into conflicted arrangements?---I'm not sure I know enough about the topic to go that far.

30 I see. When a customer comes into a Westpac branch, do you think what they are expecting is the staff to provide advice or to sell them a product?---It depends – you would have to be specific on what category and it depends what they've come in for.

35 Well, presumably, if they come into a Westpac branch what they're expecting is to be told about Westpac products rather than anybody else's products?---If they're walking in off the street and they're a non-customer and they want to open a relationship with us, then that would be true.

40 And you may or may not have a view about this, but what then is the significance of the distinction between general advice and personal advice when it comes to only offering Westpac products within a branch?---Well, it really goes to the point you were making earlier, that for many customers their needs are relatively simple. And going through the full process of giving personal advice and all the controls and documentation you need to put around that, can be cost prohibitive for many ordinary Australians. One of the core ideas behind FOFA was the creation of this
45 general advice category which was designed to make it much simpler to be able to – to provide simple products for people in an affordable way without tripping into all the obligations of personal advice.

I understand. Commissioner, is that a convenient time to take a five minute break?

THE COMMISSIONER: Yes. If I come back at 11.

5 MR HODGE: Thank you.

ADJOURNED

[10.55 am]

10

RESUMED

[11.01 am]

THE COMMISSIONER: Yes, Mr Hodge.

15

MR HODGE: Thank you, Commissioner.

Mr Hartzer, I want to move to two last topics which come out of – each of which come out of the submissions that Westpac has made in relation to the interim report.

20 The first is about variable remuneration - - -?---Yes.

- - - in banks. You would accept that remuneration and incentive structures are capable of encouraging poor conduct?---Yes.

25 If they're poorly designed?---Yes.

And Westpac has recently changed its incentive structures in line with the Sedgwick recommendations?---Yes, we have.

30 And for retail bank employees, financial measures attract a maximum weight of 30 per cent when calculating variable reward payments?---That's right.

Westpac has addressed in its submission – and it may be useful to bring this up, the doc ID is POL.9100.0001.0906. And if we go to page 7 and paragraph 16. And the first point that Westpac makes at the beginning of that paragraph is that:

35

Westpac remains of the view that it is appropriate and consistent with all relevant stakeholders' interests for some component of variable reward to be based on the employee's measurable contribution to the financial performance of the company.

40

?---Yes.

And in terms of frontline staff, their contribution to the financial performance of the company will ultimately be about having more customers take up more products of value which, as you say, may vary over time but from Westpac?---That's one way to characterise it. It's also about growing the number of customers that we have, the –

45

managing the deposit relationships, as well as the balance. So it's balances, it's retention. It's not just selling widgets.

5 No, I understand. There's a difference between a widget and a banking product is your point?---No, my point is that a lot of the activity that our people are about retention, about helping people manage their money better which ultimately generates a larger balance sheet, more value for the company, yes, but this often gets characterised as sell more products and that's – that's not all of what they're focused on, and it's – so in other words, they add value through retention activities and supporting customers, not just through the process of selling them another product.

10 And when you speak about rewarding or having a financial measure that is – has a maximum weight of 30 per cent, how does that take into account retention activities?---So the measures that we use – it depends on the role but the measures we use now will be about net growth in deposits, for example, net growth in customer numbers, and so that net reflects the fact that, yes, you're getting new customers to join us but you've also got to look after the ones that you've already got.

15 And each of those types of things, of net growth in customer numbers, net growth in deposits, that would be included as part of a financial measure?---Yes.

Presumably, another measure might be net growth in loan balances?---Yes.

20 And all of those things, all of those types of net growth contribute to the improved financial performance of the company?---Yes.

25 And what Westpac wants to do is to incentivise its staff to, first, achieve those types of net growth and, second, by achieving those net growth contribute to the financial performance of the company?---I'm not sure I quite understand that construction.

30 I'm sorry, what – I will take it in parts. What Westpac wants to do is to incentivise its staff to contribute to that net growth of deposits, net growth of customers, net growth of loan balances?---Yes.

35 And ultimately, from the shareholders' perspective, that's in the interests of shareholders?---Yes.

40 And sometimes the framing of this can make it appear as if the banks are just pushing products on to people and people don't want the bank's products, but presumably, your view is, quite obviously, people do want our products?---Well, my point is that the way that – as I said earlier, we view this as a service business. It's an annuity business. You want people to bank with you over their careers, over their lives, and they will have different needs through that period. And so you, yes, want to encourage them to consolidate their business with you and stay with you over time, and that grows the long-term value of the company.

Just stepping back a bit, from the perspective of a customer, or from most Australians, Australians want mortgages, they want to be able to deposit their money in accounts, they want a credit card, they want home insurance?---Actually, the way we talk about it is they want to buy a home, they want to manage their money, they want to have a good retirement, they want to be able to afford a lifestyle. Now, that's an important point because that's actually the way we run our business is thinking about how we help people buy homes. The mortgage is an element of that process but it's not the full process. Just like internet banking is a critically important part of what we offer to people to help them manage their money. We charge nothing for internet banking. So, yes, when you get a – an everyday banking account you have a margin on that where you earn money on that but that money provides support for the full range of the service we're providing.

I understand. The point I'm trying to get you to agree with, which I don't think you – I think you do agree with is you are offering products that people want?---Yes.

And for them, acquiring those products is in their interest, for the reasons that you've talked about; they get a mortgage so they can buy a home?---Yes.

And for you, it's in your interest to be able to sell those products to them because you generate a profit and that's good for your shareholders?---Yes.

And the more products and services that Westpac is able to sell, the greater the returns to its shareholders?---Just the subtlety of that is it's not the number of products, it's the depth of the relationship which may or may not mean another product.

And - - -?---The broad – I'm just taking issue with the way you frame that because it's often viewed, as you said, that we're trying to flog products. That's not what we're trying to do.

Well, there's two aspects to it, isn't it? One is you want growth in the number of products and the number of customers?---We want growth in the depth of the relationship, that is, the number of products can be an element of that but it is not synonymous.

I think – I think a cynical person might think you don't make any profit simply from having a deep relationship with somebody. The deep relationship that you're talking about means something in financial terms to Westpac?---In the sense that people consolidate their holdings with us. Yes. That doesn't mean necessarily more products.

And what you – well, what you mean by a deep relationship is that people will come to Westpac for their banking needs rather than going to another bank?---Yes.

And so the deep relationship has, can I suggest, these aspects to it: that people will, if they need them, acquire more products from Westpac?---Yes.

And people won't choose to leave Westpac and go to another company?---Yes.

And you want to incentivise your staff to try to achieve those outcomes, that is, people acquiring more products if they need them and not switching over to other companies?---Yes.

And one of the ways in which your frontline staff might be able to do that is to do the things that everyone is always complaining about in relation to banks, which is to offer good service?---Yes.

And one of the ways in which at a technological level you might be able to do that is by having a high quality internet banking platform?---Yes.

And so that's a reason why you might also have some sort of financial measure relevant to the variable remuneration for those employees who are dealing with the development of your technology platform?---I am sorry, you lost me.

Well, you want – you want the employees who are developing your technology platform - - -?---Yes.

- - - to produce a platform that will encourage customers to come to and stay with Westpac?---Of course.

And in that way, the – that will contribute to the financial performance of Westpac?---Yes.

And you, therefore, want to incentivise your employees to achieve the high quality platform which you measure based on the financial performance?---I'm sorry, you lost me again.

Let me - - -?---I'm trying.

No, I know. It's my fault, Mr Hartzer. You have financial performance metrics for effectively all of your employees. There would be some - - -?---They're different.

- - - within risk that are different?---Generally, yes.

And the reason that you do that is because you want to incentivise them to contribute to the financial performance of the business?---Yes, but maybe I should just clarify. By financial metrics, the people building our mobile banking platform are not given financial revenue targets necessarily unless they're particularly involved in some aspect that generates revenue.

I see. As it moves up, though, the organisation – so once you get up to the higher level people that will be in charge of the section developing that sort of technology, they will have financial metrics?---Again, it depends where you draw the line. I'm

not trying to be difficult but if you're talking about the technology department their metrics are going to be quite different than the retail bank.

Let's just stick with frontline staff?---Okay.

5

The point that you're trying to make by your submission is that it is that variable reward is effective at incentivising the behaviour of staff?---It can be, yes.

If you reward somebody based on a particular outcome, then you expect an increase in whatever the metric is for that outcome?---Broadly speaking, yes.

10

And for a bank, the way to increase financial performance is to get – one of the ways is to get a customer into a product?---That's one of the ways, yes.

And one of the things that Westpac wants is more customers acquiring products that they want within the risk appetite of Westpac?---Yes.

15

And, therefore, variable reward is a way of incentivising your staff to contribute to that outcome?---Yes.

20

And the challenge then that you've recognised already is that variable reward can encourage poor conduct in order to achieve the outcomes?---If it's structured badly, yes.

And the problem is it's easy to measure pure financial performance?---Yes.

25

And it's much more difficult to measure other things relating to behaviour?---It can be.

And so in terms of your position about variable remuneration, your position is we should be able to continue to offer variable remuneration, but we have to have the right process to be able – within that structure to be able to ensure we're not incentivising poor conduct?---Yes.

30

And that there's nothing inherently wrong with variable remuneration, is your point?---Yes. Our view is if it drives – if it can drive bad behaviour it can also drive good behaviour if it's structured well.

35

And the challenge then is trying to figure out how you drive the good behaviour rather than the bad behaviour?---Yes.

40

The alternative would be to try to drive the good behaviour in other ways?---Well, you need to do that too but I'm not suggesting REM is the only way that you motivate people.

45

Is REM, do you think, a more effective way of motivating people than anything else?---No, I think it's – it's one of the ways that you motivate people, and I would say it's an important tool in the tool kit.

5 How do you think that you develop the right ethical culture within an organisation?---Well, that's a very broad question. I would say it starts with clarity of purpose of the company, and the way that the senior leaders talk about what they're trying to do, and then the way you embed that in what we think of as the hard wiring and soft wiring of the company.

10 I want to then move to another topic coming out of your submissions. It appears that Westpac opposes many of the potential reforms that are raised in the interim report?---You would have to be specific.

15 All right. It opposes preventing authorised representatives from recommending a product manufactured or sold by the licensee?---Yes.

It opposes prohibiting remuneration of financial advisers based on value or volume of sales?---Entirely, yes.

20 It opposes requiring annual as opposed to biennial opt-in notices for ongoing fee arrangements?---Yes.

It opposes structural separation between product manufacturers and advisers?---Yes.

25 In respect of consumer lending it opposes any duty being imposed on intermediaries beyond that proposed by the combined industry forum?---Yes.

It opposes a ban on trail commissions for intermediaries?---Yes.

30 It opposes a ban on introducer programs?---Yes.

It opposes industry codes being given legal or further legal effect?---Yes.

35 And do you think that one of the reasons that Westpac opposes each of those changes is because there will be an effect on the profitability of Westpac's business?---That's – that's a component of it but that's not the main driver. You would have to go through each one and I'm happy to explain our view on them. The way you described that sounds like we're completely opposed to change which we're not, but each of those points has subtleties around them.

40

Is there a culture, do you think, within Westpac that is resistant to change?---No.

45 When APRA initially approached Westpac about undertaking a self-governance assessment, was Westpac happy to do that?---Well, we certainly – are you asking it in the context of the CBA review?

Yes?---Yes. So we certainly expected that we would need to look at the CBA review and understand what the implications were, if any, for us.

5 Well, when – I’m assuming you’ve seen this document. Can we bring up APRA.0050.0001 - - -

THE COMMISSIONER: Can we have the number again, Mr Hodge.

10 MR HODGE: APRA.0050.0001.0253. This is a note by APRA of a prudential consultation between APRA and Westpac?---Yes.

And you’ve looked at this in the course of preparing to give evidence?---I have.

15 Okay. And it’s recording – I’m sorry, you were present at the consultation?---Yes.

And amongst other people, Mr Byres of APRA was present?---Yes.

20 There’s a slight oddity, which is the note for the file is dated 6 August 2018 but the prudential consultation was held back on 9 May 2018?---In this case I remember the meeting so it doesn’t matter what the date was.

You will see that there’s a section at the beginning which is “Observations from the prudential consultation”?---Yes.

25 And the fifth bullet point down says:

Brian thinks unfair everyone has to go through CBA exercise when nothing has gone wrong to CBAs scale.

30 ?---Yes.

35 Was that a view that you expressed at that meeting?---I saw that. I – I don’t think – I don’t recollect saying it quite like that. That doesn’t sound like – I don’t think I would have said it quite like that. My point was CBA had had a series of massive public and customer issues that were well understood, Storm Financial, CommInsure, AUSTRAC. These had been very large, very significant things, and there had been – it had been well reported that those hadn’t been addressed very well. And my point was simply, “We haven’t had that. We have issues. We’re dealing with them.” And my concern was that the very extensive exercise that CBA was asked to undertake by
40 APRA, which was very large and very comprehensive, seemed – it didn’t seem obvious to me why we should have to do the same exercise. I wasn’t resistant to us looking at the issues that came out of the report. In fact, I sent the report to our entire staff and said, “Everyone should read this.” So I – that characterisation is not, I don’t
45 think, a fair summary of how I thought about it.

Well, you can see from the preceding bullet point, the context in which this was coming up was about the self-assessments that APRA was proposing that the other institutions would have to undertake?---Yes.

5 Am I understanding you to be saying you weren't expressing any resistance to undertaking a self-assessment?---No.

10 You were happy to undertake the type of self-assessment that APRA was proposing?---I was happy to undertake a self-assessment. This – my issue was that I was aware that the scale of the self-assessment that CBA had to do was extremely large and that it wasn't obvious to me that we should be required to do the same level of exercise, but I wasn't resistant to us doing one, it was a debate about the scale and the scope and how it was done.

15 And in the end, were you happy with the scale of the self-assessment - - -?---Very much so.

20 - - - that APRA asked for?---Yes. Well, actually, just to be clear, I am very happy with what we ended up doing, which I believe APRA was happy with the way we did it and it was a fantastic exercise.

You found it valuable in terms of understanding your institution?---Very much so.

25 And was there an issue with collective decision-making and collective accountability that became apparent to you through that exercise?---Yes, that was one of the things that came out of it.

30 And could you explain to the Commissioner what that issue was?---Well, my summary of the self-assessment we did is every coin has two sides. And what we found often were things that we often thought of as strengths of Westpac also could become weaknesses. So in the example you give, a strength of Westpac is it's a very collaborative place and people don't generally let organisational boundaries get in the way of working together to create good outcomes for customers, to run the business well. The consequence of that, though, is sometimes where the organisation has been managed through a matrix, that clarity of accountability as to who it is that actually has to make a decision or get something done has become a bit diffused. And so that has been a really – that's something we were – I've been aware of, actually, for a while and been working on but it was something that came out of the report.

40 And does that make it hard, do you think, to bring about cultural change if there tends to be an assumption of collective responsibility?---Well, I think that, in itself, is one of the things that we have to – to address and we're addressing in a variety of ways. I don't think, as a cultural change, I don't think it necessarily gets in the way. 45 The organisation wants to do the right thing, people want to work together to get good outcomes but we've got to work a bit more on structure, and accountability and so forth and in that respect the BEAR regime, for example, has been very helpful.

Commissioner, I tender that document.

THE COMMISSIONER: Prudential consultation note of meeting 9 May '18 dated 6 August '18, APRA.005.0001.0253, exhibit 7.56.

5

EXHIBIT #7.56 PRUDENTIAL CONSULTATION NOTE OF MEETING 9 MAY '18 DATED 06/08/2018 (APRA.005.0001.0253)

10

MR HODGE: It has been very helpful, the BEAR, because you've had to map out the accountabilities of individuals?---Yes.

15 Do you think that the BEAR – or do you view the BEAR as being primarily concerned with prudential issues?---I think it's pretty comprehensive, actually. So no, I would say it's – it's broader than that.

20 Do you think if the – if you view the BEAR as having been helpful in terms of mapping out the accountability as required by the BEAR, that there would be any reason not to expand the scope of the BEAR to make sure that it covers other accountabilities?---Well, I think it's a matter of degree and how much bureaucracy you want to put around the process. I think, in – my view would be in the way that we now drive role clarity for our people through the company at levels below the BEAR accountable executives, it's very much informed by what the accountable executives have to do. So there is a natural cascading that happens anyway and has happened. I'm just not sure whether you would – the formality of the BEAR process applying throughout the organisation would add much more to that.

30 This is - - -

35 THE COMMISSIONER: As to this question of formality, can I just ask you about the role of APRA as prudential regulator. And to distinguish between two roles that APRA might have, that might establish a very formalised elaborated structure. That's one end of the possibilities. Or it may simply use its existing supervision personnel and mechanisms as means and mechanisms of questioning, nudging, inquiring, suggesting, challenging. Do you have any view on whether APRA should play that role, could play that role, or should go to a more formalised elaborated structure?---Well, I have to say I think we're pretty lucky with APRA. I think APRA is a very good regulator that serves the country well and performs its role very well. I think a bit more formality around the BEAR has been broadly helpful. I think it's important that it not devolve into a box ticking exercise which I'm sure we would all agree. But if you start with the premise – and it is my premise – that we set out to do the right thing, we set out to manage our company in a good way. We set out to have a strong balance sheet, we set out to deliver good outcomes for customers. Then an interactive relationship with the regulator where they do poke and prod and it is more back and forth and what do you think about this and we're worried about that, is really helpful and we find that incredibly valuable. And, you know, from time to

time, appropriately, they pull us up where they think we're not meeting a standard and they give us a hard time or take more formal action. That's fine. And I think that's appropriate. But I would not want it to devolve into too formalistic a mechanism, because the – the – again, if you start with my premise that we're trying to do the right thing, having an interactive dialogue is incredibly helpful.

And ultimately, the entity itself bears the immediate and direct responsibility for how it runs itself?---Yes.

10 We start from that premise?---Yes.

And the centrality of that premise can never be denied?---Yes.

15 But how familiar are you with what has been happening in other jurisdictions about prudential supervision starting to take a closer interest in matters of conduct, compliance, regulatory risk, and matters of that kind?---I'm reasonably familiar with it, Commissioner.

20 And is it something that we need to be doing in this country, something that we are doing in this country? Where do you think we are at the moment?---I think – well, clearly there's been a massive hit to trust for the – for the sector and it's really important that we restore that. And I think the regulators and their ability to attest to the fact that they've gotten – gotten into the detail, had a good look, are comfortable, have strong powers to intervene when things are going wrong, I think that's an important part of restoring that trust. I think as with all things, there's a continuum and you can go too far and – and, you know, I'm sure you know what I mean by that.

30 Sure. And should APRA as prudential regulator be able, in effect, unbidden to start challenging the board, the chair of the board, or should it be dealing only with the executive level of the bank? How do you see APRA intersecting with the entity itself? At what levels or level?---I – I think all levels. I think that happens today. The chairman of APRA and the senior APRA people come and meet with our board at least once a year. It might be twice. And there's a formal discussion part of which I participate in and then at some point I leave so they can have that conversation without any executives present. I think that's appropriate. I do think day-to-day the interactions should be with the management because in the – you know, I think there is a danger of asking board to become management. But I think it – clearly the board needs to get comfortable with its responsibilities for overseeing the risk appetite and the risk management framework, and in that they should absolutely have feedback and consultation with the regulators.

Yes. Yes, Mr Hodge.

45 MR HODGE: Thank you, Commissioner.

I want to then explore with you one aspect of the change in culture or Westpac's change in culture which is something we began with yesterday, and that is the relationship between Westpac and ASIC?---Mmm.

5 I think you would be aware that in May of 2015 ASIC held the view that of the big four banks Westpac appears most resistant to ASIC and the laws we administer?---Yes.

10 And that there is a sense that Westpac only tells us about issues when they think we are likely to find out about them through other means, and that they are reluctant to give us any more information than the minimum amount of information?---I'm aware they held that view.

15 And since then, Westpac has taken some steps to try to improve the relationship?---Absolutely. It's really important we have a good relationship with ASIC.

20 And those steps appear to have been relatively recent, in the sense that it was as at June of this year that you were seeking to reset your relationship with ASIC?---I think that has been a – we described that as a more formal step given we had a new chairman, but from the moment I became CEO I reached out to ASIC to try to improve the relationship. But – well, actually, at first I was surprised by that perspective. That was certainly not ever our intent to have that approach. I met with the previous chairman of ASIC shortly after becoming CEO and made it very clear to 25 him that I wanted a good relationship, I wanted to be transparent with them. If he had an issue, this was my mobile number, please call me any time. So that's certainly something we've been working on since I've been CEO.

30 By about May of this year Westpac – I'm sorry, ASIC, I think, had expressed or given feedback to you that while Westpac's relationship with ASIC had improved, at times Westpac did not always engage and behave consistently?---I'm aware of that perspective, yes.

35 And that was part of the reason why you were, again, in June of 2018, looking to formally reset your relationship with ASIC?---Yes.

And ASIC attended Westpac's 19 June 2018 board meeting?---Yes.

40 And sought to – well, we gather, at that meeting there was an attempt by both ASIC and the Westpac board to agree that it was important to maintain a respectful, open, and constructive relationship?---Certainly.

And that's what you're aiming for now?---Absolutely.

45 And do you have – or have you thought about the reason why you didn't have that sort of relationship in the past?---Yes. I think there are a couple of things that have contributed to that impression. And, again, I would say, certainly it has never been

our corporate intent to have anything other than a constructive relationship with ASIC.

5 And what are the reasons that have contributed to it?---There have been a couple of things. I think – we spoke yesterday about the regulatory team that we’ve beefed up. I think historically we had a little – we were a little too centralised in the relationship with ASIC. What that meant was that some of the frontline businesses were not necessarily as plugged in and aware of what was going on or what ASICs concerns were, so there’s a bit of telephone tag going on. And so businesses might do things
10 that ASIC would think, “Hey, we told the company that” but that message wasn’t getting through well enough. So we’ve taken steps to have more direct meetings between the line executives and ASIC counterparts which helps keep that dialogue going. I think that’s – that has been really important. We’ve had a number of significant legal cases. We don’t like to go to litigation if we can avoid it but we
15 have had a couple of occasions where we couldn’t agree and ended up in litigation. And that inevitably, I imagine, colours things. And, clearly, there has been some questions around how we deal with notifying ASIC of matters and breach reporting, and getting more clarity and control of the process of that, which I suspect has contributed, and that, again, is something we’ve taken steps to address.

20 It doesn’t seem as if any of the reasons that you’ve identified are cultural reasons, as distinct from process reasons?---I would agree with that.

25 Have you considered whether – it may now be fixed – but whether there was a cultural issue that contributed to this?---The only aspect that I might put in that category would be around, particularly going back a few years, when we had issues related to a particular staff member or something, and legal privilege was looked at before communication to ASIC happened. And so there may have been a sort of over – I know one of the issues we’ve done to try to address the breach thing has
30 been to talk about how we can limit the number of cases when legal privilege would be claimed in the process of working through an issue.

35 The breach issue is this, is it, that in about June of this year ASIC provided Westpac with feedback about report 594?---Yes.

That’s 594 is the Review of Selected Financial Services Groups’ Compliance with the Breach Reporting Obligation?---Yes.

40 And ASICs feedback to Westpac was, first, that Westpac had reported fewer significant breaches than other entities and those breaches had more affected customers and higher financial effects?---Yes.

45 And second, ASIC thought this was because Westpac applied a higher threshold when interpreting the meaning of “significance”?---Yes.

And I think I said two. There's a few more. Third, Westpac's ability to readily identify non-significant AFSL breaches is constrained compared to the rest of the industry?---Potentially.

5 That was ASICs - - -?---Right.

- - - feedback to you?---Yes.

10 Fourth, ASIC was concerned about Westpac's ability to get matters into the pipeline?---Yes.

And do you agree with those observations from ASIC?---Well, I think they are statements from ASICs perspective. So in that sense, I – I agree with them, although I think there are other aspects to the breach process.

15

Do you think Westpac applies a higher threshold to the significance test compared with other institutions?---Well, until that report we didn't have any visibility about how other banks did it, and we certainly have said – and I think we've said in our submission that more clarity as to what definition of "significance" – what the definition is would be very helpful. We think that would be a useful reform. I would add, though, that we have, nevertheless, increased the number of voluntary disclosures to ASIC. So significant breaches are not the only times that we alert ASIC to issues, and the number of voluntary notifications, even if they weren't classed as a significant breach, has included in that. Those numbers are not in that report.

25

Do you think that the results, and particularly the difference between Westpac and other institutions says anything about the extent to which Westpac has historically engaged with ASIC?---I don't think so. I think this is about process and clarity of – of protocol for dealing with things. It certainly doesn't reflect any lack of intent to have a good and open relationship with ASIC.

30

When you think about the difficulties that occurred with credit card limit increase offers back in 2012 through to 2014, and these breach reporting issues and the history of litigation you have with ASIC, do you draw any conclusions about culture within Westpac from that?---I don't.

35

Do you wonder whether collective decision-making might encourage attributing problems to being process problems, rather than cultural problems?---Not necessarily. I – I could see that collective decision-making could have contributed to slowing down the process of working breaches through the system. And – and I – I can completely understand why from ASICs point of view, if it's taking longer for breaches to come, they can draw the conclusions that you describe. My perspective, being in the organisation, is it's not a lack of intent but that collective decision-making and not strong enough process around breach reporting could have contributed. It's something, as I said before, we're trying to fix.

45

Thank you, Commissioner. Nothing else.

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

5

<RE-EXAMINATION BY MR SHEAHAN

[11.39 am]

MR SHEAHAN: Just two matters if I might, Commissioner.

10

Yesterday, Mr Hartzler, you were asked about ASIC writing to the bank in 2014 in relation to the CLI problem?---Yes.

15

And at – this is at transcript 6794 to 6795. And you disagreed with the proposition that ASIC intervened in 2014 because it had discovered then that you had changed two years before?---Yes.

20

And you said you thought you had seen a document that mentioned that ASIC was aware of the processes that you were following?---Yes.

25

Can I ask you to look at this document, please. ASIC.0010.0005.0489. I just want to draw your attention, Mr Hartzler, to the text commencing at the bottom of that first page. You will see it's a letter from ASIC to Westpac of 13 January 2014. And over to the top of the next page, to the end of the second full paragraph. Now, the next page is page 2, which is 0490. Thank you?---Yes.

30

Is this the document you had in mind?---I suspect so. That paragraph starting "As a result of previous discussions" I think is what was in my mind when I said that.

35

Thank you. Commissioner, this morning Mr Hartzler was asked about the document that became exhibit 7.55 that dealt with current policy in relation to ongoing advice. I was going to simply tender, if I might, a document which just gives a slightly fuller statement of the current policy on that topic in case it assists. It's WBC.119.001.0001. And the text, in particular, dealing with the subject he was examined about is at 0002.

THE COMMISSIONER: The ASIC letter to Westpac of 13 January '14, ASIC.0010.0050.0489, exhibit 7.57.

40

**EXHIBIT #7.57 ASIC LETTER TO WESTPAC DATED 13/01/2014
(ASIC.0010.0050.0489)**

45

THE COMMISSIONER: The ongoing service arrangement policy, WBC.119.001.0001, exhibit 7.58.

**EXHIBIT #7.58 ONGOING SERVICE ARRANGEMENT POLICY
(WBC.119.001.0001)**

5 MR SHEAHAN: Sorry, Commissioner, I meant to tender the two documents.
Thank you, your Honour.

THE COMMISSIONER: Thank you, Mr Sheahan. Anything arising out of that, Mr
Hodge?

10 MR HODGE: No, thank you, Commissioner.

THE COMMISSIONER: Thank you very much, Mr Hartzler, you may step
down?---Commissioner.

15

<THE WITNESS WITHDREW [11.43 am]

20 MR HODGE: Commissioner, can we take a break for five minutes, Commissioner,
and change around the parties or would you like to take a longer break?

THE COMMISSIONER: No. Well, yes, but no. Shall we say 10 to midday.

25 MR HODGE: Thank you, Commissioner.

ADJOURNED [11.43 am]

30

RESUMED [11.50 am]

THE COMMISSIONER: Yes, Mr Hodge.

35

MR HODGE: Commissioner, the next witness is Mr Moore. Mr Rich will be
leading his evidence.

40 **<NICHOLAS WILLIAM MOORE, SWORN [11.50 am]**

<EXAMINATION-IN-CHIEF BY MR RICH

45

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

MR RICH: What is your full name?---Nicholas William Moore.

And what is your business address, Mr Moore?---50 Martin Place, Sydney.

5 Are you attending this Commission in response to a summons?---Yes, I am.

Do you have that summons with you, Mr Moore?---Yes, I do.

Commissioner, I tender the summons to Mr Moore.

10

THE COMMISSIONER: Exhibit 7.59, the summons to Mr Moore.

EXHIBIT #7.59 SUMMONS TO MR MOORE

15

THE COMMISSIONER: Yes.

MR RICH: Mr Moore, have you signed two statements in response to requests from
20 the Commission?---Yes, I have.

Do you have both of those statements with you?---I do.

Is one of those statements headed Rubric 7-06 and dated 19 November 2018?---Yes,
25 it is.

Are the contents of that statement true and correct?---Yes, they are.

I tender that statement, Commissioner, which has been given the ID number
30 MGL.0043.0005.0001.

THE COMMISSIONER: That statement concerning Rubric 7-06 becomes exhibit
7.60.

35

**EXHIBIT #7.60 STATEMENT OF MR MOORE CONCERNING RUBRIC 7-
06 DATED 19/11/2018 (MGL.0043.0005.0001)**

MR RICH: I also tender the exhibits to that statement, Mr Commissioner, subject to
40 non-publication direction 419 which you made on 14 November.

THE COMMISSIONER: Those can form part of the exhibit. Yes.

MR RICH: Mr Moore, is the second of your statements headed Rubric 7-16 and
45 dated 19 November 2018?---Yes, it is.

Are the contents of that statement true and correct?---Yes, they are.

I tender that statement, which has been given the ID number MGL.0043.0005.0042.

5 THE COMMISSIONER: That statement and its exhibits in relation to Rubric 7-16 becomes exhibit 7.61.

10 **EXHIBIT #7.61 STATEMENT OF MR MOORE AND ITS EXHIBITS IN
RELATION TO RUBRIC 7-16 DATED 19/11/2018 (MGL.0043.0005.0042)**

MR RICH: May it please the Commission. Thank you, Commissioner.

15 THE COMMISSIONER: Thank you very much, Mr Rich. Yes, Mr Hodge.

<CROSS-EXAMINATION BY MR HODGE [11.53 am]

20 MR HODGE: Thank you, Commissioner.

Mr Moore, you've been the managing director and CEO of Macquarie Group Limited since 2008?---That's right.

25 And you started at Macquarie in 1986?---That's correct.

You will be finishing as managing director and CEO at the end of next week?---That's correct.

30 And so by the time you finish with Macquarie you will have been there for 32 years?---A little bit more but yes, that's correct.

35 And is that length of tenure at Macquarie usual or unusual for the institution?---For the senior members of the executive committee, it's not unique. We have a number of other senior executives with a similar period of service.

40 And do you have a view about how the longevity of senior executives at the company affects the culture of an organisation?---Yes, I do.

And what is your view?---I think – certainly from our viewpoint, we very much see the relationship between the employees and the shareholders as a long-term partnership. And we are very focused on the long term.

45 And, therefore, if you have senior executives who are there at the company for a very long time, their interests, their long-term interests align with the shareholders' interests and the customers' interests?---That's correct.

One of the points you make in your statement is that you are reluctant to make some general comments outside of the confines of Macquarie, and your point is, effectively, your professional experience is confined to the Macquarie Group?---That's – that's correct.

5

What I want to try to do then is to first just try to tease out some of the differences between Macquarie and some of the other institutions that we've been looking at. And so I want to do two things. First, deal with the nature of Macquarie's business and, second, deal with the enforceable undertaking that was given by Macquarie Equities Limited and then we will move to some other topics. Macquarie, I think you say in your statement, opened its doors in 1969?---That's correct.

10

And as at 31 March 2018 it's operating in over 25 countries?---That's right.

15

It has a market capitalisation of \$39 billion?---Yes, correct.

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

20

Consolidated net assets of approximately \$18.2 billion?---Correct.

And assets under management of just shy of \$500 billion?---Yes. Correct. It's a little bit more than that now, but yes.

25

And the business of Macquarie – of Macquarie Group has five divisions?---That's correct.

One of those divisions is the banking and financial services division?---That's correct.

30

And that would seem to be the division most comparable to some of the other institutions that we've been dealing with?---That's correct.

And within that banking and financial services division, you offer personal banking, wealth management, and business banking?---That's right.

35

And it may be helpful just to put this in the context of the rest of the Macquarie business if we bring up your statement in response to Rubric 7-06, so that statement should be MGL.0043.0005.0001. And if we go to page 3 of that statement. And this is figure 2 where you've broken down the five divisions and their respective Australian and New Zealand and international income?---Mmm.

40

And we gather the point you're making in this figure is that for the other four divisions, they – a much higher percentage of their income comes from overseas compared to Australia?---That is correct.

45

And also – and this will become more apparent if we then go over to page 4 and look at figure 3 – if we just blow up figure 3, we see that the contribution of that banking

and financial services group to Macquarie Group's operating revenue and income is only 15 per cent of operating income and 11 per cent of net profit contribution?---That is correct.

5 And - - -?---I should just point out, though, we have within our CAF division there is a car leasing division as well. That is an Australian - - -

That's your capital asset finance?---Yes. That's right.

10 I'm sorry, corporate asset finance. And within the banking and financial services division sits Macquarie Equities Limited?---Correct.

And you make a point in your statement which is Macquarie Equities advice business contributed .5 per cent of Macquarie's profit in the 2013 year?---In net profit, that's correct.

15

Net profit. And how does that compare to its current level of contribution?---It wouldn't – it wouldn't be a lot larger today. It would be larger but not a lot.

20 And what is the strategic value of Macquarie Equities advice business to the Macquarie Group?---When we first acquired the broker – well, taking a step back, the – the – it – the business was a stock – retail stockbroking business largely. It was built by buying a range of retail brokers around the country. And part of the thinking – part of the rationale back in the nineties when we acquired these brokers is it would be a good support for our wholesale equity capital markets business. So in our equity capital markets business we underwrite capital raisings for companies and we then distribute it, and the view is that we had something to add to the retail market by being able to provide these sorts of issues to the market.

25

30 So if you think about the competitors to the Macquarie Equities advice business, given that it has come out of those types of stockbroking roots, who would the major competitors be?---Well, it would be the smaller – it has changed over the while. I mean, you know, it has been an evolving story, obviously. So there was a period where most of the international investment banks would have had a retail offering of some sort. Now, many of those have stepped back in recent years from that. So some would have them and some wouldn't. So I really couldn't give you an accurate answer on that today.

35

I understand. The point, though, I think, where this goes is to say Macquarie is not a retail bank that has then acquired a wealth management division. Macquarie is an investment bank that has acquired a stockbroking arm?---That's right. Largely.

40

And what happened in 2012 was that ASIC identified some advice misconduct and cultural failings at Macquarie Private Wealth?---That's right. We entered into an enforceable undertaking with them.

45

After ASIC had conducted some surveillance and identified issues?---Yes.

And you've explained at paragraph 12 of your statement, 7-16, that the concerns included the effectiveness of Macquarie Equities licensee risk policies, processes, controls and systems?---Yes, that's correct.

5 Compliance with obligations regarding the provision of personal advice?---That's correct.

Whether representative conduct had been dealt with consistently and appropriately?---That's correct.

10

The adequacy of record keeping?---That's correct.

The effectiveness of monitoring and supervision?---That's correct.

15 Whether compliance, training and education had taken place?---That's correct.

The identification, recording, assessment and reporting of breaches?---Yes.

20 We can see that there now. And whether Macquarie Equities management had failed to foster and maintain a proper commitment to a culture of compliance?---That's correct.

25 Now, initially when ASIC raised the issues or these concerns, did they – I'm sorry, I withdraw that. When ASIC raised these issues and concerns and before the EU was entered into, were they brought all the way up to the attention of you and the board of Macquarie Group?---Yes. We heard from the business that ASIC was reviewing the operations of the business from the business, so the business advised us of that. Then there was a meeting, as I recall, with our central compliance and chief legal counsel with ASIC who went through their statement in terms of their view of the shortcomings of the business.

30

And do you recall whether there was an initial reluctance to accept ASICs conclusions that there were fundamental problems in the business?---I think there was – there was questioning. There was questioning.

35

Was that questioning by the business or questioning by you and the board?---There was questioning by the business, which resulted in us having the central functions directly review the situation by, I think, spending a weekend going through the files and the – and the evidence that was being discussed.

40

The central function is what?---Legal and compliance.

Legal within Macquarie Group rather than within Macquarie Equities?---That's – that's correct.

45

And was the view initially of the business that ASIC just didn't understand the business?---I think the – as I recall, the view from the business was there is an

5 evolution taking place across the market, and – and the business was part of it where firms were moving from a traditional stockbroking world into – into a modern world of providing independent financial advice, and that the systems – they had put in place systems, they had put in place training, and the – that was transforming the nature of the – of the brokers into independent financial advisers. And it was a – an evolution taking place across the market, and that we were, in the business’s mind they were leading – one of the leaders in terms of that development in the marketplace.

10 And what happened after the central – centralised function reviewed the business?---They spent a weekend reviewing the files and they came back and reported that they thought there were – there were issues here, and so we engaged with ASIC seeking the – seeking the – to discuss the enforceable undertaking.

15 And you’ve, presumably, considered then and have considered now what the root causes were of the issues with the business?---Yes.

20 And in your statement you identify two root causes. Can you explain what, in your view, was the first of those causes?---The first is along the lines you’ve raised already, that there was an evolution taking place from a – a retail stockbroking business which had a relatively limited focus, to a – an advice business. So that evolution was – was taking place. It was the rate of that evolution and the need for that evolution to happen faster than it did. The failing in the business is that we didn’t recognise – the business didn’t recognise that they weren’t – they – they weren’t provide – they hadn’t moved the business as fast as they were required to do it. So within the business, they didn’t see that. And – and, thus, we ended up where we were.

30 And is one of the issues that became apparent that, at least within Macquarie Equities Limited there was a cultural difference between those who were stockbrokers and had come out of the stockbroker model and those who were the smaller number of financial planners in the business?---Perhaps, but I don’t think that was the main cause. The main cause, I think, was just a lack of recognition of the issue, that people understood there was a change necessary. They thought they were engaged in making the change take place. They just didn’t realise the urgency and the importance of actually delivering on that. So I think there was a – a failure of recognition by management of – of the situation that we faced.

40 And what was the second root cause?---The second – well, one is – is management. Secondly, from a structural viewpoint we had compliance reporting into the business itself. And that was a – a failure of design that compliance should be independent of the business so it can actually provide a – a challenge to the business of the way the business thinks about the world and the requirements they need to meet.

45 Now, the ways in which those things were addressed were under the EU Macquarie Equities was required to conduct an assessment of its licensee risk framework?---That’s correct.

5 And what was the purpose, as you understood it, of assessing the licensee risk framework?---To determine the risks that we had in the business by its very nature, and to see what we had in place to manage those risks, and to identify the deficiencies between the risks that were there and the controls we had around those risks.

10 Consistent with some of the points you've been speaking about, when those issues were – when the initial assessment occurred, it showed a number of problems in relation to risk where there were risks that were very high and where the controls were weak?---That is correct.

15 And it may be helpful if we bring those up. Can we bring up exhibit NM-04, tab 2 to the statement which is 7-16, and the relevant pages we want to go to are .0119. The initial doc ID is MGL.0001.0002.0105. So this is the licensee risk framework assessment that was conducted in April of 2013, as required by the EU?---So I believe.

20 And if we go to page .0119. We can see the summary of the high level assessment results setting out the various types of issues that had been identified, the risk being advisers do not provide financial advice in a compliant manner, that advisers provided advice which is inappropriate, advisers provide financial services to clients without the express instruction of the client, etcetera?---That's correct.

25 And Macquarie also engaged Deloitte in order to undertake a risk culture review?---That's correct.

And that report also painted a concerning picture about the risk within the business?---The risk culture, correct.

30 And in your view, what did it show fundamentally about the risk culture within Macquarie Equities Limited?---Well, there were a number of findings in the report. And these – I mean, I wasn't a direct recipient of the reports, but the – the story – I don't know if you are going to bring it up but it's a pretty clear story of a – a lack of control, a lack of challenge. I think one of the expressions used is freedom without boundaries. That general nature of a – an environment.

40 And the consequence then, having done this licensee risk – licensee risk framework assessment and also having the Deloitte report in relation to risk, was that Macquarie then went about attempting to make a number of changes in relation to the risk culture within that business?---Certainly.

45 And some of those changes were structural changes?---That's right. Fundamental changes to – not just the culture but the – the – all elements of the organisation. We changed the management, obviously, of the organisation. We changed compliance reporting, we made it report centrally. We embarked on a whole range of new systems, processes and procedures in terms of how the business managed itself, and,

of course, as part of the EU we sought to compensate any clients who may have suffered.

5 And I think in your – in your statement you summarise those changes as having – or there being three key changes. The first one you identify is the replacement of individuals within management within the business?---That's correct. As I said, changing management, correct.

10 And is it your view that the approach to risk being demonstrated by those individuals was different and outside of appetite compared to the approach to risk that, say, is demonstrated at the senior executive level within Macquarie Group?---We have no appetite for businesses failing to meet their regulatory requirements.

15 And the response then, in terms of consequences, was, in a broad sense, you removed a number of individuals?---That's correct.

You let them go?---That's correct.

20 And specifically in relation to remuneration – and we will come back to this in a moment – there were – there was a remuneration consequence for the senior executive within the business?---That's correct.

25 And it may be that it will be easier if we come back to that when we are talking about the particular way that Macquarie deals with that, but in a broad sense, the amount of variable remuneration that that executive received in 2013 compared to 2012 halved, in terms of profit share?---Different levels of executives. The – the person responsible for this business specifically, obviously, lost their job.

30 Yes. But the senior executive within - - -?---That is correct.

All right. That is the person who suffered the halving of the profit share?---That is correct.

35 And is the reason why changing the senior executives makes a difference because ultimately it's the most senior people within the business who have to set the tone from the top?---That's correct, but it's – it wasn't just the senior people. Obviously, there was changes taking place throughout the organisation to reflect the changes that we needed.

40 I understand. One of the other things that you did was to remove, not just senior executives within that particular business, but you also removed advisers that when you reviewed their files you considered that they had engaged in some sort of unacceptable conduct?---Advisers, managers, reviewers, people in the compliance function.

45

And is it by, in your view, by removing those people, by showing that there are definitive consequences for stepping outside of Macquarie's risk appetite that you set the cultural tone within the organisation?---Certainly.

5 And that then, therefore, creates the norms of behaviour within the organisation?---It's part of it. There's a whole – consequence management is important across all the businesses at all time. So it's not just people losing their jobs, it's people having pay consequences, as you say, promotion consequences. There's a whole range of different consequences that can follow.

10 That's right. But they are individual – they are consequences for individuals as a result of the conduct that they have been involved in?---That's right.

15 And also, the conduct that has happened on their watch, in the sense that you make the point the manager who is directly involved in the business lost their job but the more senior executive responsible for that part of the business also suffered a pay consequence?---That's correct.

20 And showing those consequences from Macquarie's perspective is part of, to use a word that seems to have become very fashionable, embedding norms of behaviour within the business?---Correct. We have – one of our key tenets is accountability and key principles in terms of how we run our business.

25 And what does that mean, exactly?---We say to every person in the business they're accountable for the outcomes that they deliver, particularly for business managers. So every business manager is accountable for all the outcomes of the business. And so that's a – all the outcomes, financial outcomes, conduct outcomes, regulatory outcomes, client outcomes, all the outcomes.

30 The second change or significant change that you pointed to was a change to the reporting lines within the compliance division?---That's correct.

35 And was that about shifting over to reporting from BFS into the group level risk management group?---That's correct.

40 And how did you expect and how has that affected the approach to risk within the business?---Well, it's fundamental for the second line of defence that you have an independent risk function. So one of our key structures from a risk management viewpoint is to ensure we have an independent risk management group that does review issues such as compliance.

45 And the third change that you refer to was that, in general, there was an introduction of a material number of training programs, policies, processes, and systems to address the compliance concerns identified by ASIC?---Correct.

And presumably, that means incurring a cost in order to develop those programs and implement those processes?---Certainly.

And the view of Macquarie was it was to make the business do what you wanted to do, you had to incur that cost. That was a necessary part of it?---That is correct.

5 And I think there are then some more specific changes that were made but they've been dealt with by Ms Weber. So your awareness of them is effectively just what Ms Weber has told you about them?---Exactly right.

10 All right. And do you have a view about the effect of ASICs engagement with the implementation of the EU?---I think it was effective.

15 And how exactly – you may not know but how exactly was ASIC engaging with Macquarie during the two-year period in relation to the implementation?---I don't know directly, as you say. I wasn't engaged in that engagement. But I do know there were regular meetings between the – the group head, Greg Ward. He stepped up to take on the role of the enforceable undertaking, as well as subsequently running the group. Regular meetings at the highest level with – with ASIC, as well as throughout the – the teams involved at Macquarie, at KPMG and at ASIC itself.

20 The closure report, I think, was delivered in about 2015?---Yes.

And the closure report said that there had been a significant improvement in adviser compliance grades and quality of client records. And the improvements are embedded and sustainable?---Correct.

25 The outcome, though, wasn't that things stopped at that point. Macquarie Equities then engaged KPMG to complete some further work. And can you just explain to the Commissioner what the nature of that further work was?---Well, it wasn't – I personally wasn't engaging – engaged with the discussion, but the – the documents, I think, that are part of the statement talk about the ongoing need to embed the changes and to review 12 months after the event that changes had taken place.

30 And so then there was a further report delivered, I think, in 2016 from KPMG talking about what the outcomes of it had been?---A transformed business, correct.

35 Which, as you say, concluded the business had been transformed in terms of its approach to risk. And do you have a view now as to where Macquarie Equities is at in its dealing with risk, its culture of risk and its compliance?---My understanding is it's – it's – it is fully compliant. We have recently an internal audit report that was positive. It had two medium issues that were identified and have been resolved. We have our normal staff survey results that came through looking at the risk mindset of the group. And very strong results coming through in terms of the risk mindset of the people within the division.

45 And when you reflect on it, what do you think would have happened if ASIC hadn't tapped Macquarie on the shoulder?---It's a – a good question. I'm – I'm not sure. It was, as you suggested, with the benefit of hindsight it was – it was fortunate that it was brought to our attention so we could take the steps we did.

5 If these types of problems arose in a business within the Macquarie Group now, do you think they would – it's possible that they could be identified and addressed without the need for ASIC?---Absolutely. Absolutely. As we said before, the failing was at the – not having an appropriate second line of defence. Given it reported into the business, sadly, it was not sufficiently objective to see the weaknesses. We do have a very clear second line of defence now across Macquarie. So we would expect our risk management group would detect any failings. We've got a third line of defence, of course, as well-being internal audit that hopefully would pick up any failings that weren't picked up through the second line.

10 I want to move now, Mr Moore, to a different topic, which is in relation to grandfathered commissions. In July of this year, Macquarie Equities announced that it would cease the payment of grandfathered commissions. You're aware of that?---Yes.

15 And that decision, you explain in your statement, was made by Greg Ward?---That's correct.

20 And Mr Ward's role is what?---He's the group head of banking financial services.

And that wasn't a matter that needed to be considered by the board of Macquarie Group?---No, that's a – it's a business decision for that group.

25 And you've said in your statement you agree with Mr Ward about why it's in the clients' interests to remove grandfathered commissions?---Yes.

30 And you may not have a view about this because this may be a business issue, but do you know what sort of time period it would require under Macquarie's systems to remove all grandfathered commissions?---No, I'm afraid I can't answer that today.

35 Thank you. I want to then move to another topic, which is concerned with remuneration. And I want to deal with two issues. The first is variable remuneration within the Macquarie business. And the second is remuneration of brokers, which is something I think you know Macquarie has addressed in its submissions on the interim report?---Yes.

40 In relation to executive remuneration, the way in which Macquarie executives are paid – and, in fact, perhaps, effectively, all Macquarie employees are paid – is quite different from the way in which employees and executives within the retail banks we've been dealing with are paid, as I'm sure you know?---Yes.

And Macquarie has a – or employees at Macquarie have a relatively low fixed salary?---That's correct. At a senior level, that's correct.

45 And can you explain to the Commissioner at what level is it fixed? What is the purpose that is attempted to be achieved by the particular level at which it's fixed?---It depends upon the role and the person. So it does vary role by role. And

as you suggested at junior level, it's – it's higher than at a senior level. At a senior level, it more reflects the underlying performance of the business. So the way the – the profit sharing system is set up is a sharing of the profits between the staff and the shareholders. And it – and the variability increases the more senior you are in the organisation. With risk functions, central functions, that variability is less, for obvious reasons.

And so, for example, when it comes to the way in which you are remunerated, you're paid a fixed salary of something in the order of \$800,000, a bit more. But then you receive a substantial profit share that's deferred over a number of years?---That's correct.

And if we were to – to attempt to compare it to the way in which the CEO of one of the retail banks is paid, really, they're entirely different systems of pay. There's no – there's no fixed relationship between the maximum amount of variable remuneration that you can receive and the fixed salary that you receive?---I believe our system is unique.

And, in fact, there's – I think one of the points you make in the statement is we asked – we asked all entities some relatively standard questions, like what is the maximum amount of variable remuneration that you can be paid, and Macquarie's response is there is no maximum amount of variable remuneration - - -?---That is correct.

- - - we can be paid. And what is the maximum percentage compared to the fixed base salary and the answer is there is no maximum percentage. There is no relationship whatsoever between the fixed salary and - - -?---That is correct.

- - - the variable remuneration. And the variable remuneration then for senior executives is set each year as a percentage of profit share?---That's correct.

And the way in which that occurs or is fixed is by taking into account four factors?---That's correct.

And the first of those factors is financial performance?---That's correct.

The second of those factors is risk management and compliance?---That's correct.

The third of those factors is business leadership, including client outcomes?---Client outcomes, that's correct.

And the fourth of those factors is people leadership and professional conduct consistent with Macquarie's code of conduct and what we stand for?---That is correct.

And do we take it that's – it's not a – it's not a measurement process of trying to say it's 25 per cent for financial performance, 25 per cent for risk management?---That is correct.

It's a process of effectively intuitive synthesis of considering all those factors together and then arriving at a value?---Yes, it is. That is correct.

But - - -

5

THE COMMISSIONER: The reference, Mr Moore, is to the process of fixing a sentence for crime. Intuitive synthesis comes from that realm of discourse. You should know what its source is?---Thank you, Commissioner. I was impressed with the phrase. I didn't know where it came from so thank you for that.

10

Fixing sentences.

MR HODGE: And the point, though, I think that you try to make in your statement in relation to remuneration is that the emphasis upon risk management and compliance and business leadership and people leadership and professional conduct is not just – it's not just something in name only, it actually matters when it comes to that process of synthesis?---Absolutely. Correct.

15

And to take the example – we might bring this up – of the executive who suffered consequences as a result of the issues that led to the EU, if we bring up MGL.0043.0005.0001, which is the statement in response to Rubric 7-06. And go to page .0019. We see in paragraph 71 you explain that the group head of banking and financial services at the time that Macquarie Equities entered into the EU was a relevant senior executive. That means they were subject to the types of performance-based pay that we've been talking about?---That's correct.

20

25

And notwithstanding that the net profit contribution of the BFS operating group for the year ending 31 March 2013 was 22 per cent higher than compared to the preceding year, that group head's profit share allocation was halved?---That's correct.

30

And, therefore, that's a consequence not of intuitively or only focusing on financial performance, it's factoring in and taking into account all of these considerations?---Correct.

35

And was that a decision that you had to make personally?---I was involved in the decision-making. I made a recommendation to the board remuneration committee.

And they accepted it?---They did, with discussion.

40

Sorry, did you say with discussion?---Yes. We discussed these matters.

I see. And do you think that this approach of – within Macquarie of there actually being remuneration consequences for senior executives where there is conduct outside of risk appetite which would include any misconduct, is something that then affects the culture of the organisation?---Certainly. Absolutely.

45

Because they would understand that there are actually direct consequences of doing so?---Yes.

5 And one of the other features of the Macquarie model in relation to pay is significantly deferred remuneration?---That's correct.

10 And I may get this wrong but your – you have the most, as the CEO, the most extreme model or the most extreme rules, which are that 80 per cent of your variable remuneration gets deferred?---That's correct.

And it gets deferred to years four to seven after the period when it's allocated?---Yes.

Sorry, three to seven?---Different elements, but, yes, broadly.

15 And the consequence then, presumably, is that in Macquarie's view accentuates the focus upon the long-term outcomes of decisions?---That's – that's the intention. Long-term alignment in terms of the outcome for the shareholders and the clients and the remuneration.

20 I want to move then to a different element - - -

THE COMMISSIONER: Before you do - - -

25 MR HODGE: Yes.

THE COMMISSIONER: I understand the remuneration system is unique to Macquarie and it has been tailored for Macquarie and its businesses. What, if anything, is generalisable from the Macquarie experience? Are there either principles or elements of the remuneration model that Macquarie adopts that you think yield more generalisable ideas?---I think the idea of profit – a profit share is more powerful than bonus. Bonuses often relate to revenue rather than bottom line outcomes. Deferral, I think, is very important. I think deferral – to see the outcome of decisions being made in finance, as we know, decisions being made today have consequences over many years. And so making sure there is that alignment over a period of time I think is – is very important. And the third element as we're talking about, it's not just being driven off a financial metric; it has a broader application to all the other elements that are critically important to the success of an organisation and to the success of clients.

40 Does the requirement to synthesise a number of factors, some of which are incapable of reduction to numbers, yield decisions that are sometimes difficult to explain or difficult to have accepted by those to whom they're applied? Are there issues about – that emerge then in the management of the system with the staff understanding and those below understanding what's happening?---I think there – there will be a natural pushback, but I think as – coming back to the point about the longevity in terms of people in the organisation, they do understand the importance of it, and they do, you

know, mostly, accept the outcomes. And they – they might debate them but in my experience, people accept the outcomes.

5 What sorts of explanation are they given for the outcome?---A very clear explanation. The – we have a – with people who have been with you for a period of time, there is a precedent in terms of what they have seen in prior years. And if the events in the current year are different, we talk about those events in the current year. There's a financial result, you talk about the events and you talk about why the events should be having a consequence. And it's a very open discussion.

10 A recurring theme through these aspects of the discussion has been the retention of executives and the longevity of engagement. It appears that that's not necessarily a universal experience in some aspects of the industry. There seems to be a churn?---As I said, our – our philosophy is very much this partnership one. We want
15 people joining the organisation effectively to be committing for a long period of time. And we are set up on that basis where decisions we're taking we will be living with. And they will be living with. And that's, I think, throughout the organisation. That's certainly our hope and expectation.

20 But, again, is that capable of generalisation? Is it something to which entities generally, in your view, should be tending - - -?---Well, I – I think we see it across a number of different sorts of organisations, particularly in the private capital world where people have an interest in the underlying business. The – from a financial
25 sector viewpoint, I think when you look at a number of the larger international firms, they would have elements – very similar elements to what we're talking about for the senior leadership team. We're perhaps unique in having it go all the way through the organisation. And I think that's – you quite rightly ask for more junior people how does this apply, and how do they – how do they feel the connection with the
30 underlying profitability and the underlying risk in the organisation. So this is why we have this key concept in terms of our organisation of accountability, that everybody in the organisation, no matter what role, have to actually feel they're accountable for the outcome that they deliver. And that consciousness, we think, is the greatest safeguard we have in terms of the long-term health of the organisation and the client outcomes. And it's – we are constantly reinforcing in terms of staff
35 training and staff review, that idea of accountability.

Thank you. Mr Hodge.

40 MR HODGE: Thank you, Commissioner. Mr Moore, the last topic that I wanted to move to then is in relation to mortgage brokers and broker remuneration. And Macquarie's submission to the – in response to the interim report raises this issue. Can we bring up POL.9100.0001.0987. And then if we go to page 0011, you see section F dealing with the role of intermediaries. Now, I'm assuming you weren't
45 personally involved in the preparation of this submission, Mr Moore?---I have seen it, yes.

And have you thought about it and considered this issue of the role of mortgage brokers?---Yes, I have.

5 All right. So I just want to ask you some questions about that. Macquarie makes a couple of points. The first is, in paragraph 32, that it was in the 1990s that Macquarie introduced mortgage securitisation to the Australian market and that then led to non-bank participants?---Correct.

10 And that then led to competition, that is, competition that's occurring at the level of banks and non-bank lenders to provide mortgages?---That's correct.

15 And that competition is what drove down in – at least in one view drove down by two and a half per cent the interest rates that were being paid by consumers?---That's correct.

And then the second point which is made in paragraph 33 is that that couldn't – that competition couldn't have occurred without the mortgage broker distribution channel?---That's correct.

20 And the point that is made in 33 is that brokers and those sorts of intermediaries are particularly important to a lender like Macquarie?---That's correct.

25 Macquarie, as we will see in a moment, has a very small share of the home mortgage market in Australia?---That's correct.

And the point that is made by Macquarie is that it's not like the big four who have an extensive branch network?---That's correct.

30 And, therefore, presumably, where this goes is to say the mortgage brokers, as the intermediated distribution channel, offer a distribution service to Macquarie?---That's correct.

35 And that's a benefit to Macquarie, that is, it gets a service from the intermediated distribution channel?---That's correct.

And it allows Macquarie to be able to compete with much larger lenders who have a branch network?---That's correct.

40 And if we bring up then figure 4 from your statement in response to 7-06 and go to MGL.0043.0005.0009. We see there you've, as part of your statement, set out a table which shows Macquarie Group's share of the domestic mortgages market?---Yes.

45 And at least as at August of 2018, it was about the eighth largest player in relation to mortgages?---That's correct.

But after the first four, the big four, everybody else has a much smaller share of the market?---That's correct.

5 And, presumably, does not have the same branch distribution network as the big four?---Correct.

And so from Macquarie's perspective, at the moment it's paying commissions to mortgage brokers?---That's correct.

10 And that is a payment, from the perspective of Macquarie, in exchange for a service that the brokers are providing to Macquarie?---That's correct.

15 And that is as distinct from another issue, which I'm sure you're aware of, and it's raised from a number of perspectives, which is mortgage brokers also provide a service to the customers?---That's correct.

20 And this, in a sense, is probably no different to any other intermediated market, either whether you consider it as a two-sided market or one participant playing upstream and downstream in two different markets?---That's correct.

That is, by the one activity they provide a service to two different people?---That's correct.

25 And what I then want to understand is what is the concern that Macquarie has about how changing commissions might affect the ability of mortgage brokers to provide that service to the non-major lenders?---Good question. The – we're dealing a little bit about potential regulation we don't know the shape of. And our general point is one of caution to say there can be unintended consequences of regulation. We are dependent upon this broker network for our – our business. And we think, having regard to history, that the broker network does provide genuine competition, and that 30 genuine competition has reduced the cost for all mortgages. So our nervousness would be regulation could severely hamper that broker – broker business, and so we're providing a note of caution in terms of any thoughts about changing the regulatory structure that people think broadly about what the implications may be.

35 Can I just try to tease two ideas out of that. The first is there can often be a misguided impression that competition is happening between the mortgage brokers and the bank so that you would expect the mortgage – or potentially expect the mortgage brokers to be offering a lower interest rate than the interest rate that's being 40 offered by the bank. That – I am not putting that to you as true but you understand that that's an impression that people have?---I – I would agree it should be very clear the role of the mortgage broker to the customer.

45 Can I – I'm more for the moment just want to focus on the competition that's occurring, because I think the point that you are making is that the competition isn't happening between the bank and the mortgage broker, the competition is happening between the banks and the mortgage broker allows - - -?---Correct.

- - - smaller banks to be able to compete with bigger banks?---And banks to compete with banks.

5 That's right?---I mean the large banks also – they're the largest user of the brokers, of course.

10 And you wouldn't – you wouldn't really expect that the banks would be offering a lower interest rate through the mortgage broker distribution channel compared to their own origination channel. That is, over time you would expect that whatever rate they're offering – whatever any individual bank is offering is going to be the same whichever channel it comes through. Do you agree with that?---I would agree they would have to meet the market. And if the – the broker will be sourcing offers, and if banks aren't meeting the market, they will not be receiving the business. So it's very simple, in our circumstance, we need to meet the market if we are to do the business.

15 Yes?---And I think it's the same, even though the other financial services organisation, the other banks may be larger than ours, the need to meet the market is consistent.

20 And the point I'm trying to get at is it can be suggested that if there isn't a lower rate being offered by a mortgage broker compared to what is available by direct origination that it therefore means that the broker is failing to do the broker's job, but that, I'm suggesting, is not necessarily the case. And I'm interested in your view about that?---I'm not quite sure of the point. The point of the – or the broker or the market more broadly is to be bringing to light the different offers which change. And it's offers not just in terms of price but terms and conditions as we know with long-term commitments are often even more important. And showing people the way through these situations – and it's not just the upfront price but all the other circumstances around it – is an – is an important function. So I see the broker providing a – a market role in terms of being able to provide the different offers, different offers to the client base.

25 Different offers between banks as opposed to a different offer – some secret offer that's only available by a bank through a mortgage broker?---Different offer between banks, I imagine.

35 Yes?---And other providers of mortgage financing.

40 And then the second point I want to try and understand is from the perspective of Macquarie, if it's not paying – or if it's not able to pay commission, then the consequence is it's prohibited, in one way, from remunerating brokers for a service that the brokers are actually providing to the bank and that Macquarie sees value in. Do you agree with that?---That's right. We have a direct to the market outlet but it would be about 10 per cent of our total mortgage volume.

And what do you think would be the consequence if Macquarie was prohibited from being able to pay mortgage brokers any commission or, in fact, make any payment to brokers and the brokers were only able to obtain remuneration by charging a fee for service to the customer?---I don't know. Obviously, we would be speculating but superficially, it would not be – it doesn't sound as attractive as the – as the current structure. But, you know, I'm guessing here.

THE COMMISSIONER: Attractive to whom? It doesn't seem as attractive to whom?---To the – I think the expression used is the shock of actually seeing the upfront fee. One of the other issues discussed, obviously, is whether the fee should be upfront or over the life. And our position is we would like it, coming back to the alignment point, to reflect the value being delivered which is over the life of the – over the life of the loan. So there is an issue, obviously, for – if you have an offer without a – a broking fee versus with a broking fee. That makes a difference in the mind of the – of the consumer. Economically, of course, the fee is – is being borne.

MR HODGE: I don't have any further questions, Commissioner.

THE COMMISSIONER: Yes. Is there anything arising, Mr Rich?

MR RICH: Nothing, Mr Commissioner.

THE COMMISSIONER: Thank you very much, Mr Moore. You may step down?---Thank you.

<THE WITNESS WITHDREW [12.51 pm]

THE COMMISSIONER: Now, Mr Hodge, where to from here?

MR HODGE: We adjourn, Commissioner, now until 2 pm.

THE COMMISSIONER: 2 pm.

MR HODGE: For Mr Shipton.

THE COMMISSIONER: Mr Shipton at 2. Yes. Very well. 2 pm.

ADJOURNED [12.51 pm]

RESUMED [2.00 pm]

<JAMES ROGER FRANCIS SHIPTON, SWORN [2.00 pm]

<EXAMINATION-IN-CHIEF BY MR COLLINSON

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

MR COLLINSON: If the Commissioner pleases. Mr Shipton, would you give the Commissioner, please, your full name?---James Roger Francis Shipton.

10 And your position?---Chair, ASIC.

Business address?---120 Collins Street, Melbourne.

15 Now, in the materials you've got there, you should have a copy of your summons to appear before the Commission?---I do, indeed, Mr Collinson.

I will seek to tender that document, if the Commissioner pleases.

20 THE COMMISSIONER: That will become exhibit 7.62, the summons to Mr Shipton.

EXHIBIT #7.62 SUMMONS TO MR SHIPTON

25 MR COLLINSON: Now, Mr Shipton, if you could take your primary statement next, please?---Yes.

30 There are just a few amendments in two places I want to take you to, please. The first is paragraph 151. Commissioner, I will hand up – what this is are some amendments to the table in paragraph 151. We have a typed version of the amended figures, but we thought it wouldn't take that long to put the amended figures in the original if that - - -

35 THE COMMISSIONER: It would have been much better if they had gone in originally, wouldn't it, Mr Collinson?

MR COLLINSON: Yes, that's so.

40 THE COMMISSIONER: Hand them up. Yes.

MR COLLINSON: Now, Mr Shipton, if you've got a pen there, can I just ask you to make these changes to the column 2018/2019?---Yes.

45 Where it says 45, could you just change that to 56?---Yes.

Where it says two, in the next line, please change that to three?---Yes.

- In the next line, where it says four, please put in six?---Yes.
- In the next line where it says one, please put in three?---Yes.
- 5 Next line, change 20 to 24?---Yes.
- Next line, change five to seven?---Yes.
- And then in the total, could you please change 77 to 113?---Yes.
- 10 Now, just in the total column, instead of 1211 at the top, please put in 1222?---Yes.
- Change 29 to 30?---Yes.
- 15 And jumping one, if you change 119 to 121?---Yes.
- And change 363 to 365?---Yes.
- And change 419 to 423?---Yes.
- 20 And please change 167 to 169?---Yes.
- And then at the very bottom where it says 2839 change that please to 2875?---Yes.
- 25 And if you could initial, please, adjacent to those changes to the table?---Yes.
- Yes. One final matter. If I could ask you, please, to go to paragraph 185?---Yes.
- I understand you want to delete paragraph (a)?---Yes.
- 30 So if you could rule a line through paragraph (a)?---Yes.
- And please renumber paragraph (b) as paragraph (a)?---Yes.
- 35 And if you could renumber over the page (c) and (d) should become (b) and (c)?---Yes.
- And if you could initial those changes on both those pages?---Yes.
- 40 With those changes, Mr Shipton, is that statement of yours true and correct?---Yes, it is.
- I will tender that statement, if the Commissioner pleases.
- 45 THE COMMISSIONER: Exhibit 7.63, statement of Mr Shipton.

EXHIBIT #7.63 STATEMENT OF MR SHIPTON

5 MR COLLINSON: If you could take now, please, your supplementary statement, Mr Shipton. Is that statement true and correct?---It is.

I tender that statement.

10 THE COMMISSIONER: Exhibit 7.64, the supplementary statement of Mr Shipton.

EXHIBIT #7.64 SUPPLEMENTARY STATEMENT OF MR SHIPTON

15 THE COMMISSIONER: Yes. Yes, Ms Orr.

<CROSS-EXAMINATION BY MS ORR

[2.05 pm]

20

MS ORR: Mr Shipton, you commenced as the chair of ASIC on 1 February this year?---Correct.

25 And prior to joining ASIC, you were the executive director of Harvard Law School's program on international financial systems?---Correct.

And before that, you were an executive director and commission member of the Securities and Futures Commission of Hong Kong?---Correct.

30 You held that position from 2013 to 2016?---Correct.

And you are now one of seven members of ASIC?---Correct.

35 And ASIC is required by statute to have no less than three members and no more than eight members. Is that correct?---That's my understanding, yes.

And ASICs other six members are the two Deputy Chairs and four Commissioners?---Correct.

40 Now, Mr Shipton, you've said publicly that you see the purpose of regulation as being:

To modify behaviour with respect to agreed norms in order to preserve the benefits of the underlying enterprise.

45

Is that your view?---Yes, that is my view.

- And ASIC has a range of tools that it can use to modify behaviour?---Correct. Yes, it does.
- 5 And the tools available to ASIC include both reactive and proactive tools?---Yes. I would classify it like that, yes.
- 10 And the chief reactive tools, do you agree, are enforcement-based tools?---I would say that enforcement-based tools are both reactive but have a very strong proactive element as well.
- And would you call them the chief reactive tool that you have?---Yes. And I have said that they are – I think I’ve used the expression in the public main reactive tool.
- 15 And you’ve said publicly that they’re designed to punish previous behaviour and deter future recurrence?---Yes, I have.
- And your chief proactive tools at ASIC include engaging with the industry?---You say “chief tool”, I wouldn’t say that is the chief proactive - - -
- 20 I’m sorry, I didn’t mean to suggest that was the only chief tool. Is that one of the chief proactive tools?---That is certainly – that is certainly one of the tools. Whether – I wouldn’t – I wouldn’t apply the word “chief” to it.
- I see?---But I would say it is certainly one tool.
- 25 What would you describe as the chief proactive tool that you have?---It’s very difficult – and I prefer to avoid usage of – of – to the extent possible of tools – prioritisation of tools, because there is a degree of equality amongst them but I do believe that there is a foundational tool.
- 30 What is a foundational tool, Mr Shipton?---The foundational tool of any regulator, I believe, is enforcement.
- And other tools that you have that you’ve referred to publicly in the proactive setting, as well as engaging with industry, include granting and revoking licences and authorisations?---That would be one tool, yes.
- 35 Providing regulatory guidance?---That is a tool, yes.
- 40 And conducting reviews and issuing reports?---That is a tool, yes.
- Now, I want to ask you about how ASIC has used and proposes to use both reactive and proactive tools to modify behaviour in the financial services industry. But first, I want to ask you about ASICs role at a more general level. Over the past 20 years, ASICs remit has expanded considerably?---Yes, it has.
- 45

Now, could I show you a diagram that tracks through how ASICs remit has expanded over time. It's part of an exhibit to your statement. It's a page within the ASIC Capability Review. ASIC.0800.0016.0917. This is the capability review into ASIC done in December 2015 which I am going to come back to and ask you some
5 questions about later, Mr Shipton, but for now could I ask you to look at 0959 within this document. And we see here that in 1998 ASICs existing responsibilities as a corporate securities and futures regulator were expanded to include responsibility for consumer protection in respect of financial services?---Yes.

10 And in 2002 responsibility for financial services conduct and disclosure was added?---Yes.

And in 2006, ASICs remit in respect of superannuation was expanded?---Yes.

15 And in 2010 ASICs responsibilities were, again, expanded in respect of consumer credit?---Yes.

And at that time ASIC also took over market supervision functions, the supervision of domestic licensed equity, derivatives and futures markets?---Yes, from the ASX,
20 yes.

In 2013 ASIC assumed additional market supervision responsibilities and responsibilities for the FOFA reforms?---Yes.

25 And the result of all of that is that ASIC now has a wider regulatory remit than comparable market conduct regulators overseas. Do you agree with that?---That's my understanding, yes.

And in the same period, your regulated population has also increased
30 significantly?---Yes, it certainly has.

But despite that, we know from the submissions that ASIC made in response to the interim report that ASICs staff numbers and budget have increased relatively modestly?---Yes. Modestly would be a good description.
35

Is there another description you would use, Mr Shipton?---No, I think modest would be an appropriate one.

And how do you think that ASICs resourcing compares with that of conduct regulators in other jurisdictions?---In my own experience, I believe that ASIC is
40 under-resourced compared to some of our peers globally.

And how does the level of resourcing that you have affect the way that you perform your functions and exercise your powers?---Well, it weighs very heavily on the regulatory choices that we have to make, because it means that we are restricted in
45 our ability to take on matters or to pursue matters in a way that, perhaps, we would like to.

And could you explain further how that plays out, Mr Shipton? Does it mean that you are not able to investigate matters that you would like to investigate?---It means – it would be across the – the full spectrum of our regulatory activity. We are constrained in probably every aspect of our regulatory work. Certainly in
5 investigations, certainly in other matters relating to enforcement, but I would also make the case that we are constrained in our surveillance, our supervision, our important work on financial capability, and – and other work that we undertake.

Now, Mr Shipton, the government periodically publishes a document called a
10 Statement of Expectations that sets out its expectations about how ASIC is going to perform its functions and exercise its powers?---It most certainly does, yes.

And ASIC formally responds to that Statement of Expectations by publishing something called a Statement of Intent?---A Statement of Intent, indeed.
15

And the government gave ASIC the most recent Statement of Expectations in April this year, a couple of months after you started as chair?---That's correct, yes.

And ASIC then published a Statement of Intent in response?---Yes, we did.
20

Now, you've exhibited a copy of the current Statement of Expectations to your statement. And I would like to take you to that?---Please.

ASIC.0800.0016.3087. Now, this is the current Statement of Intent – I'm sorry, the
25 current Statement of Expectations?---Yes, it is.

And if we look at paragraph 2 of the Statement of Expectations we see that it says:

*This statement outlines the government's expectations for how ASIC fulfils its
30 role including how it balances its objectives and responds to changing circumstances.*

?---It does say that, yes.

35 And could I direct your attention to paragraph 7, which says:

*A key role for ASIC is to reduce the likelihood that consumers will suffer losses as a result of misconduct by corporations and financial services licensees. This is done by ASIC enforcing and promoting expected standards of conduct using
40 the range of regulatory tools at its disposal, including stakeholder engagement, surveillance, guidance, enforcement and policy advice.*

Now, could I ask you a bit about each of the regulatory tools mentioned in that
45 paragraph, Mr Shipton. The first is stakeholder engagement. Can you explain what you understand the government to be referring to there?---Stakeholder engagement, as I understand the government, it's difficult for me to – to speak for the government

and I – I would – I would avoid not doing so, but what I would, with permission, is to talk about my interpretation of what stakeholder engagement - - -

5 That’s what I would like, your understanding of what this is asking of ASIC?---I believe that they’re asking us to engage with industry to understand their drivers and their business models. But I also took stakeholder engagement to mean that we would be speaking directly and frankly to members of the financial sector industry about our regulatory expectations. I would also add that I take the word “stakeholder” to be very broad, to include civil society, consumer groups, Members of Parliament, and other civil and business leaders.

10 The second regulatory tool in that section is “surveillance”. Can you explain briefly how ASIC conducts surveillance?---Traditionally, ASIC has been conducting surveillance in the form of – let’s call it desktop or paper reviews of situations, of transactions or of themes across the financial sector or corporate sector. It’s really a review, an oversight, an assessment-type exercise, and it does involve, obviously, engagement with the regulated population.

15 And the third tool referred to is “guidance”. Does that refer to the regulatory guides and reports that ASIC publishes?---I took that to mean both the formal guidance that we produce, but also speeches, statements that we make in public, but also engagements and liaisons that we have with, again, the regulated population, but also and more broadly to the community and influencers, professional advisers, for instance, in the financial and corporate arena.

20 And the fourth tool is enforcement. I want to return to that in greater detail, but that includes – do you interpret that as including commencing court proceedings, taking administrative action, suspending or cancelling a licence, issuing an infringement notice. Are they the sorts of matters that you interpret that to be referring to?---Most definitely, yes.

25 And the fifth matter referred to there is policy advice. What do you understand that to be a reference to?---I understand that to be a reference of our engagement with the government, and, indeed, with the Parliament in relation to the determination of new legislation, regulations, particularly in relation to tools, powers, remit of jurisdiction, and those types of matters.

30 Now, I want to ask you a little more about ASICs stakeholder engagement activities. If we turn within the Statement of Expectations to paragraph 31, which is at 3090, we see that the government says that it expects ASIC to have an:

35 *...open and sound working relationship with supervised entities and to ensure that industry participants are encouraged to communicate considered and candid views to ASIC.*

40 ?---Yes. That is a government expectation of us.

Can I ask you to look now at what ASIC said in its Statement of Intent in response to that particular expectation. The Statement of Intent is also exhibited to your witness statement. ASIC.0800.0016.3133. And if we turn to 3137, we see ASICs response to the expectation that I just took you to under Our Relationships: Regulated Population and Industry Stakeholders, ASIC says:

We will engage with regulated entities in a variety of ways, for example, through advisory panels, roundtables on specific issues across sectors and regular meetings. These forms of engagement help us to gain a deeper understanding of industry and consumer developments, consult on policy matters, consider and help to address systemic risks or harms in the sectors we regulate, and discover potentially harmful behaviours by particular entities.

And it goes on to say:

Commission level engagement with stakeholders at all levels, further assists us to understand market trends and emerging issues.

Now, that reference to “commission level engagement” is a reference to the members of ASIC, the Commissioners meeting with ASICs stakeholders?---Yes, it is.

Including financial services entities?---Yes. As I mentioned earlier, I took stakeholders to be a broad – have a broad meaning and definition.

So it includes the regulated population?---It certainly does.

And you tell us in your second statement that since 2015, ASIC has had a stakeholder engagement strategy for members of the Commission?---That’s correct, yes.

Now, can I take you to that document, which you’ve exhibited to that statement. ASIC.0800.0016.3760. Now, this is your stakeholder engagement strategy?---Yes, it is.

And we see in this first page:

Having the Commission engage with the boards and senior executives of our key stakeholders through regular meetings, contributes to ASIC achieving our strategic priorities.

Do you see that in the first paragraph?---Yes, I do. Yes.

And the strategy goes on to say “From 2016” – do you see this a couple of paragraphs down:

In addition to this, from 2016 the Commission commenced an enhanced engagement program to ensure they meet regularly with boards and senior

executives of our largest financial institutions and boards of key industry associations. Under our enhanced engagement program, the Commission will hold more than 50 meetings with boards and senior executive groups of financial institutions and industry associations each year.

5

?---Yes, that's correct. And in 2016, as I understand it, it was coming out of recommendations from the capability review.

10 Thank you. And further down in this document under the heading Financial Institutions, we see:

15 *Meeting with the boards and senior executives of our largest financial institutions provides an opportunity to exchange information and discuss issues directly with the leadership of these organisations. It enables ASIC to hear directly from our stakeholders about any issues or concerns and to receive updates on new developments in the institution. It also allows ASIC to provide direct feedback to those involved in overseeing these institutions about compliance and/or enforcement issues we are seeing in their organisation. In many cases, boards would not otherwise have an opportunity to hear this feedback directly.*

20

?---Yes.

25 So your stakeholder engagement strategy requires regular meetings between the Commission and the boards and senior executives of the entities that ASIC regulates?---Requires would connote that it's sort of set in stone. I would say that the – it's – it's a practice that we have established.

30 It's a practice that is the subject of a particular strategy document - - -?---Correct.

30

- - - that requires relatively frequent meetings between members of the Commission and the leaders of these organisations?---I think we're saying the same thing. But yes, the practice is that we have been having these meetings following this – this strategy document. What I – the point I'm just trying to make is that if we don't meet these objectives, there wouldn't be consequences.

35

I see. But is it intended to continue with this practice?---Yes. This – this is the current strategy and current practice that we are adhering to, I believe, to a greater or lesser extent.

40

And how frequently do these meetings take place?---Well, I can only speak for my experience in the last nine or so months that I've been in the role, and we have had reasonably frequent meetings with boards and senior executives of large financial institutions but I would also point out with many others as well.

45

And what do you mean by “reasonably frequent”, Mr Shipton?---It depends what type of meeting that you're asking for. The – this paragraph is talking across a range

of different types of meetings – or these paragraphs, I should say – are talking about a range of different meetings with boards and senior executives so take, for instance, the boards. We would have an annual meeting with the boards of some of the larger financial institutions. That’s, as I said, on an annual basis. I’ve had a number of
5 meetings, which you would say are an ad hoc or out of cycle. When I first started this role, because I was new both to the role and essentially new to the Australian financial system, having spent a large part of the 20 to 25 years outside of Australia.

10 Separately to those meetings, do you also have direct contact with the senior executives and boards of the entities that ASIC regulates?---I do, yes.

And how frequently does that occur?---That is – that would occur – there’s – there’s – there’s no constant rhythm to it, as it were, but there are conversations or
15 notifications that happen, let’s say, two or three or four times a month. They can be as – as much as leaving a voice message about an imminent press – no, sorry, an imminent announcement on the – on the market, given that we’re a market regulator. It could be me calling a CEO to express dissatisfaction, which I’ve done on a number of occasions, or it could be a meeting to discuss engagement and passing on my own thoughts, views and perspectives. In other words, regulatory feedback.

20 What have you called CEOs to express dissatisfaction about?---I’ve called CEOs to express dissatisfaction on a number of occasions as regards the handling of particular matters that are being handled by our – our enforcement teams. I have called CEOs and spoken at meetings about my dissatisfaction about what I call legal trench
25 warfare. I have also expressed my dissatisfaction to these leaders about the lack of professionalism in the Australian financial sector, and I have also spoken to these leaders to a man and a woman about the fact that I believe that they have forgotten that they are dealing with other people’s money.

30 When you say that you’ve spoken to them about the handling of particular matters by your enforcement teams, what are you referring to there?---I am referring to – on a small number of occasions where concerns by the enforcement team have been escalated to me, either directly by the team member or via another Commissioner,
35 about handling or delays or intransience by the financial institution, and I have asked CEOs to, firstly, be aware of the issue, and, secondly, to respond in a more timely fashion to us. I do not get involved in the matter itself. My role is to escalate and amplify our concerns.

40 When you’re speaking of delays there, delays in doing what?---For instance, responding to information requests, in relation to trying to get documents, in relation to responding to substantive requests for clarification or information.

45 And how has that worked for you when you’ve contacted leaders of those organisations about those matters?---It has been extremely successful.

So they have been receptive to your approach?---They have been receptive to my approach, and it has had a operational impact to speed up the response. And it

speaks to a broader point that I firmly believe that CEOs, chairs and other leaders of these financial institutions should be more engaged and more aware of some of these issues that are taking place between their organisations and our agency.

5 Is the contact that you have, that sort of direct contact with the leaders of these organisations, more frequent for the large financial institutions?---It has been for the large financial institutions. But I am keen to broaden out my engagement with other leaders of the financial sector and, importantly, other advocates of let's say consumer welfare and other influencers in the financial and corporate sector.

10

On Tuesday this week Mr Comyn from CBA gave evidence that you get together – you and he get together in a structured way every quarter. Did you hear that evidence, Mr Shipton?---I didn't hear that evidence.

15 Is that correct?---I – I would not clarify them as get-togethers. I would clarify them as meetings.

I see. What is the difference there, Mr Shipton?---Well, just in my own interpretation – and maybe I'm being pedantic, so apologies. I took get together – I personally interpret it – and maybe it's my own personal interpretation – as a more familiar or more social gathering and I just wanted to clarify at least in my own mind that I have very structured – I aim to have very structured formal meetings with people like Mr Comyn.

25 And he said that you also speak more frequently than that in a less structured way. Is that correct?---Well, less structured way – my take of the less structured communication with Mr Comyn is that we often speak by phone. Often pre-market, as I said, because Mr Comyn is giving us, as a markets regulator, the heads-up of a – a market announcement which is coming the next day. That's important for us as a market regulator but it's also very important for us to be aware of business
30 developments inside a financial institution as important as the Commonwealth Bank.

And Mr Comyn spoke of a number of things that he contacts you to discuss. And one of them was whether CBA is appropriately engaging with ASIC on particular
35 topics. Is that correct?---Yes. And he has engaged with me on those types of issues. He has been proactive and I have been proactive back in engaging with him as well on points of engagement between his bank and – and my agency.

He also said that he spoke with you at times to get a sense of what might be on
40 ASICs mind?---He – he certainly has. In fact, I would go farther and say that I have spoken directly to him and his senior colleagues and the board exactly about our expectations, and my expectations as a regulatory agency.

Is that type of contact that Mr Comyn has described having with you, and you've
45 now described, common from the CEOs of the other major banks as well?---Yes. I – I would say that it's – it's – it's common. It's a common point of engagement and

there is a consistency to a greater or lesser extent across the financial institutions, yes.

5 And you encourage that sort of contact?---I am open to that sort of contact. I think it's very useful. I think it's useful for two main reasons: (1) it gives me an opportunity to pass on my expectations and feedback directly to the most important people inside a financial institution. And secondly, it allows me, personally, to have a benchmark as to whether or not I think, over time, these institutions and the leaders of these institutions are changing.

10 Is it important to you to build a relationship with the CEOs of the major banks?---By "relationship", I would take that to mean a professional relationship and a culture – sorry, a relationship and, indeed, a culture of open and frank dialogue. I'm heavily influenced by a report done in 2011 by the International Institute of Finance which is
15 a global industry body which speaks about a culture of no surprises, and the importance of a culture of no surprises between regulated entities and the regulator themselves.

20 Mr Comyn's evidence also was that you occasionally call him to discuss things such as the close and continuing monitoring program, which I'm going to come back to?---Yes.

25 That's correct; you contact him as well as being open to receive calls from him?---Correct. Yes.

And do you do that with the CEOs of the other major banks?---I've done that with the CEOs of other major banks and I have also passed on personally via personal correspondence important reports and feedback that I think it is important that the chairs and CEOs receive directly. One example of that is our important breach
30 report, report earlier this year, because there are important findings, both industry-wide and bank specific.

35 Would you say that you and the Commissioners have good working relationships with the boards and CEOs of the major banks?---I would say we have an open working relationship and a professional working relationship.

40 And we saw from the Statement of Expectations the expectation that industry participants be encouraged to communicate considered and candid views to ASIC. You recall that?---Yes. I – I would put – put particular emphasis on the word "considered". I think considered feedback is important, not any feedback.

45 But these meetings and discussions that you have with the leaders of these entities take place against the backdrop of section 912D of our Corporations Act, don't they?---Yes. 912D is a core component of our regulatory regime.

Because 912D imposes a legal obligation on these financial services entities to report information about significant breaches or potential significant breaches of their legal obligations to ASIC in a timely way?---It most certainly does.

5 So the financial services entities are already required by law to report misconduct to you?---They are required by law to do so, yes.

10 So you don't need to hold meetings for that purpose?---Meetings are not held for that purpose. These meetings are not breach reporting meetings. They are not a substitute for breach reporting. I'm not aware that they ever have been, nor should they ever be so into the future.

15 And these meetings aren't the only way that ASIC can communicate its messages and expectations to these entities. You can do that through many other channels as well?---We certainly can and we certainly do.

20 Do you think, Mr Shipton, that there are any risks associated with frequent personal contact between regulators and the leaders of the entities that they regulate?---I do, and that is why I personally exercise the highest degree I can possibly apply of professional judgment when I have these interactions, when I have these meetings.

25 What are the risks that you're aware of, Mr Shipton?---For – I think I've alluded to it with my clarifications earlier, that somehow this would be seen by the other side as too familial, too friendly, too social, and ensuring that these remain, as they are in my mind, professional and very much anchored in the purpose in which I do them, which is, as I said, information – information accumulation, regulatory messaging, and baseline assessment as to the – to be brutally honest and blunt, their performance as regards compliance with our laws and regulations.

30 It's the Commissioners who have the ultimate responsibility for making decisions about whether to take enforcement action against these entities, isn't it?---Ultimately that – the Commission is the – the ultimate decision-making body in matters like that, yes.

35 But through these frequent meetings with the leaders of these entities, you and the other Commissioners necessarily develop a relationship with the boards and the senior executives of the organisations?---A professional relationship and a professional engagement, yes.

40 Well, it's part of human nature, isn't it, Mr Shipton, that when we have a relationship with someone, it's usually harder for us to do something that might harm that person's interests?---That's why I am emphasising the importance of having a professional relationship and, as I emphasised earlier, exercising the highest degree of professional judgment in relation to these interactions.

45 And what about the professional judgment of your fellow Commissioners; what do you do to oversee how they exercise their professional judgment?---I have mentioned

to my colleagues the importance of treating carefully and with a healthy dose of scepticism some of our interactions with the regulated population. In my interactions and feedback from my colleagues, it's very clear that they share that – that mindset as well.

5

Well, Mr Shipton, even accepting that there are benefits to ASIC from regular engagement with boards and senior executives of these organisations, is it really appropriate that the same people who have that engagement are the people who are ultimately responsible for making decisions about whether to take enforcement action against these agencies?---I do think it's appropriate, again, on the foundation that we continue to exercise the highest standards of professional judgment in our interactions, and that they remain as such.

10

Would you accept that ASICs practice of having these regular meetings involves a trade-off?---No.

15

You don't accept that?---No, I don't accept that.

You don't accept that there are benefits to ASIC but also risks from that engagement?---As I have mentioned before, one has to be aware and has to be attuned, there has to be a degree of scepticism but I come back to something I fundamentally believe in, we need to be exercising the highest standards of professional judgment in these engagements.

20

Do you think ASIC is transparent enough with the community about the risks involved in having the Commissioners attend these regular meetings?---I – this subject matter I don't believe has come up in the public domain before. But I am more than happy to have our organisation engage on the topic. I would also quickly highlight that we are – all of us, the Commissioners included – we are governed by the rules and protocols as part of legislation against conflicts of interest and our code of conduct and we have statutory obligations which go far beyond the professional standards that I mentioned before. In fact, not only do they go beyond, I would say that they reinforce. If I remember correctly we, as Commissioners, are under criminal sanctions if we do breach these legislative guidelines in relation to conflicts of interests.

25

30

35

In your second statement you say that:

At these meetings, topics of discussion can but do not always include matters of relevance to current or potential enforcement or regulatory action by ASIC against the regulated entity.

40

You say:

Although such engagement is kept at a necessarily high level –

45

What do you mean by a “necessarily high level”, Mr Shipton?---Well, I will speak to my own experience in the last nine months, and essentially that is just talking broadly and almost in passing about a matter with these board engagements. To speak about the importance, maybe, the awareness of, but we do not – and I have encouraged this
5 – we do not delve into detail, again, because we are exercising, I believe, the highest degree of professional standards.

Well, why is there any need to talk broadly about current enforcement matters at these meetings?---Because when they are touched upon, and they are certainly not –
10 they are certainly not, in my – in my view main agenda items but they certainly are key regulatory messages. When we take enforcement action we are trying to send a message to that institution but also more broadly. I would describe it as us reinforcing and amplifying the message in passing that we are trying to pass on via that action. But I agree with you that we should be very careful about delving into
15 too much detail on these types of subjects.

Well, do you have a policy governing the types of topics that can be discussed at those meetings?---We don’t have a policy, but, again, I am relying on my own good judgment, professional judgment and the highest standards that I expect of myself
20 and I know the highest professional standards that my colleagues apply to themselves.

So I assume you don’t have a policy governing the involvement of Commissioners in making enforcement decisions about entities that they’re attending meetings
25 with?---Not to that precision. We do, as I said before, have overarching conflicts of interest policies, both written into codes and written into legislation.

You don’t keep any minutes of these meetings between Commissioners and members of the boards of financial services entities or CEOs of those entities?---Formal
30 minutes are not taken but my practice in relation to meetings, whether they be a board – meeting with a board or meeting with another senior leader, if there is a matter of significance, particularly a matter relating to an enforcement matter, for me to take a note and to brief my colleagues involved directly on that as soon as possible.
35

Wouldn’t it be better, Mr Shipton, for the sake of transparency, for there to be a formal record of the meetings that you and the Commissioners have with the leaders of these organisations?---It may very well be. These meetings were designed originally and have been – have been pursuing along these lines where they are
40 meant to be a free-flowing dialogue between the board members and the Commissioners of ASIC. I believe that the reason why there is no formal minutes, at least from our side, is to enable that dialogue to be free-flowing. But I will make one amendment to that, because I, after attending one or two of these board meetings, I thought it entirely appropriate to have somebody there who was not a Commissioner,
45 who is in – in the cases that we’ve had in recent time, a senior executive leader, who observes the meeting and is not a Commissioner but observes the meeting, in many respects to ensure that we have a record and a witness to those discussions. And this

is something that I've instituted in recent times. And it is also now correlated to the senior executive leaders who are involved in our close and continuous monitoring program.

- 5 So why not have that person keep a formal record of some sort of the meeting?---I – I think that is something we can certainly look into. But the expectation on that person is that they would keep a record and they would escalate and they would highlight if there is a matter – significant matter that needed to be recorded.
- 10 Well, what would constitute a significant matter that needed to be recorded?---Well, for instance, if unbeknownst to our intent somebody did launch into great detail on a matter which was, let's say – this is all conjecture – but something that is not of a more general matter. These board meetings – these liaisons with the board, to be frank, the ones that I've attended to, I've done most of the talking, to be frank. To be frank, I've been passing on the messages, my expectations, and it has been a bit of a one-way dialogue. So no matters of significance, at least coming from a financial institution has been raised because I have been very forthright in using these platforms and forums to tell these people what I think.
- 15
- 20 So there hasn't been much in the way then of communication of considered and candid views by the entities in these meetings?---I actually find, which I was surprised when I first attended these meetings, I was surprised that such senior people spoke so little. So the degree of candidness was, to some degree, muted.
- 25 Do you think it would be preferable to keep some separation within ASIC between the enforcement function and the engagement function so that the parts of ASIC who are engaging frequently and cooperatively with the entities are kept distinct from the parts of ASIC who are making the decisions about enforcement action against those entities?---Yes, to a – to a – to a – to the degree practical that is, in part, the design and the structure that we are – that we are moving to under the reform agenda that I'm implementing.
- 30

35 You're referring there to something, I think, that I want to come back to, which is the creation of a new layer of people within your management structure who will take many of the day-to-day operational responsibilities away from the Commissioners. Is that right?---That is absolutely correct.

40 Okay. Now - - -?---In part. There's more to it but I'm sure we will come to that later.

40 We will. Now, I want to stick to the topic of transparency, which I've raised in connection with those questions, and turn to another of the regulatory tools referred to in the Statement of Expectations - - -

45 THE COMMISSIONER: Just before we leave that, Ms Orr, can I go back to this question of engagement with entities. Would not having a note-taker at these meetings ensure that there was a method of preserving the corporate memory within

the organisation of what has been said, when it has been said, and what was said?---Yes. I agree with that, Commissioner, and I think, in part, that was the intent behind having one of our senior executives for the first time attend these meetings in recent times.

5

But the preservation of corporate memory of contacts of this kind is itself, surely, a matter of very considerable importance to the proper governance of ASIC?---I certainly agree with that. I most certainly agree with that. And that is – that is, in part, why I initiated having a senior executive leader accompany us on these types of engagements.

10

Yes. As I recall your answer to one of the questions, it was that he or she would take a note of matters of significance. What I'm talking about is a note-taker as more generally understood, a note-taker who took a note of all that was said at the meeting?---Yes, it's a suggestion that I think is very worthy and I am minded now to ensure that this happens from here on.

15

You said also that if questions of enforcement – of – if mention was made of regulatory action that had been taken, you would wish to, as you put it, I think, reinforce and amplify the message conveyed by that regulatory action. What do you mean by that?---Well, firstly, Commissioner, the – I'm not aware of any of my interactions at this board level where there has been much time or significant time or significant mention of an enforcement action. But I would reserve the right that should a action be mentioned or if there's an action taking place, which is in the newspapers or something like that, using that opportunity to speak directly with the leaders of these financial institutions about the case at hand or the case in point, the regulatory message behind that, and in many respects – in fact every respect – either the specific deterrent aim or the general deterrent aim of that action. I would also hasten to add that we speak about other regulatory tools, such as reports and on site supervision, and so on, and we talk about, again, what we expect to be the outcome by way of behavioural change, deterrence, stopping of actions, and so on.

20

25

30

Yes.

MS ORR: I said, Mr Shipton, that I wanted to stick with the topic of transparency, which was part of the questions that I put to you earlier and turn to another of the regulatory tools mentioned in the Statement of Expectations, being Guidance. Now, you said earlier that that includes publishing reports?---Correct.

35

And ASIC issues a number of reports each year?---Yes, we do.

40

And some of those provide updates on your activities?---Yes, they most certainly do.

And some set out your response to submissions received on consultation papers?---That's correct, yes.

45

And some describe the results of reviews conducted by ASIC using its compulsory information-gathering powers?---Yes.

5 Now, I want to ask you about that last category of reports, reports containing the results of reviews where you've exercised your compulsory information-gathering powers. Over the course of this year, the Commission has referred to a number of those sorts of reports in the hearings. And in the last round of the Commission's hearings, the sixth round, there were a number of references to report 587 published a couple of months ago on the sale of direct life insurance?---Yes.

10 Now, there were also references in those hearings to report 498 on ASICs review of life insurance claims handling?---Yes.

15 Are you familiar with both of those reports?---I'm aware of both of those reports, yes.

20 Both of those reports identified poor practices on the part of financial services entities and set out ASICs expectations for how those entities should change their behaviour. Is that a fair description of them?---Yes, that's a fair description.

And both reports set out the results of detailed reviews that had been conducted by ASIC based on information brought in under compulsory information-gathering powers?---Yes.

25 Now, underpinning those reviews was ASIC investigating the practices of certain financial services entities. Is that correct?---Yes, that's correct.

30 Now, could I ask you to look – we will bring up report 498. That's the earlier of the two, the one dealing with claims handling in life insurance. RCD.0006.0016.0626. This is a report from October 2016 – I'm sorry, have I given the wrong number – sorry, I may have given the wrong number. We have it. Sorry. Perhaps I gave the right number but the wrong document came up. So this one is the report that was published in October 2016, report 498. And the findings in this report are based on ASICs industry-wide review of claims handling in the life insurance industry?---Yes.

35 Now, if we look at 0640 towards the beginning of the report, we see that ASIC there identified the 15 insurers covered by the review. Do you see that in Table 1?---Yes, I do.

40 But when it came to set out its detailed findings, ASIC did not identify which of its findings related to which of those insurers?---I believe that to be so.

45 And when ASIC set out case studies in this report based on its review, it didn't identify the insurer to whom the case study related?---I understand that to be the case.

And why not, Mr Shipton?---I'm not aware why not. I wasn't in ASIC at the time. But I would only point to the fact that reports of this nature during my time have named entities.

5 Well, I want to come to - - -?---Please.

- - - a report during your time. But do you agree that an important purpose of these reports is to get financial services entities to improve their practices?---Most definitely.

10

And do you agree that an entity that is publicly identified as being the worst performer amongst its peers is likely to have a strong incentive to improve their practices?---I most certainly do.

15 All right. Now, can we move to a report from your time. We tendered this report, I believe, in the sixth round of hearings but for completeness, I would be happy to tender it again in this round, Commissioner.

THE COMMISSIONER: If it has gone in, it has gone in.

20

MS ORR: Thank you. Now, I mentioned report 587 earlier. That's at RCD.0003.0075.0138. Now, this is a report published on 30 August this year, in your time as chair of ASIC, relating to the sales of direct life insurance?---Correct, yes.

25

And it summarises ASICs findings from its review of practices of those selling direct life insurance?---Yes, it does.

30 And if we turn to 0251. We see an appendix to the report which named the entities covered by the review?---Yes, it does.

As we saw in the other report?---Yes.

35 But when we see comparative diagrams within this report, we don't see any reference to the particular insurers. If I can give you an example at 0207, we see a table depicting claim outcomes for accidental death by firm. And we see that the data is presented as being referable to firm A, firm B, firm C, firm D, and firm E?---Yes.

40 Why didn't ASIC identify which of the insurers had engaged in which particular practices dealt with in this report?---I do not know in relation to this particular report. I have been briefed, though, however, that there are sometimes statistical reasons that it cannot be done. All I can say is that I've told the team in recent time that our strong preference – my strong preference is moving forward these types of reports
45 should identify the institution by name.

Well, what type of statistical reasons could there be? Either these statistics or good or they are poor. You've chosen to publish them so you have some degree of confidence in them. Why not identify the firms to which they relate?---As I said, I can't comment in this particular report. I was talking more generally about some of the difficulties moving forward, because I have had a conversation with my colleagues about moving forward that my strong preference is to ensure that these types of reports do name names. I am not aware of the reason in this particular report why it wasn't. All I can say is that I have expressed in very clear terms moving forward that these types of reports should name names.

And did you express those sentiments prior to 31 August when this report was published, Mr Shipton?---No, I – I did not express that prior to this report.

Right. So that's something that you've recently conveyed, is it?---It is something I have recently conveyed, yes.

And why have you conveyed that?---Because I – it came up in a – it came up in a decision relating to the publication of the breach report report and that was a matter which we reported, I think, on very significant practices by the financial institutions, and we decided to name names in that report, and from that experience of naming names, it was very clear to me, as you – as you make the case with this question – of the importance of naming names. It's very clear. I agree with you entirely.

Well, Mr Shipton, you say that you made the decision to name names in report 594. Report 594, like this report and the other I showed you, included multiple case studies throughout the report to demonstrate particular instances of noncompliance with section 912D. Those case studies did not identify the entity to which they related, did they?---Could you just clarify to which report you're referring to?

I'm referring now to the report that you've just directed me to - - -?---Yes.

- - - report 594?---If my memory serves me correctly, we do identify and we do identify the performance, the timeliness of – of financial institutions on a relative basis.

Well, perhaps if I can bring up on the screen for you some portions from report 594?---Please.

Which is the breach reporting report that you say embodies the decision that you made to name names. Now, while I find some references to that, can I ask you do you recall that one of the things that ASIC said in report 594 was that there were two financial services entities that had referred to remediation historically as a distraction?---I do remember that – that comment.

And do you recall whether ASIC named those two entities in report 594?---No, we didn't go to that detail, I don't believe.

Why not?---Because we believe that – well, I believe that the purpose of that report was to report on the broader themes and the broader theme was lack of – significant lack of timeliness and systems and processes in and around financial institutions.

5 But - - -?---We – we – we can't – I think there is a degree of judgment needed to be exercised to the extent that we name names, and we clearly decided not to name names on every single aspect and reference point in that – in that – in that report.

Well, why not, Mr Shipton? You – your evidence a moment ago was that you had
10 decided to name names and that report 594 was demonstrative of that decision. Do you now say that the decision was to name names in some respects in the report but not others?---Well, I – we were – we believe that in that – in that report we were reporting about themes and processes of the financial institutions, the important themes and processes and failings. We refrained from speaking about individual
15 cases in relation to that report because we were – this is a thematic industry-wide report. That was the intent and purpose. And I believe that the intent and purpose of that report was duly served.

You said to me a short time ago, Mr Shipton, that you agreed that an entity that's
20 publicly identified in a particular way, such as by being the worst performer is likely to have a strong incentive to improve their practices?---Yes.

So why not identify the entities, the two entities who you called out in this report as having referred to customer remediation as a distraction?---Because, as I said before,
25 the main purpose was to talk about systems and processes in financial institutions on a relative basis. That was the main purpose.

You don't think that purpose would have been well served by naming names throughout the report?---I – I don't – I don't – I don't think that it would have
30 necessarily added to the broader impact and purpose of that particular – of that important report. Again, the purpose was not to speak about case-by-case basis. The purpose and intent of that report was to talk about themes and processes as opposed to case specific matters. So there is a difference between the purpose. If it was a matter which was primarily aimed at case specific matters, then perhaps that would
35 be a more appropriate forum, but this was a report about processes, procedures, systems and decision-making inside financial institutions that were found wanting. But I am disturbed by that response. I agree with you. And I know that the team followed up directly with the institution on that.

40 What's the point of having case studies then in a report of this nature?---Case studies show – are examples of that – as I said, the purpose of this particular report was to identify systems failures, cultural failures, decision-making failures. That was the point. So having individual case studies in relation to that were examples of those failures. I think what we're – what we're speaking about here is, you know, an
45 exercise of judgment as to whether we make mention or name names of that particular incident is one that we – we exercise. For what it's worth, there are a number of examples also mentioned there that would trigger the same line of

questioning that you mentioned, and if we were to name names on each of those individual – let’s call them triggers or catalysts – the report would probably just be far too long.

5 Well, it wouldn’t increase the length of the report at all to use the name of the entity in each of the case studies, would it?---I think what we did – in fact, what I know we did was exercise judgment as to what we thought was meaningful disclosure. You are making a case, which I can certainly understand, that we should be disclosing each and every reference to incidents and observations. That is a degree of
10 professional judgment. I believe that the report was incredibly impactful and effective. And, you know, usage of examples and case studies are important. You make a good point. I – I see the point that you’re trying to make. But what I’m trying to also say is that we’re trying to exercise – let’s call it editorial judgment as to these types of reports moving forward.

15 THE COMMISSIONER: Well, let me understand. What’s against naming the entities that were picked out in the case studies?---Well, I think the – I think, Commissioner, Ms Orr is referring to some of the references, such as two cases which were – two cases where the reference was to a distraction.

20 Well, my question is directed to the fact that there are at least 17 – 18 case studies set out in the report, probably more, but my scrolling is not quick enough. Each of them is simply described as an AFS licensee did this, did that, did the other?---I apologise

25 What’s the downside in naming the AFS licensee?---I - - -

30 What’s the countervailing feature that forms this editorial judgment?---Apologies, Commissioner. I misunderstood the question. I think we may have been speaking at cross-purposes for quite some time, I apologise for that.

I don’t think you have been speaking at cross-purposes. Just focus on my question for the moment?---Of course.

35 What’s the down side in naming the AFSL holder?---As I understand the naming of the AFSL would have just taken more time to – to actually go through the process of – of – of agreeing – not agreeing, of confirming the facts and situations, almost a right to be heard by the actual case. But I believe you make, Commissioner, a very good point about the naming in the particular case studies moving forward. We – let
40 me – let me sort of explain where my thinking was when we made these decisions. We named names in the breach report in relation to relative bases, and I believe there’s a series of graphs as to the relative performance of different financial institutions. I now understand that you’re talking about the individual examples in case studies, and that is something we can certainly look at. I – I don’t want to
45 dispute the suggestion in that regard.

MS ORR: Perhaps it might assist you if I bring up an example of that - - -?---Please.

- - - from the report. If we go to RCD.0003.0078.0001. And we turn within that report to 0033. We will see at the bottom of that page case study 6, compliance systems:

5 *An AFS licensee’s external audit during the review period found it was not possible to conduct analysis of risk indicators such as customer complaints, operational issues and financial data (eg. customers’ refunds) to look for systemic compliance issues. The audit found that the present incident data was inadequate, incomplete and inaccurate, and as such would inhibit conducting such an analysis. In 2018, despite years attempting to improve the system, the licensee still had great difficulty searching their compliance system and, therefore, delivering reports of misconduct.*

10

15 Why did ASIC not identify the AFS licensee to whom this case study related?---I – my – my – my response would be I certainly see the utility of disclosing the name of the licensee in this particular point in time. And I would also suggest, subject to any statutory limitations or fairness limitations, that this is something that we should be thinking about moving forward.

20 Well, what are the statutory limitations, in your view, Mr Shipton?---Well, I would have to seek advice from – from my legal office but I know that there – I am informed that there could be some restrictions about usage in the public domain of material. I cannot opine on that because I’m not an expert on this area, but subject to there being clearance and – and an ability to do that, I believe that the suggestion that you are making is a good one. I would also quickly add that what we are doing is at a journey. We are starting – and we started with this, in my – at least my time at ASIC, we’ve started with naming more names than we’ve named before in relation to the relative performance. The next suggestion, which you are clearly making, is that we name names in case studies and I think that has utility.

25

30 Yes, I want to be very clear, Mr Shipton. I put to you that you are not naming enough names?---Well, I think you made a good point, Ms Orr.

35 All right. I will tender the breach report, report 594, Commissioner.

THE COMMISSIONER: ASIC report, report 594, Review of Selected Financial Services Groups Compliance with the Breach Reporting Obligation, RCD.0003.0078.0001 becomes exhibit 7.65.

40 **EXHIBIT #7.65 ASIC REPORT, REPORT 594, REVIEW OF SELECTED FINANCIAL SERVICES GROUPS COMPLIANCE WITH THE BREACH REPORTING OBLIGATION (RCD.0003.0078.0001)**

45

MS ORR: Mr Shipton, does ASIC discuss the findings in these sorts of reports with the entities involved before it releases the findings?---I believe in this particular case, in the interests of fairness, we informed the financial institutions, yes.

5 I want to understand that. So what do you mean “in the interests of fairness”?
You’ve exercised your compulsory information-gathering powers to bring this
information in. You have analysed it. You have prepared a report. Why is it in the
interests of fairness for you to discuss the results of the report with the entity before
you make those results public?---I wouldn’t say “discuss”, I would say notify as a
10 matter of, as I said, fairness so that they have an awareness that we’re going to
publish their names.

Why do you need to give your regulated entities awareness of these matters before
you release them to the public?---I – as I said, I – I would regard it as – as a matter of
15 fairness.

Well, I just want to try and understand this more and why you’re concerned about
fairness with your regulated population, when you have brought in information that
yields very disturbing results about the conduct of your regulated population, why
20 are you concerned at that point to be fair by giving them advance notice of your
findings?---I – I do not believe that giving advance notice of our intent to publish
their names in any way distracts from the importance and the impact of this
particular report. And as an administrative body, I – and as an – as the administrator
of an administrative body I, and I know my colleagues keep in mind procedural
25 fairness type concepts in the execution of our work. I do not believe that providing
notification – advance notification that we are going to publish this in any way
detracts from the impact or the importance of it.

Does this come back to the relationship that you’re trying to cultivate and maintain
30 with the entity, Mr Shipton?---Absolutely not. Absolutely not. I see it as the
exercise of professional judgment. I – I see it as ensuring that we are tough, we are
resolute, we are strong, but we also apply principles of fairness and – and follow due
process. I – I do not see that there is an inconsistency in those two concepts.

35 Has ASIC at times discussed the recommendations that it proposes to make in these
reports with the entities involved in the review?---Not that I’m aware of.

Does ASIC invite at any time the entities involved in the reviews to comment on the
findings in the review before finalisation of the report?---Not that I’m aware of.
40

All right. Could I ask you to look at ASIC.0081.0004.2852. Now, this is a
document, I believe, would have been shown to you in preparation for your evidence,
Mr Shipton. It’s an ASIC note about a meeting with a representative of BT Financial
on 1 June this year. And if we bring up 2857 and 2858, we see on these pages
45 references to an ASIC report in relation to adviser-operated accounts. Do you see
that at the top of the left-hand side?---Yes. May I – may I, please, see the front page
of this?

Yes, Mr Shipton. It was 2852?---So that's the front page. Pardon me. Thank you.

And if we go back to 2857 and 2858 – we're part way through the paper now under the heading Other Issues and we see a reference to an ASIC report about adviser-operated accounts. Do you see that?---Yes.

And ASIC is about to publish its report of key findings and recommendations?---Yes.

10 Do you see that?---Yes.

Following a review that we see under the table had been commenced in April 2017, which involved five banks, including Westpac. Do you see that information on the left-hand side of the page around – and then over on the right-hand side of the page –
15 I'm sorry, we don't have the right page. We need 2858 on the right-hand side of the screen. Now we see the two pages as they appear in the report, Mr Shipton. And under ASICs review and report, the second dot point we see that:

20 *DCI met with Westpac on 18 October 2017 to discuss the practices we observed across all banks in the review. Following the meeting, Westpac wrote to ASIC setting out its position on the findings and recommendations, and rejected some of the recommendations. ASIC has not responded to this yet as we are finalising the report.*

25 ?---Yes.

Do you see that? So this was in June this year, engagement with one of the entities who was the subject of the review about the findings and recommendations resulting in Westpac writing to ASIC with its view of those findings and recommendations
30 prior to publication?---Yes.

Do you wish to comment on that? That appears to be inconsistent with the answer you gave earlier?---I don't think it's inconsistent. I – I would point out – I point out that these are briefing notes of a meeting that I didn't attend.

35 Yes?---I point out that the conversation about that feedback was in October in 2017.

Yes?---And if there was – if there was a back and forth, I'm – I'm not aware of it, and I do not know what happened in relation to that correspondence or that
40 interaction. I would also - - -

I'm sorry?---I would also point out that often it's the time that – it's very often the case that financial institutions put us – put to us many things that we don't necessarily - - -

45 Yes?--- - - - take on board.

5 But I asked you earlier if ASIC ever discusses the recommendations or findings in these reports with the entities prior to publication. This shows that in this instance, that sort of discussion did occur?---Well, let me – let me – let me emphasise the point. Not that I was aware of. And I was also talking about at the time – during the time at my tenure here at ASIC. So that was the context in which I was responding to your question earlier.

10 Did you review this document before you gave evidence, Mr Shipton?---Yes, I did look at this document before I gave evidence, but I reviewed – had to review thousands of pages of documents before I gave evidence. So it’s difficult for me to know – have knowledge of each and every paragraph in each of those documents.

15 But now that you’ve seen these paragraphs in this document, do you agree that it appears that ASIC does at times discuss the recommendations and findings that it proposes to make in these reports with the entities who are the subject of the report prior to publication?

20 MR COLLINSON: Well, can I raise an objection, Commissioner. My friend has put this a number of times. I don’t want to help the witness but it’s not what the paragraph says. There’s a degree of precision which would be appropriate for this line of questioning.

THE COMMISSIONER: Yes. Well, put the question again, Ms Orr.

25 MS ORR: Well - - -

THE COMMISSIONER: Just wait before you answer it, would you, Mr Shipton. What’s the question, Ms Orr?

30 MS ORR: I’m focusing, Mr Shipton, on a particular line in the paragraph before you:

35 *Following the meeting, Westpac wrote to ASIC setting out its position on the findings and recommendations, and rejected some of the recommendations.*

40 Now, having read that sentence, I’m asking you whether you wish to qualify the answer that you gave me to an earlier question about whether ASIC does, at times, discuss the recommendations that it proposes to make in reports with the entity the subject of the report prior to publication?

THE COMMISSIONER: Just a moment, Mr Shipton. Do you maintain the objection, Mr Collinson, in - - -

45 MR COLLINSON: No.

THE COMMISSIONER: No. Yes?---Well, I – the point – I used the expression “notify”. I’m not aware that this paragraph says that there is actually a two-way

discussion or a response from us in relation. “ASIC has not responded to this yet.” So that that was a matter that was, it seems from my reading – and, again, I do not have context as to what happened in October 2017 – but my reading of that is that we notified Westpac. They came back and we did not respond.

5

MS ORR: Well, you can see that there was a meeting with Westpac on 18 October 2017 “to discuss the practices we observed across all banks in the review”. And following that meeting, Westpac wrote setting out its position on the findings and recommendations. Do you say that that suggests that the findings and
10 recommendations were not discussed at the meeting referred to in that paragraph?--Well, there was a discussion but what I am – the – what I am trying to make the point of is that often there is one-way discussions. Often, a matter can be put to us which we reject. In fact, that happens to us in our – in our – in our
15 existence on a very frequent matter. There are representations and submissions made to us. I cannot – I cannot conclude with the – the documents before me that there was a back and forth discussion, a full connotation of a full back and forward discussion. That’s why I wanted to be quite precise about the one – the apparent one-way nature of this interaction.

20 All right. I will tender that document, Commissioner.

THE COMMISSIONER: ASIC note of meeting with BT Financial dated, Ms Orr?

MS ORR: Dated 1 June 2018.

25

THE COMMISSIONER: 1 June ’18, ASIC.0081.0004.2852, exhibit 7.66.

30 **EXHIBIT #7.66 ASIC NOTE OF MEETING WITH BT FINANCIAL DATED 01/06/2018 (ASIC.0081.0004.2852)**

MS ORR: Yes. Mr Shipton, I want to turn to another of the regulatory tools referred to in the government Statement of Expectations and that’s enforcement
35 action. And the government has been clear in the Statement of Expectations about what it expects on the role of enforcement action. Do you agree with that?--Yes, I – I do. It would be helpful if we could have that back up - - -

40 Have that on the screen of course. It’s ASIC.0800.0016.3087. And perhaps if I could direct your attention to paragraph 8:

45 *The government expects ASIC to use its full regulatory tool kit and to direct a substantial proportion of its resources to surveillance and enforcement. Timely and effective enforcement strategies will deter misconduct and maintain confidence in the financial system. ASIC should clearly articulate publicly when it will and will not take certain enforcement action, so as to manage the public’s expectations and to promote confidence in ASIC.*

Now, Mr Shipton, can I ask you, firstly, in the time that you have been with ASIC, do you consider that ASIC has used its full regulatory tool kit and directed a substantial proportion of its resources to surveillance and enforcement in the way contemplated by the Statement of Expectations?---The starting point is yes, but I do believe that there could be builds and improvements.

In what way, Mr Shipton?---Well, I believe that we need to be using our enforcement tools more effectively and more – on a – on a more timely basis moving forward, amongst other things, and I also believe that we should be utilising new types of regulatory tools like supervision – on site supervision, the close and continuous monitoring program that no doubt we will speak about later.

We will. What about considering that question based on your engagement with the matters highlighted by the Royal Commission. So I'm turning now to a period that includes prior to your time - - -?---Yes.

- - - as chair of ASIC. What observations do you have about whether ASIC has in the past used its full regulatory tool kit and undertaken timely and effective enforcement strategies?---I would say that there is certainly room for improvement as regards the timeliness of conducting and starting investigations and commencing legal proceedings. I would also hasten to add, though, that what we're talking about is, essentially, because of the regulatory choices we have to make and the resource constraints in which we operate, with – you know, in many respects it's a binary choice. We can't do everything that we would like to do at a particular point in time. So I would comment in the past that decisions were made with that context in mind. But moving forward, I have certainly issued instructions that we should be utilising enforcement tools, particularly in relation to large financial institutions, more frequently and as quickly as possible. And that's why we've sought to accelerate our enforcement program.

You focused very heavily in that answer on the timely aspect of this statement. What about the requirement to engage in effective enforcement strategies. Do you have any observations to make about whether ASIC has engaged in effective enforcement strategies. And I want you to consider that question through the lens, in particular, of matters that you've seen in the Royal Commission this year?---Yes. So I think if I was looking at the word "effective" through that lens, I would anchor that – my response on deterrence, both specific and general. And I think, both through being informed by the – the work of the Royal Commission, but also in my observations returning to Australia, that the utilisation of tools with a particular and robust deterrent capability is something that needs to be utilised more frequently, more often, and, as I said earlier, more quickly in relation to larger financial institutions as well as others.

In ASICs submissions in response to the Commission's interim report, ASIC accepted that it needed to alter its enforcement priorities and practices within the financial sector, particularly for large financial institutions. Are the matters that you just discussed the ways in which you believe that ASIC should alter its enforcement

5 priorities and practices, or is there more to that?---Well, there's a – the – there's a number of things to that. There's a number of areas that we are now actively working to accelerate our enforcement outcomes. Large financial institutions is one, but also in the wealth management space is another, and we have a range of areas that we believe there is demonstrable harm or threat of harm in the sector to consumers that we are working to prioritise.

10 So in what particular ways do you think that ASIC needs to alter its enforcement priorities and practices? Could you explain that?---We need to do more - - -

Yes?--- - - - enforcement actions in relation to this misconduct.

So more of it?---More of it.

15 That's the answer?---More of it and quicker and more robust, utilising court-based tools, utilising court-based tools because that would be at the apex of the enforcement pyramid, as it were, and realising that in the case of a number of financial institutions or segments of the financial institution, that we – that – that the previous tactics have not been as successful as they – as we hoped them to be, and, therefore, we need to up our ante and be more agile in the – in the deployment of that enforcement tool.

25 So do I understand that answer to mean there needs to be more enforcement action taken by ASIC, it needs to be taken more quickly, and it needs to involve more court-based tools?---Yes. That's exactly right. The only limitation to that, of course, is resource constraints, but that is certainly our intent and that was the intent behind some of the structural changes that we've put into place in and around enforcement and enforcement decision-making. That was certainly the intent of the government and myself in bringing on board a deputy chair who has a leadership role in enforcement matters.

35 In the submissions that ASIC gave the Commission in response to the interim report, ASIC referred to a number of things that it has done already with a view to altering its enforcement priorities and practices. One of those was commissioning a review and analysis of your enforcement policies, processes, and decision-making procedures, which you refer to in your statement as the internal enforcement review?---That's correct. That's one of the responses, yes.

40 And pending the outcome of that review, you've introduced a number of interim measures which you refer to as the interim enforcement measures, which require decisions that might result in a matter not being litigated where there is a prospect of litigation being reported to a deputy Commissioner?---To the deputy chair or another Commissioner, correct, yes.

45 And you also refer – ASIC refers in those submissions to accelerating your enforcement activities through greater use of external expertise and resources. Does that include through ASIC's expanded wealth management project?---Yes. So there's

a – there’s a correlation between the deployment of that extra funding which we received in August - - -

Yes?--- - - - and what is now termed the expanded wealth management program.

5

Now, I want to ask you a little more about the internal enforcement review?---Please.

You proposed to the other Commissioners that an internal enforcement review be done on 21 September this year?---That’s correct, yes.

10

And what made you make that suggestion on 21 September this year?---In part, some of the testimony that was being made at the Royal Commission, but also because it was an agenda item of mine from the very beginning of my tenure at ASIC to work with Mr Crennan, the deputy chair with enforcement oversight, to undertake a review. So this was always in the works. This was always an intent. This was always a plan of both Mr Crennan and myself, but with – without a doubt, that was catalysed into action because of the, to be honest, what I thought important testimony in the week leading up to that date.

15

20 So that proposal on 21 September was made a week after the conclusion of that sixth round of public hearings?---I believe it – I believe my conversations – verbal conversations were earlier than that but it’s around about that time.

25 And influenced, you say, by the evidence in those hearings?---I have been highly informed and influenced by the work of the Royal Commission throughout this last nine months.

30 And it was also a week prior to the publication of the interim report. Was the impending interim report a factor in your proposal?---I can tell you honestly and sincerely, no.

Now, you suggested that Mr Crennan, one of your deputy Commissioners lead the review?---Deputy chairs, yes.

35 I’m sorry, your deputy chair. And on 1 October, which was the Monday after the Friday on which the interim report was published you emailed Mr Crennan about the review. Do you recall that?---Yes, I recall the email. I don’t recall the exact date.

40 I will bring it up on to the screen, if it assists. It’s ASIC.0079.0002.0029. So we see your email starting partway down the page on 1 October to Mr Crennan?---Yes.

So 1 October, being that Monday after the release of the interim report. By the time you wrote this email, you had read the interim report?---Yes, I had. Yes, that weekend.

45

And you sent in this email to Mr Crennan, what you described as a first cut of the terms of reference for the review?---Yes, I thought that would be helpful for Mr Crennan.

5 Now, at this time, what were your key objectives for the review?---The key objectives were, if – if I can sort of be prompted by my email, essentially, to look at a root and branch review of how we made decisions in relation to – about taking enforcement action or pursuing other alternatives, and making sure that we had the – you know, the best possible decision-making processes and guidelines and that we updated them to be what I hoped – and I expect them to be the very best practice that we can apply.

10 So this is your first cut of the terms of reference. It then took a couple of weeks for the terms of reference to be finalised. Do you recall that?---Yes, I recall a number of discussions I had with Mr Crennan and my fellow Commissioners to finalise a terms of reference.

15 And they were finalised by the Commission – by ASIC on 17 October 2018. Is that right?---That’s right.

20 And that was after this Commission, the Royal Commission, had issued a notice to produce for the terms of reference for the review. Do you recall that?---Yes. I do recall that the notice to produce actually predated the – predated the finalisation. So that is correct, yes.

25 All right. Now, you’ve annexed a copy of the final terms of reference to your statement. And I would like to take you to those, but first I will tender this email, Commissioner.

30 THE COMMISSIONER: Email Shipton to Crennan, 1 October ’18, ASIC.0079.0002.0029, exhibit 7.67.

35 **EXHIBIT #7.67 EMAIL SHIPTON TO CRENNAN DATED 01/10/2018 (ASIC.0079.0002.0029)**

40 MS ORR: Now, the terms of reference are ASIC.0079.0007.0001. And we see, if we turn to 0002, in paragraph 2, that the review:

45 *...is forward looking and is designed to identify what changes should be made to the enforcement policies aligning with internal and external expectations of ASIC and ensuring ASIC obtains enforcement outcomes that are necessary for a fair, strong and efficient financial system for all Australians.*

?---Yes.

And we see from paragraph 3 that there was to be an assessment of:

Regulatory, supervisory and investigatory policies.

5 ?---Yes.

Now, Mr Shipton, what were the key changes between your first cut of the terms of reference and this final approved version?---I – I – I couldn't, off the top of my head, give you an analysis or document comparison between one or the other, except to
10 emphasise that that first cut was written over a weekend with initial thoughts, it was a stream of consciousness, which I hoped would inform Mr Crennan who had pen – who had the pen on this – on this particular terms of reference.

In your first cut of the terms of reference, you posed a broad question which was
15 what are, in practice, the enforcement goals being pursued? Do you recall that from your email, Mr Shipton?---Yes, that sounds right.

I can bring it back on the screen if that would assist you?---Yes, that would help, yes.

20 Yes. Back to ASIC.0079.0002.0029. And if we look at your paragraph 2(b), you see your question:

What are, in practice, the enforcement goals being pursued?

25 ?---Yes.

Now, we don't see that sort of higher order question in the final terms of reference?---Yes.

30 Do you know why not? Why has that idea that you had about interrogating the enforcement goals that ASIC is pursuing not been incorporated into the terms of reference?---I cannot explain why that particular form of words is absent from the final terms of reference. But all I can say is that the spirit of the terms of reference is very much aligned with that sentiment.

35 I understand. What, Mr Shipton, in practice are the enforcement goals that you think ASIC should be pursuing?---Well, I have – I have – I have actually provided input to my colleagues on a range of different enforcement goals, and that – that input is presumably being processed – not presumably, I know being processed and
40 considered by my colleagues - - -

Could - - -?--- - - - which includes – which includes, you know, being more willing to take on enforcement actions. Prioritising cases where I believe that there has been disregard or disdain by financial institutions to us or misleading conduct to us. I
45 believe that we should be prioritising cases that should have a – will have meaningful specific and general deterrence. I also believe that we should be looking very closely at cases where there is demonstrable conflict of issues issues that are at hand. I will

5 pause there to make an observation, because, of course, there is a cross-over between enforcement goals being pursued, which is a strategic – which is a strategic decision, and that strategic decision will be made by the Commission, and the terms of reference of the – of – of the enforcement review, which is looking at an adjunct, related adjunct to that which is how do we have the processes and procedures to implement and give effect to those goals or strategies.

10 But do you accept that it's necessary to understand what those goals are before you can work out whether you have the tools to achieve those goals?---Absolutely. And that's why I have passed on to my colleagues what I believe are a number of goals. I have – you know, I have a whole range of different views on those goals. But equally – equally, these procedures that we hope to adopt will endure as those goals will change which, of course, they will over time. So what we're trying to do here by this exercise and related exercises no doubt that we will come to, because this
15 terms of reference is only in relation to the processes and procedures that apply to our enforcement and investigatory processes. Separate to that is changes afoot relating to the development of our overarching regulatory strategy which includes enforcement goals.

20 Now, your goals, as you've articulated them, sound more like priorities that might shift at different points in time than enduring goals, such as to deter misconduct, to change behaviour. Is that right? Do I understand correctly what you've articulated as goals are priorities about - - -?---I think – I think it's important to clarify that we're talking in this email – I was talking about, essentially, two things: best
25 processes, structures, decision-making on one hand and, secondly, priorities. Deterrence will always be a priority. Enforcing the law will always be a priority. But the tools that we approach and the tools that we apply to do that, and how we do that, how we deploy it, what resources we have at a particular point in time will vary. So the processes will endure. The processes are designed to enable that change of
30 strategy, but, yes, of course, there are, as you allude, perennials in our world and the perennial is the enforcement of the law, the perennial is the administration of the law. A perennial is to have deterrence and a perennial is to make sure we act against bad actions.

35 Now, ASIC has appointed a number of external people to assist in this task. Is that right?---That's correct.

You've appointed three barristers?---Yes, that's right.

40 An academic?---That's right.

And a deputy commissioner of the Australian Federal Police?---Correct.

45 What is the role of that last person in this review, the deputy commissioner of the Australian Federal Police?---Well, we thought it would be very good to have an investigatory input into it, and a law enforcement input because we wanted to make sure that we had different angles, all of the angles covered. Because, of course, when

one thinks about our enforcement processes, it includes an investigatory component to it, and we thought that there would be no better person than a senior police officer to – to provide input and guidance on that.

5 Will the product of the review be a report, Mr Shipton?---The product of the review will be proposals to change our internal practices, guidelines and procedures. And, if necessary, terms of reference of – of our enforcement committee, which is the principal decision-making forum for enforcement matters.

10 And when will those proposals to change practices be available to the Commission – our Commission?---This is of high importance to us that we would like to get these changes and proposals to the Commission – your Commission – as soon as practicable. In fact, what we have done is accelerate the timing – the original timing was going to be in the new year, but because we believe that it's important that you,
15 the Royal Commission, have – have sight of these, that we're bringing it forward to – to a December time. Hopefully before the holiday season.

What time in December are you anticipating being able to provide this to us, Mr Shipton?---I – I believe that we're aiming for mid-December, but please be assured
20 we are working as quickly as we possibly can to get it done as soon as possible.

Have those undertaking the review communicated any preliminary views to you?---No, they haven't communicated any preliminary views to me. I have, nonetheless, been speaking to Mr Crennan about progress, and his interactions. And
25 I've, nonetheless, submitted my thoughts to Mr Crennan and to – and to my other Commissioners as well, and no doubt I will be getting feedback very soon on that.

So has Mr Crennan indicated any preliminary views on his part or of those assisting him to you?---Not preliminary views, no. We – it has been – it has been, at this
30 stage, me providing inputs to them at this stage.

So have there been any preliminary concerns communicated to you about your existing policies and processes?---There has been a comment that we need to be mindful about entrenched conventions or practices that have come into existence and
35 ensure that those practices are practices that are rooted and grounded in – in a procedure that we want them to be. And I think that's a – a very astute finding and area to watch out for. In fact, I had an early conversation with Mr Crennan about this, that we also have to be mindful that practices and conventions build up in institutions and that we have to test and challenge those practices to ensure that they
40 are actually adhering to guidelines that – that we believe to be appropriate.

What sorts of entrenched conventions or practices were being referred to?---I haven't gone into that level of detail with Mr Crennan except to say that I understand that, you know, ways of doing things or, you know, default thinking often in any
45 organisation it – is very common. And I have experienced that over work – working in the public and the private sector over many years, but because it has been done one way in the last – in the last time that we had a matter like this, we will do it the

same way again. That was the type of thing that I asked Mr Crennan to be mindful of. Mr Crennan has given me feedback essentially to say that that – that is a – that is a very appropriate thing to be watching out for.

5 Has Mr Crennan or those working with him signalled any changes that they're considering recommending?---Not to me. Again, I – I provided inputs to them and I understand that they're working very hard reviewing processes, sitting in on meetings, and – and investigating and interrogating and interacting with decision-makers and people in the processes, including at sort of the very initial stage, the
10 very end stage. So at this point in time given that that degree of interrogation and deep diving is taking place, I'm leaving it to those professionals who I have every confidence in to do that research and no doubt when that deep dive, that deep interrogation is finished, they will come back to us as a Commission.

15 I also mentioned the Expanded Wealth Management Project to you, Mr Shipton, and I think you agreed that that was part of ASICs acceleration of its enforcement activities. When was the Wealth Management Project originally created?---I do not know the exact date but I believe that it has been in existence for – for quite some time. I – I would imagine a number of years.

20 And it was created to focus on investigations and enforcement action concerning wealth management operations of the major banks, AMP and Macquarie?---I believe that that was a significant part of their original work, yes.

25 And historically, it has been funded by the enforcement special account or the ESA?---That's correct, yes.

Can you explain what the enforcement special account is?---Yes, I can. The enforcement special account is a special funding reserve that is given to us,
30 appropriated to us by the government to allow us to undertake significant enforcement matters, and it is – let's call it a sequestered funding arrangement so as to ensure the independence of our enforcement decisions from government. In other words, it is not tied to the appropriation. It is permanent funding and it is our funding that we don't have to use or lose on an annual basis.

35 In August this year the government announced a package of additional funding for ASIC?---They certainly did, and that was in response to what I call a surge strategy that we came to in March/April of this year.

40 Can you explain what you mean by a surge strategy?---So early in my tenure I determined, within three or four months of arriving in the role, that ASIC needed to pivot to new approaches. One of those approaches was that we needed to accelerate our enforcement outcomes. We needed more resources to get the case book through as quickly as possible, but in addition I also identified and proposed to my fellow
45 Commissioners that we adopt new supervisory strategies and new approaches, amongst other things, with regulatory technology and a focus on corporate governance.

So the package included \$26.2 million to accelerate and increase the intensity of ASICs enforcement activities and enhance its capacity to pursue actions for serious misconduct against well-funded litigants through the enforcement special account?---Correct.

5

And has that funding been used to expand the wealth management project?---Yes, it has been used directly to expand that.

10 And the expanded wealth management project will investigate and address issues that have arisen from the Royal Commission?---Yes, amongst others, correct.

15 And an early suggestion by Mr Mullaly, the senior executive leader of financial services enforcement at ASIC, was that the expanded wealth management project be called the Royal Commission response team. Are you aware of that?---Yes, I did see that proposal in an email correspondence which was not directed to me but that was a – a proposal, as I understand it, of a number of different names.

20 Because the Expanded Wealth Management Project is going to deal with matters raised by the Royal Commission which ASIC was not otherwise investigating?---I would put it – a way that we have been investigating or aware or undertaking regulatory work on a – on a range of different matters which were subject of the Royal Commission. The way I would describe it is that obviously we are informed by the Royal Commission and the matters at hand that have been raised at the Royal Commission are each individually being re-evaluated if – if an investigation is not
25 already underway or is – it’s a matter of surveillance or the investigation was suspended for whatever reason, we are undertaking a project to re-evaluate each and every case that has been mentioned at the Royal Commission to ensure that we are getting the right approach to it.

30 But there are a number of matters that have been raised by the Royal Commission which are going to be examined by the Expanded Wealth Management Project which ASIC was not investigating. Do you agree with that?---Yes, I believe there were some matters of that nature.

35 Yes. Now, in the documents that ASIC has provided to the Commission about the expanded wealth management project, there are suggestions that this project is going to do things differently. How is the Expanded Wealth Management Project going to do things differently, Mr Shipton?---There is a number of ways. I believe Mr Mullaly and also I have provided inputs that we should be thinking about more novel
40 solutions to particular matters. We should be thinking creatively in relation to utilisation of other provisions of the Act. But above all, what we are doing is also asking ourselves in each and every occasion should we be pursuing court-based enforcement actions for these matters. We also have a particular intensity – and this is a broader goal of mine – a particular intensity in relation to breaches of section
45 912D, the breach reporting provision. That is a particular – that is an area of particular focus, and rightly so. And we are also – we are also recruiting, I believe, up to 40 staff to – to help on this project. We are also going to be utilising – utilising

specialists, like IT specialists, forensic accountants, and so on, with this funding, and finally, I understand that what we are doing differently is briefing junior counsel, for instance, to undertake banning order actions which ordinarily would have been undertaken by ASIC staff, in other words – in other words freeing up resources. So
5 we are doing things differently from a – how we do a – how we handle a matter from a work basis, but we’re also applying new ideas, new methodologies, and the final point that I have said to Mr Mullaly on this, we should be thinking about sequencing our – the publication of our enforcement or going live with our enforcement matters. In other words, there has been a convention or a tradition or a business practice
10 whereby everything in relation to a matter, in relation to an entity, is gathered up and all of the different component parts are gathered together. I’ve encouraged Mr Mullaly and he agrees if there could be a component of the broader issue there could be an action or a court action that could be separated that we wouldn’t wait for those other component parts to be finished if that investigation was complete and we were
15 good to go.

I want to ask you some questions about how ASIC decides what to do when it has formed the view that a financial services entity may have engaged in misconduct. Do you understand?---May have engaged?
20

Yes. Now, I will come back to that, and why I have used those words. But I want to start by understanding who the principal actors are within ASIC who deal with misconduct and how responsibility is divided across the different teams. You have stakeholder teams within ASIC?---Yes, we do.
25

And what do they do?---They’re basically teams that are responsible for surveillance and – and – and supervision. They are – they are best described as non-enforcement teams.
30

And what do your enforcement teams do?---Well, the enforcement teams conduct a number of things. They conduct investigations into potential breaches, and they pursue litigation, court-based litigation, administrative action, enforceable undertakings, and they run that – that – let’s call it legal process.
35

And the enforcement committee which you’ve referred to in your evidence already. Can you explain the function of the enforcement committee?---The enforcement committee is the main decision-making forum for significant or major enforcement matters.
40

And who is on the enforcement committee?---There are the Commissioners and a number of SELs – senior executive leaders.

Now, I want to understand in a broad sense how these teams interact in respect of enforcement activities and how decisions are made at each stage of the process. And I want to do that by reference to ASICs information sheet 151. I will bring that up.
45 And it’s an exhibit to your statement. ASIC.0902.0001.0067. Now, this information

sheet represents ASICs current approach to enforcement?---Yes, current. And this – this information sheet is – is under review by the enforcement review at the moment.

5 Yes. But as of today, this document reflects your approach to enforcement?---Yes. But I would quickly add that the interim measures are an important addendum to this.

10 Yes. I understand. Now, I want to ask you to look at 0068 which contains a flowchart depicting ASICs approach to enforcement. And this flowchart shows, in summary form, what happens after ASIC receives a report of misconduct?---Yes.

15 And it records a number of important decisions made at different points in the life of a matter. And the first is whether or not the potential misconduct that has been reported falls within your regulatory responsibility?---That’s correct. And that really goes to a jurisdictional - - -

15 Yes?--- - - - question.

20 And if it does, then ASIC proceeds to conduct an assessment of the matter by reference to the factors indicated in the first white box?---Correct.

Now, who undertakes that assessment? Is that the stakeholder team?---Well, it depends where this report comes from. And if you look at the very top line - - -

25 Yes?--- - - - there are different points of entry - - -

Yes?--- - - - for these reports or complaints. They can be given to us by external parties, they can be given us by breach report or they could be discovered in our own work.

30 So a breach report. Who undertakes the assessment for a breach report matter?---A breach report would come into our breach reporting team.

35 Right. I see. So the type of report that carries the allegation of potential misconduct determines who it is who assesses the matter?---Yes. So if it comes in, the initial – the very initial response would be whoever is the ASIC team receiving that information. Again, it could be a report or it could be a discovery by ourselves.

40 And then the next decision that’s made is whether a formal investigation should be held?---Correct.

45 And is that decision co-extensive with the decision about whether the enforcement team will accept a referral from the stakeholder team or whichever team has conducted the assessment?---Yes. So that – that really is a question – well, firstly, there is an assessment by the team, often with the breach reporting team, they will then hand off or liaise with the relevant stakeholder team. So there is a – an important coordination with the relevant party and the relevant entity or the relevant group. So decisions are not made in isolation. There is – there is – there is – there is

interaction and coordination. And then whether or not a decision to conduct a formal investigation is and essentially the formal nature of that is the decision – the formal referral process, but, as I said before, there is interaction and liaison with not only stakeholder groups but often enforcement colleagues to get their advice and guidance, and often legal colleagues to get their inputs as to legal matters.

Now, if a decision is made to hold a formal investigation, that's led by the enforcement team. Is that right?---Correct. So there's a referral, a referral process, duly documented, and then an investigation will be conducted by the enforcement team.

And from what you've seen in your role so far, including through the evidence in the Royal Commission, do you think ASIC has failed to commence formal investigations against large financial institutions when it ought to have done so?---I – I don't – I wouldn't agree with the word "fail". What I would make the observation is that we get approximately 2000 breach reports a year. We get, I think, approximately, 12,000 complaints a year. And we have approximately 240 staff in enforcement. So we have to make real-time decisions as to which matters we can investigate. I would not consider the very difficult real-time choices and very hard choices as a failure. And to put that number – I think it's important to give context – and this isn't a like for like – but when I say 240 – without reference, that's probably – that doesn't mean anything. So, again, this is not a like for like reference, but we have less staff in enforcement of that 240 than there are sworn police officers in the Australian Capital Territory. In fact, there are nearly three times as many sworn police officers in the Australian Capital Territory than we have staff members in enforcement. Now, I just say that not because it's a like for like reference, but to give you a context of the volumes – the tens of thousands of complaints we receive, the number of resources that we have, which means we have to make very difficult choices. So I don't think that's a failure. What I do think, though, it is a very difficult process to make the right decisions. And that's why we are reviewing the processes around our decision-making in this area.

What sort of proportion of the 2000 - - -

THE COMMISSIONER: Reviewing them on the basis that whatever their outcome, it's not a failure. Is that the premise?---Not a failure.

That's what I took from your answer, Mr Shipton, and it's a very odd conclusion?---Commissioner, I would say that it's a restriction. Without a doubt we have to make regulatory choices. I – I don't - - -

I understand that. I well understand that. Yes.

MS ORR: The 2000 breach reports that you said come in a year, what rough proportion of those come in from the major financial institutions?---I do not have that number at hand. Can I also highlight that we have had nearly 40 to 50 per cent increase in breach reports in the last couple of months.

Now, Mr Shipton, prior to the evidence that was given by NAB in the first round of hearings in the Royal Commission in March, had ASIC contemplated investigating NAB for its conduct in overseeing its introducer program?---Not – I – I do not believe that that was a decision to expand that investigation. That decision at that time – that decision was made, I believe, only in the last couple of months.

In the last couple of months?---Yes.

So do I understand from your answer that ASIC had not contemplated investigating NAB for its conduct in overseeing the introducer program prior to the evidence?---Contemplation – let me just – let me just sort of say a decision was made so that it was – it was contemplated but a decision was made, as I understand it, to focus in on the wrongdoing of the individuals and to investigate the – the individuals, and that investigation is continuing.

Yes?---That was then – that investigation was expanded to include NAB in recent times. So, yes, there was a contemplation, but there was a decision, again, with resource constraints in mind, also in mind that there was a number of other things going on at that time, and that’s why I was talking about resource constraints, and the regulatory decisions that we have to make. But I will most certainly say that we should have made that decision earlier.

Was that a failing, Mr Shipton?---That was unfortunate, and that would have been a decision that I would – believed should have made – been made otherwise. So that was – that was highly regrettable.

You’re reluctant to call it a failing, Mr Shipton?---I’m – I’m reluctant to call it a failing for the following reason. The reason why I’m reluctant is because a reasonable – it is a reasonable – it was a reasonable held view at that particular point in time to make that decision. A reasonable regulator would make that decision. That doesn’t mean that I, myself, would have made the same decision, but what I am saying is that it was reasonable in the circumstances at the time but it is not something that I would have decided myself because I believe that we should be acting quicker when it comes to financial institutions. And that’s – and looking not just at the bad apple but looking at whether the barrel is faulted itself.

I want to challenge that statement you’ve just made, Mr Shipton, that a reasonable regulator would have made that decision, and I want to do that by referring to the material that was before ASIC when that decision was made. NAB had lodged breach reports notifying ASIC that multiple bank employees across multiple branches in the Greater Western Sydney area were accepting false documents in support of loan applications and were falsely attributing loans as having been referred by NAB introducers in order to obtain commissions?---Yes, that is correct. And I will reiterate that I would have made a different decision, but I do – have received representations and explanations as to what was going on at the time, and it was not an unreasonable reliance to, at that particular point in time, that the – that the – the team were relying on, I believe, KPMG were undertaking a review of NAB.

The fundamental point is – the fundamental point is I would have done this differently. That’s the fundamental point.

5 That’s your fundamental point, Mr Shipton. It’s not mine. Because you don’t personally make each of these decisions. You oversee an organisation in which numerous people make these decisions. And you tell me that it was a reasonable decision, a reasonable regulator would have made that decision despite NAB having given you that information in its first breach report and then lodging a second breach report with ASIC on 31 August 2016, which made clear that the conduct was even
10 more extensive than that covered by the first breach report?---I do not disagree with the facts and I am disturbed and disappointed by the facts. That is why – you are right, I can’t make every decision – but that is why processes and decision-making structures are so important. And that is why I was explaining to you the difference between processes and decision-making structures and strategy. ASIC needs to do a
15 better job on both. That’s my key point here. When I came and took up this role, that was a key part of my reform agenda, because I cannot make every single decision, so how can I look at a case study like this and do my level best to ensure that it doesn’t happen again. And that level best is having improved processes and procedures, decision-making structures, that’s the enforcement review and some
20 other things that we’re doing, but equally, being very clear at a Commission level that we have a strategy and priorities clearly articulated so that when these decisions are being made that type of decision wouldn’t happen again.

25 Why is it that a decision was only made – did you say a couple of months ago. Is that what your evidence was before?---Yes, that’s – that’s as I understand it.

Why was it that a decision was only made a couple of months ago given the evidence that was given in March this year in the Royal Commission hearings to commence an investigation into NAB for the introducer program conduct?---Because it was clear
30 from the evidence that was put before the Royal Commission that this matter needed to be reviewed. And we made the right decision and I will grant and I will concede that that decision was made too late. That, to me, speaks exactly to the point that I raised before. We need better decision-making structures and we need a better strategy.

35 Well, I want to show you an email chain from mid-this year that explains the types of considerations that came into play when ASIC began to consider after the hearings in March whether it could take enforcement action against NAB. So I will show you ASIC.0076.0006.0279. Now, this is an email from Kevin Foo, the senior manager or
40 a senior manager in the deposit takers, credit and insurers stakeholder team to Mr Saadat and others within ASIC on 16 July this year. And Mr Foo says to Mr Saadat:

45 *Further to the FSE catch-up on Thursday last week, the NAB loan fraud matters were before the enforcement committee today. The full Commission was there, including Daniel Crennan. Although supposed to be an update on FSEs GWS –*

Greater Western Sydney:

5 ... banning actions, the discussion turned to the Royal Commission and what action we should or could take against NAB. The enforcement committee asked why we have not taken action against NAB. Comments from FSE, Peter –

Peter Kell –

10 ...and myself included. The matter was breach reported to ASIC (in a fairly timely matter – although the Royal Commission suggested otherwise). NAB was taken the matter seriously, were conducting a wider review, having their internal review tested by KPMG and developing a remediation program. These are the things DCI would have asked for if they were not already doing these. We have reviewed KPMGs review and are comfortable they have done a
15 reasonable job (or not a bad job to cause us concern). The conduct was viewed as particular employees defrauding the bank. FSE has taken action against the individuals. NAB is not the only bank that has a loan fraud problem (although Peter suggested we be careful not to relay any message the loan fraud is not a very small minority of behaviour). FSE has taken other action that has
20 penalised loan fraud and banks responsibilities – Esanda/ANZ. Cathie (the enforcement committee chair) was of the view that we should seek an enforceable undertaking from NAB with a community benefit payment. What do we have to lose from doing this. James and John were supportive on taking some action against NAB to send the message that dealing with loan fraud is
25 important. Peter wanted to test these ideas and tempered the discussion with comments that taking no further action might be the right decision. We just need the right narrative.

30 That was the discussion between Mr Saadat and a senior manager in your deposit takers, credit and assurance team and others in July this year?---Yes, that's correct.

35 Do you have any observations to make about what I've just read to you from that email, Mr Shipton?---My – my observations are was that there was a discussion around the next steps in this matter and there was a range of different views in relation to this matter, and that the view to proceed with an investigation whilst not on this document, ultimately prevailed.

40 Well – but what does it say to you, Mr Shipton, the list of matters that were given in response to the question about why we have not taken action against NAB. Let's go through those. The first was that the matter was breach reported to ASIC. There was a legal obligation on the part of NAB to do that, was there not?---Yes, there is a legal obligation.

45 So should that have had any bearing on whether or not action should have been taken against NAB?---Of course it should.

Of course it - - ?---It should have a bearing.

It should have a bearing?---Yes, because if there's a report of a breach we should be looking at that breach.

5 I'm sorry, you've misunderstood my question. In deciding whether or not to take action against an entity - - -?---Yes.

- - - is the fact that the entity complied with their legal obligation to tell you about the conduct a factor that bears either way on whether or not you should take the matter further?---Stepping out of this particular case study, a factor as to the - the
10 helpfulness of a subject is - is a factor in - in consideration. That's part of our regulatory guide. But stepping back into this, I - I am of the view, and was - and this is clearly reflected in this particular exchange - I'm clearly of the view that we need to be taking action against NAB. This was a view expressed by one person, as it is minuted. I cannot speak for Mr Foo, and his interpretation, but this is a - this
15 exchange is representative of - of exchange of different views which were being fleshed out. It was a conversation which, again, I - I ultimately observe landed in the right place.

20 But the considerations that went into the decision that at this point did not land in the right place, Mr Shipton, this was not the point at which a decision was made to pursue NAB. I would like you to reflect on whether these are the matters that you want your people to be considering when making these decisions. And I want to pick up on something that you said, which was that the helpfulness of the organisation is a relevant matter in deciding what next step ASIC should take. That
25 was what I understood you to say?---Yes, but I was stepping out of this case study and just referring back to - and that - that is one matter in - in - in our 151 regulatory guide.

30 Well, is providing ASIC with a breach report something that you would describe as a helpful thing that should be taken into account?---No, and that's why I was stepping outside of the case study.

I see. So what do you say then to the fact that - the fact the matter was breach reported was one of the considerations in what to do with NAB at this time?---I
35 cannot speak for the person who said that.

No, I don't want you to speak for them. I want you to reflect on what we can see from this email were the considerations?---Well, again, all I can say is that that was not my view and this note articulates that that was not my view. And I do not agree
40 with that consideration, and I - and I dismissed - I personally dismissed and ultimately we dismissed that view.

THE COMMISSIONER: But the bottom line is - literally the bottom line on the screen is:

45

Develop an options paper about what action we could take against NAB and the narrative for each.

?---That's correct, Commissioner, but I would also say that there was then decisions that were ultimately made that had this action be pursued by an investigation. So the right decision was landed upon. I think this case study is a good case study to make my broader point that we need to improve our decision-making processes and our criteria that goes into how we make these decisions, and that is the very purpose of our review so that we can sharpen up, guide and direct, so that these types of what we would all agree would be extraneous, unnecessary considerations don't enter into the conversation.

5
10 MS ORR: Well, what are the - - -

THE COMMISSIONER: Can I invite your attention to whether any of the following considerations appear in this report of the meeting. First as to the conduct. Is there any examination of the seriousness of the conduct?---Commissioner, I – I just want to highlight that this, as I remember correctly, this was not the main purpose of this particular meeting. This meeting was all about the investigation in relation to the individuals. The conversation then went more broadly to NAB, the organisation, and there was a conclusion that, as I remember, that came out of that which was to look not just at the – or not – not just the individuals but to look more broadly at NAB. And that happened, I – I concede that happened too late in the process, but it is happening.

15
20
25 Well, would you come back to my question. My question was do we see in this record of the meeting any consideration of the seriousness of the conduct?---Not in this record of the meeting, but this is not – this is not an official record of the meeting, but I grant it is a record of the meeting, but there wasn't – there was, in my recollection of the meeting, an importance to consider and act against NAB to investigate the fact that their dealings and how they handled loan frauds was extremely important.

30
Do we see any consideration of the prevalence of the conduct?---Not on – not on this particular conversation.

35
Do we see any consideration of the size of the actor involved, namely the size of NAB?---Not in this consideration, but, Commissioner, again, this was not a formal decision point for this particular element. What happened as a consequence of this conversation were those decision points that you raise. Those issues that you rightly ask were addressed at a later point in time.

40
45 In the context of an options paper which was to address specifically the option of doing nothing?---That was – I don't recollect the option but I do recollect and can confirm that we are doing something, so that the ultimate decision was the right decision, and I agree with you that it was – it happened too late and we should have been discussing at a much earlier stage, a much earlier stage, in fact, I would say years before this, the – the wrong – the potential wrongdoing by NAB.

MS ORR: But the document records, Mr Shipton, that Cathie Armour, the chair of the enforcement committee, was of the view that:

5 ...we should seek an enforceable undertaking from NAB with a community benefit payment.

Do you recall that?---I don't recall but I – I – I don't recall that my – myself but that is clearly Mr Foo's recollection.

10 And was that an appropriate response?---Again, I can only say that a number of views were expressed, were thrown out in this discussion which was not a formal decision-making point for this aspect of the investigation, but, clearly, catalysed the formal extension of the investigation to include NAB. I think that's very important. This was a discussion around that aspect that led to formal – more formal expansion
15 of the matter. This was a very initial and premature discussion. Admittedly happening far too late in the broader process and a number of options were clearly suggested according to the narrative in this email. Again, those options that ultimately were not pursued.

20 So it was an initial and premature discussion more than two years after the breach report was received – the first breach report?---I am more than happy to say once again this discussion, this initial discussion happened far too late. The formal discussion and the formal decision-making happened far too late.

25 And what do you say to the sentiment recorded in this email in response to the suggestion that an enforcement undertaking with a community benefit payment be sought, "What do we have to lose from doing this?" What do you say to that, Mr Shipton?---Well, if that was said, and, again, I don't recollect that being said, but if that was said, that does not agree – that does not align with my line of thinking, nor
30 does it align with our current practice that we have in place, which is to ask ourselves the question why not litigate these types of situations. And in my view, and I expressed this when this conversation was happening, we should be pursuing much harder, much tougher action and we ultimately did.

35 It's the antithesis of that, isn't it, Mr Shipton, the view that's expressed here, let's not investigate further, let's just ask NAB for an enforceable undertaking with a community benefit payment. We've got nothing to lose from doing that and we will then be seen to have publicly responded to the evidence in the Royal
40 Commission?---Well, that was a view – that may have been – that may have been a view expressed. Again, I cannot respond with absolute confidence as – as to what was said. All I can say is that there were, from my recollection and from what Mr Foo writes, a range of different views which were thrown around, views which were explored and tested, but ultimately we decided to pursue an investigation and an
45 investigation has commenced in this matter.

Well, the view that I've directed you to was the view of the chair of your enforcement committee. Does that concern you, Mr Shipton?---It – it is a view that I

do not agree with. It is a view that, clearly, that I – I – I suggested an alternative approach. All I can say is that this was a – that’s why I used the expression premature, because there was not before the committee at that particular time a broader, more thought out, more thoughtful and more structured discussion in relation to NAB itself. That came later. It came too late, but it came later. I think we should just put an element of caution of reading too much into this discussion which was at a albeit late occurrence in the timetable, but, nonetheless, was not a fully informed one. And that ultimately, when an informed discussion took place, the right decision was made and that was to pursue an investigation and not to pursue an enforceable undertaking.

Well, I want to return to enforceable undertakings, and Ms Armour, the chair of your enforcement committee’s role and enforceable undertakings tomorrow. For now I will tender this document, Commissioner.

THE COMMISSIONER: Email July ’18 from Mr Foo of ASIC concerning NAB loan fraud matters, ASIC.0076.0006.0279, exhibit 7.68.

EXHIBIT #7.68 EMAIL JULY ’18 FROM MR FOO OF ASIC CONCERNING NAB LOAN FRAUD MATTERS (ASIC.0076.0006.0279)

MS ORR: I apologise, Commissioner, I see we’ve run quite late. It may be useful to start earlier tomorrow, a 9.30 start would be helpful.

THE COMMISSIONER: Yes. Is it possible for you to be here at 9.30, Mr Shipton?---Of course, Commissioner.

9.30 tomorrow then.

<THE WITNESS WITHDREW

[4.33 pm]

35

MATTER ADJOURNED at 4.33 pm UNTIL FRIDAY, 23 NOVEMBER 2018

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