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TRANSCRIPT OF PROCEEDINGS

O/N H-871458

THE HONOURABLE K. HAYNE AC QC, Commissioner

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

MELBOURNE

9.45 AM, FRIDAY, 23 MARCH 2018

Continued from 22.3.18

DAY 10

**MS R. ORR QC appears with MR A. DINELLI and MS E. DIAS as Counsel Assisting
with MS S. ZELEZNIKOW**

MR J. SHEAHAN QC appears with MS P. NESKOVCIN QC for Westpac

THE COMMISSIONER: Ms Dias.

MS DIAS: Commissioner, today we will hear evidence from Mr William Malcolm
in respect of the final case study to be heard today, and that concerns credit card limit
5 increases by Westpac. Mr Sheahan will adduce the witness statement and summons.

THE COMMISSIONER: Thank you. Mr Sheahan.

MR SHEAHAN: Commissioner, might I apologise immediately for the late
10 correction to his statements. It was a correction of substance. I wanted to emphasise
that it's no reflection on Mr Malcolm that that error occurred. He relied on
information. We checked it before his statement went on, and double checked it
after his statement went on in the course of this week, and it was then that the error
was discovered. But we apologise for that.

15 THE COMMISSIONER: Thank you for the apology. The last minute nature of the
change always presents difficulties, Mr Sheahan. That's the reason I mention it, not
as some idle critical commentary, but to try to avoid the difficulty. But thank you for
the apology.

20 MR SHEAHAN: Thank you, sir. I call William David Malcolm.

THE COMMISSIONER: Mr Malcolm.

25 <WILLIAM DAVID MALCOLM, SWORN [9.46 am]

30 <EXAMINATION-IN-CHIEF BY MR SHEAHAN

THE COMMISSIONER: Do sit down, Mr Malcolm. Yes, Mr Sheahan.

35 MR SHEAHAN: Thank you. Your full name is William David Malcolm?---Yes.

But you are known as David?---Yes.

40 And your residential – your business address is 283 to 285 Kent Street in
Sydney?---Correct.

And your current position, Mr Malcolm?---I am general manager, credit.

For Westpac Banking Corporation?---Westpac Banking Corporation.

45 Thank you. Now, for this Commission you have signed two statements?---Yes, I
have.

The first is dated 19 March 2018, and the second 21 March?---That's correct.

And you're attending here today pursuant to a summons?---Yes, I am.

5 Do you have the summons in front of you?---Yes.

I tender the summons dated 8 March 2018, Commissioner.

10 THE COMMISSIONER: Exhibit 1.163 will be summons to William David Malcolm.

EXHIBIT #1.163 SUMMONS TO WILLIAM DAVID MALCOLM

15 MR SHEAHAN: Now, in relation to your first statement, Mr Malcolm, you have indicated you need to correct paragraph 60(b)?---That's correct.

20 Now – and the substance of your second statement is the correction to that paragraph?---That's correct.

Commissioner, would you like him to strike out paragraph 60(b) in the first statement so there's no - - -

25 THE COMMISSIONER: That's probably the most efficient way, isn't it - - -

MR SHEAHAN: I think so.

30 THE COMMISSIONER: - - - Mr Sheahan. If you would be good enough to delete the relevant paragraph and initial the deletion, Mr Malcolm?---Yes.

MR SHEAHAN: With that correction, Mr Malcolm, are its contents true and correct?---Yes, they are.

35 I tender it, sir.

THE COMMISSIONER: That will be exhibit 1.164, statement of William David Malcolm, 19 March 2018.

40 **EXHIBIT #1.164 STATEMENT OF WILLIAM DAVID MALCOLM DATED 19/03/2018 (WIT.0001.0014.0001)**

45 MR SHEAHAN: And for the record, the doc ID is WIT.0001.0014.0001.

THE COMMISSIONER: Thank you.

MR SHEAHAN: And your second statement, Mr Malcolm, is dated 21 March 2018?---Yes, it is.

And do you have any corrections to that statement?---No.

5

No. Are its contents true and correct?---Yes, they are.

I tender it, sir.

10 THE COMMISSIONER: Exhibit 1.165 will be further statement of William David Malcolm dated 21 March '18 with the doc ID - - -

MR SHEAHAN: WBC.900.001.0161.

15 THE COMMISSIONER: Thank you.

**EXHIBIT #1.165 FURTHER STATEMENT OF WILLIAM DAVID
MALCOLM DATED 21/03/2018 (WBC.900.001.0161)**

20

MR SHEAHAN: Thank you, sir.

THE COMMISSIONER: Thank you. Ms Dias.

25

<CROSS-EXAMINATION BY MS DIAS

[9.49 am]

30 MS DIAS: Mr Malcolm, you said you were the general manager of credit at Westpac. You have held that position since June 2015; is that correct?---That's correct

And you have been employed at Westpac since 1988?---Yes, that's correct.

35

You were the chief risk officer of Westpac – or Australian banking, sorry, for Westpac from November 2010 to March 2013; is that correct?---That's correct.

40 And you were also a member of the Executive Leadership Team for the Westpac Financial Services Division from 2010 to 2013; is that correct?---For the – for the Australian financial services division, but before that it was product and operations in the consumer banking team.

45 Yes, thank you. You have been put forward by Westpac today as its witness for this Royal Commission on issues connected with credit card limit increases offered by Westpac during the period between September 2012 and December 2014; is that correct?---Yes, that's correct.

And that's the relevant period you deal with in your witness statement?---That's correct.

5 And you are familiar with the events that took place in that period,

Mr Malcolm?---I am.

10 I just want to talk a bit about the credit cards that are on offer by Westpac which you also discuss in your statement. Westpac offers 25 different credit cards at present; is that correct?---Yes. I believe that's what I have in my statement, yes.

Yes. And some of these are offered under the Westpac brand, others are offered under other brand names; is that correct?---That's correct.

15 Can you tell us those other brand names, Mr Malcolm?---The St George Group, Bank of Melbourne, Bank SA.

20 And there are also credit cards – 62, I think you mention in your statement – that are in circulation, but they are no longer offered as products; is that correct?---That's correct, yes.

And at page 4 of your statement you set out the total balance outstanding for all credit cards. I think we will bring that up, if that's possible. There it is.

25 THE COMMISSIONER: The screen next to you is probably the – I hope the easiest and best, Mr Malcolm?---Thank you.

30 MS DIAS: So that shows that as at January 2018, total balance of all credit card products issued by Westpac is over \$9 billion; is that correct, Mr Malcolm?---Actually – that's actually around 10 billion.

My maths is not as accurate but around 10. And does that figure include balances for cards issued by other brands or under other brand names?---That's - - -

35 St George - - -?---That's all the brand names, yes.

All the brand names. Thank you. And does it include – it doesn't include balances written off by Westpac?---No.

40 No. And credit cards are offered to customers through branches and Westpac's websites; is that correct?---Yes. Through branches, online, and through call centres and also through affiliate sites and directly to staff.

45 And calls through the call centres that Westpac operates?---Yes.

Yes. What about through letters and mail-outs, that kind of material?---No. Not to – not to new customers.

And at page 3 of your statement – that’s 0003 of that document that’s on the screen, thank you – you refer to three different types of customer. And you refer to the terms “transactors” and “revolvers”. Are they terms commonly used in the banking industry, Mr Malcolm?---Yes, they are.

5

And so transactors are the customers who pay their full balance on time each month, so they don’t pay any interest or late fees; correct?---That’s correct.

10 And revolvers are the people that don’t pay off their balance each month, so they would pay interest; is that correct?---That’s correct.

And you say in your statement there that they generally use credit cards for short-term finance to meet short-term cash flow needs?---Yes.

15 And sometimes will they pay late fees too, Mr Malcolm?---If they – if they pay late, they will pay late fees, yes.

Yes. And would you agree that revolvers are the most profitable customer for the bank?---Yes, they probably are.

20

And it’s also the case that they’re likely to pay more interest over time because they won’t reduce their balance?---Well, they do reduce their balance, but they – but they do pay – they do pay interest. By definition, transactors are paying off each month so they don’t pay interest, but we – and other revenue from transactors.

25

Sorry. What about revolvers, Mr Malcolm?---Yes. They pay - - -

Yes?---They pay interest when they revolve.

30 Westpac has made a number of submissions in response to letters from the Commission which mention the issues that you deal with in your witness statement. I will take you to those. I am not sure if you’ve seen them, but the first one is dated 29 January 2018. And that is doc ID RCD.0001.0029.0003. Have you seen this document before, Mr Malcolm?---I have seen it in the course of preparation, yes.

35

At page - - -

THE COMMISSIONER: Sorry, in the course of preparation to give evidence or in the course of preparation of the document?---To give evidence.

40

Yes?---Sorry.

Thank you.

45 MS DIAS: At 0114 – 0014, apologies, you see the heading Credit Cards. And under the heading Bank-initiated Credit Card Limit Increases there is a reference there I will read briefly:

5 *In September 2012, ASIC raised concerns with the Australian Bankers' Association (ABA) and other industry associations regarding different credit limit increase practices and expressed the view that responsible lending obligations required banks to consider, among other things, the current income and employment status of prospective recipients of credit increases. Through an industry survey in January 2014 and notices issued from August 2014 onwards ASIC sought, and Westpac provided, information and documents regarding its credit limit increase processes. Westpac informed ASIC that, in its view, its processes satisfied its responsible lending obligations.*

10 *ASIC raised specific issues with Westpac about its automated responsible lending processes in use from 2012 to 2014 and suggested that they may not have been adequately taking income and employment factors into account. Approximately 6600 accounts were affected by this automated approval process. In December 2014 Westpac temporarily suspended credit limit increase invitations until it had implemented changes to its processes. Customer-initiated credit limit increase applications continue to operate. Throughout 2015 Westpac engaged with ASIC about resolving its concerns in a way which would remediate any affected customers now facing financial difficulty.*

And those are the matters that are dealt with in your statement; is that correct, Mr Malcolm?---That's correct.

25 Westpac has also provided another submission to the Commission which lists events of misconduct that have been engaged in over the last five years. I will take you to that. The document ID is RCD.0001.0029.0114. And the relevant pinpoint is 0118. Apologies, Mr Malcolm. Have you seen this sort of document before in your preparation of your evidence?---Yes. I believe I have seen this, yes.

30 And you can see there there's an item numbered 26 which refers to the incident that we just discussed in the earlier response?---Yes.

35 So this listing here, would you agree, is an acknowledgement by Westpac that its conduct in relation to the credit card limit increases that you discuss in your witness statement was misconduct?---Yes. We've defined it as – as – as an issue of interest, so yes.

40 And I should clarify by misconduct there I mean within the terms of reference of the Commission?---Right.

I want to go to some things in your statement before we turn to a chronology of the events that led to Westpac remediating customers.

45 THE COMMISSIONER: Before you do, Ms Dias, should we - - -

MS DIAS: Tender.

THE COMMISSIONER: - - - tender first, as exhibit 1.165, Westpac response to – dated 29 January '18, RCD.0001.0029.0003 at 0014, paragraph B Credit Cards, I think is the title. Is that the portion of it?

5 MS DIAS: Yes. We only need that page, Commissioner, thank you.

THE COMMISSIONER: Yes. That will be exhibit 1.166, to make it count.

10 **EXHIBIT #1.166 WESTPAC RESPONSE PARAGRAPH B CREDIT CARDS
DATED 29/01/2018 (RCD.0001.0029.0003 at 0014)**

15 THE COMMISSIONER: And exhibit 1.167 would be the further submission of Westpac, item 26 RCD.0001.0029.0114 at 0118.

20 **EXHIBIT #1.167 FURTHER SUBMISSION OF WESTPAC ITEM 26
(RCD.0001.0029.0114 AT 0118)**

MS DIAS: Thank you, Commissioner.

25 THE COMMISSIONER: Is that right?

MS DIAS: That's correct, Commissioner. Thank you.

30 If you could go back to your statement, Mr Malcolm. At page 13, if you have it there – and the doc ID is WIT.0001.0014.0013 – you say in the period from September 2012 to December 2014 Westpac sent 1.16 million letters to customers inviting them to take up a limit increase on their credit card. And of those letters, 217,169,000 customers responded to the letter offer and were granted credit limit increases by Westpac; is that correct?---Yes, that's correct.

35 And you are aware that from 1 July 2012 banks, including Westpac, were prohibited from sending unsolicited invitations or offers to customers without their consent?---That's correct.

40 And you say in your statement that Westpac had the consent of 1.16 million customers who received their offers?---Yes, that's correct.

45 How did Westpac attain consent at the time?---It was previous to this period where we would have obtained consent, either through the online banking system, or by contacting customers and obtaining their consent.

And what were the forms of contact?---I'm sorry, I don't – I don't know exactly what they were.

Tick boxes on letters such as, “Please consent to or I consent to receiving these offers”?---I – sorry, I don’t remember exactly what it was, but they were – they were – they were in a form that was acceptable from a legal and compliance perspective and they were sent and accepted.

5

And does Westpac do its best to send out as many offers as it can?

THE COMMISSIONER: Well, if you know enough to tell me it was all compliant, I think - - -?---Sorry. I should say it went through a compliance process and was
10 signed off for compliance before - - -

Somebody decided it was compliant?---Yes.

Yes. Is it unduly cynical to think that at least some of these consents would be
15 constituted by a failure to uncheck a pre-populated checked box on a website?---No. It was an opt-in process.

It was opt-in?---Yes.

20 Yes.

MS DIAS: If someone tells Westpac that they don’t want to receive marketing material, does that mean they won’t receive the sorts of offers that we will be discussing today?---Yes. They’re – it’s – it depends on what type of things that
25 they’ve requested, but yes, if they’re on the do not call register or do not market register, they would normally be excluded, but if we’ve got a consent to receive customers for dealing with our own customers and there – there were offers sent to – to customers on that list if they had consented to receiving them.

30 And when did you start – when did Westpac start asking customers for consent?---I don’t recall the exact date.

And so would you agree that an increase offer is marketing material?---It’s – it’s partly marketing, yes, and it’s partly customer servicing. So they’re existing
35 customers and we’re offering them an additional service.

I want to take you to an email which is from 2011. It’s WBC.099.001.0356. This is an email from May 2011. Apologies for the small type, Mr Malcolm. This is before that prohibition that I referred to came into effect. Now, the names have been
40 redacted – or the email addresses, apologies – have been redacted but you can see it’s an email from Rob Love, head of financial crime management and unsecured risk product and operations, and he is forwarding an email to someone. Now, I’m not sure if you have a copy of this, Mr Malcolm, but it is you that is being the recipient of this email, but your email address has been redacted. And below we can see what
45 Mr Love is forwarding is an email in relation to credit cards and initiatives. It says:

In addition to the attachment below, the following underway:

CLI months between offer for non-responders to be decreased from 6 to 4 months, subject to approval.

5 Now CLI months there, is that credit limit increase, the gaps in the offers being made to customers?---Yes. That refers to the frequency with which offers are being made for non-responders.

10 And those are the people that don't – don't respond to the first offer. So they get targeted with another request within four months?---Potentially, if they've passed the eligibility – eligibility criteria.

For the second occasion?---Yes. Well, on both occasions.

15 Yes. And 4, item 4:

CLI offers to go to the no marketing group greater than 300,000 customers will now qualify for offers as we have finally gained agreement that CLI letters are account management letters rather than marketing offers. A common sense decision.

20 Now, is that still the approach taken to these sorts of offers?---I'm – I'm not sure, and I don't – I'm – I – that's a – that's an email. I don't know whether that decision has – was actually ever implemented.

25 You received the email. Do you not know what happened after that?---No.

30 Do you know what happens now?---I'm – I'm not aware of – of – of whether they – whether we market to the no marketing group, but there was obviously a discussion of that at the time. This email itself is not – it's not conclusive that that was actually approved.

I'm asking you if you know if it was approved?---I don't know.

35 And the next item, number 5:

The NCCP FCA (further credit assessment) group of CLI offers (30 per cent of offers) that are currently being excluded from offers will be reintroduced from August. This will provide a significant uplift as this is the more credit active group.

40 Now, there's a few things that we would unpack there but further credit assessment group, you refer to them in your statement – and we will come to that. That's the category of people that were asked for further information when they were sent their offers, but there was also a group that wasn't asked for further information; is that
45 correct?---Yes, that's correct.

So this is saying that that group, the further credit assessment group, will get 30 per cent of the proportion of offers sent out?---Yes.

And that's still the case, isn't it?---Yes, that's - - -

5

Or during the relevant period?---During the relevant period, yes.

And the final item there, 7:

10

Proposal to be developed regarding increasing exception fees for repeat offenders, eg, keep it at \$9 for first time delinquency –

I'm reading now, I interpolate –

15

but if twice in three months then make it the higher value. Product are pushing this one.

Who is "product" there. Who does that refer to?---The product management team within Westpac.

20

And product being the credit card team?---In this case, yes, but product includes other products as well.

Thank you. I will tender that email, please, Commissioner.

25

THE COMMISSIONER: Exhibit 1.168 will be email from Love to Malcolm, 27 May 2011, WBC.099.001.03556.

30

EXHIBIT #1.168 EMAIL FROM LOVE TO MALCOLM DATED 27/03/2011 (WBC.099.001.03556)

35

MS DIAS: Mr Malcolm, I want to take you to some of the letters that were sent to customers between September 2012 and December 2014. I will take you to an exhibit that's in your statement. It's WBC.104.002.0003. And that's the eighth exhibit – WDM8, Mr Malcolm?---Thank you.

40

So the people that receive this letter, Mr Malcolm, they are customers that Westpac considered no further credit assessment was required; is that correct?---Yes, that's correct.

45

And this sort of letter made up the majority of invitations sent in the relevant period; is that correct?---Yes, that's correct.

And a cohort of these customers ended up being the subject of the remediation program?---That's correct.

5 In your statement, this group of customers is referred to as the "no further credit assessment category". That's the no FCA category, and we will discuss that a bit later as well; that's correct?---Yes, that's correct.

10 So when the customer receives this letter, they won't be asked a – further financial information?---No, they – they weren't.

Thank you. Now, this customer is being asked – or sent an invitation to increase their credit limit from 3700 to as much as 6000. They're told:

15 *Simply choose how much you would like to increase your limit by, up to 6000, then apply online or complete the form below.*

20 Now – and the form below has that tick box and they can fill out the smaller amount there but they can also opt to have the increase to \$6000. Now, on the back of that letter, Mr Malcolm – maybe we can put them side by side. So 0004. Thank you. There's some – there's a title there, Important Information:

25 *Westpac's lending policies and guidelines are designed to ensure we lend responsibly. Before applying to increase your credit limit, please make sure you're comfortable with the higher monthly –*

repayment –

monthly payments –

30 apologies –

35 *and higher credit limit. If your circumstances have recently changed or are likely to change, or you think you wouldn't be able to afford the increased payments, you shouldn't apply for a credit limit increase. To manage your credit card, just remember these two simple rules: (1) always aim to pay off more than your monthly minimum amount as making minimum payments is not an effective way to manage your credit card debt.*

40 Now, the customer that receives this letter, as we said, isn't asked to provide any current financial information about themselves. They're not asked to tell Westpac about their income or debts; is that correct?---That's right.

45 And if they ticked the box that we saw before and sent it back, they would be approved for their credit card limit increase?---That's right. They've – they signed – signed the letter.

Yes. Thank you. Now, you're aware that the National Credit Act prohibited at this time, and still does, Westpac from entering into a credit contract with a customer without doing certain things first, and that would include increasing the limit on a credit contract?---Yes, that's right.

5

I will take you to some of those provisions, Mr Malcolm.

THE COMMISSIONER: Just before we leave this document.

10 MS DIAS: Yes.

THE COMMISSIONER: I direct your attention to the second page, that "We respect your privacy" part of it. Do you see that?---Yes, I do.

15 Do those two sentences that next follow support a view that what was suggested in the email in 2011 was in fact implemented? Namely, that withdrawal from marketing was not treated as withdrawal from receipt of credit limit increases? They're treated separately, aren't they?---They're treated separately, that's right.

20 Yes.

MS DIAS: Thank you.

THE COMMISSIONER: Yes, do go on.

25

MS DIAS: RCD.0022.0001.0001. Thank you. And that's the – that's the first page, Mr Malcolm. So that's the National Credit Act. And then 0098 and 99. If we could put those side by side. Thank you. Thank you. So we can see there, Mr Malcolm, the obligation under section 128:

30

The licensee –

and that would include Westpac –

35

must not enter a credit contract with a consumer who will be the debtor under the contract

and (b), subsection (b):

40

Increase the credit limit of a credit contract with a consumer who is the debtor under the contract unless –

And then further down, they have they have made the assessment and:

45

made the inquiries and verification in accordance with section 130.

And then over the page we see the reasonable inquiries that must be made under section 130. And those include inquiries about requirements and objectives in relation to the credit contract, the consumer's financial situation, taking reasonable steps to verify the consumer's financial situation and steps required by the regulations. And you're familiar with those obligations, Mr Malcolm?---Yes, I am.

10 In your statement, you describe in detail how Westpac identified customers who were eligible to be sent an offer, and this was an automated process of identifying those customers; is that correct?---Yes, it was.

And it used – I call it data analytics. Is that a correct term for that process?---It used all data that we had on those customers. They were existing customers so we had a number – data from a number of different sources.

15 But it wasn't a process undertaken by asking customers for information and then verifying that information at the time of the offer?---No, it wasn't.

20 Now, the modelling program is quite complicated, but I want to focus on the first step, and that's the step by which the customers are split into those two groups that we talked about, the group of customers that require the further credit assessment or the FCA, and the second group that don't require that assessment. And they're the group that sometimes we see described as no FCA. Now, the way that Westpac determined the split is based on usage of the card and the ratio of the payments to the balance; is that correct?---Yes, that's correct.

25 Now, in your statement you set this out – we will bring that up.
WIT.0001.0014.0007. Thank you. So at paragraph 28 you explain this categorisation, and these two things: you explain the utilisation ratio is a measurement of the customer's credit card utilisation expressed as a percentage based on the average of their last three statements, and the payment balance ratio is a measurement of the customer's payments compared to their credit card balance. So in the brackets it says there:

35 *For example, if a customer had an average outstanding balance of \$50 at the end of each statement period and repaid on average \$25 of that balance, their payment/balance ratio would be 50 per cent.*

40 And these were used to determine whether Westpac thought the customer could service a higher minimum repayment amount; is that correct?---It – it wasn't a full serviceability assessment. The only purpose of this step of the process was to categorise the customer into where we needed further credit information or where we believed that no further credit information was required.

45 Well, we will go down to paragraph 29, Mr Malcolm. So that's where you've said that it's used to calculate the theoretical maximum:

Where serviceability meant that the customer would be able to repay the minimum repayment amount of 2 per cent plus a buffer of .5 per cent –

so the total being 2.5 per cent –

5

of the outstanding balance per month, assuming that 100 per cent of the total credit limit was utilised.

Now, would you agree that that's quite a low serviceability threshold?---It – again, just to sort of reiterate, the purpose of this was only to determine whether or not we needed to get further credit information. So what that calculation would do would be put on to a plot, and where the customer was very comfortably able to service a higher limit, they would go into the non-further credit information category, but a – so it only classified customers into whether or not further credit information was required.

15

THE COMMISSIONER: But was the dividing line as described here or was there some other dividing line?---In my statement, Commissioner, I have the tables which are – which are used to – to decide whether or not a customer was further credit assessment required.

20

MS DIAS: But in your statement, Mr Malcolm, at paragraph 27, which is just a bit further up on that page, you say:

25

Categorising a customer as FCA was effectively a determination that Westpac required additional information before it could be satisfied that the CLI was not unsuitable.

Now, does that not involve a conclusion that if a customer was classified as non-FCA, that Westpac had determined that it didn't require additional information in order to conclude that the CLI was not unsuitable?---It – it only takes it to that stage of the process. The process for whether or not a customer is eligible for a CLI also involves the next two stages of the process, which is the application of 36 exclusion rules and then more detailed analysis about whether a customer would be eligible for a CLI. So this is only one stage of the process.

30

But the other stages don't involve a calculation of serviceability. This is the stage where you're trying to determine whether the customer can afford the increase; is that right?---It – it does – it does have a serviceability calculation within this, and it has a presumption within that that they're – if they're making actual payments to their account against the balance of their account, so we know exactly what amount that they're paying, which is well in excess of the minimum, then that would mean that they could service the higher limit, yes.

35

And you've told customers, we saw in that letter earlier, that they should pay more than their minimum?---Yes, they should.

40

45

But is it not inconsistent for Westpac to assess suitability here, which you refer to, by reference to this minimum repayment and buffer of only .5 per cent, having told customers that they should really be paying a lot more than that?---Yes. It – what we are – what we are assessing there is their ability to service their payment obligation, and without substantial hardship, which is the – the requirement. So that’s – that’s the assessment that we did, based on the actual payments they were making to their account after paying out all of their other expenses.

And how long – how far back do you look at the actual repayments? What’s the minimum period that you need to take into account for this program to pop out a figure at the end?---The – the percentage was based on the – the last four months of payments.

Only four months?---Yes. The average of the last four months.

Four payments, essentially?---Yes.

THE COMMISSIONER: Sorry. And that was an average of four months?---That’s right.

So one big payment in month number 1 may be enough to tip you over into the average?---It’s the average amount repaid compared to the actual balance over the last four months. So it’s – it’s how much they are paying as a percentage of their – their balance each month.

Yes.

MS DIAS: Thank you. And you would be aware that there have been legislative reforms that are going to take effect from 1 January to require banks to take into account not just that minimum repayment anymore but the entire limit over a certain reasonable period of time. Are you aware of those changes coming up?---Yes. I am aware that - - -

And will this process be changed to implement those reforms?---It – the other part of the reforms are that bank initiated CLI offers will no longer be allowed. So it makes the process - - -

So this whole program will be defunct from that. I see?---We – we will still need to do customer initiated credit limit increases, but – but not bank initiated.

Thank you. So returning to your statement, we mention that you say that if a customer was categorised as FCA, that’s effectively a determination that Westpac required additional information to be satisfied of that unsuitability under the Act. But if they were categorised as non-FCA, there would be no additional information required and we saw the letter didn’t request additional information; that’s correct?---That’s correct.

Okay. And you say in your statement that 840,000 offers were made to the no FCA customers during the relevant period; is that correct? This is at paragraph 73, Mr Malcolm, sorry?---Thank you. Yes. 840,000 offer letters.

5 And 183,143 were approved as a result of that letter that we saw before?---Yes. 183 increases as a result of the customer responding to the letter, yes.

Okay. Now, in your statement you also set out the types of information that Westpac had access to before it decided to send out those letters, and you mentioned that
10 before, data. So data about their credit card account and the transactions. Now, would the data come from other Westpac accounts as well that they would have?---Yes. We would use data from all of their relationship with Westpac.

Okay. But if the customer had only one account, say just the credit card account,
15 that's all the information Westpac would have to put into this automated process; is that correct?---Yes. We would have their transaction data on their credit card and other demographic data that they would have supplied on origination of – of the credit card.

20 But the customer could have accounts with other banks and other liabilities that Westpac just isn't aware of; is that correct?---Yes.

And this automated process couldn't take into account those non-Westpac commitments, if I could call it those?---No. Not for the – not for the non-FCA
25 customers.

And in terms of income, if a Westpac customer only had a credit card account, Westpac wouldn't have information about their income other than what, perhaps, was given in the initial credit card application; is that correct?---That's – that's
30 correct.

So, Mr Malcolm, do you agree that Westpac's reliance on this automated process adopted for certain customers would not have been adequate to ensure that Westpac could take into account the financial situation of the customer in making that
35 assessment that we discussed under the Act? In other words, it didn't involve taking reasonable steps to inquire about the customer's financial situation when the offer is made?---Well, we were of the view at the time that the totality of what we did in – for these existing customers constituted reasonable inquiries based on the data that we held on that customer for the size of the limit increase that – that we were
40 providing. So it was proportionate to the additional commitment they were making on – that they were taking on, and the actual payments they were making to the account. So we thought that was reasonable for the size of the additional commitment that they were taking on.

45 But they weren't asked about their income or their debts; is that correct?---That's correct.

Okay. Now, Westpac conducted a remediation for the customers that received that no FCA letter that we looked at. Now, you give an example of a customer who had their credit card limit increased from 1800 to 3500. We will take you to that. It's WIT.001.0014.0017. And this is page 17, Mr Malcolm. And it's under question
5 14(a). So this customer was contacted as part of the remediation and Westpac found out that they were on social security at the time that the credit limit increase was approved; is that correct?---During the remediation process, the customer informed Westpac that he had been unemployed at the time of the CLI.

10 Yes. And, further below, he was contacted in May 2016 and he said that as a result of injury, he was unemployed at the time the CLI was granted, had been receiving social security payments, and estimated that his income had fallen by almost 50 per cent. You have agreed that Westpac didn't make financial inquiries of people like this customer. Do you agree that Westpac didn't take reasonable steps to verify his
15 situation?---At the time - - -

At the time of the CLI?---At the time of the CLI? Again, one of the rules that we had in the second stage of the process, the exclusion rules, was that we would check our systems for whether the customer had informed us that they were unemployed, and
20 also we did a check of their transaction accounts to see if they were making – they were receiving social security payments. Now, in this case, they may have been receiving those social security payments to another account that we didn't have access to. So in this case, that – that exclusion rule didn't – obviously didn't trigger. So we – we proceeded with the – with the CLI.

25 The obligation - - -

THE COMMISSIONER: Would many – would many customers tell Westpac when they became unemployed?---Yes. We do find out. They will – if they ring – if they
30 become unemployed, they – they ring our Westpac Assist Team and ask for assistance.

If they're looking for assistance, they will tell - - -?---Yes.

35 - - - why they're looking for assistance, but short of asking for assistance, would a customer ring up and say to Westpac, "I just thought I better tell you, I am now unemployed"?---Not – not as a matter of course, but - - -

40 I wouldn't have thought so?--- - - - if they couldn't afford their repayments to their credit card then - - -

It's when they hit a wall or a hurdle they will then come to the bank saying, "I have got a problem"?---Yes.

45 Yes, I understand that?---But it's further – the further test that we do is we actually check their accounts to see if they are actually in receipt of social security payments.

So there is a step that we take but, I agree with you, for customers who don't have their transaction account with us, that's not going to be an effective trigger.

5 MS DIAS: And the Act requires Westpac to make these inquiries, not for the customer to tell Westpac. You would agree with that?---Yes.

Okay. And you say - - -

10 THE COMMISSIONER: We could multiply the colourful examples, couldn't we, Mr Malcolm? The credit card customer who has a child, the child is seriously ill, etcetera, the colourful examples could be multiplied many times, couldn't they?---Yes, they could.

15 Yes. And none of them would have been automatically detected by the processes that the bank had in place?---In - it's - it's making reasonable inquiries is - is the test that we were assessing ourselves against and if a customer is having difficulty but they're making actual payments to their account in excess of the minimum payment, such that they could afford the higher limit, that's the basis on which we thought we had made a reasonable inquiry.

20 Can I just explore that notion with you just a little further. Is it right to see the bank as measuring its conduct by reference to whether the customer was not defaulting, and further measuring its conduct by reference to whether it estimated that the customer would not default on the credit card?---I think - again, we look at it on the
25 totality of the information that we have with the customer. The actual payment that they're making to the account is a good indicator of what - how they're handling that. Any of the examples, if you're unemployment - if you're unemployed and you're not receiving income, why would you be making payments to your credit card in excess of the minimum amount that you are required to - to make? It's not - you
30 know, and it's scalable to the size of the increase that we're - we're making here. It's an existing customer with a limit already, we're talking about maximum increases of \$5000, the average was about 2800. So it's proportionate to that additional commitment that we were making the reasonable inquiry based on the actual payment that they were making to the account.

35 The contrast that's lying behind the reference to default is a contrast with any assessment of whether the customer could repay the total amount of the debt within any period, whether immediately, over a defined period of X months, X years, whatever?---Yes. I - I would agree with your characterisation there, and there -
40 that's where the other behavioural and transaction scoring that we were doing on that account were also indications of - of whether or not that customer would default or not.

45 It was default, not repayment, is the contrast I'm inviting your attention to?---Okay.

And what I'm asking you, in effect, is: was the bank judging it according to likelihood of default - it seems to me it was - rather than, according to repayment

within a necessarily arbitrary time?---Yes. And that's the new standard. The standard that was applying at the time, I agree with you, was to whether or not they could make their – their minimum obligations under the – under the facility, because a credit card is a revolving facility. It's not intended to be – it's not a term loan, it's
5 expected to be paid back within a defined term.

No. And that – having interrupted you, Ms Dias, let me just continue a moment. The notion of a revolving facility is also important in this sense, isn't it, that the assessments that are done look at – or that were done at this time looked at past
10 practice of the customer; is that right?---Yes, they took that into consideration.

Their past expenditure patterns and in particular, relevantly, their past servicing of the debt?---Yes. Particularly the recent servicing of their debt.

15 I understand that. It made – did it make any attempt to predict or take account of whether the customer's spending patterns might change if further credit was allowed?---The purpose of the serviceability assessment?

Or at all. At all. In any respect. I mean, yes, serviceability - - -?---Well - - -
20

- - - but at all?---Well, I think the reason we're offering a limit increase is that we – we want – we want it to be used because we're a commercial enterprise, we want to - - -

25 Yes?--- - - - grow the – the – the book.

Yes?---So, yes, we – if we were offering a limit increase, it was because we thought that the customer might want it, and if they do want it then we can profit from that.

30 And, therefore – I understand that. And the point I'm trying to identify, and I – forgive me if I'm not identifying it clearly, that is my fault, not your fault. You look backwards. There's a temporal element to that. You look to the customer's spending patterns, as well as income experience, in the past; is that right?---Yes, we do.
35

And the purpose of the credit limit increase, at least from the bank's point of view and probably from the customer's point of view, will be to change the expenditure habits of the client; is that right?---Yes. There are many reasons we could – we could sort of say a customer may have two different credit cards and we want them
40 to use our credit card, not the other one. We want them to – to – if they spend more we earn more revenue on a – both on interchange basis; if they revolve we earn interest income. Yes – but we look not just at the customer's spending patterns, but we also look at their behaviours and their past – the way that they're servicing not just this debt but all of their debts with us.
45

And the question which then emerges is the reliability of what you get by looking back for determining what the position will be in the future, when the hypothesis is that the customer's spending patterns will change?---Yes. And - - -

5 Do you see the problem that - - -?---No, I do.

- - - I'm trying to identify so poorly, but - - -?---No, I – I understand what you're saying, and in my statement I talk about when we're assessing credit risk generally, we're looking at three tests: we're looking at whether or not the customer can afford
10 the credit limit, but we're also looking at the behaviour of that customer not just on this account but on all their accounts, and it's that element of it – and then there's a third element, which is what's their financial situation should they get into some sort of difficulty through, you know, whether unemployment, illness, and other life events, what have they got to be able to – to weather those life events. The bit of
15 those three things that is most predictive about whether or not they will get into trouble on this debt is the second element of behaviours on the account. Whether or not they can afford the loan or not and how – by how far they exceed that test is, somewhat counterintuitively, not the best predictor about whether or not they will be able to service that debt.

20

You measure it against whether their past payments have been such that they could have met the minimum payments for the new increased limit?---That's right. So we're testing their ability to pay, but in – in all of these tests, whether or not they can pay, really it's how well they've handled their – their finances is a better predictor
25 about whether they will get into trouble with this, and that's why we put such store in the inquiries that we make about behaviour on those accounts, not just with us but with – with others as well.

30 Yes. Yes, thank you, Ms Dias.

MS DIAS: I just want to recap on what you said there. So look – when we're looking at what Westpac had access to in terms of its data, it could be weighted on one account – just the credit card account – which would tell you nothing about numbers of dependants, for example, is that right?---Well, we do get the number of
35 dependants when the credit card is originated. So there is a – this is only for limit increases. So it's an existing customer that's – that's – that's – that's paying their credit card.

40 But that could have changed?---That could have changed, yes.

So what I'm trying to get at is that the information you have can have changed, and you are not trying to ascertain or verify whether it's correct?---We're not – we're not seeking new information for customers that – that are performing very well.

45 So, for this customer, you didn't seek to ascertain what his employment status was at the time?---No, that's correct.

And you would agree, therefore, that that would have been a reasonable thing to do, to find out whether he was working and earning an income that could have serviced that increase. Do you agree with that?---We – we could have asked the customer whether they were employed at the time, or whether their income had reduced, and
5 they could have told us or they might not have told us.

But you didn't ask the question?---No, we didn't.

I put to you that it wasn't reasonable to not ask the question. That was unreasonable.
10 Do you agree with that?---Well, our assessment at the time was that that was reasonable, but in – in hindsight, you know, and with the guidance from the – from ASIC, we did change that practice.

Okay. You give a couple of other examples, but I will just take you to one more in
15 your statement. That's at 0017. It's just further down. It starts at the bottom of that page, Mr Malcolm. Now, that – thank you. This customer, 14(b), was provided a CLI and had been in arrears on their credit card for a period exceeding 60 days at some time before the CLI was offered. Now, that – and they were also remediated. Then over the page – maybe we can put them side by side. Thank you. So they had
20 their limit increased from 6500 to 8500. Now, they hadn't been in arrears at the time of the offer but, as you say, they had been in arrears for over two months, eight months before. Now, why wasn't that taken into account?---Yes. That would have been taken into account through, again, some of the behaviour scores that we – we would have looked at as part of the – that process. But if the customer has caught up
25 those – those arrears and had been current for a period of eight months, their score would have improved when – when this process would have been run and, therefore, they were deemed to be eligible.

This person went on to say contacted Westpac's assist service. This wasn't as part of
30 the remediation. They identified the CLI had contributed to their hardship, and you say there in subparagraph (c):

*The offer was made because the automated process had determined that the
35 CLI was not unsuitable.*

Don't you think it would have been reasonable to take into account that she had been
in arrears for a period not – not very long before the CLI was offered? Do you agree
now in hindsight that that would have been reasonable, Mr Malcolm?---In hindsight,
yes, if she was not in arrears at the time of the CLI, but if she had been in before, in
40 this case, yes, I would say that.

Then in subparagraph (d) you note that during the remediation process she was called
– this is in 2016, her CLI was in 2012. She returned the call. During the call the
customer indicated that though she was not certain she thought that she was
45 employed on a part-time basis at the time the CLI was granted. She said she was not
– she was unsure whether her income had changed at the time of the CLI, and that
she had not expected any significant change in her circumstances, but – yet she was

determined eligible for remediation. Again, wouldn't it have been prudent to check with her on her employment status at the time, assuming that she is right that perhaps it was on a part-time basis – or even not on that assumption, sorry, Mr Malcom, at all. Just to check with her about her employment status; do you agree?---I accept that that's – that's now the standard for reasonable inquiries.

Okay. Now, you're aware that the Australian Banking Code of Practice – or by that code, Westpac promises customers it will exercise the care and skill of a diligent and prudent banker before extending credit. And that's RCD.0021.0001.0174. And the relevant pinpoint is 0196. I believe this is a version that I think came into force around 2013, but that clause there of 27, Provision of Credit:

Before we offer, give you, or increase an existing credit facility, we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay the credit facility.

Now, one of Westpac's credit assessment methods at the time was this automated process. Do you agree that that was not a diligent and prudent process to adopt at the time?---Well, we believed it was a diligent process for the size of the limit that we were offering for – that was what was an existing customer.

But you don't hold that belief now, do you, Mr Malcolm?---Well, we've – we've certainly changed our practice that we do actually make direct inquiries about the customer's income and employment status when we make a limit increase offer.

Now, you've mentioned ASICs guidance and what ASIC told lenders. I want to explore with you the chronology of Westpac's discussions. Apologies. I should tender that, Commissioner. The banking code.

THE COMMISSIONER: 1.169, 2013 Code of Banking Practice,

**EXHIBIT #1.169 2013 CODE OF BANKING PRACTICE
(RCD.0021.0001.0174)**

MS DIAS: Thank you. And we've discussed the National Credit Act requirements. You're aware that ASIC provides guidance to lenders about their obligations under the Act. Are you aware of that, Mr Malcolm?---Yes, I am.

And there is a regulatory guide 209, that was first published in 2010, and it has been updated over the years. But relevantly, I will take you to one particular part of it that existed at the time. RCD.0021.0001.0088. That's the first page. Have you seen this document, Mr Malcolm? Are you familiar with that?---Yes, I have.

And RCD.0021.0001.0108. Now, we might just put the two pages – the previous page, sorry, side by side with this one so we can read – thank you. So the rule down the bottom there – or the guide 209.48:

5 *We recognise that, in certain circumstances, some credit providers will be able to verify a consumer's financial situation without receiving additional information from the customer. For example, a bank could look at a consumer's regular deposited salary, the timing of credit card payments, and the payment of other expenses. However, credit providers should take care*
10 *relying on such information, which may not reflect the consumer's entire financial position, for example, if the consumer holds credit cards with other financial institutions.*

15 Now, would you agree that Westpac did not take care in relying on the information it had when it assessed suitability of credit increases for the non-FCA customers?---Sorry, can you repeat that.

20 Do you agree that Westpac didn't take care for the non-FCA customers, those customers that weren't asked for further financial information? It relied on the information it had, which may not have reflected the customer's entire financial position? Do you agree that was a lack of care on Westpac's part at the time?---Yes. We didn't make inquiries about debts of other financial institutions for our existing customers in this process.

25 And you're aware that, in September 2012, ASIC told banks including Westpac that inquiries about employment status and current income with a minimum in - - - were the minimum inquiries that ASIC expected a bank should make before offering a credit increase?---Yes. They sent a letter to the Australian Bankers Association.

30 You refer to that letter in your statement, Mr Malcolm, but you don't exhibit that letter, do you?---No, I haven't.

35 I will take you to that letter. WBC.099.001.2054. So that letter is addressed to the Policy Director of ABA. And Westpac would have received or did receive a copy - - -?---Yes.

- - - of this?---Yes, we did.

40 Contemporaneously, would you say, in September 2012?---Yes.

Thank you. I will just read the first paragraph, Mr Malcolm:

45 *The purpose of this letter is to communicate ASICs views in relation to credit card limit increase invitations and relevant assessment processes in light of current responsible lending obligations and work that ASIC has been doing with the industry over an extended period of time.*

Further down:

5 *In making an assessment as to whether a credit contract or credit limit increase is unsuitable a credit provider is required to make reasonable inquiries about the consumer's requirements and objectives; make reasonable inquiries about the consumer's financial situation; and take reasonable steps to verify the consumer's financial situation.*

10 And there's reference there to RG 209 and we talked about that. And then further down ASIC writes:

15 *We understand that credit card assessment processes, particularly assessment of applications made in response to unsolicited credit limit increase (CLI) invitations are typically largely automated in order to deal with high volumes of applications. Lending decisions are made quickly and manual intervention is the exception rather than the rule.*

Do you agree that that encapsulates accurately what Westpac's process was?---Yes.

20 And then over the page at 2055, perhaps – thank you. And at the top of the page, ASIC says:

25 *The use of highly automated processes, while arguably efficient for industry, creates a potential tension with responsible lending obligations that require assessment of each individual consumer's needs, objectives and financial capacity. Some card issuers have actively responded to their new obligations, and now make direct inquiries of customers regarding relevant matters such as income and employment. In contrast, a number of card issuers continue to rely on minimal inquiry, often limited to a request that the customer acknowledge or confirm that they can meet proposed repayments and have not had and/or do not foresee any adverse change in their financial circumstances.*

35 Now, would you say that that paragraph there, beginning “in contrast”, encapsulates what Westpac's approach was at the time?---Well, again, the – we don't make direct inquiries to the customer but, in terms of our interpretation, it was the inquiries that we were making about the customer from the other information that we held. That was our view at the time.

40 But it was a minimal inquiry, was it not, Mr Malcolm, at the time? Would you agree with that characterisation?---Well, of the customer, yes. But - - -

Yes?--- - - - again, the totality of what we were – what we were inquiring to in our own systems was quite an extensive inquiry.

45 Well, ASIC here is referring to an inquiry of the customer?---Yes, I would agree with that.

Yes. Thank you. And would you agree that Westpac relied on acknowledgement or confirmation from the customer that they could meet the repayments and didn't foresee changes? We saw that in the letter, would you agree with that, that that is corroboration of that or consistent with that approach?---Yes.

5

Thank you?---Yes, I would agree.

I am reading on here:

10 *ASIC acknowledges that it is useful to ask customers about recent or foreseeable changes to their financial circumstances. We think, however, that responsible lending also requires direct inquiry about a customer's current financial circumstances so that the card issuer, not the customer, can assess suitability.*

15

That's pretty clear, isn't it, Mr Malcolm? It's telling Westpac, and other lenders, what ASIC expects of lenders?---Yes.

Yes. And further down:

20

Despite that, and while continuing to encourage more extensive inquiries where appropriate, ASICs current view is that before approving a CLI application card issuers should at least make inquiries about and ascertain a customer's current level of income and employment status.

25

And you would agree that Westpac did not do those things for the non-FCA customers in the relevant period. Do you agree with that, Mr Malcolm?---Yes, I do.

And further down ASIC says:

30

Given that these obligations have now been in effect for over 18 months, where we identify continued noncompliance ASIC will consider the full range of available regulatory responses, including enforcement action where necessary.

35 I will tender that letter, Commissioner, thank you.

THE COMMISSIONER: Exhibit 1.170, letter ASIC to ABA, 12 September 2012, WBC.099.001.2054.

40

**EXHIBIT #1.170 LETTER ASIC TO ABA DATED 12/09/2012
(WBC.099.001.2054)**

45 MS DIAS: Thank you, Commissioner.

So Westpac received this letter and you would agree with me that it makes clear what it wants lenders including Westpac to do?---Yes, it does. And - - -

5 And in your statement you refer to discussions and considerations by members of the credit risk regulatory affairs, and product teams about that letter, and that's at paragraph 62 of your statement.

THE COMMISSIONER: Sorry, paragraph?

10 MS DIAS: 62, Commissioner.

THE COMMISSIONER: Thank you.

15 MS DIAS: I want to show you an email from 5 October 2012 which records discussions by the people that you've referred to.

THE COMMISSIONER: Just before the letter - - -

20 MS DIAS: Yes.

THE COMMISSIONER: The letter has come down. The letter followed a deal of discussion between Bankers Association and ASIC, did it not?---Yes. And also discussion with – direct with banks as well. We had a number of discussions with ASIC, both in the lead-up to and the – the implementation of that about what reasonable inquiries means, and those kinds of things.

And the banks advocated their view of what was and was not reasonable?---Yes.

30 And what comes back is ASICs response, informed in part by reference to what the bankers had put to them?---Yes. And there was a paragraph in that letter, which counsel didn't read, which was – talked about scalability as well.

35 And you're going to explain scalability to me, are you, Mr Malcolm?---I was – I was hoping you could explain it to me.

That's the impression I have from other witnesses, that it's a – quite seriously, it's an expression that's found throughout the documents. What do you understand it to mean, or do you - - -?---Well - - -

40 - - - have any useful content you can give me about it?---Well, it was – it was one of the vexed areas during this whole period of time, because new legislation and a new guidance and – but there was – within the guidance there was an acknowledgement that for existing customers, customers where – and the size of the – the increase was small relative to their – their income, or it was not a complex credit contract, and that the customer had the capacity to understand it, that reasonable inquiries could be less than it would be if it was all of the things that they were not. So it did – did require some degree of interpretation, and in this – it's really the nub of this – this case, is

that we would interpret it for small credit limit increases of up to \$5000 for existing customers, that we would assess that that was what was reasonable. ASIC in this letter, I think, is giving a guide as to what they thought was reasonable as well.

5 Yes. Yes, Ms Dias.

MS DIAS: Thank you, Commissioner.

10 So the next document is WBC.099.001.0473. We were just talking about discussions that were held around this time at Westpac. This email is dated 5 October 2012. And you can see there the heading ASIC letter RL – I read that to be responsible lending concerns. If you go up – scroll up a little bit further, please, operator, we can see it says:

15 *Notes from our meeting.*

I take that to be a recording of what was discussed at this meeting, but you weren't attending this meeting – I don't purport to say that you were – but you know some of these people, particularly Josh Moyes. He is in the regulatory group; is that correct, in compliance?---Yes, regulatory affairs.

20 Is he a lawyer, Mr Malcolm?---I – I don't know.

So the email says – it's a bit hard to read, but it says:

25

*ASIC raised issue at conference following their letter dated 12 September.
Tension between automated CLI processes versus RL –*

responsible lending:

30

Mark's view that ASIC and WBC not aligned. Business took view in early RL days proxy for capacity to further service increase is the payment to balance ratio. Further credit assessment FCA segment.

35 Further down:

FCA versus non-FCA 30 per cent to 70 per cent.

40 We've discussed that. That's what the ratio was of the proportion the split was; is that correct, Mr Malcolm?---Yes, that's - - -

Yes:

45 *ASIC assert that all banks should make inquiries on current income and employment status. Group potentially almost there on first point of income, but not on source. ASIC soft approach is now over. Firmer responses to be expected.*

And then further down:

Non-FCA nothing asked; nothing validated.

5 Now – so at this time, can we take it from this email that Westpac realised that ASIC was serious about what it was saying in the letter?---Yes.

10 Yes. And what do you think – don't know what the writer means but “firmer response to be expected” would that refer to enforcement action?---Potentially.

Yes. And when it says:

...group potentially almost there on first point of income but not on source.

15 Is that referring only to the FCA or both sets of customers that Westpac was thinking that because it had the original information in the original card application, perhaps it was – it met that requirement. Is that - - -?---I don't know, sorry.

20 That's all right. Thank you, Mr Malcolm. Okay. I tender that email, Commissioner.

THE COMMISSIONER: Exhibit 1.171, WBC email 5/10/2012 re ASIC letter WBC.099.001.0473.

25 **EXHIBIT #1.171 WBC EMAIL RE ASIC LETTER DATED 05/10/2012 (WBC.099.001.0473)**

30 MS DIAS: Shortly after that, Mr Malcolm, there was an exchange of emails. You've exhibited those to your statement at WDM12. And that – the doc ID is WBC.099.001.2070. Thank you. If we might go to the last page, I think. So 73 to 74. If we could put those side by side, thank you. Thank you. Now, prior to preparing your witness statement, had you seen this email chain before, Mr Malcolm?---No, I don't recall seeing it.

35 But you have seen it now in the preparation of your statement?---I have, yes.

40 Thank you. So the first email is dated 8 October, and some of the people that we saw from the last email are recipients here. And Mark Stewart is saying to Rob that they discussed ASICs letter. Further down he says:

45 *It appears from their letter that ASIC consider that before approving a CLI we at least make inquiries about and ascertain a customer's current (1) level of income and (2) employment status. Whilst we gather current income and expense information for our FCA segment prior to CLI approval, we do not inquire about current employment status. We could take the view that by excluding based on age and then unemployment status that we've already made*

reasonable inquiries, but this only applies to the segment where we have a transaction account relationship. Likely to be in the minority.

Further down:

5

Josh's view was that, whilst the letter wasn't specifically directed at Westpac and nor did it call for a response, ASIC will be expecting credit providers to tighten processes and raise standards to what they consider to be minimum, ie, an employment status question/check-box.

10

And then further down there's the paragraph:

15

Whilst we only have CLI consent for circa 250,000 customers and considering that the FCA segment comprises circa 30 per cent of the CLI population, the current cost benefit associated with these changes would be unfavourable. However, I'd suggest that they are required if we want to continue to offer CLIs without attention or intervention from ASIC. Colin has spoken to product and will be able to advise their position on this.

20

So – now, Mark – Mark Stewart is Senior Product Risk Manager. What position is that? Is that a compliance regulatory position?---It's a – it's in the risk team but it's – it reports to the head of unsecured risk.

25

Okay. You would agree that Mark is saying – or expressing the view that, “We really do have to make this change”?---Yes.

And then Colin is going to speak to product and advise what they think. And you said before about product being the business side; is that correct?---Yes, that's right.

30

Okay. And then further on the next page we see that Josh Moyes, head of Product and Distribution Regulatory Affairs – Group Regulatory Affairs responds:

35

Thanks, Mark. Only that when considering actions you might take, to the extent we make changes about employment status and income, the former probably seen by ASIC as substantiating the latter, then the regulator, I think, expects this for all CLI invitations, not only the FCA (these distinctions might not be clear to ASIC).

40

So Mark there is saying, “We should be doing these for all invitations”; is that correct?---Yes.

45

Then the next email which is on 2072. Perhaps we will put the next two pages side by side. Thank you. 2071 and 2072. So this email from Mark back to Joshua and others – so he proposes three options there, one of which is to process all the CLI invitations as FCA. And he says – he says, down the bottom:

Options 1 and 2 are the most change intensive, but are likely to provide a better business outcome and customer experience. Whilst option 3 is technically the easiest, it does increase the likelihood of non-response (tbc in a post-CLI consent environment).

5

And then the next email we see is from one of the recipients, a Colin Twitchett, project manager, compliance projects investments and partnering:

10 *Dennis, as below noting Alla's call on Friday evening where she was opposed to doing anything until ASIC made a formal request, this view will be aired at the next meeting for wider consideration.*

Do you know who Alla is, Mr Malcolm?---I don't know her personally, but she's in the product team.

15

Okay. So she is part of the product side, okay. And the next email is 22 October from Dennis Cavestany, program manager, compliance projects:

20 *Hi Josh, what do you want to do with this one? The product view is to not do anything unless ASIC makes a formal question. Would you like to table this in the next steer committee executive working group? Given the now differing point of views, I'd rather the business have an agreed view before the project considers it as a scope item.*

25 And so the differing points of view that he is referring to there, would you say, is the difference between the regulatory camp that's saying, "We really should be doing this and complying with what ASIC is saying", and the product team that's saying - - -?---Yes.

30 - - - "We don't want to." Yes?---The regulatory affairs team and the risk team presenting one point of view and the product team presenting an alternate view.

Okay. And then the next email after that, Joshua responds to Dennis on 24 October saying:

35

SC attention is important.

Now, is SC the steering committee?---Yes.

40 Continuing:

45 *Any further formal request is unlikely to arise in a non-confrontational setting. ASIC regards their letter to the ABA as a friendly alert to all bank credit card issuers. So unless we are certain our approach is defensible we would be inviting adverse regulatory attention and public outcomes if we did nothing at this stage and ASIC then engaged Westpac directly.*

Okay. So I think that's, again, with the regulatory side of the bank is emphasising that we really do need to do something?---Yes, they're saying it's a - - -

5 Or defend our approach?---That's right. So they're saying, "If you – if you want to go down a different approach, you've got to be – you've got to have a defensible position."

10 Okay. Thank you. And then the final two emails are on that first page, 2070. Josh again writes – this is to Rob Love, and we saw he was the writer of the first email we came to today:

Hi, I am not sure where this is up to, but I'd like to know whether you've discussed this with David Malcolm –

15 that's yourself –

or product and whether it's a matter that the sustainable banking NCCP steering committee needs to consider?

20 Now, this committee, can you tell the Commission a bit about that committee? What was it set up for?---The committee was – was the steering committee for the project changes for the credit card reforms that came in in 2012, and was managing our response to – to those changes, including what hadn't been implemented from the first round of the National Credit Act because the regulations came in quite late. So
25 there were – there were still ongoing things that needed to be resolved from improving the processes from the – from the compliance date. So it was essentially a – a project steering committee, but it had representatives from product, from risk, from the – the project management team and regulatory affairs, so Josh was – would attend that committee.

30 And any executives, senior people from the bank; is that correct, or not?---Well, senior executives from product and risk. It was at that level, yes.

35 Okay. And you yourself attended some of those meetings; is that correct?---I was – I was – I think I was the chair of the committee, but I would normally delegate that to Rob Love because he was the head of unsecured risk, and it was – it was really the project steering committee and he had most of the – the implementation issues within that, but he would inform me of – of any important issues, if I didn't attend the meeting.

40 Okay. And so when Josh says to Rob Love, "Have you discussed this with David Malcolm" – had you discussed this with Rob Love?---I – again, this is six years ago, I don't remember but look, it's possible he did. I don't – I don't have specific records of having a discussion with him.

45 And you – but you were aware of the letter, the ASIC letter, you said that?---Yes, yes.

You were aware of that at the time?---Yes, I was aware of the letter.

And you were aware that discussions were ongoing within the group or between these two groups?---I – I was aware.

5

- - - about that. Okay. And then the final email is from Mark Stewart to Joshua Moyes:

10 *Hi Josh, I was unaware of product's reluctance to amend anything and had hoped to get everyone together this week (Colin to organise) to settle on a consensus position. Rob and I believe that doing nothing is not an option, but how much we do do needs to be agreed. Given that CLI population have now self-selected themselves via consent, I would argue the number of questions we ask is no longer as correlated to response rates as was the case the pre-NCCP.*
15 *The three scenarios I outlined earlier still apply. No one has provided feedback or alternatives to me.*

20 So in this email, would you agree, Mark is again saying, "Rob and I believe we can't do nothing, we've got to act on what ASIC is telling us." And he actually says here as well, would you agree, that "Maybe it won't hurt us too much in terms of the population that is targeted because we no longer circulate – it is no longer correlated to response rates." Would you agree with that?---Yes. I - - -

25 There's a few questions there, Mr Malcolm, sorry about that. Would you agree at least he's saying, "We can't do nothing, we've got to act on this"?---We've got to make a decision. That's – it's – I mean, it's sort of – it's a series of questions and discussions around what do we need to do in response to the letter and we can't just do nothing and hope it goes away.

30 So you're understanding this to be, "We have to make a decision, but not necessarily the one that would follow ASICs guidance"?---Well, not – to – exactly.

35 Okay. Well, in the end, Westpac did do nothing about the ASIC letter – is that correct – for two years – for about two years?---Well, there was a discussion and a decision made. So they – they had a discussion between risk and product, and they made a decision that based on the – on the basis of the totality of the current process, that they felt that that was enough to satisfy the reasonable inquiries without making direct inquiries of employment and income for those customers that they deemed that showed adequate information from our – our own data. So yes, they – they didn't
40 implement the change that ASIC - - -

45 And in your statement you say that ASICs views on whether Westpac's processes needed to change were escalated to the steering committee that you talked about before. And I suggest to you that that was because of the gravity of what was being discussed and suggested here in these emails and discussions; is that correct?---Yes.

Yes. And the steering committee met to consider this issue on 12 November 2012. There was a meeting. You've exhibited some minutes and action items at WDM13. That's WBC.050.099.2189. So we can see there, as you said before, that Rob Love is the chair and he's your delegate - - -?---Yes.

5

- - - for that meeting. Yes. But he would normally tell you about what happened in the meeting. You would discuss it with him afterwards? Yes?---Yes.

10 Okay. And on the next page, under General Business, the heading Responsible Lending and CLI Invitations:

J Moyes –

15 I believe that's Joshua Moyes –

raised concern about the needing to be proactive in relation to a recent ASIC letter to ABA which advises that salary and employment status should be checked prior to offering CLI invitations. Love noted that a more detailed offer letter is already available and a new business position may need to be developed. This was accepted to be a BAU issue that should be resolved by product, risk and compliance. RL to report back on conclusion.

20

That reference to BAU issue, is that business as usual issue?---Yes, that's correct.

25 And why was it accepted to be a business as usual issue?---I think what they're saying in – in that is that they're saying that the requisite people required to make that decision – empowered to make that decision was decided to be product risk and compliance, rather than it being escalated to any higher level within – within the bank at that time.

30

It was a very serious decision, wasn't it, to take? Not to follow what the regulator was telling Westpac to do?---Well, the – the decision was to analyse whether what we were doing was – was compliant with that.

35 Okay?---Rather than – I mean, I wouldn't characterise it – they didn't think of it at the time as not – directly not doing what ASIC asked them. They were thinking of it as do – is what we do compliant with – with that?

40 THE COMMISSIONER: Was there any consideration given in that analysis to whether – or to the possibility that some sales of credit limit increases may be unsuitable?---Yes.

45 Because I don't – what I notice about the email chain you looked at previously is, first, it seems to me to emphasise that Westpac regarded credit limit increases as important; is that right?---Yes.

Commercially important?---Yes.

And that what is absent from that email string and, at least subject to correction, the other documents that we've looked at, is any consideration of whether it is possible that CLIs in some cases may be unsuitable because the customer's circumstances have changed. Do you accept that that's a notable – that first it is absent, and then
5 that it's a notable absence?---Well, I think that the consideration was that the CLIs for this group were considered low risk. So I – I – that's – the consideration around suitability and compliance with the – the responsible lending obligations. I agree, it's – it's – I would characterise it the way that you did, but certainly that they – the feeling of the risk and product teams was that this group of customers, because of
10 what we knew of – about them, that the risk of – of adverse outcomes for them was low.

But the ones at the edge of capacity may be those who take up, say, an extension of their credit limit by \$1500 in the hope that that will get them over the hurdle; is that
15 right?---Well, again, it's – it's a bit hard to think of that in abstract without knowing the actual outcomes of – of these customers and, again, I have it in my statement. But when you look at the population of – of customers, the general credit card population, the actual adverse outcomes customers that defaulted was around 2 per cent around this time. For customers that went through the FCA process, the – the
20 default rate was about 0.7 times, less than half, and for the customers that went through the non-FCA process, it was only .38 times. So the views of the – of the risk people were driven by – that they thought these customers were customers that we know very well from the information that we have and are low risk. So - - -

25 Low risk of default?---Yes, in that case.

Not any consideration of whether they could repay the debt within a reasonable time or a fixed arbitrary time?---That's – that's true. They weren't – they weren't looking at it at a reasonable time.

30 Why – what's lying – did you read the evidence of Ms Cox at the opening of the – this round of evidence, by any chance, Mr Malcolm?---I watched it – a little bit of it, yes, but I didn't watch the whole thing.

35 No. I think I'm right to remember that she gave the example of someone buying a pair of jeans and still paying for it five, six years later because they've just been able to keep up the minimum payments for five or six years?---Yes. And I - - -

40 That's not uncommon amongst revolvers, is it?---Well, I – what I would suggest is if that is what the customer has, then the better product for them is not a revolving product, it's a term product that actually does pay off over time and they will pay it off quicker.

45 Exactly so. And there was no consideration given by Westpac in offering these credit limit increases to whether this product, revolving product, was appropriate or instead the customer would be better off with a fixed term personal loan?---Well, one

of the rules that we had in the exclusion rules was – was very high utilisation. So, for exactly that kind of customer, we didn't offer them.

Yes.

5

MS DIAS: But it's in - - -

THE COMMISSIONER: Go on.

10 MS DIAS: It's in Westpac's interests to maximise the number of revolving customers. You would agree with that, wouldn't you, Mr Malcolm?---We want customers to afford their loans. It's in our interest for them not to default as well. But, yes, I agree with you.

15 Not default entirely?---Yes.

You want them to keep making the repayments and pay interest. You don't want them to default entirely, but you do want them to keep paying the interest and repayments. Not – you don't want them to be transactors, in other words?---I
20 wouldn't – no, we're happy with transactors as well. Transactors are – we earn revenue a different way from transactors, so - - -

But they're not as profitable, are they, Mr Malcolm?---Well, they can be.

25 Well, in your statement you refer then to a meeting that took place on or around 4 December 2012 between Rob Love, head of unsecured risk, and Nicholle Lindner.

THE COMMISSIONER: I haven't started looking at interchange fees, Mr
30 Malcolm. I'm not suggesting I will either. That's the transactor, isn't it?---That's right. So - - -

Sorry, Ms Dias, I shouldn't interject.

MS DIAS: No, that's fine.
35

THE WITNESS: It's a complex product and I don't – I'm – we have to – when we're looking at these transactors and revolvers – and they do switch over time – some will be transactors when they take out the loan and have full intention of paying back each month, and others will take a – make a purchase and pay it off over
40 – over time, and others will – will revolve from month to month.

MS DIAS: Now – and you – just returning to the chronology, in December, Rob Love and Nicholle Lindner, she's head of credit card product, had this discussion you referred to. Now, you weren't involved in the discussion, but you've spoken with
45 them since, have you, about what they discussed – or was that at the time?---I've – I don't recall speaking to them at the time, but I have spoken to Rob Love since.

And I might take you to this part of your statement. WIT.0001.0014.0015. So you refer to their meeting. And at 65(a) and (b) you say:

5 *They were both of the view that Westpac's approached remained appropriate and that the process taken by Westpac to determine if a customer was an FCA customer or a non-FCA customer remained the prudent approach and met Westpac's obligations as a responsible lender.*

10 Would you agree that it wasn't an appropriate approach to adopt, because ASIC was telling Westpac at this time to make those minimum inquiries about income and employment?---I – the basis of their decision I also set out. What – what – in my view, what they should have done, if they believed that, that that was a – was an adequate approach would be to have gone to ASIC and engaged with ASIC at the time, and either got them to agree that that's a – that that's a – that our total approach
15 did meet the – the standard of reasonable inquiries or not. And that's, in essence, to me, the – the nub of this issue, is that they didn't – even if they believed, which they did, that it met the standards of reasonable inquiries, that they should have gone to ASIC at the time.

20 Well, Westpac did have discussions with ASIC after that for over a year, Mr Malcolm, and tried to explain its processes and ASIC didn't accept that they were adequate; is that correct?---Yes. So we didn't – again, we didn't – we didn't change our approach, and when ASIC came to the banking industry – it was January 2014 – and did a further survey of credit activity – credit card practices, we – we told them,
25 and they actually were aware that we were still using the same process, and that prompted a series of – of questions from ASIC, which we – we had, as you say, ongoing discussions with them as to whether or not we were complying with – with that letter.

30 So there was that dialogue across that period. You would agree with that?---From January '14 onwards, yes.

35 The next committee meeting was December 2012. And that's – there's a minutes for that which you've exhibited, WDM14. And that's WBC.050.097.6212. So, again, we have a got a chair here, who is your delegate. Now, perhaps if we go to the next page. There's a status update. Someone has reported back to the steering committee on the outcome of those business as usual discussions that we talked about. The status update:

40 *AFS risk & product have reviewed the current CLI letter strategy and remain comfortable with the current approach, which includes sending an offer letter with content aligned to ASICs recommendation to approximately 30 per cent of customers receiving offers. The remaining 70 per cent of offers are made to customers with a strong group relationship, including customers with regular salary deposits in transaction accounts. As such, an abridged CLI offer letter*
45 *will continue to be sent to this segment.*

Now, that 70 per cent, there's a reference there to including customers with regular salary deposits. That's not all customers, is it? There were many customers who just had the credit card account which wouldn't have shown those deposits?---There were some customers that only had a credit card account.

5

And the reference to a "strong group relationship", that wouldn't be accurate in some cases. Some customers would only have a credit card account with Westpac and no other transaction accounts at all?---Yes, some customers.

10 Do you agree with that?---Yes.

So this conclusion that's reached is that they will effectively – Westpac will effectively do nothing, which is the approach that the product team wanted; yes?---Yes.

15

So in your statement you say no changes were made to Westpac's processes until ASIC commenced its investigation in around August 2014. And then in December 2014 Westpac put its credit card offers on hold while ASIC investigated. Now, you're aware that ASIC issued various notices throughout this period - - -?---Yes, I am.

20

- - - to Westpac. Yes. I will just take you to a couple of those notices, Mr Malcolm. One is ASIC.0010.0005.0489. We can see this is one of those notices that has been sent to Mr Moyes. The first paragraph refers to ASICs monitoring of industry implementation of the National Credit Act. And the reasonable inquiries that we mentioned earlier today, and then there's a reference to the September 2012 letter:

25

In September 2012, ASIC communicated its views to peak industry bodies.

30 And you would agree that's a reference to that ABA letter we talked about?---Yes.

And then the next paragraph:

35

ASICs view is that before approving a credit card limit increase application, card issuers should at least make inquiries about, and ascertain, a customer's current level of income and employment status. Additional inquiries may be necessary depending on the age of information held by the card issuer, however we expect to see this base minimum level of inquiry.

40 So again that's making pretty clear, isn't it, Mr Malcolm, what ASIC was expecting of Westpac?---Yes.

45

Yes. And on the next page, page 2 – you could put them side by side, perhaps, would help. Thank you, operator. We're missing a page. Page 0490 available? If it's not, I will read it out. No, it's not. Okay. It's blank for some reason, Commissioner, but I will read it. I will do my best:

5 *The purpose of this letter is to seek information about your current credit card
limit increase processes. The information sought is limited to both the
customer initiated limit increase application, and assessment process, and the
issuer initiated limit increase application and assessment process. As a result
of previous discussions between ASIC and Westpac, we are aware that
Westpac's written credit card limit increase invitations largely rely on self-
certification by customers. That is, Westpac did not make inquiries about a
customer's income or employment and relied on the customer to determine
whether the proposed credit limit was appropriate.*

10 Now – and the letter also says:

15 *However, our understanding may be out dated and we would appreciate your
confirmation or correction in response to this request.*

15 And so ASIC requested information about what Westpac's processes were. Do you
recall being aware of this at the time, Mr Malcolm? Were you told about this
process, this - - -?---Sorry, at the time I was in New Zealand. So - - -

20 I see. You have seen these notices since?---I have seen these notices since, yes.

 Thank you. I will tender that letter, Commissioner.

25 THE COMMISSIONER: Exhibit 1.172, ASIC letter 13 January '14 to Westpac,
ASIC.0010.0005.0489.

30 **EXHIBIT #1.172 ASIC LETTER TO WESTPAC DATED 13/01/2014
(ASIC.0010.0005.0489)**

35 MS DIAS: Thank you. Now, there were further notices sent and other
correspondence. I won't go into detail with it, but I will tender them. One is
ASIC.0010.0005.1008.

35 THE WITNESS: Sorry. You called that a notice, but I believe that was a request.
It was a survey of current practices.

40 MS DIAS: Apologies, yes?---I think it was actually a - - -

 I think that's correct, Mr Malcolm.

 THE COMMISSIONER: I think I simply described it as a letter.

45 MS DIAS: Letter.

 THE WITNESS: Okay. I am fine with that, I just wanted to make sure that - - -

MS DIAS: Yes. But there were notices in this period, Mr Malcolm, you agree with that?---I believe the chronology is that this was a – a request to a number of industry participants around their current practices in credit cards. The notices came later, once the results of the survey came in at - - -

5

I see?--- - - - in August 2014, was the chronology I understood.

I see. This letter is undated, but it does refer to a notice in the first line:

10 *We refer to the section 253 notice attached to your letter dated 15 August 2014.*

So does that accord with your understanding of the chronology, Mr Malcolm, that a notice was received in August?---In August 2014, yes.

15 Then this response. Thank you. Then this response is Westpac providing its explanation of Westpac's approach to the credit card limit increases, and the methodology. And it contains quite a lengthy sort of description of the approach; would you agree?---Yes.

20 Yes. And it's actually the contents very similar to what you have in your statement about that process?---Yes, I hope so.

I tender that letter, Commissioner, thank you.

25 THE COMMISSIONER: Exhibit 1.173, letter WBC to ASIC re section 253 notice dated 23 August 2014, ASIC.0010.0005.1008.

30 **EXHIBIT #1.173 LETTER WBC TO ASIC RE SECTION 253 NOTICE
DATED 23/08/2014 (ASIC.0010.0005.1008)**

MS DIAS: Now further letter from ASIC to Westpac explaining the process again is WBC.300.001.0331. So this is early 2015, 20 February 2015. If we scroll up a little bit we can see that date. So again Westpac – the writer is saying:

35

We refer to your letter –

ASICs letter –

40

dated 6 February 2015 requesting an explanation as to how we determine the actual amount of a credit limit increase (CLI) that a customer will be invited to apply for. Our response is set out in schedule 1.

45 And there's many pages that follow that have, again, all that – the processes and the automated – the descriptions of the automated processes. Yes. So this is months and months of – well, over months there was this dialogue and exchange of information;

is that correct, Mr Malcolm?---Yes. So we also had a meeting with ASIC in – in October 2014 as well to explain the process because it is – you know, it’s - - -

Complicated?---Well, it’s thorough.

5

Did you attend that meeting, Mr Malcolm?---No, I didn’t.

Okay. I will tender that letter, Commissioner.

10 THE COMMISSIONER: Exhibit 1.174, letter ASIC to Westpac – sorry, it’s letter.

MS DIAS: Westpac.

THE COMMISSIONER: Westpac to ASIC.

15

MS DIAS: Thank you. So we can see that - - -

THE COMMISSIONER: Just one moment.

20 MS DIAS: Apologies.

THE COMMISSIONER: 20 February 2015, WBC.300.001.0331.

25 **EXHIBIT #1.174 LETTER WESTPAC TO ASIC DATED 20/02/2015
(WBC.300.001.0331)**

30 MS DIAS: Thank you. So over this period, Mr Malcolm, you would agree Westpac’s providing a great deal of detail about its automated process around making these offers?---Yes.

Yes. It’s trying very hard to convince ASIC that its processes are fine; yes?---Yes.

35 Because it wanted to avoid having to make the changes that ASIC was telling it to make; is that correct?---Well, actually there’s a couple of intervening issues as well. In November 2014, ASIC issued an update to RG 209 which essentially repeated the – the – the requirement to make specific inquiries. So by that stage, and in fact in
40 around September 2014, before Westpac met with ASIC, we’d already decided to implement that change. And, in fact, had commenced a project to implement that change by March 2015.

THE COMMISSIONER: Sorry, decision date is when?---I don’t know exactly when the decision date. It is around September 2014.

45

September ’14, implementation was - - -?---March 2015.

- - - aimed for March 2015?---Yes.

And achieved?---Yes.

5 That implementation date?---That was achieved in 2015. And we did – in December 2014 we ceased, suspended CLI offers in – whilst – whilst we were looking at this – this change.

10 Yes?---So the sequence, we met with ASIC, obviously had a discussion with them about the process. RG 209 came out, and we ceased – we suspended CLI offers until such time as the – as the changes had been made in March 2015 and, in fact, we didn't reintroduce them until some time later after we'd done the – agreed the remediation with ASIC.

15 MS DIAS: The very first step in the process, though, was the letter from – to the ABA in 2012?---2012, that's right, yes.

20 Yes. September 2012. Okay. At the end of 2014 there was a group unsecured credit policy at Westpac. You exhibit this to your statement. This is WDM-11. WBC.099.002.2800. This is the only policy from the relevant period that you've exhibited to your statement; is that correct?---Yes, I believe so.

25 You say actually that there's no specific policy or procedure manual for a credit limit increases; is that correct? Or at this time there was not?---Not in – not in the form of a policy like this. It's embedded in the rules of the – of the – of – of the process, if you like.

Do you mean the program, the automated process?---Yes.

30 That's the policy in that?---No, sorry, this is the policy.

This is the only policy?---This is the only policy that I'm aware of at the time.

35 Is this still the only policy, Mr Malcolm?---No. We – we – well, we still have a consumer credit policy, but we also have now introduced a responsible lending policy and a responsible lending manual, which goes into more detail around the requirements for responsible lending.

40 When was that introduced, Mr Malcolm, the responsible lending policy and the manual?---In 2016, and it was updated in 2017.

I see.

45 THE COMMISSIONER: When was it updated in 2017?---I believe June.

MS DIAS: So at this time until 2016 this was all that you had at Westpac to guide bankers, and Westpac itself on responsible lending around unsecured credit?---Yes.

And it was the only policy that we had. There were training manuals and other materials but this was the policy.

5 I see. If we go to .2822. There's a heading there Credit Cards. And we can see there at the top, date last updated 5 December 2014. This is the end of 2014, by which time Westpac is aware of RG 209 being amended? Yes?---Yes.

Yes. And we see there 10.1.2 credit card – credit limit increases, sorry:

10 *When a customer applies for a credit card limit increase their serviceability will be assessed under the following guidelines: the customer will be required to acknowledge their ability to service the increased limit, the customer will be made aware of the increase in minimum monthly repayments based on the new limit, and will be required to disclose any significant change in personal*
15 *financial circumstances that may impact their ability to service the increased repayment. Income verification may be requested.*

20 Would you agree that that policy did not implement what was in ASICs guideline, the regulatory guideline 209 about requiring, not making – making it mandatory to require income verification?---Yes. Not in the policy, no.

And there is nothing in here about ascertaining debts of the customer?---Not in the policy.

25 Would you agree that these guidelines contain very little that would require Westpac to inquire about the customer's current financial situation at the time of the limit increase?---Yes. The – the policy is a high level document. The actual processes and procedures that were implemented go beyond what's in the sort of high level policy. So in the actual letters that were sent out and the automated process would
30 require those – those assessments to be made where they were required.

35 Why have this document at all, Mr Malcolm, if it doesn't mean anything?---It – yes, it's supposed to be a high level indication to a customer and that is one of the reasons why we've given more and better guidance through the responsible lending manual to supplement this, as well as training for our – our bankers.

So who is intended to read this document, Mr Malcolm? Who is the audience?---The – the bankers in the – in the – in the network or – or credit officers.

40 So people who are assessing the credit risk are told that - - -?---Not solely on this, no. They would – they would also have procedures in their – in their own business units as to how to implement these. I – I don't have those – those - - -

45 You don't exhibit those to your statement?---No, I don't.

No. Okay. I want to go to your statement at paragraph 68. WIT.0001.0014.0015. Now, at paragraph 68 you say:

5 *With the benefit of hindsight, I consider that the approach that Westpac took to communicating with ASIC about the issues raised in the ASIC letter was inappropriate in all the circumstances. While Westpac had a general view about the soundness of its approach to CLI offers, the appropriate approach would have been for Westpac to commence a dialogue with ASIC at the time and explain why it considered that its approach of only seeking additional income and expense information from customers which were assessed to be in the FCA category, and not doing so for the non-FCA category, met Westpac's obligations.*

10 Now, we've just been through some of the correspondence. You agree with me that you had that dialogue. Westpac had that dialogue with ASIC, do you not?---Not -- not at the time. Not at - - -

15 Do you mean at September 2012?---Yes. We didn't -- didn't have that dialogue with ASIC at -- in December 2012.

20 Well, do you agree that ASIC had made clear to Westpac its expectations of compliance, and yet Westpac continued to ignore what ASIC was saying?---I'm -- I'm saying that once the decision had been made at the -- the Rob Love, Nicholle Lindner meeting, that having made decision we should have then taken that position to ASIC and said, "This is how we believe we comply with the letter that you have -- that you have sent to the ABA", but that wasn't done at the time. It was, "We've concluded that we -- we -- we comply with that letter -- with your letter." And that if 25 -- if they wanted to take -- if they wanted to make inquiries of us, we should wait. I don't believe that was the right approach. We should have gone to them.

30 Well, ASIC did have to approach Westpac and others lenders about this issue, and you've pointed that out. You're aware that ASIC held discussions with the chairman of Westpac about this issue and other issues in 2015. Do you -- are you aware of that?---I have been made aware of that. Well, actually, I knew that they -- they attended the board in March 2015.

35 Sorry, March 2015 you're aware at that time you were aware of this - - -?---I wasn't aware at that time. Sorry, I have been - - -

You became aware preparing - - -?---Preparing this statement, yes.

40 I see. I will take you to a document, ASIC.0010.0010.2491. Do you need that number again? I will read it again. ASIC.0010.0010.2491. Thank you. So this is a reference -- this is a list of speaking notes from a meeting that ASIC held with Lindsay Maxsted, chairman of Westpac. This is an ASIC document, Mr Malcolm, that the Commission has obtained. The meeting was to be held on Thursday 28 May 45 2015. Purpose:

Lindsay requested this meeting with you following the Commission's meeting with the Westpac board on 3 March and your meeting with Brian Hartzler on 4 March.

5 You referred to that March meeting earlier, Mr Malcolm. Do you recall that?---Yes. I referred to the board meeting. I wasn't aware with the meeting with Mr Hartzler until you showed this document.

10 Were you aware of this meeting from May 2015?---No.

No, I see. I will just read the extract from the first column:

15 *Of the big four banks, Westpac appears most resistant to ASIC and the laws we administer. Across DCIs multiple dealings with Westpac, there is a sense that they only tell 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 than the minimum possible amount of information, eg, in complying with notices. There are some exceptions to this, eg, Westpac was cooperative in a recent technical breach involving failure to provide FSGs in some sales of consumer credit insurance.*

20

Further down:

25 *Example: credit card limit increases. Despite clear messages about our expectations of compliance with responsible lending requirements by credit card issuers, and in contrast to the other card issuers, Westpac refused to change its practices until faced with a very direct threat of legal action.*

30 Do you agree with that statement there, Mr Malcolm, that it took the threat of direct legal - - -

THE COMMISSIONER: You might have to break it up a bit, Ms Dias. I think there's a number of statements there.

35 MS DIAS: Yes. The statement that it took – the very direct threat of legal action to force Westpac to change its processes?---Well, I would say that we were having discussions with – with ASIC and we were – we were – we were giving them information about our credit limit increase programs, and we never sought to hide what we were doing in our credit limit increase programs but, as I said, I do agree
40 that we should have approached ASIC at the time, so from the sentiment that's expressed there that we didn't engage with ASIC until they – they were requesting a number of notices, I – I would agree.

45 You've agreed already in your evidence that ASIC was clear about their expectations of compliance with responsible lending obligations?---Yes.

Yes. And you agree that it was clear from the September letter in 2012 what those expectations were?---Yes.

5 Yes. So you would agree that Westpac refused to change its practices until much later in the piece?---Yes, I agree with that.

On the next page. Thank you:

10 *After the responsible lending obligations commenced in 2011, DCI worked with industry to establish a “bare minimum” position in terms of the minimum inquiries a bank needs to make when inviting a customer to apply for a credit card limit increase*

And there is a reference to the September letter:

15 *ASIC crystallised this minimum position in a letter to the whole industry. DCI went back to the whole industry at the beginning of 2014 to assess the level of compliance and what issuers were doing above the bare minimum. To their surprise, they discovered that Westpac was not even doing the bare minimum. That is, it was not asking customers any questions before increasing their credit card limit. It was relying solely on its internal analytics. While ASIC has publicly said that internal analytics can play a role, we have also said that you need to ask the consumer (as a bare minimum) what their income is and if they are employed.*

25 *This is because the responsible lending obligations apply at the individual borrower level. With Westpac the only bank defying ASICs guidance from September 2012, DCI referred the matter to Enforcement. As part of Enforcement’s investigations, they obtained an internal memo of a meeting Westpac had to discuss ASICs letter from September 2012. The senior executive leader of DCI, Michael Saadat, noted that the memo recorded the following: “Despite someone from Regulatory Affairs in Westpac cautioning against defying ASICs guidance, the business instead insisted on ignoring ASICs guidance.” The business, as recorded in the memo, said, “Let’s wait for ASIC to challenge us directly before changing our position.”*

Now, I will just pause there. There was discussion between – you’ve said this – regulatory affairs, or that group, and the product team, and you’ve agreed that the conclusion was that nothing would be done. Do you agree that the business said,
40 “Let’s wait for ASIC to challenge us directly before changing our position”?---I – that’s – that’s put in inverted commas as if it was a quote, and I don’t think that was actually what was said, but I agree that the – the – the emails from product did indicate that they thought that they should wait until there was a direct request from – from – from ASIC.

45

THE COMMISSIONER: Is it a fair summary what appears in this document the position?---Well, the language is probably slightly stronger than I would have used.

I don't think we were defying ASIC. We simply were – had a different view, but – but we were the last bank, so I – I agree that, again, as I have said before, I thought in terms of what we should have done was to go to ASIC with that view, and – and if that – at the – at the conclusion of those meetings that they didn't agree that we were
5 complying with the – with – with the policy, with the totality of what we were doing, then we should have implemented this change earlier. So I – I agree with the sentiment that we didn't do enough to engage ASIC at the time we made that decision.

10 MS DIAS: Yes. And then down the bottom there is:

Westpac was an outlier in terms of their position. Everyone else had accepted ASICs position.

15 And on the next page, 249 - - -

THE COMMISSIONER: Pausing there, is that right?---I – again, don't know exactly what the other banks were doing at the time, but certainly from the feedback – when we got that feedback from the ASIC survey that they did in January 2014, we
20 got the results back some time later that year, that it did indicate that Westpac was the last to employ direct inquiries for employment and – and income, and which we implemented in March 2015. Well, and – but we were suspended at the time, so we weren't actually doing it.

25 MS DIAS: I see. And on that final page:

*Despite ASIC outlining its position clearly in the letter of September 2012, Westpac ignored this and didn't bother to engage with ASIC in a discussion about this. ASIC only found out by conducting our follow-up review 15 months
30 later.*

And that's true. You've mentioned that, about ASIC conducting their review and that's how ASIC found out?---Yes. That is how they found out, but in their opening of that letter they actually indicated that they – they knew that that was our practice,
35 if you recall they said, "We are aware of your practice but, if that's not true, update us."

Yes. And then:

40 *We would have expected a much more constructive engagement from Westpac, eg, "We disagree with you, ASIC, but let's talk about it".*

And you said that's your view?---I agree.

45 Is that right?---Yes.

Continuing:

The business was able to overrule regulatory affairs/compliance, which is indicative of poor culture and weakness in independent control functions.

5 Do you agree with that, that the regulatory affairs and compliance was overruled by the product or business side of the bank?---I – I don't think they were overruled. The decision was made by a second line risk person in conjunction with a first line business person, with the advice of regulatory affairs, and – and legal were on that steering committee as well. So the steering committee delegated that decision to risk and – and product, and they came to a decision. Now, I think – again, is that
10 indicative of a poor culture? Is that your question, sorry?

Well, who is second – what's second - - -

15 THE COMMISSIONER: Sorry - - -

MS DIAS: I'm sorry.

20 THE COMMISSIONER: What was your answer, Mr Malcolm, I missed it, about culture. You said something about culture. What did you say?---Sorry, when I – when I talk about who made that decision.

Yes?---It was approved by Rob Love.

25 Yes?---Who is in an independent control function. He's in the risk team, and Nicholle Lindner who is the head of cards, who was in the first line product team. Sorry, when I say first line, second line, we employ what's called the three lines of defence approach, the first line being the business that is originating loans, the second line being an independent control function, the third line being an
30 independent assurance function, or audit if you – more common language.

I think what I missed was you added, at the end of your answer:

Is that indicative of poor culture? Is that your question.

35 Well, let it be the question. Is it indicative of poor culture? What do you say about that question?---Well, the premise is that the business was able to overrule - - -

40 Yes?--- - - - compliance. And what I'm saying is that premise is not right, because the second line actually approved the decision with the advice of – of regulatory affairs and compliance in the room. So it was – that it was the wrong decision is different from a culture point of view than it was not properly governed or, indeed, that the first line did indeed make the decision overruling the – the second line. So I – my – my answer to – to the question of whether the decision was made properly with the right authority, I think it was. I think we've strengthened governance since
45 that time and I would like to think that if that same set of circumstances occurred today that a different decision would be made.

MS DIAS: Because we saw in those earlier emails from October that people from the regulatory affairs compliance section were saying, “We can’t do nothing.” Do you – did they maintain that approach?---Well, again, they were still in the room when they – at the – at the steering committee when the decision was made, and
5 minuted. So they acknowledged that the – that we were taking a risk in – in not – in not doing anything, but that that – that they had agreed that the decision could be made at that level.

When you say “they agreed”, do you concede that they didn’t want to adopt this
10 approach?---Yes, I do. And – and that – that will occur. You – you will get, in an organisation – you know, different – differing points of view, and you try and make the best decision you can based on the available advice – advice that you have, and this was – this was a decision that was made by the people with the authority to make it.

15 So ultimately you would have to agree that, because they were sitting there saying, “This is not – this is not the approach we advocate”, but the steering committee reached the decision to do nothing, now that decision was, essentially, in consequence of what the product team wanted; yes?---Yes. The product team – yes,
20 that is what the product team wanted.

I tender that document, Commissioner.

25 THE COMMISSIONER: Will be exhibit 1.175, ASIC speaking notes for meeting with chairman of Westpac, 28 May 2015, ASIC.0010.0010.2491.

30 **EXHIBIT #1.175 ASIC SPEAKING NOTES FOR MEETING WITH CHAIRMAN OF WESTPAC DATED 28/05/2015 (ASIC.0010.0010.2491)**

MS DIAS: Now, I want to take you to another ASIC document - - -

35 THE COMMISSIONER: Before you depart from it - - -

MS DIAS: Sorry, Commissioner.

40 THE COMMISSIONER: - - - Ms Dias, do you accept that ASIC – rather, do you accept that Westpac, in effect, declined ASICs request to order its affairs in a particular way?---I – I – again, my characterisation is that we believed that – rightly or wrongly, that what we were doing met the requirement for reasonable inquiries but it didn’t meet ASICs guidance, and so, therefore, yes.

45 You, that is the bank, acted in accordance with what it then judged to be the legal requirement rather than ASICs request?---Yes.

Is that right?---Yes, I agree with that.

That is, it complied with what it regarded to be its legal obligation rather than what ASIC had told the bank ASIC thought the bank's obligations entailed?---Yes, that's right. And I would say if we took that differing view, we should have gone to ASIC and – and made the case for that, and if that was rejected, then we should have
5 changed. It's the – that's – that's my view.

So that the bare fact that the regulator tells you that it considers that the law requires a step or series of steps is not something that was then regarded as determinative of the position?---I would say, in terms of regulatory relationships, there will be times
10 where you won't agree exactly with interpretations exactly, but when those – those occur, the better practice is to go to the regulator and state your case as to why you think your process meets or goes beyond the requirement – is a better practice, and then, therefore, would be compliant. Ignoring the regulator is not a good idea.

15 Never a good idea. And the better practice would not be to stop what you were doing and go and talk to the regulator?---Yes.

That would be the better practice?---Yes, that would be the better practice.

20 Stopping the practices not hitherto being something you have ever mentioned, I think, in your description of what would have been the better course of action; am I wrong?---No, other than when we did go to ASIC and make the – and have the discussions with ASIC and got ASICs views back, that we did stop.

25 Yes. After you had failed to persuade ASIC?---That's right, yes.

What I'm trying to get you to comment on is the regulator expresses its view, should the bank act in compliance with that view until it can – until it can persuade ASIC to the contrary, or should it continue along the path it is following while it seeks to
30 pursue – seeks to persuade ASIC to the contrary?---Yes, in that case.

I did intend it as an either/or?---Sorry, it should - - -

35 If I didn't articulate it, I'm sorry?---It should – so if we haven't convinced ASIC, then – then – I mean, in the case of this letter, and I really can only speak to the specifics of this circumstance, the ABA letter in 2012 didn't have, "You must do this from this certain date." It said, "We expect you to do this."

40 Yes?---So in that case, would I have advocated ceasing until we were doing that? No. But if we were deciding not to do it, then I would have – again, I think the right course of action would have been to go to ASIC. If the ASIC said no, then stop doing it.

45 Yes?---It's because there – if the ASIC set out a regulatory guide and – and said, "Here is – here is the rule and it must be complied with by this date", if you were planning to do it after that date, you either get the ruling or stop it on that date until such time as you've convinced them.

What I'm searching for, Mr Malcolm – and I'm at fault, you're not, I'm not seeking to criticise your answers, so the fact that I persist is a reflection on me, it's not a reflection on you. What I'm trying to get hold of is what's Westpac's attitude today? If ASIC says, "We think the better view of the law is X", would Westpac act on that and obey that construction of the law, or would it continue on its course while it sought to persuade ASIC to the contrary?---I think we would obey the law and – unless we made the case, and if there was a date by which that – that – this is when it should cease, we should obey that too.

10 Yes?---And I – I would say we have strengthened, partly as a result of this, but also the other incidents that have been in our submission, that overarching guidance with dealing with – with – with regulators, in particular, but ASIC as well.

15 Can I cease by asking you this question: do you manage to obligation, or do you manage to regulatory request? Do you understand the distinction I'm drawing?---Can you help me with that a little bit?

20 Do you manage to what you understand the letter of the law requires, or do you manage to what the regulator tells you it thinks the law requires?---I – I think – I think my best answer is both.

Yes, Ms Dias.

25 MS DIAS: I want to take you to another ASIC document. ASIC.0010.0006.2255. This is from 2015, Mr Malcolm. Again, you won't have seen this. 18 June 2015. This is an enforcement meeting held at ASIC. I just want to home in on the number of possible contraventions and profits. This is about the CCLI practices in Westpac and this continuing issue:

30 *ASIC does not have concerns about the inquiries made of FCA customers and the investigation only relates to non-FCA customers. The total number of non-FCA bank initiated CCLI invitations from March 2011 to November 2014 was almost 2.4 million (78 per cent of the total, the remainder were FCA). Of the 2.4 million, 247,709 replied and received an increase.*

35 Just pausing there, I am not forcing you to recollect the exact figures, but does that sound generally accurate to you, Mr Malcolm, those figures, the proportions of 78 per cent?---I – it's in line with the 70 per cent that we talked about before, so that sounds reasonable.

40 Continuing:

45 *As a result of bank initiated non-FCA CCLI invitations, net profit in the period from March 2011 to November 2014 was \$23,062,422 from income of \$39,974,790.*

Now, do you know if those figures are in the realm of being accurate for that period?---Well, during the course of preparing for this, I did look at some of the documents that we – we produced for – for the – for the notices for ASIC, and I believe there was one of their notices requested an estimation of the profit from CLI invitations at the time. What I would say is it's an estimation. It's not – it's very difficult to actually get an exact number from that, because you would have to make some assumptions around if a customer was – had a 50 per cent utilisation rate and we gave them a credit limit increase and they increased their utilisation, but it was still below the level of the original limit, how much of that additional usage was attributable to the CLI and how much was not? And then how much additional other revenue that we got. So there were a number of assumptions made within that, but yes, there was an estimation made based on a sort of six months prior to the CLI being offered, then a six months afterwards, to sort of make an estimate of how much profit we made from those – those CLIs that were offered in that two and a-half, three-year period.

So these figures have come from Westpac, we can say?---They have come from Westpac, yes. They're very precise, aren't they, four hundred and - - -

Now, this is obviously showing quite high profits. Is that another reason why Westpac decided not to act as early as it ought to have in relation to ASICs guidance?---Well, profit was – was one of the reasons why we – we did do limit increase programs, so yes.

Continuing:

WBC Westpac has told ASIC that for approximately 20 per cent of customers receiving an invitation (approximately 480,000 invitations leading to 49,500 increases), their only account with Westpac is a credit card. Assuming these customers accounted for 20 per cent of profits, profits from these customers would be approximately 4.6 million.

Now, the first sentence – this is what we talked about earlier – that some of these customers only have a credit card with Westpac; that's correct?---Yes, I – I'm – again, I'm – I've only just seen this document. I know that there have been discussions with ASIC and we have made the estimate around the number of customers with only a – a credit card, and – and that's the 20 per cent number. I'm not sure that that 20 per cent number applies directly to only the customers that receive non-FCA letters. So I – I have heard the 20 per cent number before about credit card customers who would only have a credit card account, so I'm – I will – I will take it as an assumption, but I – I'm not verifying - - -

THE COMMISSIONER: Well, the numbers in here were supplied to ASIC by Westpac; is that right?---Yes, we did - - -

And you haven't sought to challenge the accuracy of those numbers in the statements you've made?---No, but I haven't – I haven't – I've only received this document

now, so I haven't – I haven't been able to verify any of that – that number there, but I will - - -

5 But you were given notice of it?---I will – we – I think we got this – a day – two days ago.

MS DIAS: The figure of 20 per cent.

10 MR SHEAHAN: Well - - -

THE COMMISSIONER: Yes.

15 MR SHEAHAN: - - - just to be fair, Commissioner, it's not a subject that he was asked to address in his statement.

THE COMMISSIONER: These are numbers from ASIC, aren't they – from Westpac, aren't they, Mr Sheahan?

20 MR SHEAHAN: So we understand.

THE COMMISSIONER: Yes.

25 THE WITNESS: They're numbers that ASIC have derived from numbers that have come from Westpac.

THE COMMISSIONER: Yes. Yes, thank you.

MS DIAS: Yes. So the - - -

30 THE COMMISSIONER: Yes, Ms Dias.

MS DIAS: The figure of 20 per cent, Mr Malcolm, can you tell the Commission what you think – or if you know what the percentage was for the non-FCA customers?---I – I don't know that percentage.

35 I will tender that document.

40 THE COMMISSIONER: Exhibit 1.176, ASIC note 18 June 2015, ASIC.0010.0006.2255.

EXHIBIT #1.176 ASIC NOTE DATED 18/06/2015 (ASIC.0010.0006.2255)

45 MS DIAS: The next document I will take you to, Mr Malcolm, is an internal Westpac email. This is WBC.300.023.2630. So this is an email from Alexandra

Holcomb. Do you know what her position is at Westpac?---She's the chief risk officer; she's my boss.

5 To David Watts. And what is his position?---At the time, David Watts would have been general manager, Regulatory Affairs and Governance.

So she's forwarding this email below from Joshua Moyes saying, "Have you signed off?" That email below says:

10 *Westpac has been in discussions with ASIC about our credit cards credit limit increase process since mid-2014. ASIC has raised concerns about how we addressed responsible lending obligations. Since December 2014 we have placed our CLI arrangements on hold and in March 2015 we implemented*
15 *changes to our systems and application forms to reflect ASICs preferred approach. Although their investigation is ongoing, we are now exploring with ASIC the basis for a possible negotiated outcome.*

20 And you set out some of those matters in your statement, is that correct, Mr Malcolm? The negotiated outcome?---Yes.

So what was the negotiated outcome in the end, Mr Malcolm?---We agreed with ASIC to – to take a cohort of the customers that had received a – a CLI from – in the relevant period, screen out from those – or include in those customers any customers that had been in arrears for more than 60 days, any customers that had suffered
25 hardship in the 12 months after the CLI offer, and also customers that had been in arrears for two periods of 30 days in that period of time, and – and conduct a – a remediation exercise where we would contact those customers, ascertain the circumstances – their circumstances at the time the CLI offer was – was approved and accepted, and if they had been unemployed or had reduced income at the time
30 that they accepted the CLI, that we would make – offer remediation of the amount of the CLI. I mean, it's in my statement, but that's a - - -

Summary of it?---Summary.

35 Thank you. There's a memo attached to this email. I'm not sure if it will come up, but WBC.300.023.2634, which sets out some of the recommendations that were being made around what would be negotiated. And under that heading Recommendations:

40 *To approve the proposed process to identify potentially impacted recipients of a bank CLI invitation who subsequently faced financial difficulty and apply CLI special treatment.*

45 And (b):

To approve the proposed regulatory outcome involving a contribution to a worthy cause.

And you've essentially encapsulated some of that just then, Mr Malcolm. I will just take you to the last page – or the page – sorry, 2634_0002. Thank you. Just above that heading Regulatory Outcome, “This approach was developed with regard to the following”. And they're the details that you've mentioned there, the customers had received and substantially contributed to their hardship. Is that what you were mentioning before, Mr Malcolm, when you summarised the process?---Yes.

Yes. And under regulatory outcome:

10 *Our preferred approach is to seek to avoid an enforceable undertaking or infringement notice and seek to obtain ASICs agreement for a contribution to a worthy cause together with a media release.*

I will tender that document, Commissioner.

15

THE COMMISSIONER: With or without the email, Ms Dias?

MS DIAS: They're attached as one, I believe.

20 THE COMMISSIONER: Exhibit 1.177 will be email Holcomb to Watts 14 September '15, WBC.300.023.2630, together with associated memorandum

25 **EXHIBIT #1.177 EMAIL HOLCOMB TO WATTS DATED 14/09/2015
(WBC.300.023.2630) TOGETHER WITH ASSOCIATED MEMORANDUM
(WBC.300.023.2634)**

30 MS DIAS: Thank you. So this remediation that you referred to in your statement, Mr Malcolm, is it true Westpac has identified 6612 customers as potentially impacted by the process that was adopted - - -?---Yes, that's correct.

- - - in 2012/2014?---Yes.

35 Yes. And of those people you say 3397 have been provided with some form of remediation?---Yes, that's right.

40 And the remediation has varied between issues refunds to credit card balance waivers or both; is that correct?---Generally, we would – the principle was to take them back to the situation that they were in prior to the CLI. So it would be a debt waiver of the amount of the CLI or, if they hadn't used all of the CLI, the amount that they had used, and – and interest and fee reversal for the amount of interest that they had paid on that CLI.

45 Does Westpac undertake an assessment or go back and try and, in hindsight, undertake the assessment of suitability again in accordance with what ASIC was telling it to do? Does it undertake that assessment?---In essence, in the remediation

approach, the – the call to the customers would ask them the questions that we didn't ask them in the CLI. So we ask them what their employment status was at the time of the CLI, and whether they had reduced income from the time of their application to the time that they received the CLI. And so, therefore, the two questions that
5 would now be in – that we were now doing in CLI as per ASIC's letter of 2012. If they answered that they were not employed or their circumstances had changed, or that they were on reduced income, they would be eligible for the – for the treatment.

And were they the only two questions or inquiries made? Were there other
10 inquiries?---We did ask a third question as to what were the circumstances of – of – of them applying for the CLI, but it was – I don't have the exact wording of those - - -

Scripts?--- - - - scripts, but that was essentially the – there were three questions.
15

When you say the circumstances, do you understand that to mean their financial situation?---Yes. Yes.

I see. And the total amount of remediation paid is 11.3 million; is that
20 right?---That's right.

Okay. And that was only finalised in February this year, is that – is that right? The last payments were made or the last - - -?---Yes. It – in February 2017.

February 2017, sorry, yes?---So we – we got approval from ASIC in December 2015
25 and we commenced the project in January 2016, and the – we had made all the – the payments essentially by 20 February 2017. The project didn't close down until August 2017 because we did the – the assurance review.

Why did it take so long to get that process completed, calling the – contacting the
30 customers, 3000 customers or more?---Well, the approach that we took – and we agreed with ASIC – was that we should have an independent assurance process run alongside the remediation program, and that we would start with a pilot of roughly 600 customers, and get the independent assurer to provide feedback that that was
35 effective and that we were adhering to the – to the – the terms of the remediation. So that commenced relatively quickly. We then went back and made changes to the program in order to make it more effective, to improve some aspects of – of the call scripts that became ambiguous, and then we rolled it out the – the full set of the program. The – the biggest issues we had in that program, in terms of timing, was
40 actually getting in contact with customers. So whilst we would call them, and we had a contact strategy, it's – if you've run any kind of program like this, it can be quite hard to – to contact customers and get them to respond. So I – in – in my view, it was a pretty – it actually ran reasonably quickly for a program of this type.

Okay. Does Westpac still send the credit limit increase offers to this day? Do you
45 still send those sorts of invitations out?---Yes, we still do.

You're aware that from 1 July, you mentioned that, 2018, you will no longer be allowed to do that?---That's right.

5 And will you take steps to – will Westpac take steps to comply with those changes earlier than that date or will it wait until the very last minute to do that?---I'm – I'm – sorry, I'm not aware of what our – when we're going to cease the offers.

10 Okay. You filed a supplementary statement, Mr Malcolm. You were originally asked, in respect of your first statement, to list incentives and key performance indicators that were relevant to Westpac staff during the relevant period in relation to initiation acceptance of CLIs, or credit limit increase offers. I will just take you to that statement. So it's WBC.300 – there it is. Sorry, or 900, I should say. Okay. So you have attached to that some scorecards. I will just take you to a couple of those, if I could. One is WBC.300.082.1251?---Which tab is that for me? Is it - - -

15 I'm sorry. It's the first – it's the very first scorecard, Mr Malcolm, if you have that. Yes, that's it. And you can see it on the screen as well. So this is an actual scorecard for someone. Their name has been redacted?---Yes.

20 Yes. Okay. And this person was given an annual rating of high achievement; is that right? Is that - - -?---I – what I would say is these are people that didn't report to me. They're in the product team. So questions directly about what was in these scorecards, I can speak in general terms, but I can't say with – I can't say definitively what their final outcome was, because the process has a – a page where the – the employee would rate their own scorecard and then the – the manager would put in what their ratings were. It would go through a subsequent process of alignment and then a final outcome. So this is the – the request was for was – were there KPIs in the scorecards, and there were some scorecards in the product team where CLIs were mentioned, but I don't have details of the outcomes for these customers – for these employees.

30 But in any event, you can see that it says, "Annual rating: high achievement"?---Yes.

35 So do you know if that's the highest achievement that someone can get?---There's – it's a five point scale. The highest is outstanding. The next is high achievement. The next is effective. The next is needs development. And then the – the last one is unacceptable.

40 Okay. So this person has done quite well?---Yes.

Yes. Okay. And then where it says employee, that text there, is that what the employee has written about themselves?---Yes.

45 Yes. Okay. And then it's hard to find but in the middle there, there's a number 2:

Identified opportunities to increase and improve the effectiveness of our limit increase programs and CLI consents.

Further down:

5

These included the adding of RMs and transactor segments to the targeted population; introduced a holistic and “always on” program for CLI consents capture across all channels, and simplification of wordings around CLI consents capture. CLIs improved by 35 per cent with consents improved by 65 per cent year on year.

10

Is that correct?---Yes.

15 Okay. And the reference to RMs, do you know what that is in the first line?---I believe I – I am actually – I don’t know, so I will say that. I can – if you want me to, I could guess, but - - -

20 You can guess, and we will record it as a guess, Mr Malcolm?---I think it might mean relationship managers, which would be segments of customers that are managed individually by – rather than a sort of mass segment.

25 I see. Now, would you agree that from what we’re reading here, is that this person has told whoever is assessing them that they’ve done well in this area in boosting their CLI consents and capturing those consents? Would you agree with that?---Yes.

Yes. And that is valued by the organisation?---Yes.

30 And it’s still valued by the organisation; is that correct?---Well, it is until they’re not allowed any more.

Okay. There are other scorecards, Mr Malcolm, but I think we will leave it at that. They speak for themselves. Commissioner, those are the questions that we have for Mr Malcolm.

35 THE COMMISSIONER: Yes. Just before you – I ask Mr Sheahan whether he has any questions of you, Mr Malcolm, can I go back to rather more general questions than questions that are specific to the particular events that we’ve looked at. The bank’s assessment of serviceability of a credit card arrangement is an assessment that at least embraces avoidance of default. Would you accept that?---Yes.

40

Indeed, serviceability is determined by reference to analyses that are framed by reference to the minimum necessary to avoid default; is that right, and there are then add-ones on top of that, or variations to it?---Yes. And to avoid substantial hardship as well.

45

Yes. What do you say, if anything, serviceability tells the bank about the suitability for the client of a revolving credit facility?---It – it says whether or not they can

afford the minimum repayment amount and, therefore, have passed one of the key tests, that they are – they have an ability to – to repay this – this facility. It doesn't say anything about repaying it over a reasonable time.

5 No. We know that's going to change to some degree in – is it mid this year, I think?---I believe so, yes, July.

Yes. Just remaining with this notion of suitability for the client of a revolving credit facility. Are there circumstances in which different considerations would intrude
10 when considering suitability, say, of a revolving credit facility of 5000 compared with considering suitability of a revolving credit facility of 10,000?---It would really depend on the customer's circumstances and what they wanted the – the – the credit card for and the features that they wanted within the credit card. So you start from a premise that a credit card is actually more than one product. It's both a payments
15 product and a revolving line of credit. If a customer is wanting to borrow for a specific purpose and repay that over time, there are better products than a credit card. There are lower interest rates and you can make instalment payments.

Yes?---So the – the – the premise that you – how do you pick which credit card is
20 best for you is that you need to look at how you want to use that credit card. Do you want to use it simply as a payment mechanism and pay off the balance every month? Do you want to earn rewards for that spend? Or would you rather not earn rewards but have a low fee, long interest only period? If you want to say, "Well, from time to time I will have a balance in – in that account", then you may want to go for – you
25 would identify yourself effectively as a revolver to say, "Yes, I will have balances from time to time for bigger purchases that I want to do. I would rather go for a low rate card rather than a rewards card." So it's really at that point of origination. But during the period of time that you're using that card, you will change. I got my first credit card when I was a graduate and I certainly use my credit card differently today
30 than when I was a 21 year old just joining the workforce. And over time you will migrate to different types of cards and you will have different needs, and what we try to do is – so when we do analyse your behaviour within those cards, and we will give you an opportunity to make – if you've made a larger purchase, to pay that off over –
35 over a period of time or, indeed, if we see that you're only making the minimum repayments each month, we can give you what's called a nudge and say perhaps you want to look at a – a facility that you pay off over time at a lower rate.

Does the bank, at initiation of the credit card account, ask the customer any questions which are directed to those questions bearing on suitability that you've just
40 described?---Well, it – again, the way that we originate credit cards has also evolved over time. Again, when I joined the bank in 1988, you went to a branch, you met with someone, you filled in an application form and three or four weeks later you would get an answer. Today, most people would apply for credit cards online, and they're not actually speaking to a banker, and so they will get information and we
45 have tools on our website or through affiliate sites if you go to finder.com.au, they will have tools to say, "What sort of credit card suits me?" And they will look through the features and you answer some basic questions about what features you

want and they will pick a card that is, based on what you have told it, is a good card for you.

5 And they're the decisions that the customer makes, not the bank makes?---That's right.

Is that right?---Yes.

10 And they're not decisions that the bank makes at the point of offering or agreeing to a credit limit increase, are they?---No.

15 And I'm not picking out Westpac in this. At least to your knowledge within the industry, no bank asks these questions, do they?---Not for a credit limit increase, but we have other programs that will analyse the behaviour and the transactions in your account, and make suggestions to you as to – to ways that you can optimise your behaviour or get the right card.

Yes. Yes, Ms Dias, anything arising out of that?

20 MS DIAS: No. No, Commissioner, thank you.

THE COMMISSIONER: All right. Thank you. Now, does anybody other than Westpac seek leave to cross-examine Mr Malcolm? No. Mr Sheahan.

25 MR SHEAHAN: I have no re-examination.

THE COMMISSIONER: Yes.

30 MR SHEAHAN: Might he be excused.

THE COMMISSIONER: Yes, Mr Malcolm, thank you for your evidence. You're excused from further attendance.

35 <THE WITNESS WITHDREW [12.35 pm]

THE COMMISSIONER: Ms Dias.

40 MS DIAS: Yes, Commissioner, that concludes the evidence – or oral evidence that will be heard today. There are a number of witness statements that counsel wish to tender, and the summonses as well.

45 THE COMMISSIONER: Yes.

MS DIAS: Yes. So the first of those is the witness statement of Carol Separovich, dated 12 March 2018. And the document ID for that is WBC.900.001.0115. If we could hand up - - -

5 THE COMMISSIONER: I trust, if she will forgive me, if I put the emphasis on the wrong syllable.

MS DIAS: S-e-p-a-r-o-v-i-c-h.

10 THE COMMISSIONER: Spelling Separovich.

MS DIAS: Separovich. I mispronounced it.

15 THE COMMISSIONER: Thank you. Exhibit 1.178 will be the statement of Ms Separovich, 12 March '18, WBC.900.001.0115.

**EXHIBIT #1.178 STATEMENT OF MS SEPAROVICH DATED 12/03/2018
(WBC.900.001.0115)**

20

MS DIAS: And there is a supplementary witness statement of Ms Separovich dated 22 March 2018. And that is WIT.0001.0015.0001.

25 THE COMMISSIONER: That will be exhibit 1.179, further statement of Ms Separovich, 22 March '18, WIT.0001.0015.0001.

**EXHIBIT #1.179 FURTHER STATEMENT OF MS SEPAROVICH DATED
22/03/2018 (WIT.0001.0015.0001)**

30

MR SHEAHAN: Commissioner, just for good order's sake I should give the original of that, I think, to our learned friend.

35

THE COMMISSIONER: Yes, thank you. Yes.

MS DIAS: I am grateful for that.

40 THE COMMISSIONER: Is there a summons for - - -

MS DIAS: There is, Commissioner. That's the third Separovich document. There's a summons, which we will tender as well.

45 THE COMMISSIONER: Exhibit 1.180, summons to Ms Separovich. Yes.

EXHIBIT #1.180 SUMMONS TO MS SEPAROVICH

5 MS DIAS: Yes. A further witness statement to be tendered – the witness statement of Gareth Robin William Russell, dated 22 March 2018. Document ID CBA.0517.0022.0001.

THE COMMISSIONER: Yes. That will be - - -

10 MS DIAS: I tender that.

THE COMMISSIONER: - - - exhibit 1.181, statement of Gareth Robin William Russell, 22 March '18, CBA.0517.0022.0001.

15

EXHIBIT #1.181 STATEMENT OF GARETH ROBIN WILLIAM RUSSELL DATED 22/03/2018 (CBA.0517.0022.0001)

20 MS DIAS: And there is a summons as well for that statement, Commissioner.

THE COMMISSIONER: Exhibit 1.182, summons to Mr Russell.

25 **EXHIBIT #1.182 SUMMONS TO MR RUSSELL**

THE COMMISSIONER: Yes.

30 MS DIAS: Yes. Two more, Commissioner. One is the witness statement of Alan Saul Machet, dated 28 February 2018, document ID CIT.9999.0001.0001.

THE COMMISSIONER: Exhibit 1.183, witness statement of Alan Saul Machet, dated 28 February 2018, CIT.9999 double zero – sorry, double zero, double - - -

35

MS DIAS: Triple zero.

THE COMMISSIONER: Start again. CIT.9999.0001.0001.

40

EXHIBIT #1.183 WITNESS STATEMENT OF ALAN SAUL MACHET DATED 28/02/2018 (CIT.9999.0001.0001)

45 MS DIAS: Thank you. And another – a supplementary statement of Mr Machet dated 22 March 2018, CIT.9999.0002.0001.

THE COMMISSIONER: Exhibit 1.184 further statement of Mr Machet dated 22 March '18, CIT.9999.0002.0001.

5 **EXHIBIT #1.184 FURTHER STATEMENT OF MR MACHET DATED
22/03/2018 (CIT.999.0002.0001)**

10 MS DIAS: And there is a summons that goes along with that.

THE COMMISSIONER: Exhibit 1.185, summons to Mr Machet.

15 **EXHIBIT #1.185 SUMMONS TO MR MACHET**

THE COMMISSIONER: Yes.

20 MS DIAS: Commissioner, at this point in time, that concludes the evidence, and
Counsel Assisting will return to deliver the closing address, and we request an
indulgence.

THE COMMISSIONER: Will we adjourn till 2?

25 MS DIAS: If that would be suitable for you, Commissioner.

MR SHEAHAN: Could I just mention one thing, Commissioner.

30 THE COMMISSIONER: Yes, of course, Mr Sheahan.

MR SHEAHAN: You will recall my spectacular failure to be able to tender some of
the documents the other day in the auto loan part of the case. The three documents in
question I think are now on the system, but there remain some discussions between
us and our learned friends about some redactions which we think will not be
35 controversial because they're consistent with previous orders. What I was going to
ask was whether the Commission was content for that – for the formal tender of that
to be dealt with, as it were, in chambers.

40 THE COMMISSIONER: I think it's satisfactory to deal with it in that way, Mr
Sheahan. Can you just indicate what the three documents are so that we will have a
link within the transcript to what they will be.

45 MR SHEAHAN: I shall do that. The first is a letter from Westpac to ASIC dated
12 July 2016, and its doc ID is WBC.104.003.2122. The second is a draft ASIC
report entitled Car Loan Commissions and Consumer Credit Regulation. It is
undated on its face, but I think we will agree it was issued in 2013, and the third
are - - -

THE COMMISSIONER: Has that got an ID on it?

MR SHEAHAN: I'm sorry. WBC.103.005.5591. And the third are Sovereign
screen prints relevant to Mrs Thiruvangadam's loan. The doc ID is
5 WBC.104.003.7572. As far as a date goes, they commence on 24 July 2012.

THE COMMISSIONER: Now, when those are in final form, they will become,
respectively, exhibits – 1.186 will be the letter Westpac to ASIC, exhibit 1.187 will
10 become the draft ASIC report, exhibit 1.188 will be the Sovereign screen prints. And
if between the parties you can sort out this question of redactions and they can be
taken and uploaded then.

EXHIBIT #1.186 LETTER FROM WESTPAC TO ASIC DATED 12/07/2016
15 **(WBC.104.003.2122)**

EXHIBIT #1.187 DRAFT ASIC REPORT ENTITLED CAR LOAN
COMMISSIONS AND CONSUMER CREDIT REGULATION (UNDATED
20 **BUT AGREED AS BEING ISSUED IN 2013) (WBC.103.005.5591)**

EXHIBIT #1.188 SOVEREIGN SCREEN PRINTS RELEVANT TO MRS
THIRUVANGADAM'S LOAN COMMENCING 24/07/2012
25 **(WBC.104.003.7572)**

MR SHEAHAN: Thank you for that indulgence, Commissioner.

30 THE COMMISSIONER: Not at all, Mr Sheahan. 2 pm, then.

ADJOURNED [12.42 pm]

35 **RESUMED** [2.00 pm]

THE COMMISSIONER: Ms Orr.

40 MS ORR: Commissioner, before starting our closing address for this block of
hearings, there are some final documents that we wish to tender. There are 11
documents in total. Those documents are, firstly, a letter dated 15 September 2017
45 from Westpac to APRA, which is WBC.300.005.0062.

THE COMMISSIONER: That will be exhibit 1.189.

**EXHIBIT #1.189 LETTER FROM WESTPAC TO APRA DATED 15/09/2017
(WBC.300.005.0062)**

5 MS ORR: A report for Westpac from PwC dated May 2017 as part of the APRA targeted review, WBC.300.005.0098.

THE COMMISSIONER: That will be exhibit 1.190.

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**EXHIBIT #1.190 REPORT FOR WESTPAC FROM PWC DATED MAY 2017
AS PART OF APRA TARGETED REVIEW (WBC.300.005.0098)**

15 MS ORR: A memo dated 29 July 2017 to the Westpac board, risk and compliance committee in respect of the APRA targeted review, WBC.200.004.2995.

THE COMMISSIONER: That will be exhibit 1.191.

20

**EXHIBIT #1.191 MEMO TO WESTPAC BOARD, RISK AND COMPLIANCE
COMMITTEE IN RESPECT OF THE APRA TARGETED REVIEW DATED
29/07/2017 (WBC.200.004.2995)**

25

MS ORR: A memo dated 25 August 2017 to the Westpac board regarding Mortgage Responsible Lending Update, WBC.200.003.3387.

THE COMMISSIONER: Exhibit 1.192.

30

**EXHIBIT #1.192 MEMO TO WESTPAC BOARD REGARDING
MORTGAGE RESPONSIBLE LENDING UPDATE DATED 25/08/2017
(WBC.200.003.3387)**

35

MS ORR: A document entitled attachment 1: Westpac response to targeted review findings, WBC.300.005.0064.

40 THE COMMISSIONER: That will be exhibit 1.193.

**EXHIBIT #1.193 DOCUMENT ENTITLED ATTACHMENT 1: WESTPAC
RESPONSE TO TARGETED REVIEW FINDINGS (WBC.300.005.0064)**

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MS ORR: An email entitled Westpac Targeted Review Report, dated 25 May 2017, WBC.300.005.0096.

THE COMMISSIONER: Exhibit 1.194.

5

EXHIBIT #1.194 EMAIL ENTITLED WESTPAC TARGETED REVIEW REPORT DATED 25/05/2017 (WBC.300.005.0096)

10

MS ORR: A spreadsheet entitled Information Requested By APRA in Attachment B, WBC.300.005.0099.

THE COMMISSIONER: Exhibit 1.195.

15

EXHIBIT #1.195 SPREADSHEET ENTITLED INFORMATION REQUESTED BY APRA IN ATTACHMENT B (WBC.300.005.0099)

20

MS ORR: A letter dated 15 September 2017 from CBA to APRA, CBA.0517.0002.0001.

THE COMMISSIONER: Exhibit 1.196.

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EXHIBIT #1.196 LETTER FROM CBA TO APRA DATED 15/09/2017 (CBA.0517.0002.0001)

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MS ORR: A PwC report for CBA as part of the APRA targeted review, dated May 2017, CBA.0517.0002.0082.

THE COMMISSIONER: Exhibit 1.197.

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EXHIBIT #1.197 PWC REPORT FOR CBA AS PART OF THE APRA TARGETED REVIEW DATED MAY 2017 (CBA.0517.0002.0082)

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MS ORR: The Code of Practice of the Mortgage & Finance Association of Australia, RCD.0021.0001.0292.

THE COMMISSIONER: Exhibit 1.198.

45

EXHIBIT #1.198 CODE OF PRACTICE OF THE MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA (RCD.0021.0001.0292)

5 MS ORR: And the current version of the Banking Code of Practice, RCD.0021.0001.0174.

THE COMMISSIONER: Exhibit 1.199. Yes.

10

EXHIBIT #1.199 CURRENT VERSION OF THE BANKING CODE OF PRACTICE (RCD.0021.0001.0174)

15 MS ORR: Commissioner, over the last two weeks, the Commission has received evidence of misconduct and conduct falling below community standards and expectations by a number of financial services entities. The misconduct and conduct that has fallen below community standards and expectations has occurred in respect of the consumer credit products that we identified in our opening address: home
20 loans, car loans, credit cards and overdraft facilities. It has also occurred in the selling of insurance with credit products and through a variety of account administration and processing errors made by financial services entities in connection with credit products, such as home loans.

25 In this closing address, we will deal with the case studies that have been the subject of evidence in turn. We will identify the findings that Counsel Assisting regard as open on the evidence, which we will invite the entity involved to respond to in written submissions. The findings will be articulated by reference to the
30 Commission's terms of reference. For each case study, we will also identify more general questions that arise from the case study. Any party with leave to appear in these hearings will be permitted to lodge written submissions addressing these questions.

35 Before turning to the case studies, we wish to make some further comments in relation to the responses of two entities to the letters written by you, Commissioner, in December last year and January this year asking them to identify their misconduct and their conduct that has fallen below community standards and expectations. In our opening address, we referred to the fact that shortly prior to the commencement of the hearings, Westpac had informed the Commission that the information it had
40 provided in response to those letters did not take account of some categories of data, so that further acknowledgements of misconduct would need to be provided.

45 During these hearings, Westpac has provided further information to the Commission and more is yet to be provided. The additional material received to date demonstrates, for example, at least 55 instances of Westpac staff either falsifying or accepting falsified supporting documentation in connection with home and personal loan applications, a number of instances of Westpac staff receiving payments from

referrers for the referral of customers to Westpac for loans, and at least 25 instances where the Financial Ombudsman Service found, or Westpac conceded, that a customer who obtained a Westpac car loan should not have been approved for the loan as it was unsuitable for the customer.

5

We also made observations in the opening address about the adequacy of the approach taken by CBA in its responses. We referred to CBA's first submission as adopting a high level and general approach and observed that CBA's second submission contained a large volume of spreadsheets that did not enable us to assess the type or scale of CBA's misconduct. Earlier today, CBA provided the Commission with further material. We have had limited time to review this additional material, however we observe that the material refers to, for example, at least 41 significant events of which seven involve responsible lending issues relating to home and personal loans, credit cards, and overdraft facilities.

15

Remediation totalling \$5.326 million has been paid to customers in respect of these events, but remediation for at least two of the events is yet to be quantified. One event also resulted in payment of \$180,000 in penalties to ASIC. There are a further 13 events that involve processing errors, including in relation to credit cards, term deposits and overdrafts. Remediation totalling \$99.45 million has been paid to customers in respect of these events with remediation for one event, which involved a failure to apply a waiver of annual credit card fees, totalling \$77.4 million.

20

For four of these events, remediation has either not yet started or the remediation analysis is still underway. One such event involves misconduct that was identified in February 2015. At least three events involve consumer credit insurance with remediation paid to customers for these three events totalling \$26.12 million. The additional material also identifies at least 469 events that are described by CBA in this material as "low rated". Of these, CBA has described 18.98 per cent as involving incorrect fees, interest or repayment, and 11.51 per cent as involving responsible lending issues.

25

30

In relation to Aussie Home Loans, and using Aussie Home Loans' own classification of conduct, the additional material provided by CBA refers, for example, to 29 events involving brokers submitting false or misleading information, and documents to lenders or providing misleading information to customers. In four instances, the brokers involved were convicted of criminal offences, the same four brokers who were the subject of the evidence in the Aussie Home Loans case study in these hearings. There are references to 19 events involving breaches of the National Credit Act, including incidents where brokers did not make reasonable inquiries or verify the financial situation of customers, and there are references to 134 events involving either a breach of a broker or franchise agreement or a breach of policy.

35

40

We turn, Commissioner, to the case studies. We commence with the first case study examined in these hearings which involved conduct in connection with the NAB introducer program. Two witnesses from NAB gave evidence in this case study, Mr Anthony Waldron, the executive general manager for broker partnerships, and Mr

45

Angus Gilfillan, the executive general manager, consumer lending in the Customer Products and Services Division. The Commission heard evidence that established that NAB bankers in the greater western Sydney area, in other parts of New South Wales, in the ACT and Victoria, engaged in misconduct in connection with home
5 loan applications submitted through the NAB Introducer Program between 2013 and 2016. As a result of this misconduct, 10 bankers were dismissed, 10 are no longer with NAB, and 32 had internal consequences applied such as reduction of their remuneration.

10 A number of the bankers involved in the misconduct, including a number of those who were dismissed, were branch managers. The evidence establishes that NAB bankers engaged in conduct such as falsifying documentation in connection with home loan applications, knowingly accepting falsified documentation in connection
15 with home loan applications, receiving payments from introducers, failing to disclose personal relationships with introducers, failing to meet face-to-face with customers, accepting home loan application and supporting documentation from introducers rather than directly from the customer, and approving home loans in circumstances where the customer did not have the capacity to service the loan and where the loan was, therefore, unsuitable for the customer.

20 The NAB Introducer Program was, and is, a program by which third parties receive a commission payment for referring loan applications to NAB. Most loans referred to NAB by introducers are home loans. The commission was and is calculated as a percentage of the loan amount and paid to the introducer when the customer's loan
25 application is approved and drawn down. Commission payments to certain introducers involved in the misconduct totalled approximately \$630,000 over four years, of which \$488,000 was paid to a single introducer. NAB's internal policies during the period of the misconduct required introducers to submit minimum volumes of home loan applications.

30 The evidence establishes that the NAB Introducer Program has been a very profitable source of lending for NAB, resulting in over \$24 billion in loans during the three year period from 2013 to 2016. At its peak, there were approximately 8000
35 introducers in the program. As at the end of October 2015, the four introducers involved in the misconduct had provided \$139.782 million of loans drawn down to NAB. By February 2016, NAB had identified 90 customers with \$50 million in loans obtained in connection with the misconduct of NAB bankers and introducers in respect of which NAB had concerns about the customer's ability to service those loans on an ongoing basis.

40 On the evidence, it is open to the Commissioner to make the following findings of misconduct: first, NAB breached its statutory obligations under section 47
45 subsection (1) subparagraph (a) of the National Credit Act, and section 912A subsection (1) subparagraph (a) of the Corporations Act to do all things necessary to ensure that its credit activities and the financial services covered by its Australian Financial Services Licence were engaged in efficiently, honestly and fairly. Second, NAB breached its statutory obligations under section 47 subsection (1) subparagraph

(b) of the National Credit Act and section 912A subsection (1) subparagraph (aa) of the Corporations Act to have in place adequate arrangements to ensure that NABs clients were not disadvantaged by any conflict of interest that may arise wholly or partly in relation to NABs credit activities or in its provision of financial services.

5

Third, NAB breached its statutory obligations under section 47 subsection (1) subparagraph (g) of the National Credit Act and section 912A subsection (1) subparagraph (f) of the Corporations Act to ensure that its representatives were adequately trained to engage in the credit activities authorised by NABs credit licence and the financial services covered by Australian Financial Services licence.

10

Fourth, NAB breached the prohibition in section 128 subparagraph (a) of the National Credit Act on entering into home loans with consumers in circumstances where it had not made reasonable inquiries about the consumer's financial situations as required by section 130 subsection (1) subparagraph (b) of that Act.

15

Fifth, NAB breached the prohibition in section 128 subparagraph (a) of the National Credit Act on entering into home loans with consumers in circumstances where it had not taken reasonable steps to verify their financial situations, as required by section 130 subsection (1) subparagraph (c) of that Act. Sixth, NAB breached the prohibition in section 133 subsection (1) of the National Credit Act on entering into home loans with consumers in circumstances where those home loans were unsuitable for the consumer. Seventh, NAB breached its obligation under section 912D subsection (1) of the Corporations Act to provide a written report to ASIC in respect of the misconduct identified in 2015 in Greater Western Sydney which breached a number of the general obligations imposed on NAB as a financial services licensee by section 912A of the Corporations Act within 10 days after becoming aware of the breach.

20

25

The evidence established that a written report to ASIC was not made until 2 February 2016 in circumstances where the misconduct breached, firstly, the obligation to do all things necessary to ensure that the financial services covered by the licence were provided efficiently, honestly and fairly. Secondly, the obligation to have in place adequate arrangements for the management of conflicts of interest that might arise in relation to the activities of the licensee and the provision of financial services. Third, the obligation to ensure that NABs representatives were adequately trained to provide financial services, and fourth, the obligation to have adequate risk management systems.

30

35

The eighth form of misconduct that we say is open on the evidence is a finding that NAB engaged in misleading and deceptive conduct. The ninth finding that we say is available on the evidence is a finding that NAB engaged in unconscionable conduct. 10th, we say that NAB failed to comply with the expectations of ASIC in relation to responsible lending as set out in regulatory guide 209 Credit Licensing: Responsible Lending Conduct, which constitutes a recognised and widely accepted benchmark for meeting the responsible lending obligations in the National Credit Act.

40

45

11th, NAB failed to comply with the expectations of ASIC in relation to breach reporting by Australian Financial Services licensees as set out in regulatory guide 78, breach reporting by AFS licensees, which again constitutes a recognised and widely accepted benchmark, this time for meeting the breach reporting obligations in section 5 912D of the Corporations Act. 12th - - -

10 THE COMMISSIONER: Well, is it the fact that those two regulatory guides are expectations of ASIC or simply that they are either accurate summations of the law's requirements and/or they are widely accepted commercial benchmarks?

MS ORR: We put it, Commissioner, on the basis that they constitute recognised and widely accepted benchmarks within the industry for meeting certain legal obligations imposed by the National Credit Act and the Corporations Act. And, Commissioner, the Commissioner will recall that the definition of misconduct extends - - -

15 THE COMMISSIONER: Yes.

MS ORR: - - - to those matters.

20 THE COMMISSIONER: Yes, yes.

MS ORR: So in addition to the strict legal breaches of the legislation we put to you, Commissioner, that there is another form of misconduct that is also open to find based on the failure to comply with those benchmarks as published by ASIC.

25 THE COMMISSIONER: Yes. Paragraph (d) of the definition of misconduct.

MS ORR: Yes.

30 THE COMMISSIONER: Yes.

MS ORR: Yes. 12th, NAB failed to comply with the Banking Code of Practice which is the banking industry's customer charter on best banking practice standards, and is, therefore, we say, another recognised and widely accepted benchmark for 35 banking practice. In particular, NAB failed to comply with the obligation in clause 3.2 of the code to act fairly and reasonably towards its customers in a consistent and ethical manner. And secondly, the obligation in clause 27 of the code to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and forming an opinion about the customer's ability to repay 40 home loans.

Those are the findings of misconduct that we say are available in relation to NABs conduct in the NAB case study. On the evidence, we say it is also open, Commissioner, to make findings that NAB engaged in conduct that fell below 45 community standards and expectations. First, the evidence establishes that despite being aware that it had identified approximately 1300 customers who may have been affected by the misconduct that occurred in the period from 2013 to 2016, to date

approximately 71 per cent of these customers have been contacted by NAB and no customer has yet been offered any remediation.

5 Second, the evidence establishes that NAB was aware of potential misconduct in connection with the Introducer Program in greater western Sydney since at least April 2015, but did not commence a formal investigation until late October 2015 following two whistle blower disclosures. The Commission's Terms of Reference require the Commission to consider whether any findings of misconduct are attributable to the particular culture or governance practices of the financial services
10 entity, or result from other practices of the entity, including risk management, recruitment and remuneration practices.

15 On the evidence, it is open to the Commissioner to find that there were a number of causes of this misconduct which are attributable to the culture and governance practices at NAB as well as its risk management, recruitment and remuneration practices. First, it's open to the Commissioner to find that a significant cause of the misconduct was NABs remuneration and incentive scheme which rewarded bankers for the volume of sales of home loans. The evidence establishes that, from as early as April 2015, NAB was aware that one of the potential root causes for the
20 misconduct was the Star Sales Incentive Program that the relevant bankers were all operating under, which rewarded bankers with bonuses for achieving certain targets for the sale of home loans.

25 The investigation of the misconduct confirmed that the incentive program was a significant contributor to the misconduct. Although NAB has since moved many of its employees to a different incentive plan, the short-term incentive plan, that program continues to reward bankers with bonuses for achieving targets for the sale of home loans. The evidence also establishes that although NAB had a code of conduct, a breach of that code of conduct did not necessarily result in withholding of
30 the employee's bonus. Instead, certain breaches of the code of conduct, which resulted in an amber conduct gate being applied, led to a reduction in the quantum of the bonus by 25 per cent. In the words used in one of the Project Winnow documents produced by NAB to the Royal Commission:

35 *The risk and reward equation for bankers was unbalanced in favour of sales over keeping customers and the bank safe.*

40 Second, it's open to the Commissioner to find that another cause of the misconduct was the inadequacy of NABs policies and processes for the recruitment and training of bankers. One of the key findings of the root cause analysis conducted by NAB was that their approach to recruitment, training and accreditation of bankers had not been fully effective in ensuring that all bankers understood consumer lending process compliance requirements.

45 Third, it is open to the Commissioner to find that another cause of the misconduct was the inadequacy of NABs policies for the recruitment and monitoring of introducers. NAB used introducers from a variety of business backgrounds which

were unconnected with financial, property or legal services, such as gymnasiums and tailors. KPG made a series of findings in relation to the inadequacy of NABs monitoring of introducers.

5 THE COMMISSIONER: KPMG.

MS ORR: I'm sorry, yes.

THE COMMISSIONER: Yes.

10

MS ORR: Yes, it was KPMG.

THE COMMISSIONER: Yes.

15 MS ORR: KPMG brought in - - -

THE COMMISSIONER: You said KPG.

MS ORR: I'm sorry. I'm sorry.

20

THE COMMISSIONER: Yes.

MS ORR: KPMG made a series of findings noting that NAB bankers did not clearly understand the rules in relation to introducers. Fourth, it is open to the
25 Commissioner to find that another cause of the misconduct was the inadequacy of NABs processes for managing conflicts of interest. Fifth, it's open to the Commissioner to find that a cause of the misconduct was the inadequacy of NABs policies for the prevention and detection of fraud by bankers and introducers. Another of the key findings of the root cause analysis conducted by NAB was that
30 overall control effectiveness to prevent fraud events was inadequate because it was reliant on bankers doing the right thing.

Sixth, it is open to the Commissioner to find that a cause of the misconduct was the
35 inadequacy of NABs policies and procedures to ensure that its bankers were engaging in responsible lending. Mr Waldron agreed that gaps in the end-to-end loan application process were exploited by bankers, and NAB itself raised the question as to whether the end-to-end mortgage origination fulfilment, ongoing management, and eventual repayment required fundamental review from a controls effectiveness perspective. The Commission's Terms of Reference also require the
40 Commission to consider whether the mechanisms for redress for consumers of financial services entities who suffer detriment as a result of misconduct by financial services entities are effective.

45 THE COMMISSIONER: Just before we come to redress.

MS ORR: Yes.

THE COMMISSIONER: Go back to culture and governance practices.

MS ORR: Yes.

5 THE COMMISSIONER: It occurs to me that I may have to consider whether there
is a disconnect between the formal limitations on the so-called spot and refer model,
which are that the introducer may say to the customer no more than, “NABs a bank
that lends money, can I give you – can I give your name and contact details to the
10 bank.” And all it can say to the bank is, “The name and contact details of the
customer are such and such, the customer may want a loan.” There is a disconnect
between those formal requirements and the likely conduct of introducers in the real
world. It just strikes me as a very unusual conversation that – to use the expression
we’ve heard so often, it would be an unusual conversation with the client. “All I can
15 tell you is NABs a bank; it lends money.”

MS ORR: As we’ve seen from the evidence, Commissioner, that was not the way
many of the interactions with introducers, customers and NAB occurred. I had
moved, Commissioner, to effectiveness - - -

20 THE COMMISSIONER: Redress.

MS ORR: - - - of mechanisms for redress for consumer detriment, and we say that
the evidence supports a finding that NAB has not effectively and adequately
responded to the detriment suffered by its customers as a result of the misconduct. In
25 particular, as we have already noted, NAB has identified approximately 1300
customers who may have been affected by the misconduct during the period from
2013 to 2016, but none has yet been offered any remediation. The number of
customers who have experienced hardship as a result of the misconduct is unknown.
The evidence gave rise to concerns about whether the resources allocated within
30 NAB to the customer response work stream were adequate.

NAB is invited to make written submissions addressing each of the findings that we
have identified as being open to the Commissioner, as well as any other findings that
it regards as available on the evidence. All parties with leave to appear will be
35 permitted to provide written submissions addressing the following questions which
arise from the NAB case study. First, do remuneration and incentive policies that
reward bank employees for volume of sales of loans create an unacceptable risk that
bank employees will prioritise the sales of loan products over first the bank’s
responsible lending obligations; second, the bank’s statutory obligation to provide
40 loans to customers in a manner that is efficient, honest and fair; third, the bank’s
statutory obligation to have adequate arrangements to ensure that customers are not
disadvantaged by any conflict of interest that may arise; fourth, the bank’s
obligation to ensure that the conduct of its employees in connection with the
provision of loans is not misleading, deceptive or unconscionable?
45

The second question is whether introducer programs create an unacceptable risk that
banks will breach, first, their responsible lending obligations; second, their statutory

obligation to provide loans to customers in a manner that is efficient, fair and honest; third, their statutory obligation to have adequate arrangements to ensure that customers are not disadvantaged by conflicts of interest; and fourth, their obligation to ensure, again, that the conduct of their employees in connection with the provision of loans is not misleading, deceptive, or unconscionable?

The third question is: do banks have adequate policies to deter and, if necessary, detect fraud by employees and third parties such as introducers in connection with loan applications? The fourth question is: do banks have adequate policies to address customer detriment occasioned by misconduct of bankers or third parties such as introducers in connection with home loans and in a timely fashion? Fifth: how do financial services licensees ensure that they comply with the obligation in section 912D of the Corporations Act to make a written report to ASIC of any significant breach of the obligations within section 912A of the Corporations Act within 10 days?

Sixth, is the practice by banks of defaulting to use of the HEM benchmark when a customer declares living expenses that are less than the HEM benchmark consistent with the statutory requirement to take reasonable steps to verify a customer's financial situation before entering into a home loan with that customer? The Commissioner will recall that the evidence from NAB included the evidence from Mr Gilfillan, which dealt with the use of the HEM benchmark by NAB. The seventh question, which also arises from the evidence of Mr Gilfillan, is: do banks too readily permit waivers of their policies in connection with the assessment of home loan applications, including policies in relation to the assessment of serviceability of the loan?

We note the evidence of Mr Gilfillan that policy waivers occur at NAB on a daily basis and that they are made on approximately 15 per cent of home loan files. We also note the findings of Ernst & Young in 2017 that in some channels up to 55 per cent of NAB home loan files that were reviewed involved policy waivers. We turn, Commissioner, to the second case study examined in these hearings which involved consideration of CBAs arrangements with mortgage brokers and head groups. The Commission heard evidence in this case study from a mortgage broker, Mr Mark Harris, and from the executive general manager for home buying at CBA, Mr Daniel Huggins.

The Commission heard evidence that home loan applications are submitted to CBA through two channels, the proprietary channel and the third party distribution channel. The proprietary channel refers to loans offered through CBAs employees or authorised representatives, as well as through CBAs referral source program. It represents approximately 59 per cent of CBAs home loan portfolio. The third party distribution channel refers to loans submitted to CBA by brokers and represents approximately 41 per cent of CBAs home loan portfolio. The home loan applications submitted to CBA through the third party distribution channel come to CBA through mortgage aggregators or mortgage franchises which CBA and others in the industry refer to as "head groups".

Head groups have their own Australian credit licence and contractual arrangements with brokers. By contrast, no formal contractual arrangement exists between CBA and the brokers who submit loans to CBA. The Commission heard evidence that CBA requires those brokers who wish to submit home loan applications to it to go
5 through an accreditation process. As part of this accreditation process, CBA brokers currently complete an authority to act form in which they acknowledge that to maintain accreditation with CBA they need to submit a minimum of four home loan applications and settle a minimum of three home loans in a six month period. Mr Huggins gave evidence that CBA had not been systematically enforcing this
10 requirement.

The evidence establishes that CBA regards its accredited brokers as acting as its agent when dealing with customers and expects those brokers to promote its products. The Commission also heard evidence about the ways in which CBA
15 remunerates head groups for loans submitted by CBA accredited brokers. CBA pays head groups upfront commission and trail commission for each home loan that is drawn down, the quantum of which is tied to the size and duration of the loan. Upfront commission is paid when the loan is funded, while trail commission is paid during the life of the loan calculated by reference to the net balance of the home loan
20 account at the end of each month. Head groups pass on a portion of these commissions to the brokers.

CBAs contractual arrangements with head groups give CBA a number of rights and entitlements in its dealings with head groups, a number of which Mr Huggins told the
25 Commission CBA currently chooses, or will choose, not to enforce. CBAs contractual entitlements include a right to alter the commission structure if the average monthly settlements for the head group in respect of CBA loans for the previous year falls below \$5 million. Pursuant to the contractual entitlements, CBA pays bonuses to head groups if certain performance targets are met, as well as
30 payments to assist with training, development, and compliance, which are dependent contractually on the head group meeting certain minimum volume requirements for loans drawn down.

Head groups are also remunerated for sales of non-home loan CBA-branded products
35 provided to home loan customers, such as insurance products via CBAs connect referral program. Such payments may also be passed on to brokers. CBA also gives non-financial benefits, commonly tickets to hospitality events or sporting events, to brokers directly, the value of which is now limited to an amount of \$350 per person per event. Until recently, CBA segmented its accredited brokers into tiers based on
40 volume thresholds with brokers in the highest tier, the diamond tier, receiving the best service offering by CBA, primarily in the turnaround time for loan application processing.

Mr Huggins conceded that CBA had recognised that this structure could create a
45 conflict of interest and said that CBA was in the process of transitioning to a two tier segmentation system by which accredited brokers would be classified as either essential or elite on the basis of the application of quality and complimentary metrics

so that brokers could reach elite status for reasons other than the volume of loans submitted and drawn down. It emerged during the evidence that CBA's CEO holds the view that upfront and trailing commissions for mortgage brokers can lead to poor customer outcomes.

5

A letter dated 10 February 2017 from Mr Ian Narev to Mr Stephen Sedgwick, the independent reviewer for the Retail Banking Remuneration Review, was tendered. In that letter Mr Narev acknowledged on behalf of CBA that the use of loan size linked with upfront and trailing commissions for third parties can potentially lead to poor customer outcomes. Mr Narev expressed the view that, and I quote:

10

Mortgages also sit outside the financial advice framework, even though buying a home and taking out a mortgage is one of the most important financial decisions an Australian consumer will make. We would support elevated controls and measures on incentives related to mortgages that are consistent with their importance and the nature of the guidance that is provided. For example, the delinking of incentives from the value of the loan across the industry and the potential extension of regulations such as future of financial advice to mortgages in retail banking.

15

20

Mr Huggins acknowledged that there is a conflict in a broker commission structure which is linked to the size and length of the loan so that the larger the loan, and the longer the period over which it extends, the larger the commission payable to the broker. Mr Huggins acknowledged, as did his CEO, that this can lead to a conflict between the customer's interests and the broker's interests since the broker can maximise their income by getting the largest loan possible approved extending over the longest period of time. The issues paper submitted to Mr Sedgwick with Mr Narev's letter recorded that:

25

30

CBA has found its broker loans to have higher total debt to income levels, higher loan to value ratios, and higher interest costs compared to loans that originate in its proprietary channel.

35

CBA told Mr Sedgwick that these findings were consistent with the hypothesis that differences in remuneration between the proprietary channel and the broker channel were driving different customer outcomes and lent support to the case for discontinuing volume-based commissions to brokers. The paper referred to a move to a flat fee payment as a potential solution to these problems. Despite CBA's views and findings on these matters, CBA has not stopped paying volume based commissions to brokers, nor has it taken any steps to commence ceasing that practice.

40

45

Mr Huggins gave evidence that if CBA were to change its practices, customers might move to competitor lenders which would have a material impact on CBA's business. He also expressed concerns about the impact of such changes on the viability of the mortgage broking industry. The Commission heard evidence that CBA does not inform customers of the amount of commission which will be paid to the head group

or broker in respect of a customer's loan. A customer receives a credit contract schedule that records any commission amount as "not ascertainable". Mr Huggins' evidence was that the amount of upfront commission, the rate of trailing commission, and any amount paid under the connect referral program are each known and are
5 each able to be disclosed by CBA to the customer at the time the loan is entered into, but CBA makes no such disclosures.

The Commission also heard evidence about the program that CBA conducted in 2017 by which 710 accredited CBA brokers had their accreditation revoked by CBA
10 on the basis of inactivity. The Commission heard that CBA originally intended to revoke the accreditation of approximately 3000 further brokers, but that it ultimately did not proceed with this plan. Mr Huggins' evidence was that CBA had identified a group of less active or inactive brokers that were potentially associated with less desirable customer outcomes. He said that the aim of the deaccreditation program
15 was to improve the overall quality of the brokers accredited by CBA. However, Mr Huggins conceded that in hindsight, it would have been better if CBA had not deaccredited brokers purely based on volume, but had instead required inactive brokers to undergo more training in order to ensure the quality of their work.

Mr Mark Harris, a mortgage broker gave evidence that he was accredited by CBA
20 until 20 February 2017, at which time his accreditation was revoked by CBA with immediate effect. Mr Harris was told by CBA that his accreditation was revoked on the basis of inactivity. Mr Harris' evidence was that, as a result of the revocation of his accreditation, he is now unable to submit home loan applications to CBA on
25 behalf of a customer. His evidence was that if he had a customer for whom he thought a CBA loan would be a good fit, he would now need to refer the customer to another broker if they wished to apply for that loan. The evidence shows that CBA is presently introducing new accreditation standards for brokers. Mr Huggins' evidence was that these standards will be focused on monitoring quality and
30 delinking volume requirements from accreditation.

The Commission also heard evidence of CBAs activities in relation to broker oversight. In August 2017, the group audit and assurance internal audit for which Mr Huggins was accountable found that CBA was not doing enough to monitor the
35 activities of the head groups and the mortgage brokers who sit under those head groups. The audit report noted that it is not industry practice for banks to complete assurance in respect of aggregators, and that CBA was reliant on brokers to confirm the product offered to the customer was not unsuitable. The report found that whilst CBA has various contractual rights to monitor head groups, it has not exercised those
40 rights. The report listed large numbers of different types of compliance issues by brokers who had submitted home loans to CBA.

On this evidence, we submit that it is open to the Commissioner to make the following findings of misconduct against CBA: first, CBAs remuneration
45 arrangements with brokers and head groups breach its statutory obligations under section 47 subsection (1) subparagraph (b) of the National Credit Act and section 912A subsection (1) subparagraph (aa) of the Corporations Act to have in place

adequate arrangements to ensure that customers of CBA whose home loans are submitted by a mortgage broker are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to CBAs credit activities or in its provision of financial services.

5

Second, CBAs failure to adequately monitor the activities of its head groups breaches its statutory obligations under section 47 subsection (1) subparagraph (a) of the National Credit Act, and section 912A subsection (1) subparagraph (a) of the Corporations Act to do all things necessary to ensure that the financial services covered by its financial services licence and the credit activities authorised by its credit licence are engaged in efficiently, honestly and fairly. Third, CBAs failure to disclose to customers the commissions paid to head groups in respect of their loan breaches its statutory obligations under section 47 subsection (1) subparagraph (a) of the National Credit Act and section 912A subsection (1) subparagraph (a) of the Corporations Act to do all things necessary to ensure that the financial services covered by its financial services licence and the credit activities authorised by its credit licence are engaged in efficiently, honestly and fairly. Fourth - - -

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THE COMMISSIONER: Just before you leave three.

MS ORR: Yes.

25

THE COMMISSIONER: There may be two elements to that. I can't now recall, but it may be that the failure – if there is one – would be whether there was any commission payable because I have a recollection, which is subject to correction when I look back at the transcript and evidence, that all that was said was a conditional statement, “commission may be charged”, and then there's this question of “not ascertainable”.

30

MS ORR: Yes. The Commissioner is right. There were two separate documents. The consumer credit schedule, which had been in place for some time, was the document that recorded not ascertainable next to the word “commission”. The second document, which was introduced in December 2017, which was said to improve the situation, is the document that we would say lessened the certainty in a consumer's mind about what was going on because it made the payment of a condition [erratum: commission] seem like a possibility rather than a certainty, and there was certainly no reference to the quantum of any commission payable in that document.

40

THE COMMISSIONER: And that leads on not only to consideration of 47 and 912A, but also misleading and deceptive, I would have thought.

45

MS ORR: Yes, it does. It does, your Honour, yes. Now, the fourth form of misconduct – I won't deal with misleading and deceptive conduct because the Commissioner has already raised that, but the fourth form that we submit is open to you, Commissioner, is a finding that CBAs remuneration arrangements with brokers and head groups, as well as its failure to disclose commissions to customers, breach

the Banking Code of Practice. In particular, we submit that they breach the obligation in clause 3.2 of the Code to act fairly and reasonably towards the customer in a consistent and ethical manner.

5 On the evidence, it is also open to the Commissioner to make findings that CBA engaged in conduct that fell below community standards and expectations. First, despite taking the position that volume-based commissions paid to brokers are potentially associated with poor customer outcomes, CBA has failed to remove such commissions or take steps to remove the conflict of interest created by these
10 commissions, a conflict between the broker's interest in maximising upfront and trail commissions earned from the loans they submit and the customer's interest in obtaining a loan that meets their needs.

15 Second, by revoking the accreditation of hundreds of mortgage brokers on the basis of inactivity with immediate effect, and without first providing brokers with an opportunity to satisfy CBA of the quality of their activities, CBA paid insufficient regard to the interests of brokers in being able to recommend a full suite of potentially suitable loan products to a customer. All parties with leave to appear will be permitted to provide written submissions addressing the following questions
20 which arise from this CBA case study.

First: does the use of upfront and trailing commissions for remuneration of head groups and the brokers who submit loans through head groups lead to poor customer outcomes? Second: should upfront and trailing commissions be replaced with an
25 upfront flat fee payment? Third: is the first mover issue identified in CBAs evidence a genuine commercial impediment to change in respect of the structure of broker remuneration? If so, what can and should be done to overcome that impediment? Fourth: will the program of reforms in the mortgage broking industry, announced by the Combined Industry Forum in 2017, ameliorate the conflicts of
30 interest or any other issues that have been referred to in this case study? We turn to the third case study - - -

THE COMMISSIONER: I would also be assisted, I suspect, by submissions from parties generally about what's a deceptively simple set of questions to ask: who does
35 a mortgage broker act for? You can put it in three ways, I think, and the issue has at least three elements to it. Who does the broker act for? That might be seen as an inquiry about fact or fact and law. Two, who does the customer think the broker is acting for? And third, who does the lender think the broker is acting for? And do you give separate answers at separate steps along the way? If you do, what are the
40 markers that tell you, "I've gone from a step where this set of answers is appropriate into the next stage where that set of answers is appropriate."

So who does a broker act for, who does the customer think the broker acts for, who does the lender think the broker acts for, are there varying or varied answers at
45 various steps? If there are, what are they? The sort of question that invites, "You have three hours in which to answer it, you may commence writing now, I think. And don't forget to put the number at the head of each page." Do go on, Ms Orr.

MS ORR: Commissioner, I was turning to the third case study examined in these hearings, which involve misconduct by four former Aussie Home Loans brokers, Mr Shiv Sahay, Ms Emma Khalil, Mr Madhvan Nair, and Mr Bernard Meehan during the period from 2011 to 2015. The Commission heard evidence in this case study
5 from Ms Lynda Harris, the general manager people and culture at AHL Investments Proprietary Limited and Mr Giles Boddy, the chief financial officer at AHL Investments Proprietary Limited. A witness statement was also tendered from Mr David Smith, the general manager of strategy and products at AHL Investments Proprietary Limited.

10 The evidence established that the misconduct of the four former brokers included the falsification of documents submitted to lenders in support of home loan applications such as bank statements, payslips and letters of employment the loan submitted to lenders by each of these brokers gave rise to a loan book with Aussie Home Loans
15 receiving upfront and trail commission payments from lenders in respect of each of the loans in the loan book. A portion of these commission payments was passed through to the broker and the remainder was retained by Aussie Home Loans.

20 The size of the portion Aussie Home Loans passed through to the broker was determined by Aussie Home Loans by reference to the total settled loan amounts. The higher the value of the settled loan amounts, the higher the percentage of the upfront commission passed through to the broker. Aussie Home Loans brokers had a contractual obligation to introduce a minimum number of loans per month. The evidence established that Aussie Home Loans did not detect the misconduct engaged
25 in by three of the four brokers, each of whom had been with Aussie Home Loans for a number of years, despite obvious anomalies in the supporting documentation that those brokers were submitting to lenders.

30 In each of those instances, Aussie Home Loans was notified of the misconduct by a lender who had detected it. In each of these instances, Aussie Home Loans terminated its relationship with the broker. In each of these instances, one or more of the lenders had told Aussie Home Loans that they had, or intended to, revoke their own accreditation of the broker, and Aussie Home Loans terminated their relationship with the broker on this basis. In each of the three instances where the
35 misconduct was detected by a lender, Aussie Home Loans was reliant on one or more lenders to conduct a review of the broker's files and investigate the misconduct.

40 The misconduct of the fourth broker, Mr Meehan, was detected by Aussie home loans as part of a file review process it undertook in respect of brokers who were submitting more than 50 per cent of their loans to one lender. The selection of Mr Meehan's files for review was also informed by the fact that the lender to whom Mr Meehan was submitting more than 50 per cent of his loans was Westpac, which Aussie Home Loans knew accepted a letter of employment to verify income, a document that could be easily falsified. Aussie Home Loans did not report the
45 misconduct of any of the four brokers to the police, nor did Aussie Home loans report the misconduct of three of the four brokers to ASIC.

5 Instead, it submitted a standard form to ASIC notifying ASIC that the brokers had
ceased as credit representatives of Aussie Home Loans. As part of ASICs
investigation into Mr Sahay, which resulted from notification by a person or entity
other than Aussie Home Loans, Aussie Home Loans subsequently told ASIC that it
10 had terminated its relationship with Ms Khalil and Mr Nair on the basis that they
were suspected of fraudulent misconduct. Each of the four brokers was ultimately
charged with criminal offences as a result of their misconduct. Aussie Home Loans
also did not report the misconduct of three of the four brokers to the Mortgage &
Finance Association of Australia, despite the evidence that it was obliged to do so as
15 a member of that association itself, and the evidence that it required each of its
brokers to be members of that association because the association had powers to
expel a broker for misconduct.

15 Aussie home loans did not notify the customers of any of the four brokers of the
basis on which it had terminated its relationship with the broker. It transferred the
broker's customers to another Aussie Home Loans broker. Following the
termination of its relationship with Mr Sahay, Aussie Home Loans was contacted by
two of Mr Sahay's customers, both of whom were in a situation of distress as a result
of Mr Sahay's misconduct. Aussie Home Loans chose not to advise either customer
20 of the basis on which Mr Sahay's relationship with Aussie had been terminated.
Following the termination of its relationship with Mr Nair, Aussie Home Loans made
an ex gratia payment to a customer who had engaged solicitors and complained about
the misconduct of Mr Nair.

25 Aussie Home Loans was unable to explain the basis for this ex gratia payment, the
sum of the ex gratia payment, or provide any other details about it. On the evidence,
it is open to the Commissioner to make the following findings of misconduct against
Aussie Home Loans: first, Aussie Home Loans breached its statutory obligation
under section 47(1)(a) of the National Credit Act to do all things necessary to ensure
30 that its credit activities were engaged in efficiently, honestly and fairly. Second,
Aussie Home Loans breached its obligation under section 47(1)(b) of the National
Credit Act to have in place adequate arrangements to ensure that Aussie Home Loans
clients were not disadvantaged by any conflict of interest that may arise in relation to
Aussie Home Loans credit activities.

35 One such conflict of interest was the conflict between the broker's contractual
obligation to introduce a minimum volume of loans per month and the broker's
contractual obligation to comply with the law, including the responsible lending
obligations. Third, Aussie Home Loans breached its statutory obligation under
40 section 47(1)(c) of the National Credit Act to take reasonable steps to ensure that its
representatives complied with the National Credit Act. Fourth, Aussie Home Loans
breached its obligation under section 47 subsection (1) subparagraph (1)(ii) to have
adequate risk management systems.

45 Aussie Home Loans risk management systems did not adequately prevent, detect or
respond to the fraud; they did not create clear accountabilities for risk or prioritise
ownership of risk, and they did not require reports to be made to law enforcement

authorities, regulators or disciplinary bodies; they did not require lenders whose loans were potentially affected by the fraudulent conduct to be notified of the nature of the fraudulent conduct or even that there was fraudulent conduct; where the lender had detected the fraud, Aussie Home Loans relied on the lender to investigate and respond to the fraud; Aussie Home Loans did not require current or former customers to be notified of incidents of fraud or the potential impact of such incidents on their home loans, and on their ability to service their home loans.

Fifth, Aussie Home Loans breached the obligation in section 117 subsection (1) subparagraph (a) of the National Credit Act to take reasonable steps to verify the financial situation of customers prior to making an assessment of whether the home loans for which it assisted customers to apply would be unsuitable for the customers. Sixth, Aussie Home Loans, through its representatives, engaged in conduct involving lenders and conduct involving customers that was misleading, deceptive and unconscionable. Seventh, Aussie Home Loans through its representatives failed to comply with the expectations of ASIC in relation to responsible lending as set out in regulatory guide 209 which, as we've already submitted, constitute a recognised and widely accepted benchmark for meeting the responsible lending obligations.

Eighth, Aussie Home Loans breached the obligations imposed on it by the Code of Practice of the Mortgage & Finance Association of Australia. Under that Code of Practice, Aussie Home Loans was obliged to comply with all applicable laws; to act with appropriate care, skill and diligence, to not engage in any acts or omissions of a dishonest or fraudulent nature; to suggest or recommend to customers only credit that Aussie Home Loans reasonably believed was appropriate to the needs of the customer after undertaking an appropriate assessment of the customer's capacity to service the proposed credit; to keep customers informed of all relevant information known to Aussie Home Loans relating to current credit applications on the basis that the fact that a broker had been terminated for reasons connected with allegations of fraud related to any current credit applications of that broker.

On the evidence, it's also open to the Commissioner to make findings of conduct by Aussie Home Loans that fell below community standards and expectations. First, Aussie Home Loans failed to advise customers whose loans had been submitted by one of the four brokers, and which had been approved, of the termination of their relationships with the brokers and the reasons for the termination of those relationships. Second, Aussie Home Loans prioritised the retention of its trailing commissions from the broker's home loan book over investigating and dealing with the conduct that had led to the termination of the broker, or ensuring that such conduct had not led to any detriment for a customer.

Third, Aussie Home Loans lodged annual compliance certificates under section 53 of the National Credit Act in 2014 and 2015 that certified that Aussie Home Loans had adequate arrangements and systems in place to ensure that it did all things necessary to ensure credit activities authorised by its licence were engaged in honestly and fairly, adequate arrangements and systems in place to ensure that its customers were not disadvantaged by conflicts of interest, adequate arrangements and systems in

place to ensure that its representatives complied with the National Credit Act, and adequate risk management systems in circumstances where it was aware that a number of its brokers had, in the years covered by these certificates, engaged in fraudulent conduct, much of which had not been detected by Aussie Home Loans.

5

On the evidence, it is open to the Commissioner to find that the misconduct arose not merely because of rogue conduct by individual brokers but because the systems, processes and culture at Aussie Home Loans permitted such misconduct to occur.

We note the following matters in particular: the remuneration of Aussie Home Loans brokers was tied directly to the number and size of home loans introduced by the broker. Therefore, the more loans the broker introduced and the higher their value, the greater the commissions that would be paid. This resulted in a culture within Aussie Home Loans that prioritised selling of home loans over the proper assessment of the customer's requirements and objectives for the purpose of identifying and recommending a loan product that was not unsuitable for the customer.

The systems for prevention and detection of fraud, as already noted, were inadequate. Whilst Aussie Home Loans was aware that certain lenders accepted supporting documentation for a loan application that was capable of being easily falsified, they did not implement systems that proactively and routinely identified brokers who were potentially taking advantage of the more lax verification requirements of these lenders by submitting falsified documents. The systems for ensuring that the recommendations made by Aussie Home Loans brokers complied with Aussie's general conduct obligations and responsible lending obligations under the National Credit Act were inadequate.

We note also the evidence that in an internal audit of Aussie Home Loans, that was the subject of a report in December last year, it was concluded that the Aussie Home Loans control environment was unsatisfactory and that management awareness and actions required improvement. We note the views expressed to the CBA audit committee in February of this year that CBAs oversight of Aussie Home Loans needed to strengthen, and the risk culture at Aussie Home Loans needed to lift.

As to the effectiveness of the mechanisms for redress for Aussie Home Loans customers who suffered detriment as a result of the misconduct of the four former brokers, it is open to the Commissioner to find that Aussie Home Loans did not effectively and adequately respond to the potential detriment suffered by customers. Aussie Home Loans is unable to say how many of the customers of the four brokers were affected by their fraudulent conduct. It is not known whether, and if so how many, customers obtained loans through the conduct of one of the four brokers that were unsuitable loans, and which therefore should not have been approved, nor how many of those customers are now in arrears on those loans.

It is also open on the evidence to find that Aussie Home Loans did not effectively and adequately respond to the danger posed to other future customers of the four brokers. By failing to report the details of their misconduct to law enforcement

authorities, regulators, professional disciplinary bodies, or to lenders engaging with the broker, Aussie Home Loans failed to take adequate steps to ensure those with powers to impose consequences on the brokers were put in a position where they could exercise those powers. Aussie Home Loans is invited to provide written
5 submissions addressing each of the findings that we have identified as open, as well as any other findings that it regards as available on the evidence.

All parties with leave to appear will be permitted to provide written submissions addressing the following questions which arise from the Aussie Home Loans case
10 study. First: do remuneration structures that reward mortgage brokers for volume of sales of loans create an unacceptable risk that mortgage brokers will prioritise the sales of loan products over their responsible lending obligations; their obligation to recommend loans to customers in a manner that is efficient, fair and honest; their
15 obligation to have adequate arrangements in place to ensure that customers are not disadvantaged by conflicts of interest; and their obligation to ensure that the conduct of the brokers is not misleading, deceptive, or unconscionable?

Second: do credit licensees, whose representatives engage in mortgage broking activities, have adequate systems and processes to prevent fraud, to detect fraud, to
20 respond to fraud, and to identify and address any detriment to current and former customers occasioned by the fraudulent conduct of its representatives? We turn to the fourth case study examined in these hearings.

THE COMMISSIONER: It may also be a general question, I think, about ACL
25 holders, about whether those who hold ACLs, as distinct from AFSLs, should be made subject to a system broadly similar to the 912A plus 912D reporting obligations of part 7 of the – I think it's - - -

MS ORR: The section 912D obligation.
30

THE COMMISSIONER: Of the Corporations Act.

MS ORR: Yes.

THE COMMISSIONER: Now, there are, no doubt, issues that people will say arise
35 about 912A, 912D. Some may say that they are issues that require reconsideration of the whole structure of those provisions – I don't know – but should ACL holders be subject to broadly similar requirements, or is there some reason why ACL holders should be subject to differing reporting obligations from those that apply to AFSL
40 holders?

MS ORR: We turn to the fourth case study, Commissioner, which examined ANZs responsible lending practices in connection with home loans. The Commission heard
45 evidence in this case study from Mr Robert Regan, a consumer who had entered into a home loan with ANZ, and from Mr William Ranken, the lead of the homeowners team at ANZ. The evidence established that Mr Ranken is responsible for ANZs home loan portfolio which is worth approximately \$265 billion. In FY2017, ANZ

had approximately 1.008 million home loan accounts on offer, a majority of which originated through the broker distribution channel.

5 In the period from 1 October 2016 to 30 September 2017, ANZ sold over \$67 billion of home loans and, of that amount, almost 38 billion came from the broker channel. The Commission heard evidence about ANZs policies and procedures for dealing with home loan applications submitted by brokers. The evidence establishes that ANZ relies heavily on brokers to make inquiries into a customer's financial situation. The results of the broker's inquiries about the customer's financial position are
10 provided to ANZ in a document referred to as a statement of financial position, which is signed by both the customer and the broker.

The evidence establishes that ANZ does not take any steps to verify the customer's general living expenses as declared on this form. The evidence also establishes that
15 where ANZ holds information about a customer that is inconsistent with information about the customer's expenses, as recorded on this form, it disregards that other information and does not make any further inquiries into that inconsistency. In the words of Mr Ranken, ANZs processes in this situation are to do nothing. Mr Ranken's evidence was that it would be highly complex, very time-consuming, very
20 costly and, ultimately, not necessarily that helpful to undertake a manual review of paper based bank statements in order to verify a customer's statement of financial position.

When asked about the requirement to take positive steps under ASIC regulatory
25 guide 209 which sets out ASICs expectations in relation to responsible lending obligations, Mr Ranken accepted that there was a customer benefit trade-off when considering how strictly regulatory guide 209 was to be complied with. Another theme of Mr Ranken's evidence related to ANZs use of the HEM benchmark. Mr Ranken initially suggested that some indirect verification of a customer's living
30 expenses took place by way of comparing the customer's declared living expenses with the income adjusted HEM benchmark and using the higher of the two.

However, Mr Ranken subsequently accepted that the primary purpose of undertaking that comparison was to assess the customer's capacity to service the loan, not to
35 verify the customer's financial situation. As at April 2017, in 73 per cent of ANZs home loan files reviewed by KPMG in the course of the APRA targeted review process, the customer's living expenses had defaulted to the HEM benchmark. The evidence establishes that approximately the same percentage of ANZ files would currently default to the HEM benchmark.
40

Mr Ranken gave evidence about the application of ANZs processes to Mr Robert Regan's application for a home loan from ANZ. Mr Regan was a 72 year old pensioner who sought and obtained a \$50,000 home loan from ANZ in March last year in order to obtain money he could send to individuals overseas. Mr Regan
45 subsequently learnt that the individuals were part of a scam. The loan was secured against his unencumbered home and the application for the loan was submitted by a mortgage broker. At the time of making the loan application, Mr Regan's income

was approximately \$1229 per fortnight. Mr Regan provided the broker with bank statements evidencing his income and expenditure.

5 The bank statements showed that Mr Regan had spent significant amounts of money on the scam in the previous month. Mr Regan did not discuss his expenses with the broker, but understood that the broker would calculate his expenses from his bank statements. The bank statements reflected, on their face, multiple Western Union money transactions by which Mr Regan sent thousands of dollars to people involved in the scam. The statement of financial position prepared by the broker and signed
10 by both the broker and Mr Regan recorded Mr Regan's monthly expenses as \$1140, approximately half their true value. The statement of financial position was submitted to ANZ by the broker, along with supporting documentation that included Mr Regan's bank statements and a Centrelink statement from the previous year recording the receipt of pension.

15 In assessing Mr Regan's home loan application, an ANZ assessment officer considered Mr Regan's exit strategy on the loan, which was considered to be that he could downsize if required and pay out the loan. No such exit strategy was discussed with Mr Regan. Mr Regan's age was also not considered as part of the assessment of
20 the home loan application other than a reference to consideration of only the untaxed component of his superannuation payment because he is aged. ANZ granted the home loan to Mr Regan for a 30 year term. Mr Regan drew down on the loan and lost the money in payments to the individuals involved in the scam.

25 From early on, Mr Regan found it difficult to make his loan repayments. He sought assistance from ANZ, who completed a hardship application form on his behalf but completed it incorrectly. Had the form been completed correctly, it would have shown that Mr Regan did not have sufficient money to make his monthly repayments. However, ANZ rejected Mr Regan's application for hardship assistance
30 on the basis of the incorrectly completed form. Mr Regan continued to seek hardship assistance from ANZ, communicating with ANZ through a financial counsellor and a community legal centre. The day before Mr Regan gave evidence in the Royal Commission, ANZ offered to reverse all fees and interest applied to Mr Regan's home loan since drawdown, stop the accrual of future fees and interest, and apply a goodwill credit of \$1500 to the balance. Mr Regan gave evidence that he intended to
35 reject the offer.

On the evidence, it is open to the Commissioner to make the following findings of misconduct against ANZ in relation to the home loan it entered into with Mr Regan:
40 first, ANZ breached its obligations under section 47(1)(a) of the National Credit Act and section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that its credit activities in relation to Mr Regan and the financial services provided to Mr Regan covered by its financial services licence were engaged in efficiently, honestly and fairly. Second, ANZ breached the prohibition in section 128
45 subparagraph (a) of the National Credit Act on entering into a home loan with Mr Regan in circumstances where it had not made reasonable inquiries about Mr

Regan's financial situation as required by section 130 subsection (1) subparagraph (b) of that Act.

5 Fourth – I'm sorry, third, ANZ also breached the prohibition in section 128
subparagraph (a) of the National Credit Act on entering into a home loan with Mr
Regan in circumstances where it had not taken reasonable steps to verify his financial
situation as required by section 130 subsection (1) subparagraph (c). Fourth, ANZ
breached the prohibition in section 133 subsection (1) of the National Credit Act on
10 entering into a home loan with Mr Regan in circumstances where that home loan was
unsuitable for Mr Regan. Fifth, ANZ failed to comply with regulatory guide 209
which, as we've already submitted, constituted a recognised and widely accepted
benchmark for meeting the responsible lending obligations.

15 Sixth, ANZ failed to comply with the Banking Code of Practice. In particular, it
failed to comply with the obligation in clause 3.2 of the Code to act fairly and
reasonably towards Mr Regan in a consistent and ethical manner, and the obligation
in clause 27 of the Code to exercise the care and skill of a diligent and prudent
banker in selecting and applying credit assessment methods and forming an opinion
20 about Mr Regan's ability to repay the home loan. On the evidence, it is open to the
Commissioner to make a finding that ANZs conduct in relation to Mr Regan also fell
below community standards and expectations. First, ANZ completed the hardship
application form incorrectly, which resulted in Mr Regan being denied hardship
assistance in circumstances where he ought to have been granted such assistance.

25 Second, having subsequently received information that established that Mr Regan
was suffering hardship, ANZ failed to make an offer of hardship assistance to Mr
Regan in a timely fashion. No offer was made until the day before Mr Regan gave
evidence before the Commission. Third, the offer of hardship assistance made by
ANZ to Mr Regan the day before he gave evidence is inadequate and does not
30 adequately address the hardship that Mr Regan is experiencing as a result of being
provided with an unsuitable loan. It is also open to the Commissioner to make a
finding that ANZs conduct more generally, in connection with the assessment of
home loan applications, falls below community standards and expectations because,
in verifying the declared living expenses of a customer and in assessing a customer's
35 ability to service a home loan, it relies on the HEM benchmark, a conservative
measure of expenditure.

40 THE COMMISSIONER: But whether that constitutes verification is itself a
separate issue, I think you've already identified.

MS ORR: A misconduct issue.

THE COMMISSIONER: It's a conduct issue, yes.

45 MS ORR: Yes. So that gave rise to a suggestion, Commissioner, that there be a
finding of misconduct for breaching 128 subparagraph (a) of the National Credit Act.

THE COMMISSIONER: The third of your – the third of your conduct findings.
Yes.

5 MS ORR: That's right: entering into the loan in circumstances where it hadn't
taken reasonable steps to verify. It's open to the Commission to find that the
misconduct of ANZ, in connection with Mr Regan's home loan application, can be
attributed to a culture of being willing to undertake, in the words of Mr Ranken, a
customer benefit trade-off in relation to responsible lending obligations. Such a
10 culture may favour administrative convenience over strict adherence to the law. It is
also open to the Commissioner to find that ANZs policies and procedures relating to
broker initiated home loans are inadequate as they do not provide a system for ANZ
to take reasonable steps to verify a consumer's financial situation insofar as that
verification relates to a customer's general living expenses. In relation to the
effectiveness of mechanisms for redress for customers who have - - -

15 THE COMMISSIONER: Before – again, before you come to that, is there anything
to be made – again, my memory of the evidence may be imperfect – but I thought
that Mr Regan drew the bulk of the funds – or drew part of the funds at the bank in
the form of a draft payable to London.

20 MS ORR: Yes, that's so.

THE COMMISSIONER: And dealt with the person who had signed the mortgage
documents on behalf of the bank.

25 MS ORR: Yes. The - - -

THE COMMISSIONER: And that person, at least as far as Mr Regan's evidence
went, made no remark on the fact that the drawdown was for payment in RGBP
30 rather than payment in AUD for – what was it – the stated basis on the broker
completed loan form, renovations and extensions, or something.

MS ORR: Renovations, yes.

35 THE COMMISSIONER: Yes.

MS ORR: Yes, that was the evidence, Commissioner. And the evidence of Mr
Regan was that no questions were asked, when he asked for an international transfer
for a significant component of the funds.

40 THE COMMISSIONER: Yes.

MS ORR: And, Commissioner, that does seem to be another basis for a finding of
conduct that falls below community standards and expectations.

45

THE COMMISSIONER: Yes. Possibly even a conduct finding, I don't know. These are things I am going to have to think about, and ANZ are going to have to tell me their views about, but I must say the evidence was a little striking. Yes.

5 MS ORR: I was moving, Commissioner, to effectiveness of mechanisms for redress.

THE COMMISSIONER: Redress.

10 MS ORR: And we submit, Commissioner, that the evidence renders it open to you to make a finding that ANZs mechanisms for redress have been inadequate to address the detriment suffered by Mr Regan, as a result of being provided with an unsuitable loan. This is apparent, we say, both from ANZs conduct in relation to the failed hardship application, and from the nature of the offer and the timing of the offer made to Mr Regan on 15 March this year. ANZ is invited to provide written submissions addressing each of the findings that we have indicated we regard as open, as well as any other findings it regards as available on the evidence.

20 All parties with leave to appear will be permitted to provide written submissions addressing the following questions which arise from the ANZ case study. First, do credit providers have adequate policies to ensure that they comply with their obligations under the National Credit Act when offering broker-originated home loans to customers, insofar as those policies require them to make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract, to make reasonable inquiries about the consumer's financial situation, and to take reasonable steps to verify the consumer's financial situation?

30 Second, is use of the HEM benchmark an appropriate way to deal with the difficulties associated with securing an accurate assessment of living expenses from a customer? Third, is use of the HEM benchmark appropriate in assessing whether a loan is unsuitable for a customer? Fourth, is the HEM benchmark too conservative a measure of a customer's living expenses? And fifth, does the widely-known use of the HEM benchmark as a default for customers' living expenses create an unacceptable risk that brokers will fail to make reasonable inquiries about a customer's financial situation, instead opting to declare an amount of living expenses for the customer that is known by the broker to be in the vicinity of the relevant HEM benchmark?

40 THE COMMISSIONER: Now, it may be that the general issues in this area might go a little further, at least so far as the evidence reveals HEM seems as close to universal as may be as the benchmark. First, is the use of any benchmark suitable? HEM, Henderson Poverty, a newly devised benchmark, is the use of any benchmark suitable? Second, as a related issue, in light of the evidence that has been given, I think, by a number of witnesses, that by and large customers are poor historians when it comes to identifying their outgoings. People are not very good at providing the information, not for want of trying, not for want of prompting, just by and large people are poor historians. What does that say, if anything, about judging home

loans on a measure of UMI? I think one of the targeted review reports – we now have all five, don't we?

MS ORR: All four.

5

THE COMMISSIONER: All four.

MS ORR: There is another entity whose – I did not tender, who is not part of these hearings.

10

THE COMMISSIONER: There are four targeted review reports in, and one of them, I think, referred to the fact that home lending in other sophisticated systems does not operate by reference to UMI. Now, those are very large questions, and it may be that they are questions that are ultimately better treated much later in the course of the Commission's work. I don't know. But those who are preparing submissions about HEM and its use, I think need to be on notice that there may be questions of the kind that I have mentioned which are then provoked by whatever conclusions I get to about HEM.

15

20 That is, those preparing the submissions should not take the identification of questions you have made, which is important, as the entire universe of debate in this field. It may be that you answer those questions and answering those takes you into a rather larger universe, and the scope of it is most conveniently indicated by the fact that other systems work out home lending by systems other than surplus monthly income, UMI. Yes.

25

MS ORR: We turn then, Commissioner, to the fifth case study examined in these hearings which involve two add-on insurance policies sold by CBA to customers who did not meet the employment eligibility criteria to claim certain benefits under the policies. The two products were CreditCard Plus insurance and loan protection product insurance. The latter product, in fact, comprised two separate sub-products, the personal loan protection product and the home loan protection product. Both CreditCard Plus insurance and the loan protection product have been sold by CBA since at least 2003. The Commission heard evidence in this case study from Ms Irene Savidis, a customer who had purchased CreditCard Plus insurance and from Mr Clive van Horen, the executive regional manager for products within the retail banking services business unit of CBA.

30

35

We deal first with the evidence about the CreditCard Plus insurance product. Customers are offered this insurance product as part of their application for a CBA branded credit card during the period from 2011 to 2015, 29.5 per cent of CBA branded credit cards had a CreditCard Plus insurance policy attached to them. In April 2015, as a result of an internal audit, CBA determined that approximately 65,000 customers who had purchased CreditCard Plus insurance may not have been eligible to claim benefits under the policy in the event that they suffered temporary or permanent disability or involuntary unemployment, as they were not employed when they were sold the policy.

40

45

Whilst a customer was provided with a copy of the product disclosure statement for the policy, CBA staff had not been required to inform the customer that such benefits could not be claimed if they remained unemployed. This was despite the fact that ASIC had produced a report in 2011 containing a number of recommendations in relation to the sale of consumer credit insurance, including a recommendation that sales scripts include an explanation of the main exclusions under the policy. Mr van Horen referred to CBAs reliance upon the disclosures in the product disclosure statement and the failure to refer to exclusions in the sales scripts as a flawed assumption and a flawed judgment.

In around May 2015, CBA amended its sales scripts to introduce a knock-out question to prevent the sale of CreditCard Plus insurance to people who didn't meet the employment eligibility criteria. Changes were also made to the form used for online sales of credit cards, but these changes did not introduce a knock-out question. No such question was introduced into the online form until two years later in 2017. Also in May 2015, CBA made a good governance notification to ASIC of the CreditCard Plus issue. The notification substantially underestimated the number of customers affected by the problem, and CBA now accepts that it should have made a significant breach notification under section 912D of the Corporations Act in respect of the incident.

Extensive correspondence between ASIC and CBA followed which involved negotiations over more than a year about whether CBA would remediate any customers who had been sold CreditCard Plus insurance when they were unemployed and, if so, how it would remediate them. After being pressed by ASIC, CBA changed its position on remediation a number of times. Initially, it did not offer to remediate customers. It then offered to only remediate customers with open policies. It ultimately agreed to remediate customers with both open and closed policies. Similarly, CBA moved from a position of only refunding part of the premiums paid to refunding the entirety of the premiums, at least to students. In addition, aspects of the remediation program required customers to proactively opt in, in circumstances where CBA knew that the likely rate of uptake by consumers was low.

Customers who purchased CreditCard Plus insurance in circumstances where they did not meet the employment eligibility criterion paid \$11 million in premiums and received half a million dollars in response to claims made. CBA expects that at the conclusion of the remediation program, it will have remediated approximately 64,000 customers who will be refunded amounts that total approximately \$10 million. We turn to CBAs sale of the loan protection product. Customers are offered this product as part of their application for either a CBA home loan or a CBA personal loan. During the period from 2011 to 2017, 42.64 per cent of CBA personal loans had an associated personal loan protection policy, and 10.34 per cent of CBA home loans had an associated home loan protection policy.

The exclusions from the LPP product were similar, but not identical, to the exclusions from the CreditCard Plus insurance product. Only customers who met the

employment eligibility criterion could claim loan repayment cover in the event of disability or involuntary unemployment. As it had done in May 2015 for CreditCard Plus insurance, in October 2015 CBA introduced a knock-out question for its assisted channels which meant that an application for LPP insurance would not proceed if the employment eligibility criterion was not met, at least in relation to the home loan protection product. An equivalent question was not introduced into the digital online application form, again, until almost two years later in June 2017.

Although CBA knew that there was a problem with the loan protection product insurance being sold to people who did not meet the employment eligibility criterion from at least October 2015, CBA did not report that issue to ASIC or take any steps to identify how many customers were affected by the issue. Instead CBA made a decision, in the words of Mr van Horen, to sort out CreditCard Plus insurance first and then move on to the other insurance product. CBA decided, again in the words of Mr van Horen, to prioritise the CreditCard Plus insurance matter on an assumption, which proved to be mistaken, that the scale of the issues in relation to the loan protection product would be less than for the CreditCard Plus insurance product.

Approximately two years after CBA changed its sales scripts for the loan protection product to introduce a knock-out question, when CBA said it was preparing to notify ASIC of the issue with that product, ASIC raised the issue with CBA as a result of a customer complaint about being sold loan protection product when the customer did not meet the employment eligibility criterion. That customer complaint had resulted in an ex gratia payment from CBA. The quantum of the ex gratia payment and the circumstances of that payment are not known. At ASICs request CBA thereafter made a significant breach notification under section 912D of the Corporations Act in October 2017, about two years after the sales scripts had been changed. In that notification, CBA and Colonial Mutual accepted that they had breached the efficiently, honestly and fairly obligation, being a condition of their financial services licence.

As things have transpired, CBAs estimate is that the loan protection product issue has affected a far greater number of customers than the CreditCard Plus insurance issue. As at 5 March this year, CBA estimated that it would be communicating with approximately 140,000 customers in relation to the loan protection product issue. In its initial submission to this Commission dated 29 January 2018, CBA had told the Commission that it had identified only 20,000 customers eligible for refunds. Shortly prior to the commencement of these hearings, CBA decided to cease selling CCP insurance and to stop selling the personal loan protection stream of the loan protection product.

Mr van Horen accepted that CBA made this decision at least in part because the products would not be economically viable after the implementation of a deferred sales model which was expected to extend from credit card sales to personal loan sales. CBA intends to continue to sell the home loan protection stream of the loan protection product, which is the most profitable of each of the products. On the

evidence, it is open to the Commissioner to make the following findings of misconduct against CBA and against its wholly-owned subsidiary, Colonial Mutual, which issued the policies. First, CBA and CommInsure, Colonial Mutual breached their statutory obligations under section 912A(1)(a) of the Corporations Act to do all
5 things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly.

Second, CBA and CommInsure breached their obligations under section 912D of the Corporations Act to provide a written report to ASIC when they realised that
10 CreditCard Plus insurance and loan protection product insurance had been sold to customers who did not meet the employment eligibility criterion, on the basis that that was a breach of the efficient, honestly and fairly obligation. The obligation to report that breach arose within 10 days after becoming aware of the issues in 2015. Third, CBA failed to comply with the Banking Code of Practice. In particular, CBA
15 failed to comply with the obligation in clause 3.2 of the Code to act fairly and reasonably towards its customers – excuse me – in a consistent and ethical manner. On the evidence, it’s also open to the Commissioner to make findings of conduct by CBA that fell below community standards and expectations - - -

20 THE COMMISSIONER: Is it open for me to mind there was misleading and deceptive conduct? Selling a product to someone in the circumstances that they are not eligible to claim a significant benefit available under the product?

MS ORR: The - - -
25

THE COMMISSIONER: No doubt CBA will say an answer is to be found in the product disclosure statement.

MS ORR: Yes.
30

THE COMMISSIONER: Yes. Is there an issue whether that’s a complete answer?

MS ORR: Yes, there is, Commissioner. But that is the issue that we identified, that deep within the product disclosure statement the customer would find these
35 exclusions. ASIC had, as I indicated, made recommendations about the importance, with these particular types of products, of highlighting for the customer the exclusions, and that was not done.

THE COMMISSIONER: Well, I will need to go back and read Ms Savidis’
40 evidence quite closely in this respect and, therefore, what I’m about to say is not intended as an accurate representation of her evidence, but someone says to a customer, “You need this to help you if you hit hard times, it will help you pay off your debt or if you die or you are totally or permanently disabled, it will give you a moratorium or it will pay the minimum payments”, whatever the benefit was, “If
45 you’re out of work for a few months.” I would have thought there’s an issue there whether there’s not M and D.

MS ORR: Certainly in the case of Ms Savidis we think that there is, Commissioner, because the evidence given by Ms Savidis about the conversation that she had with the person in the branch in which she was told that it was good for her and that, despite the fact that she was unemployed, it would be useful in some way for her to
5 have the product that, we say, is evidence that yields a potential finding of misleading and deceptive conduct.

THE COMMISSIONER: A rather more general issue which is not, I think, on the table yet, but which is useful to flag, is you have all this detailed regulation. We
10 inevitably and necessarily get down into the weeds of the particular provisions, and we look at whether this paragraph of this provision applies or not. But lying behind them there are some very general norms of conduct, and a general norm of conduct often worth close examination is corporations shall not in trade or commerce engage
15 in conduct that is misleading or deceptive or is likely to mislead or deceive. And that's replicated in the ASIC Act and many other Acts, but that high level "don't mislead or deceive your customers" is a, often enough, important point of entry into consideration of issues.

MS ORR: We would say that another norm of conduct that sits behind this, and is
20 relevant to this, is the norm of conduct reflected in the clause of the Banking Code of Practice that I read out, which is the requirement to act fairly and reasonably towards customers in a consistent and ethical manner.

THE COMMISSIONER: And, of course, statutorily there's the honest, efficient,
25 fair provision

MS ORR: Yes.

THE COMMISSIONER: And I rather suspect we could have an hour or two
30 debating what the differences are, if any - - -

MS ORR: Yes.

THE COMMISSIONER: - - - that emerge from the differing formulae that are used,
35 but the bottom line is: be honest, be fair to your customers. One's a statutory obligation, the other's an obligation that's voluntarily assumed by membership of the - or adoption of the relevant code.

MS ORR: That's right.
40

THE COMMISSIONER: Yes.

MS ORR: We were moving, Commissioner, to findings - - -

45 THE COMMISSIONER: Before you were rudely interrupted, you were moving to?

MS ORR: We were moving, Commissioner, to findings that we say are open on the basis that CBAs conduct fell below community standards and expectations. We say first that, having become aware that CreditCard Plus insurance was being sold to customers who didn't meet the employment eligibility criterion, CBA failed to
5 introduce a knock-out question to the online credit card application form to prevent the sale of the product online to people who didn't meet the employment eligibility criterion. It took almost two years before this occurred.

10 In addition, having become aware that the loan protection product was also being sold to customers who didn't meet the employment eligibility criterion in 2015, CBA again failed to produce a knock-out question to the online form to prevent the sale of the product, again for approximately two years. Second, having become aware that the loan protection product was being sold to people who didn't meet the
15 obligation to make a significant breach report to ASIC under section 912D, but it failed to notify ASIC of the problem in any way until ASIC approached CBA with a customer complaint approximately two years later. So we draw a distinction there between the good governance notification that occurred in relation to the CreditCard Plus product and the lack of any notification in relation to the loan protection
20 product.

Third, CBA took over a year to agree to implement a remediation program that was acceptable to ASIC in order to compensate customers who had been sold CreditCard Plus insurance when they didn't meet the employment eligibility criterion. Fourth,
25 the sales scripts that CBA requires its staff members to use when selling these products in assisted channels explicitly – Commissioner may recall, explicitly invite CBA staff members to attempt to overcome the customer's objections up to two times during the entire application. That, again, is conduct that we say falls below community standards and expectations.
30

THE COMMISSIONER: Can I just embroider a little. Remediation.

MS ORR: Yes.

35 THE COMMISSIONER: Community standards and expectations, is anything to be made of the fact that there seems to be repeated steps in the negotiation: not only does it take a long time, but there seem to be a number of steps along the way.

40 MS ORR: Yes. The incremental nature of the negotiations, and the fact that CBA moved a small amount, then another small amount, then another small amount, adds, we say, to the conduct falling below community standards and expectations, particularly bearing in mind that the position from which CBA started was to offer no form of remediation to any customer.

45 THE COMMISSIONER: Well, the question includes: is there a community standard, an expectation that, confronted with an issue like this, a financial services entity will front up and accept it pretty promptly, and then set about fixing it pretty

promptly? Now, that's a pretty broad-axed description, and I'm sure that those who are interested in these matters, obviously particularly Commonwealth Bank but perhaps other entities more generally, would say that a much finer blade needs to be taken to the issue than the broad-axe I've just described. But the basic question is:
5 does the community expect financial service entities who are faced with allegations of inappropriate conduct, in effect face up to it, accept it, fix it, quickly?

MS ORR: In our submission, the community expects financial services entities in these situations to firstly, fix the problem; secondly, compensate the customer for
10 any detriment caused to the customer as a result of the problem; and thirdly, to do so in a timely fashion.

THE COMMISSIONER: Yes. Much more elegant than my broad axe, Ms Orr. Go
15 on.

MS ORR: Not at all. We say, Commissioner, that on the evidence it's open to find that CBAs misconduct in connection with the sale of the CreditCard Plus insurance and loan protection product insurance can be attributed to a culture and processes within CBA that permitted such misconduct to occur. In particular, we note that
20 CBAs processes required its staff members to attempt to sell CreditCard Plus insurance as part of the credit card application process, and to attempt to sell loan protection product as part of the application process for a home loan or a personal loan. CBA processes did not require its staff members to highlight the major exclusions of the two types of policy, despite the recommendations of ASIC that
25 CBA do so approximately two years earlier.

In our submission, it's open to the Commissioner to find that CBA did not effectively and adequately respond to the potential detriment suffered by customers who were sold these products in circumstances where they didn't meet the eligibility criterion.
30 CBA was not proactive in the approach that it took to remediating customers who suffered detriment, and as we have already discussed, Commissioner, CBAs negotiations with ASIC about remediation were protracted and involved ASIC pressing CBA a number of times to extend the scope and reconsider the form of any proposed remediation program.
35

In relation to customers who suffered detriment as a result of the sale of the loan protection product, CBA elected not to attempt to identify them or address the detriment they had suffered until the issues with the CreditCard Plus insurance product had been resolved, some two years later. Mr van Horen accepted that this
40 was, at least in part, based on an assumption that CBA could compensate those customers at a later point in time.

THE COMMISSIONER: Well, the premise seemed to be that CBA could cope with one thing at a time, not two things. I would be interested in CBAs submission about
45 that.

MS ORR: The questions that we pose, Commissioner, for written submissions by any party with leave to appear that arise from this case study are as follows: first, are the processes that financial services licensees have in place for the sale of add-on insurance sufficient to ensure that those entities comply with their obligations under section 912A(1)(a) of the Corporations Act, the obligation to do all things necessary to ensure efficiently, honestly and fairly?

Second, are existing legal mechanisms considered in light of the regulatory changes which are anticipated to come into effect under the deferred sales model sufficient to address the issues associated with the sale of add-on insurance to customers identified by ASIC in its report 256? Third, how do financial services licensees ensure – this is a question we posed in another case study as well – that they comply with their obligation under section 912D of the Corporations Act in relation to reporting significant breaches? Commissioner, I see that we’re already past 4 o’clock.

THE COMMISSIONER: Yes.

MS ORR: And in anticipation – I’m sorry.

THE COMMISSIONER: Yes. Can I just – while we’re talking about general issues arising out of add-on insurance - - -

MS ORR: Yes.

THE COMMISSIONER: - - - other parties might also be good enough to address a question which can be framed at its most general as what am I to make of the fact that CBA has chosen to withdraw from this – or from large parts of this market? Am I to make of that that CBA has made a particular commercial judgment which is distinctive to CBA, or am I to make of that anything about whether other entities can or should be looking at their continued participation in that market? That is, do other entities want to be heard to say, “Look, what CBA has done is a matter wholly for CBA. It’s absolutely irrelevant to what we do.”

Or is it an observation that CBA has got out of large parts of this market that I might take into account in deciding whether other financial entities, could, should, might, look carefully at either participating at all or participating only in certain ways or participating only with certain particular ring fences around them? Now, you were pointing to the time, Ms Orr. We’ve still got how many case studies to go?

MS ORR: Still have the last few days of case studies to go, Commissioner, but in anticipation of potentially running out of time we have prepared our submissions, our closing submissions in relation to those case studies, in writing. And we would be happy to make those submissions available to the parties.

THE COMMISSIONER: So long as the parties don’t run away with the idea that somehow these last few days are to be treated as sort of B grade, second-class, less

important than those matters you've addressed orally, the fact that we resort to writing simply might tell you a deal about my stamina, Ms Orr. So what arrangements can we make to get copies of the balance of the subs - - -

5 MS ORR: We can upload the written submissions to the court book, to the online court book immediately.

THE COMMISSIONER: Right. So the parties can get access - - -

10 MS ORR: They will then be available - - -

THE COMMISSIONER: - - - to them before close of business tonight.

MS ORR: Yes, Commissioner.

15

THE COMMISSIONER: So the timetable set can stay in cement.

MS ORR: Yes, Commissioner. Yes.

20 THE COMMISSIONER: There we are. Well, thank you very much, Ms Orr, for your submissions. I'm sorry that my stamina should prove to be finite. I suspect the stamina of all in the room may have proved to be finite. May I thank all who have participated in round 1 in the various respects for their contributions to it. As I have announced earlier, round 2 of hearings is planned to commence on 16 April, and at
25 least it is intended that it should be conducted in this courtroom commencing on 16 April next. I will adjourn the Commission until 16 April at 0945.

MATTER ADJOURNED at 4.09 pm UNTIL MONDAY, 16 APRIL 2018

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