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TRANSCRIPT OF PROCEEDINGS

O/N H-896298

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, WEDNESDAY, 23 MAY 2018

Continued from 22.5.18

DAY 22

MS R. ORR QC appears with MR M. HODGE QC, MR A. DINELLI and MS E. DIAS as Counsel Assisting with MS C. SCHNEIDER
MS P. NESKOVCIN appears with MR J. ARNOTT and MS A. SMITH for Westpac
DR M. COLLINS QC appears with DR M. RUSH and MS E.A. BENNETT for ANZ
MR N. HUTLEY SC appears with MR B.A. McLACHLAN and MR T.M. DOWLING for Bank of Queensland

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner. Commissioner, we will continue now with the evidence of Ms Gibson.

THE COMMISSIONER: Yes.

MR HODGE: So if Ms Gibson could return to the witness box.

THE COMMISSIONER: Thank you very much, Ms Gibson.

<KATE GRIFFITHS GIBSON, ON FORMER AFFIRMATION [9.45 am]

<CROSS-EXAMINATION BY MR HODGE

MR HODGE: Thank you, Commissioner.

THE COMMISSIONER: Yes.

MR HODGE: Ms Gibson, we were exploring at the end of yesterday afternoon some issues that touch on the question that I want to explore more fully with you this morning, and that is at what point in time the bank has to say, "This is just the personal responsibility of the borrowers", in order to make the decision that they're going to make to enter into this business loan. And I want to explore two different elements of that with you: (1) is some issues in relation to whether just looking at the documents there will be questions that would be raised in the mind of the banker as to whether it made a lot of sense to enter into this business, and we will come to that second. The first thing that I want to deal with is a more direct issue for the – from the perspective of the banker, which is assessing cash flow and the projected cash flow and how the banker ought to go about doing that. So with that introduction, can we bring back up the document which is tab 30 to your statement, and if we go to page .0034 – I'm sorry. It's ANZ.800.534.0034. Do you recall we were looking at this document yesterday, and the things that we observed were that the projected cash flows and profit and loss forecasts are said to be based on the existing store sales?---Yes.

And you had identified that it's unclear what that means, in the sense that it's unclear whether that means they've taken foot traffic in some other stores and then somehow projected that over into Australia, whether they've just directly imported sales from some other stores, or how exactly they've gone about this exercise?---Yes, I – I don't see that in here.

And we had agreed, I think, that there's no indication on the face of the documents that you've reviewed that this is something that was delved into or explained in writing by either the franchisor or the borrowers?---I haven't been able to see that, no.

Okay. And your expectation would be, as I understand it, that for the banker, and also the credit officer responsible for assessing this, that they would make some assessment as to whether the loan could be repaid, based on the forecast cash flows?---Yes.

And what I would like to understand is what would you expect the diligent and prudent banker to do in a case such as this in assessing the reliability of the cash flows?---My expectation is that they would have looked for indications that they – the business plan had taken into account appropriate expenses, that they would have looked at the revenue, and had some understanding of how the revenue had been arrived at, and that they would look for obvious signs that it hadn't been thought through in the context of how the business would operate, and the most common thing there is if you don't see seasonality in the revenue figure, for instance, then that would be a flag that that's not really a cash flow forecast; that's more of a budget.

And so in this case, where we just look at the monthly sales trend and see it's up in January, and the hottest month, it's down in June and July, the coldest month, that's, at least, something that indicates seasonality?---Yes.

And would that be sufficient then, in your view, for a banker to be satisfied that there were no obvious signs that there were problems with the cash flows?---I – I think so, yes.

Okay. And in terms of the source data that was involved, would you expect that the banker – or the credit officer would make a request for the source data?---Not specifically, no. I would – as I said, I would expect them to have had a conversation with the customer about the business plan. As to asking for the underlying source data, they might ask for that, but I don't see it's – it's mandatory to do so.

THE COMMISSIONER: I'm sorry, can I ask you to keep your voice up a bit further?---I'm sorry, Commissioner. Yes.

Thank you.

MR HODGE: I think you – what I heard you to say then was you don't think it's mandatory for them to do so; is that right?---I think the – what I was trying to convey is what – what is being done by the credit officer is an exercise in judgment. They need to form an opinion. We provide guidance on the sorts of things we think they should take into account, but we're not prescriptive about exactly what has to be sourced beyond saying that they do need to provide a business plan, they do need to provide cash flow forecasts, and the bank officer and credit officer need to have formed an opinion that they're reasonable.

And so if we – can we put this document on one side of the screen and bring up on the other side of the screen exhibit number 5, which is ANZ.800.399.3292, and can we go to the second page. So you recall we looked at this document yesterday, Ms Gibson. This is the credit principles that ANZ applies?---Yes.

And I recall you made the point yesterday this applies effectively to all credit that ANZ is offering?---This is a group-wide policy, yes.

And it would have applied to this particular lending that we're talking about in this case as well?---The – at a principle level, yes.

All right. And in relation to – for business lending, you will recall we looked at the point which was for business lending:

> *Understand the drivers of the customer's cash flow, considering the impact of a customer's business and economic environment on cash flow, and then analyse historical financial data and assess projected cash flow as the primary repayment source.*

As I understand it, your view is what was done in this case in relation to this projected cash flow was sufficient to follow the requirements of the credit policy?---I think so. I think that the challenge in answering that question is I don't have notes as to what the conversation was between the banker and the customer, but on the face of what I've seen, I – I think that they were forming an opinion, yes.

Well – and I just – obviously, as you say, you're not involved in this. You're coming to attempt to reconstruct this later and, no doubt, you have to do that a lot, you have to go back and look at credit decisions that have been made at different times to try to understand what it is that has happened?---The bank does. I don't personally do this on a frequent basis, no.

Well, if we just think for a moment about what seems to be a critical fact in this cash flow, which is it's based on existing store sales, and, as – you made various points yesterday about the uncertainty as to what that means, is that something that it would be expected that a banker making the judgment or forming the opinion about whether credit should be given, should press down on before being satisfied that the cash flows are legitimate?---I think that the – the banker needs to have established in their own mind that there has been a basis for how the revenue figures have been arrived at. I think that in the case of a cash flow like this where there's a franchisor that is saying that they've used existing store sales, albeit from a different jurisdiction as the basis, then they have some basis for forming an opinion this is – is based in fact. I personally would have preferred to see the data and the detailed assumptions, but that's my personal opinion, and I – I can't say what the banker did or didn't do in this circumstance.

So what you've identified is one way that you might go about testing this, and what would be your preferred way, which is to get more detailed data and understand the assumptions that have gone into this document; that would be one way?---That would be one way, yes.

Another way of doing it would be to benchmark what was put forward against other available information?---You could, if you had other available information, yes.

And that was what FOS said ought to happen – ought to have happened?---FOS did say that we should have benchmarked against applicable ratios. The ATO ratios that are provided are ratios that talk to particular expense lines as a percentage of turnover. And they are presented in – in three categories or three ranges of turnover, but they don't actually provide benchmarks as to what the turnover figure itself could be expected to be.

I understand, and your point is they don't tell you whether or not this amount of store sales is a realistic figure or not for what would be made by a Westpac – I'm sorry, a Westfield kiosk?---No.

So the only way that you could really delve into and understand whether or not the store sales represented a realistic assessment of sales would be to unpack and understand the assumptions behind the projections?---That would be one way. You could do – you could, if you had access to other comparable businesses, you could look at what revenue levels they were achieving. You could do the sort of back of the envelope test that the Commissioner was discussing yesterday. So there are other ways of forming an opinion, and with a start-up business, that's what you need to do because you don't have historical operating figures to project from.

I understand. And I don't think – I'm not trying to suggest to you there should be some mandatory requirement. I think you've used that word a few times, "mandatory requirement". What I just want to understand is, you're a very experienced person within the bank and very experienced in relation to dealing with small business lending, and I want you to assist the Commissioner to understand, from your perspective, as somebody who is very careful and obviously over the detail, what is to be expected of the prudent and diligent banker in going about assessing this? And I think – I could be wrong but I think what you're saying is you can't see, on the face of the documents that are within ANZs records, that the banker – sorry, take the banker first, the banker has done the things that you would expect a prudent and diligent banker to do?---I – I can't see that they have done any analysis of the underlying assumptions for the revenue, no.

And similarly, when it comes to the credit officer, you can't see that the credit officer, on the documents that ANZ has, has done the things that you would expect a prudent and diligent banker to do?---I can't see that the credit officer has done any of those assumption testing either, no.

But your point, I think, to be fair to you, is maybe somebody did them and they just didn't write it down?---They may have. I think, also, coming back to – there were a number of people involved in this transaction, and I think that the – look, I don't know what conversations occurred, and – and I'm not seeing any evidence in the file notes of what conversations may have occurred on the topic, no.

All right. And then if we can then, for a moment, step away from sales and just think about the next point that you raised, which is expenses and benchmarking. Again, presumably there are different ways that a banker could be expected to form a view as to whether the projected costs were reasonable or not?---Well, I would expect them to look at what costs had been included, yes, and – and form a view about it.

And one way would be to do what FOS suggested, which is to use a benchmark available from the ATO?---Yes, you could use a benchmark from the ATO to – to form a view about whether the assumption was in line with that benchmark, yes.

And we can go to the detail if it would help you, or go to the documents if it would help you, but I suspect you know these things from memory. You know that the business plan predicted a ratio of expenses to turnover of 68 per cent?---Actually, no, I didn't remember that number, sorry.

That's all right. Well, I'm sorry, Ms Gibson, that's not a criticism of you?---Sorry.

You seem to have every detail at your fingertips. Can we just bring up tab 62 of the exhibits to Ms Gibson's documents. And this is – this is the FOS recommendation. If we go to page .1652. You will see on the – at the top of the page under section 3.3, "expenses/turnover" under the industry benchmark which comes from the ATO is 84 to 93 per cent, but under the business plan, it's 68 per cent?---Yes.

And that would be one way in which a very – one would think a very quick way in which a banker might look at a profit and loss and say, "Does this look right compared to industry benchmarks"?---They could certainly look at it and see whether or not the assumptions, you know, fell in the average for the industry, yes.

In this case, they fall significantly out – away from the average, don't they?---Yes, they're outside the range.

And – that's right. They're outside the range and they're also outside – significantly away from what the average is?---Yes.

200 basis points, aren't they, from the - - -?---I haven't – I have to say, I looked more at the COGS and the – the expense to turnover ratio, but yes.

And I just want to – I'm sorry, I said 200. It's 2000 basis points?---It's 20 per cent, I think it's probably easier just to say that.

The – so the point that we're trying to get at here is to understand your view, which is there is no need to do this?---I – I'm not sure that I'm saying that there's no need to do it. I'm just saying that it – I don't believe it's a requirement that you have to reset the cash flows to the industry benchmark in order for that to be reasonable. I think if – if somebody presents to us with a business plan where they're outside the industry benchmarks, you should expect that you have an understanding of why they believe that they can run the business that way. And I also think that in the context of – excuse me – looking at the serviceability, that's one of the reasons that we do stress testing on the – the serviceability.

And the stress testing of the serviceability, though – we will come to that in a moment?---Mmm.

But all of the stress testing of the serviceability in this case involved consideration of the income outside of the business; do you agree?---In terms of what was documented, it was looking at the holistic income, yes.

I think you're agreeing with me, but I will ask my question again. All of the stress testing that has been recorded in writing by ANZ as having been done in this case involved including the income from outside of the business?---Yes.

All right. And there was no stress testing done of looking just at the serviceability of the loan based just on the income of the business?---Not that I've seen recorded in the file, no.

All right. And if we just come back to this question of assessing costs – I want to make sure I've fairly allowed you to explain to the Commissioner your view about it, which is FOS said, "This is a way you could have done it"; you agree?---Yes.

And you're not disagreeing that that's a way you could have done it?---No.

You're saying there's no requirement that you do it that way?---I'm saying that FOS said we could have done that and should have done that, and the fact that we didn't do it meant that the loan had been – was irresponsible, in their opinion. I'm saying it is a way it could be done, and I don't think that it – it should be mandatory that you use that as – for every application that comes through the door. It's a distinction. You can do it. I'm just saying I don't think that it has to be done in every instance.

Thank you. And perhaps then, again, just to be fair to you, to make sure I haven't – I don't say something in closing that unfairly portrays your evidence, you don't suggest, though, that there's anything that you can see in writing on the ANZ file that shows that ANZ has otherwise done something, other than using benchmarks, to satisfy itself or to act as the prudent and diligent banker in assessing serviceability?---There is a note by the assessor in the assessment notes where she has, I believe, thought about the total expenses as a per cent of sales and formed a view that it seemed reasonable. That is – it's been calculated off a sales figure that was incorrectly entered, and so I think that the assessor did take a step of thinking about whether or not the expenses looked reasonable, but standing back, in hindsight, looking at it, she was doing that from a data point that was incorrect.

All right. Now, then, we spoke a little bit about the methods of serviceability, and I just want to go and deal with that now. You know that one of the issues that FOS raised was that ANZ had relied on the director's personal income – or one of the director's personal income to fund the loan if the company could not meet its obligations?---Yes.

And as I understand it, and I think as you understand it, FOS found that that was, itself, a breach of ANZs obligations of due care and skill under the Code of Banking Practice?---Yes. I believe that was their finding.

And this – as you may get a bit confused, I think, in the way that it gets put together and some questions that I've already asked you. You have a criticism of FOS' approach in the way that it deals with guarantor's income. Can you just explain to the Commission that criticism?---Are you – are you referring to my statement?

Yes?---The – what is on my statement? The concern that I had with respect to the way that FOS – or my understanding of what FOS was saying should have been done is that we should have – beyond considering what a bank would term a first way out, which is that we had to form a view that the company could afford the loan, and we had a view that they could. We then need to give regard to what would happen if they were in default, and we were to rely on the guarantee that the directors had provided. FOS' view seemed to be that because there was no tangible security that was sufficient to extinguish the liability, that second way out would rely on the income that was available to make the bank's – the payments on the bank loan. And that in considering that serviceability, we should have regard to that individual director being able to afford all of their personal commitments and the entirety of the business loan. My concern – and that if that wasn't demonstrable, then that would be irresponsible and we should not have extended the loan, or at least not taken the guarantee. My concern with that approach is that when you are lending to a business, and particularly a small business, I – we have a policy at ANZ of requiring guarantees from each of the directors, and that reflects the fact that the – in most cases, the directors are also the owners and are often the managers as well. And so in order to understand the true debt servicing capacity of a business, you do need to give regard to all of the entities that have a right to those cash flows and control of those cash flows. That's why we take – that's one of the reasons we take guarantees from directors. And then we look at the capacity to service holistically for all of the directors and the borrowing entity which, in this case, was the company. So – and that's – that's why we have included the husband's income and the consumer liabilities in that calculation. If – when we looked at the stress test, if you like, or the – the – I think what the assessor termed the break-even, she was looking at what would happen if the company was stressed. She – I suppose collectively did that by reducing the profit generated by the business to zero, and reducing the salary that the owner would take to 25,000, rather than 50,000, and then she combined that with the directors' income, and expenses to look at it. My understanding of what FOS is saying is that you don't have an asset, you go to the income. If you don't have an income that's sufficient to cover all of the family's expenses and the business loan, you shouldn't lend. And that would mean that somebody who wanted to start a business who didn't have a tangible security and didn't have a partner with an income sufficient to cover the business debt and all of the family expenses, would not be able to get a loan.

This is quite an important point and I want to try to break it down in a way that I hope will be of assistance to the Commissioner. You've referred to an idea within ANZ which is there has to be two ways out, or at least two ways out?---Yes. We talk about that in the credit principles as well, yes.

And the first way out is that the company should be able to, from its income, service the loan?---Yes.

And should be clear when we talk about a way out, that's effectively ANZs way out of a loan; how is its loan going to be paid out?---Yes, it is how do we form an opinion that the borrower can actually repay the loan.

And the first way out, as we say, is the borrower, in this case the company is going to be able to repay the loan?---Yes.

And the second way out is only relevant if the borrower can't repay the loan out of the borrower's – out of the borrower's income?---Yes.

And the second way out in this case and in many small business loans is going to be by recourse to the income or assets of a guarantor?---Yes.

And, typically, ANZ would require the directors of the borrower to give a guarantee?---The directors – if the borrower is a company, then yes.

And in this case, the two directors were the husband and wife?---Yes.

And the second way out then for ANZ would be by recourse to the assets of the husband and wife that were secured by the guarantees?---The guarantees are – the directors' guarantees are – it's up to the guarantor to decide which assets or income that they would use, but yes, we have recourse to the directors' guarantee that they take on the obligation to – to pay the loan back.

And one way of reading FOS's determination, and I think the way that you read it, also the way I read it, is that FOS was suggesting that just with respect to that second way out, ANZ also ought to have been satisfied that the income of one of the directors, in this case, the husband, would be sufficient by itself to service the loan?---Yes.

And pay the family's expenses?---Yes, that's how I read it.

And that director wasn't working or wasn't going to be working in the business of the borrower, or not full-time?---He wasn't going to be drawing an income as – based on the plan, no.

They were – it appears as if FOS was suggesting that it would be necessary – that the relevant income for that second way out would be his income from an unrelated occupation?---Yes.

And the point that you're making is if that was really what was required of a bank, then that would have a very significant and detrimental effect on the ability of small businesses to get credit?---I think it's difficult to say exactly how significant and detrimental it would be but I think that if – if banks accepted that definition, then we would have to look at these – these applications, and in the absence of there being, you know, a – an income available to service the debt in the event of default, under FOS' definition then we shouldn't lend. And I have to say, I believe that we do lend in those circumstances. I believe there are probably many small businesses who get funding in those circumstances who could be assumed not to be able to access that if that was the case. So I do believe it would have a negative impact.

Let's just, again to help the Commissioner, see just how wide the potential negative impact effect could be. The situation we are dealing with is a husband and wife?---Yes.

And in that case, if the husband and wife are guarantors and directors of the company that's starting the business, but one of them is going to work in the business, then at least there's an income outside of the business?---Yes.

And the significant restriction that this would place on the availability of credit in that sort of circumstance is that unless one spouse had an income from a separate occupation sufficiently high to not only cover the family's living expenses, but also to cover the full borrowing of the business, then seemingly, on FOS' approach, the bank would be unable to lend?---That – that's my interpretation of it, yes.

And how that would apply then, if it wasn't a couple, if it was just an individual wanting to start a business, but offering up their home as security is unclear?---Well, my – my understanding is if – you know, if you had an individual who was single, who had not, at that point in their life, accumulated sufficient assets to be able to offer security equal to the loan that they were requesting, clearly, they wouldn't have an income outside the business if they were going to be working full-time in it, and, therefore, I'm not sure how you could say that you had met FOS's expectation. And so I'm not entirely clear how you would lend to a person who didn't have a spouse or assets.

And - - -

THE COMMISSIONER: If I just understand what you believe FOS' expectation to be, is that an expectation to service the debt or to repay the debt?---On my reading of it, they – and, look, I haven't – my reading of it was they said there wasn't sufficient equity in the second residential mortgage, and, therefore, we were giving regard to the income to service the debt and, therefore, that – that's what they were talking about, that we – they didn't believe that we had considered that director's capacity to pay for all of the family's expenses and the business debt.

And service the debt or - - -?---Servicing the debt.

Service not repay?---Yes, not repay. Well – yes, not repay in full at that time, but service the debt, yes.

Yes.

MR HODGE: And your – to summarise then, your point is that's just if that's what FOS' determination means, then that's just not something that seem – that seems to go well beyond what could be expected of the prudent and diligent banker? Sorry, go on?---In the context of small business, I suppose the skill and care of a prudent banker to me is what the bank as a whole is doing, and, therefore, the risk appetite that the bank has is part of – of that – my estimation. And it would imply – if we as a bank say that we have got risk appetite to support small business owners in that situation, and FOS is saying that that's contrary to the code, then I – I think that's problematic, yes.

Now, having made these criticisms of what is, perhaps, the interpretation of FOS and the uncommercial interpretation of FOS, there was a circumstance that led into that, wasn't there, in this case, which was that on the documents, the only serviceability assessments that ANZ had done included the personal income of the husband?---As one of the directors, yes.

And so it's possible that this is, really – I should be clear about this so it's not meant as a general criticism of FOS' approach – it's possible that this is just a particular case linked to the particular way in which ANZ went about assessing serviceability in this case?---I'm sorry, I'm not entirely sure I understand your question.

Well, you haven't seen other cases where FOS has said for the second way out, for the security offered for a loan, it's necessary that there be a second income outside of the business capable of servicing the loan?---I haven't, but I did read the determination, and in the determination, they say that they are making that determination with reference to other cases, and so my – my, I suppose, assumption is that they are making this determination with – with reference to how they think about this generally.

All right. And can I – because I think this is quite helpful for the Commissioner – is there any other – apart from the two types of circumstances we've talked about, which is a couple, and the difficulties that would be created if a couple were trying to borrow and an individual, and the difficulties would be created if an individual was trying to borrow because the individual doesn't have any other income, are there any other observations you want to make about the problems that would be – that would arise if it was necessary to factor in the ability of a guarantor on the guarantor's own income to service the loan?---I think with regards to the income, no, that was the main concern that I had.

Now, when we're dealing with guarantors, can I ask about ANZs approach to parental guarantees; are you familiar with that?---To the extent that it is discussed in – in the small business credit guidelines, I am.

Okay. Is there a distinction, do you think, between a parent guaranteeing a child's borrowings, business borrowings as compared with a husband and wife, or two partners where one of the – where one of the spouses is, effectively, the controller of the borrowing?---I think that there are differences. I think that our concern with respect to guarantees is to understand whether someone who is providing a guarantee is actually getting a financial benefit from the loan, and that would put them in a – in a different category, I think, in our minds. I think we're – and I'm sorry. I'm going from memory here and I probably should go to the policy, but I'm pretty sure that we are clear that if it is obvious that the guarantor is not involved in the business, that we should be ensuring that that is understood by the guarantor, and that they should be getting legal advice.

Sorry, if the guarantor isn't receiving any benefit, did you say?---If – if the guarantor is not involved in the business and can't be seen to be getting benefit from the business, then it's our expectation that that puts them into a higher risk category, and that the banker would need to ensure that they had advised them that they should be getting independent legal advice.

Yes. So if, for example, a parent wasn't a director or a shareholder of a company controlled by a child that was making a borrowing, but the parent offered a guarantee, that wouldn't, necessarily, mean the guarantee couldn't be accepted. It would just mean that extra care needed to be taken with respect to the guarantee?---Yes, I don't think that we would seek to exclude the ability of parents to guarantee their children's loan.

And business loans, in particular?---Business loans, yes.

All right. Now, I want to then look at the serviceability assessment - - -

THE COMMISSIONER: Just before we leave the question of parental guarantees, there may be a number of considerations at play here, and I just wanted to understand them better than I do. Would you accept that there are cases where a parent's decision to guarantee a loan made to a child is dictated by considerations other than commercial considerations?---Yes, I would.

The parent is concerned to – or the parent provides the guarantee as a sign of support for or endorsement of the child's ambition?---Yes, I think that's reasonable.

And that, at least in some closely held proprietary companies, being a guarantor – being a guarantor – being a director or a shareholder may not tell you much about whether that person has any realistic prospect of standing to benefit commercially from the transactions the company makes?---I think it is – you have to look at each case on a case-by-case basis.

I went back to reread this morning the Garcia's case, 1997/98. Mrs Garcia was a director and a shareholder of – what was it called – Citizens Gold or something. So I think being a director and a shareholder may not be conclusive of it. There we are. I'm just revisiting my past, Ms Gibson. Don't worry about that?---But I think, Commissioner, the point that you're making – and I haven't read the case in question – but the point you're making that somebody can be a shareholder or a director on paper in a family business and not necessarily be heavily involved in the business is a fair point. And you need to understand who is going to be involved in the business and what understanding anyone who is signing up to a loan has of what they're signing up to.

MR HODGE: And that's – and I think, to be fair to you, if we bring up ANZs credit – small business credit requirements which is exhibit 7 or tab 7 to your documents, ANZ.800.497.5048, and go to the page ending .5135, and there's this section dealing with guarantors requiring independent advice. And the ANZ policy is:

> *A guarantor will require independent advice if he or she is an individual in a special relationship of dependence with the borrower.*

And then you will see a little down the page:

> *Some of the circumstances that may indicate that the guarantor does require independent advice include –*

and then the second bullet point:

> *Relatives, including parents, guaranteeing business facilities, where they have no financial interest in the business.*

And that's the point you're making, that in that circumstance, what ANZ would expect to happen is that they get independent legal advice?---Yes.

And then the question becomes what does that actually mean, what is – how much advice is required, and do you have a view about that?---My personal view is that they should take the information to a lawyer and have the lawyer advise them on what the legal implications are of signing up.

And do you think it would be a problem for ANZ to provide to the guarantor and also to, therefore, the lawyer providing advice, detailed information about ANZs credit assessment of the borrower?---It depends what you mean by "detailed". Like, we are quite prescriptive about the information that needs to be made available to a guarantor. I think it is set out in one of my exhibits. I just can't recall at the moment where.

For example, I will just see if we can turn this up, but ANZ makes a calculation of the serviceability of the loan, and it does that in order to assess the risk to it, that its first way out is available?---I think you might be referring to the uncommitted monthly income amount that we need to see that that's a positive number in order to see that it can be serviced, the loan can be serviced. I don't believe that we make that number available to guarantors, no.

Would it be a problem, do you think, for ANZ to make that information available to guarantors?---I think that that number might end up creating a lot of questions in the mind of the customers that would be complicated to explain, and the reason I say that is that when we calculate the – the UMI, the uncommitted monthly income, we sensitise all of the consumer liabilities by using higher interest rates that mean that a lot of the payments that someone will have declared to us on their application are going to look higher in the – the calculation we do. And – so, I mean, we could provide it, but I suspect it would end up in some reasonably heated conversations with customers about why we were counting expenses higher than they were. I think the thing that is important for the guarantor to understand is what is the information that's been provided to us on which we have made our decision. Whether there is information about the credit history of the borrower that they may or may not be privy to, and I believe that is one of the things that is provided. If they have been defaulting, for instance, then that's disclosed to the guarantor. But I think the UMI is – is an internal calculation, rather than it is a number that we would seek to explain to a guarantor.

And - - -

THE COMMISSIONER: But is the guarantor in a position where, without the borrower's cooperation, the guarantor or the guarantor's advisers could determine serviceability coverage, repayment coverage, issues of that kind?---When you say without the borrower's cooperation, are you referring to if – if the borrower's not sharing with their parent what the details are? Is that – no, I think it's unlikely that a legal adviser could – could do that. I think that the legal adviser would assume that that had been done by the bank or the loan wouldn't be extended in the first place.

MR HODGE: Did you have any more questions - - -

THE COMMISSIONER: No.

MR HODGE: - - - about that topic, Commissioner? Thank you.

I want to return to the business plan document that we were looking at, which is exhibit 30. And I want to look at this document again and now look at it in the context of the second question or issue that I foreshadowed at the beginning, which is about drawing or connected with drawing the line between personal responsibility and the responsibility of the bank. If we go to the page .0010 that we looked at yesterday?---Yes.

Again, you will recall this says that this is a successful New Zealand franchise. Were you able, on your perusal of the document, to find anything that indicated how many New Zealand franchises there were?---In the business plan? No, I wasn't.

All right. Or in what areas of New Zealand they were located?---No, I wasn't.

Or what proportion of stores fell into their – what they describe as their four different types on page ending .0012, retail store, kiosk store, production pod and event pod?---No, I wasn't.

And we looked at a few slightly comical parts of this business plan yesterday. You've obviously seen many – I assume you've seen many more business plans than I have. Does this seem consistent with the type of business plan that you would expect a borrower to put in when starting up a business?---I think I would say that the business plans are many and varied, and there are very different levels of detail in them.

I suppose, what I'd suggest is, looking at this document – and we can, perhaps, most easily, just turn through the pages to see what it's like – if we go to page – the next page, and the next page, and the next page, and the next page, and the next page, and the next page, and the next page, and the next page, and the next page, and the next page. It appears – well, in fact, actually, I'm not even sure that's gelato in that. If you have a look – I think that's a Cornetto - - -?---It does appear to be an ice cream, yes.

But it appears as if this is a document presented – now, it's – we discussed yesterday the issue of has it come from the franchisor or the franchisee, and it appears to have come from the franchisor; you agree?---It looks to me like a template document that the franchisor would use with franchisees and would populate with data specific to the franchisee, but then would reuse, you know, for future business plans.

And can I suggest substantially filled with what looks like clip art; do you agree?---Yes.

And I think to use terminology that you and I were using yesterday, using a lot of very general marketing language to explain what exactly the business is and how it's going to operate?---Yes. I think it could have been more succinct, yes.

And it looks like a marketing pitch rather than a business plan; do you agree?---I think business plans serve multiple purposes and one of them is a marketing document. So it's not surprising that there is an element of that in it.

Do you think that – it's obviously a document that when you looked at, you thought, perhaps, lacked the type of directed detail that you would like in a business plan?---I suppose I have to say I have looked at a lot of business plans, but I have – I have done so outside of small business as well, and I'm not sure that I am necessarily the –

I'm going to look for a lot more detail – I think that that's my nature – than perhaps everyone else is going to.

And I wonder then – and we move into this issue of personal responsibility. Do you think that there's any need or obligation on the banker to raise or query with the borrower whether they really understand what they're getting into and what the success or otherwise is of the franchisor?---I – I do think that the banker should be asking questions about whether or not the person who's going into the business, you know, has – has thought about it, and has – has understood what they're getting into. I do recall seeing notes in – between the assessor and the banker where he says that he has spoken with the applicants and that they do understand what they're getting into. I'm obviously not privy to what exactly those conversations were about. I think that in a situation where applicants are saying that they are going to put, you know, a very significant amount of their own money into a business, it's not unreasonable for a banker to expect that they have thought hard about that investment.

And take some level of personal responsibility for that, rather than expecting somebody else who is not their financial adviser to note problems for them?---Yes.

In your review of the documents, do you think that one of the problems in this case may have been the drive for sales by various people involved in the transaction?---I'm sorry, I'm not entirely sure where you're going.

Well, let me break it down. If we go to the beginning of exhibit number 30, to ANZ.800.534.0041?---The email?

Yes. So this is the chain of emails between the banker and the broker. And you will recall the broker writing to the banker saying:

> *Mate, my neck is on line here. I've lost couple of deals from the franchisor as well. Please let me know. Already explained their consultant ANZ manager and knew this is a deal.*

Unsurprisingly, the broker is obviously pushing to get this loan made and get this potential franchisee into the franchise?---Well, the broker will have met with the customer. The broker has obviously formed an opinion that he believes that the loan should be approved, and the broker's business model is that they are paid commissions on the loans that are done. So yes, he has – you know, if he thinks that the loan should be done, he has an incentive for it to be done.

And then when we move then to the – what happens then between the credit manager and the broker – I'm sorry, the credit manager and the banker, you referred to some file notes. Perhaps if we just bring up one of those, which is KGG-34, and if we go to the page ending in .0145. Sorry, actually, it should be .0144. So this is a section of the document by which the loan is built up setting out the nature of the business?---Yes, in – in the loans – the system that was used by the bankers at the time, they needed to put notes in about the application for the credit officer to refer to.

And so what the banker says to the credit officer is:

> *Just to note a few things. You will see that this particular franchise is a big franchise with over 100 franchise sites in New Zealand and have just started to sell franchises in Australia. This franchise model has been a proven one all over the world with headquarters in New Zealand.*

?---Yes.

And I take it you don't know where that statement came from?---I don't know, no.

And the banker hasn't recorded – hasn't kept any notes or any documents explaining where that statement came from?---He hasn't got any notes about the conversations he had, no.

And then over the page on .0145, the banker says:

> *CTS evident with projections.*

CTS is capacity to service; is that right?---Yes.

And:

> *Projections prepared/given by franchisor based on performance of similar sites in their franchise model based on demographics/traffic.*

?---Yes.

And that statement appears to go well beyond what's contained in the business plan?---Well, it goes beyond, inasmuch as it talks about the demographics and traffic. It - - -

And also that it's done based on the performances of similar sites in the franchise model?---I think when we were looking at that exhibit, it said that it was based on similar store sales. So in that sense, I – I assume that's the extension of what's in the business plan.

I see. But insofar – at least then insofar as it refers then to demographics/traffic, again, the banker hasn't recorded any document or any note explaining what the source of that information is?---No, he hasn't.

All right. And then if we go then to the document which is exhibit 30, ANZ.800.470.0103. And these are the internal notes being made, I think, by the credit assessment officer; is that right?---I believe what this is, is that the notes that are in the SB loans system have been extracted into – because they're not actually able to be read when you look at the screenshot, so they've been extracted into a document to make it easier to read.

But if you've got the unredacted version, you can see who's making the notes. You can't see it on this because it's marked as confidential?---Sorry, I'm just trying to work out which page that is in the – I thought we were in exhibit - - -

Have you got tab 35?---35, sorry. I was in the wrong tab. Yes, sorry.

And you can see the blue highlighted name in your version. That's the credit assessment officer?---Yes.

And if we go over to the end page, .0104, the – you will see the last note:

> *Clients purchasing franchise which is a big franchise with over 100 franchise sites in New Zealand and have just started to sell franchises in Australia.*

This is the credit officer picking up the information that's been provided to him by the banker?---Yes.

And if we go back to the first page, .0103, when he's explaining his approach to the cash flow forecast, he notes this turnover and the net profit after management wages and then he says:

> *Cash flow forecast cannot be tested in this instance.*

Do you understand what that means?---My understanding of what they mean there is that because this is a start-up business, that can't be tested against historical financials.

I see, but it could be tested in other – or could be either explored or tested in other ways we've already talked about today?---Yes.

And then the decision – the finding is:

> *Believe break-even is achievable based on stress test, completed with capacity to service clearly evident based on the husband's continuing PAYG income.*

?---Yes.

And then a slightly more expanded version of that. You see the final note is:

> *Refer comprehensive business plan.*

?---Yes.

Would you expect the credit officer to be slightly more sceptical of the business plan we've seen in this type of case?---As I said before, the reality of business plans that present in the small business space is that they are – are very varied in their content and level of detail, and I think that – notwithstanding, you know, the concerns that you and I have discussed, I think that the bulk of the detail one expects in a business plan is there.

And then if we go to tab 40 – I'm sorry, tab – yes, tab 40. No, 41. ANZ.800.539.0217, and go to page .0263. And this is the capacity to service form that is setting out the different ways in which capacity to service was considered by ANZ in this case?---Yes.

And there's – as I understand it – no consideration done to just the projected income of the business?---It hasn't been recorded. I think, as it said in the notes earlier, the – based on the cash flow forecast projection, serviceability was clearly evident. And so I – I think they just haven't – they haven't gone and recorded that. They've moved straight on to the planning for default scenario, and looking at that.

Well, the planning for default scenario, which I think is called the break-even scenario, is just halving the income from the business and removing – for the wife and removing any of the net profit from the business, and then just using the husband's income?---That's – that's the break-even column, yes.

And one of the problems then with that break-even column is, as you've already noted, it actually leaves out some liabilities?---Yes, it does.

And so then you get over the page to .0264, and the – on that break-even scenario, the uncommitted monthly income is only $586, and that's with some liabilities left out?---Yes.

And do you accept that, insofar as ANZ decided to assess the serviceability of the loan on this break-even scenario and only on the break-even scenario without testing the cash flows, that the consequence is that it failed in this case to exercise the care and diligence – or the diligence and prudence of a prudent banker?---I don't think that this – I don't have a problem with using a break-even like this as a way of stressing the cash flows. I do have a problem that there were liabilities left out of that calculation, but no, I – I think that this is something that the assessors would do. It serves as a way of, I suppose, stressing a number of assumptions at once, particularly if you don't have an actual model to stress them individually.

Well, if we just confine it then to the fact that, as you say, some liabilities have been left out, that means that on this break-even scenario, the consequence is that if you put the liabilities back in, they wouldn't have been able to service the loan?---If you put both of the liabilities in, then it would have been a negative UMI. However, it's a scenario, and so having – I have looked at this, I have brought it up and – and seen what happens when you do put the liabilities in. Certainly, the lease payment which was 485 a month, doesn't take it to negative. The personal overdraft of 7000 would.

However, the assessor may have, if that had occurred, vary the scenario, and if you increase the salary taken by the owner to 30,000, then you're back into positive territory. And so it's not – it's hard to say what would have happened had that been – that been the outcome and they had been in there. The assessor may have exercised their judgment to vary that scenario.

And that – that involves this problem, though, doesn't it: that what's happening in all of those scenarios is that, rather than just focusing on and testing the information that you have about the borrower's income, you're, effectively, treating the borrower's income as something very flexible, and then just adding it to the income of the spouse who's not working in the business?---Well, in – in the case of a company, the income is very flexible. So yes, we are.

But you're doing that in circumstances where you've already concluded, "We can't actually test – or we haven't tried to test the income or projected income of the company"?---Yes, we are. And, look, I did grapple with this and looked at, you know, what – if you were to vary some of those assumptions, you know, what would that look like, but I – that's not the way that the assessor has gone about it, no.

All right. And now I want to just ask you a few questions about incentives in this case. Can we go to exhibit 23 of your statement which is ANZ.800.528.0001. This is the incentive scheme that applied at the relevant time?---No, this was the incentive scheme for the first half of 2014, which goes from October '13 to March '14. There were two incentive – the period when the loan started would have been what we called second-half '14, and the period when it settled was the first half of '15.

All right. And - - -?---Those are both in there, if you would - - -

Well, perhaps if we – I think we can do this just by reference to this document to begin with?---Okay.

If we go to .0025. So this is – I'm sorry, .0024, it should begin with?---Mmm.

I just want to work through the four key measures that ANZ was using at the time. The first was financial?---Yes.

And obviously enough, that's – that's financial. That's concerned with some of lending and cross-selling?---The specific measures for each of the roles was a bit different but it's – it's about the sales and revenue, yes.

And then for customer, there are performance objectives, and they also appear to be concerned with ultimately financial measures, total drawn lending, funds under management, and new to business drawn lending funds under management?---Yes, they are.

And then if we go over the page to .0025, the process part is meeting five out of six product targets. Does that – could you just explain to the Commissioner what that means?---That is a – it's a sales target. That is with respect to six of the products that the small business bankers were able to either sell to customers or refer to other parts of ANZ. And that refers to them – they had targets against each of those, and if they were meeting target in five of the six categories, then that was considered meeting.

And then the last category is people, which is:

> *Collaboration and contribution to a high performance culture.*

Where would – and that doesn't seem to, necessarily, involve a financial target?---That – that category would be assessed by the line manager or the state head, and that would be factored into the calibration session that was held at the end of the half.

All right. And I'm not sure you've quite answered my question, though. Does that mean they would take into account financial matters, the line manager?---Not for the people objective, no.

Okay. And would that include compliance then?---I believe that that was the objective against which the "not receiving any behaviour" or compliance flag was – was rated at that time.

Under people; is that right?---Yes.

All right. And then if we go to .0040. So these are the – see the hurdles to enter the scheme are set out on the bottom of the page?---Yes.

One of them is financial?---Yes.

And one of them is risk, compliance and behaviours. And that's:

> *Strictly no risk or behaviour flags triggered –*

is one of the criteria?---Yes.

And how would one trigger a risk or behaviour flag?---There were a number of ways that that could happen. There were, at the time, a list of behaviours that could result in what was known as a negative alert. And if a banker was to receive three of those in the half, they would get a behaviour flag, which would mean that they were not eligible to receive an incentive. If a banker had – you know, there was some aspect of their behaviour that the line manager or the bank took issue with, they could issue a behaviour flag, and, again, that would take them out of eligibility for an incentive.

And do you know – you may not; this may be outside of what you need to deal with, but do you know how frequently somebody in the position of the banker we're dealing with in this case study would end up with a risk or a behaviour flag against them at the time?---I'm sorry. I don't know that.

I understand. All right. What I want to do then is look at some other documents, which are the performance reviews for this banker at the time. Can we bring up ANZ.800.602.0001. I think you've got a hardcopy of that document as well, do you?---I do. I'm just trying to find it. Actually, it's quite small. It might be easier to look at the screen for this one.

All right. So this is the first half of 2014 performance review for the relevant banker?---Yes.

And as I understood what you said before, the borrowing that we are concerned with wouldn't have fallen within the first half of 2014?---No, it wouldn't have.

It would have fallen in the second half of 2014?---Actually, no, it would have fallen in the first half of '15.

I see. And what's – at the time then, this banker was described as – that is, in the first half of 2014 – as having a great half in the first half of 2014 and meeting the majority of his targets, but he did not meet new-to-bank lending and was one home loan from target?---Yes.

I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 3.18, performance management plan and review, first half 2014, ANZ.800.602.0001.

EXHIBIT #3.18 PERFORMANCE MANAGEMENT PLAN AND REVIEW, FIRST HALF 2014 (ANZ.800.602.0001)

MR HODGE: Now, before we go to the next performance review, can we bring up exhibit 24 of Ms Gibson's statement which is ANZ.800.528.0345, and can we go to .0346. And this is setting out the key messages for small business banking for the second half of 2014?---Yes.

And the first key message is:

> *To achieve our aspiration in becoming the leading corporate and commercial bank in Australia, we need to constantly review and change the way we relentlessly acquire new-to-bank business –*

I mean – I'm sorry –

> *new-to-bank customers.*

?---Yes.

And then it's explained a little further down:

> *Given the importance of new-to-bank acquisition we have increased new-to-bank lending targets for business banking managers while leaving the overall lending target unchanged.*

?---Yes.

And can we then bring up ANZ.800.602.0006, and this is the banker's performance review for the second half of 2014?---Yes.

And what's said is that:

> *The banker's half has been fantastic, outperforming across most measures. He is a role model for the team and, in addition to his numbers, has spent a lot of time training branch staff and the new SBS above and beyond what is expected. He has been promoted to a business banking manager and thoroughly deserves it.*

?---Yes.

And he says:

> *Has been a great half, given the challenge I put myself to achieving new-to-bank lending.*

?---Yes.

And – I'm sorry. I tender that document.

THE COMMISSIONER: Exhibit 3.19, performance management plan and review second half 2014, ANZ 800.602.0006.

EXHIBIT #3.19 PERFORMANCE MANAGEMENT PLAN AND REVIEW SECOND HALF 2014 (ANZ 800.602.0006)

MR HODGE: And do you accept that the relentless focus on new-to-bank lending may have contributed to poor practices at ANZ in relation to bringing in new loans?---No, I don't. I think bankers were very clear that they needed to meet the compliance and requirements. It certainly would have meant they focused on building their circle of influence and finding opportunities to bring customers to ANZ, but I – I don't accept that it follows that it led to poor practice.

Can we bring up ANZ.800.558.0008. Now, it appears that by 2015, things had come a little unstuck for this banker; do you agree?---I think you've brought up an exhibit of a disciplinary matter that occurred for the bankers.

And can we go to the page .0014. So this was a warning given in 2017 by ANZ to the banker, but it concerned conduct through 2015?---It concerned two loans that had been made in 2015, yes.

And the banker had provided a response as part of the investigation to ANZ?---Yes.

And if we go to page .0016, the particular point I want to draw your attention to is point number 3 which is that the banker's response or one of the banker's responses was that:

> *In the excitement of closing new deals, a culture of sales pressure that you felt weighed heavily at the time and your relative inexperience and newness to the role at the time all contributed to these oversights and the lack of due diligence you showed.*

?---Yes.

Do you accept that, at the time, there was a culture of sales pressure that the banker was under?---I have thought a lot about that phrase. I think that it is – it is the case that the culture in small business was one of wanting to perform. I'm – I don't accept the characterisation of being under sales pressure, but I accept that that's what the banker has said that they felt they were under.

And having regard to the performance reviews that we looked at and the performance targets, the targets were – I say the targets. First, the targets were primarily concerned with financial matters?---At that time, yes.

And the comments that were made and the performance review were primarily concerned with financial matters?---Yes.

And you made the point "at that time". In your view, has there been a change in approach by ANZ over the last three or four years?---With respect to the - - -

Financial targets and sales pressure?---There has been – yes. There – as you identified, there were sales targets that were against customer and process, and that was something that I personally didn't feel made a lot of sense. Those incentives have evolved. It wasn't overnight, but it has been an evolution that started with the first half '15 incentive plan, and has reached a point now where the financial measures are up to 30 per cent of a banker's measures, and that the measures that are against customer and process and people, I think, are more appropriately aimed at – at what we're trying to achieve in those objectives.

Thank you. Commissioner, I have no further questions for Ms Gibson.

THE COMMISSIONER: Yes. Thank you. Ms Gibson, can I go back to guarantees?---Yes.

You have been asked a number of questions about bankers – or the care and skill of a diligent and prudent banker, and you know that that's an expression that ultimately finds its source, for present purposes, in the Banking Code of Conduct; is that right?---Yes, I do.

And do you understand that under the code, as it presently exists – leave aside the future code – the notion of care and skill of a diligent and prudent banker is a notion that can apply to a prospective guarantor?---Yes, I do.

Yes, and what I want you to think about is how does that duty – or what does that duty say, if anything, to a case where the prospective guarantor has the characteristics of parent, no income except social security payment, and is about to pledge the only asset they have, which is their residence? Does the notion of care and skill of a diligent and prudent banker say anything to that set of circumstances?---I'm sorry, Commissioner, because that's not the circumstance that – I probably haven't given huge thought to that prior to being here today. So if I can just take a moment?

Yes. I recognise the question is not easy, but I would be assisted by your understanding?---In – in the circumstance that you're saying, I am presuming you mean where that guarantee is being offered with respect to a business loan?

Yes?---Yes.

The child's business venture, the parent is offering to go guarantor, but you – the circumstances I'm positing - - -?---Yes.

- - - are parent, no income except social security, guarantee to be supported by mortgage, mortgage over the only asset the parent has which is the residence?---I think that in that scenario, there is clearly a risk that the business could fail, and in the scenario you've – and that's because there is a risk that any business might fail. In that scenario you've described, it would seem inevitable that the bank that had taken such a guarantee would seek to have recourse to the home, and that would, clearly, cause hardship to the individual whose home it was, and, therefore, you would need to be – I suppose, personally, I'm uncomfortable with – with that sort of scenario, but I understand that parents – and I am a parent – might, you know, want to provide that support to their children and shouldn't be prohibited from doing so, but you would – you would want to be comfortable as a banker that they absolutely understood what they were doing.

And I think it may be that there was a time – maybe it still is the time, I don't know. It's something I am going to have to hear about, but there would have been a time where intersection between parental feelings of duty and support and affection and sentiment, and the commercial assessment of the transaction, would have been seen as matters wholly for the guarantor and only for the guarantor, and the guarantor makes his/her own choice. That's why I – I asked - - -?---Yes.

- - - you the question about whether or to what extent this notion of care and skill of diligent and prudent banker is speaking at all to the hard case I've put to you, and if it is speaking at all, what's it saying?---Commissioner, I think it is – it's extremely difficult question because if the bank decides that it should be in the business of telling parents whether or not they can support their children, I'm uncomfortable with that as a position, both as a parent and as a banker. I think that – look, I think that the phrase that is in the Code of Banking Practice as it – well, as it stood before – I believe the ABA may have published a new one this week, but I haven't read that one. The code that I – I have had in place at – through this period, it is, necessarily, a subjective phrase. I think the bank does need to exercise prudence in determining to lend in the first place. I think that the bank is – or any bank is warranted in understanding whether there is security that can be provided because banks are going to have a limited appetite for lending without security, which is done in the commercial sense, but you – you wouldn't want that to be the whole book. And if someone is saying that they are willing to go – offer security, then in some ways, that is a matter for the guarantor, but as you've highlighted, that those – the parents may not have full understanding of what they're doing, and I – I think you should be, you know, at least checking that they have understood what they're doing before they would enter into that arrangement.

Thank you very much. Mr Hodge.

MR HODGE: Commissioner, I don't have any questions about that. I did just want to ask Ms Gibson about one other matter which I just - - -

THE COMMISSIONER: Yes.

MR HODGE: Thank you. And perhaps if we just do this by reference to exhibit 35, which is ANZ.800.470.0103. These are the notes that you looked at earlier. And if we go to page .0104. And you see it sets out at the top of the page – well, then I should read the sentence beginning on the previous page:

> *A formal letter of offer will be issued on satisfaction of the following conditions precedent.*

And then it sets out what the conditions precedent are?---Yes.

And the first condition precedent is:

> *Provision of signed copy Contract of Sale confirming franchise purchase –*

and the price?---Yes.

And I take it, from your perspective, that seems entirely conventional?---Yes.

You wouldn't – would you be surprised if the loan had been approved without getting confirmation of the purchase price of the business?---I would expect that if we're going to lend money on the assumption that they are buying a business for a certain amount, we would want to see the contract of sale or the – in this case, I believe it was the franchise agreement that set those details out.

And if this had been approved without having required provision of the contract of sale confirming the purchase price, would you regard that as a failure to exercise the care and skill of a prudent and diligent banker?---The assessor should have had some basis for understanding what was the – what was the substance behind the amount that was being lent.

Thank you. That's all I wanted to ask, Commissioner.

THE COMMISSIONER: Mr Hodge, did we put in evidence that bundle of disciplinary process documents?

MR HODGE: I'm sorry. I'm not sure we did, Commissioner. I tender that document.

THE COMMISSIONER: And is it sufficiently described as the bundle of disciplinary process documents, 2017.

MR HODGE: Yes.

THE COMMISSIONER: ANZ.800.558.0008 will become exhibit 3.20.

EXHIBIT #3.20 BUNDLE OF DISCIPLINARY PROCESS DOCUMENTS 2017 (ANZ.800.558.0008)

MR HODGE: Thank you, Commissioner.

THE COMMISSIONER: Yes, Dr Collins.

<RE-EXAMINATION BY DR COLLINS [11.22 am]

DR COLLINS: Ms Gibson, could I just ask some questions arising out of the exchange you had with the Commissioner about guarantees being made to family members, and could I ask you to have a look at tab 13 in your folder, and if the operator could display ANZ.800.515.0458. Ms Gibson, do you recognise those as being the current small business credit requirements for the ANZ Bank, dated 17 April this year?---Yes.

I'm sorry, have you found it?---Yes, I have.

Thank you. And do you recognise that as being the current small business credit requirements for the ANZ Bank?---Yes.

Could I ask the operator to go, please, to page .0551. Ms Gibson, that's page 94 of those documents, and I just want to direct your attention to the section headed Unacceptable Guarantors, and I just want to ask you a couple of questions about the intersection between those bullet points and the matters the Commissioner was asking you about. So you will see the requirement is that guarantees are not to be accepted from persons in certain circumstances. The first bullet point is about intellectual disabilities. The second a power of attorney. Third, where there's reason to suspect that the guarantor is incapacitated, eg, under the influence of alcohol or drugs. Fourthly, reason to suspect the guarantor did not understand the effect of the guarantee. But it's the next two I wanted to ask you about:

> *Unacceptable guarantors in this document include where it is suspected that the proposed guarantor is under duress from the customer or another guarantor or is under the influence of the customer or another guarantor.*

Is that a matter which would be of relevance in assessing whether a guarantor, being a parent of a customer, ought be accepted?---It would be relevant, yes.

And the next - - -

THE COMMISSIONER: It is relevant to enforceability, I would have thought, Dr Collins.

DR COLLINS: Or to both, your Honour, yes – Commissioner, yes.

THE COMMISSIONER: Yes, or if undue influence still exists. Yes.

DR COLLINS: These – this part of the requirements was addressed to whether the bank will accept a guarantor in the first place. What about the next bullet point:

> *From individuals who are independent to the customer group.*

What do you understand by that expression?---The phrase "customer group", I take to be the way we describe, particularly with reference to small business, the fact that many – many small business customers have multiple entities that are interrelated. And so for us, the customer group is looking at the borrowing entity which might be a company, the directors of that company, if – it might be a trust, who are the trust beneficiaries, etcetera. You would want to look at the entire – what's called a family tree structure for the customer group. So someone who is independent of that customer group, I would take to be someone who was not a director or a shareholder or a beneficiary of the customer group.

And so parents of directors of a corporate customer would be independent for the purpose of that bullet point, as you would understand it?---Yes.

Thank you. You were asked some questions by our learned friend Mr Hodge about whether in the context of the gelato franchise application, ANZ had exercised the care and skill of a diligent and prudent banker, and you were asked the questions by reference to isolated features of the application. One example, just by way of example, was obtaining assumptions underlying cash flow forecasts. Do you regard looking at isolated features of an application as being the way to assess whether the bank has, in the context of a particular application, complied with the standard of the diligent and prudent banker?---I would – I think you have to look at the overall opinion – I mean, the banker is required to form an opinion, and you would have to look at all of the data points to form that view, I believe.

Okay. Now, you have reviewed the application that was examined in the course of this case study, including by reviewing the business plan that was supplied to ANZ?---Yes, I have.

Mr Hodge suggested that there were features of the business plan that might be regarded as comical. Did you regard the business plan as being comical?---No.

And are you able to identify to the Commissioner the features of the business plan that you consider supported the application that was made in this instance?---I considered – I gave consideration to the fact that they had looked at the industry and the expectations for what would happen for ice cream retailing.

Just pausing there, what feature of the business plan supported the application in relation to industry prospects?---There are – there is a page where they talk about the – I probably will have to go to it, but it's the market prospects. I can't remember the exact wording. They have reference to an IBISWorld industry report and talk about the growth prospects for ice cream retailing. They talk about - - -

Perhaps I will bring it up for you. Sorry, Ms Gibson, perhaps I will just bring it up for you. It's tab 30 in your folder, ANZ.800.534.0008. And if the operator could go to pages .0023 and .0024. Is that the section to which you are referring, Ms Gibson?---Yes, it is.

And could you just identify what feature of that, in your view, supports the application in this case?---The – they've looked at what is the expectations for ice cream retailing with regard to the IBISWorld industry report, and they have also looked at the shopping centre in question, where it is situated, the population. They've looked at, you know, spend. It – this is – when I look at this, this says we are looking to open a store in a busy, successful shopping centre which would be expected to have foot traffic and have people who have money to buy ice creams.

And one of the criticisms that Mr Hodge attributed to this business plan was its generic nature. What do you say about the generic nature of this business plan having regard to the data that we see on the screen?---I think that this data is specific to the particular location that they were planning to open their store in.

Thank you. Could I ask you – could I ask the operator to go to page .0033 in that document. Do you see, Ms Gibson, this is a page headed Assumptions. And I wanted to ask you about the assumptions generally, but, in particular, the assumptions about hours that would need to be worked. Again – I will wait for you to find it?---Sorry, I'm just going to get the paper one up. It's just a bit easier than – yes.

And can you tell the Commissioner what the relevance of this page is for the purpose of the banker's obligation to assess the application?---I think that, notwithstanding the conversation we had about the lack of specific assumptions underpinning the revenue line, it does call out a number of the assumptions that have been used in putting together the detailed cash flow forecast.

Yes. What about the assumption as to hours that would be worked?---Well, they've included a roster that showed they were going to have to work in the business – or the owner or owners were going to have to work in the business. They were going to employ at least two people, one on a full-time basis and one as a casual, and they showed a roster that provided coverage for the hours that they would have to be open.

Yes. And could I ask the operator to go to page .0040. So this page, perhaps, has a bit of clip art Ms Gibson but at the top it's got a SWOT analysis. What's a SWOT analysis?---A SWOT analysis is strengths, weakness, opportunities and threats analysis.

Yes, and what can you say to the Commissioner about the relevance of that analysis for the review that was undertaken by the banker?---At a high level, it reflects a fact that they've looked at – they've had consideration to why they think that this is – what are the strengths of the business and the weaknesses. I mean, it – it shows they've given some regard to things that could go wrong. It – it calls out – I'm not entirely sure. I mean, they would want to know that the – they had considered some of the potential threats.

Ms Gibson, having considered the whole of the application in this case, have you formed a view about whether ANZ breached the standard expected of a diligent and prudent banker?---With regards to the whole of the application?

Yes?---Yes, I have.

What view have you reached?---I actually don't think that we did in this case. I am uncomfortable, as I went through this file in its entirety. There are a number of errors. There are data entry errors. Some of those data entry errors then caused other people to make decision without regard to data that they should have had, and I don't think that that level of error is acceptable.

Yes, but in relation to whether, overall, the standard was breached, the conclusion you reached was to the contrary?---I'm sorry?

I thought you said to the Commissioner that the conclusion you reached was to the contrary?---I said that I thought that the business plan – the consideration of the business plan was that it was acceptable. I wasn't – what I was referring to was more, having taken the business plan for what it was, I've then looked at the overall application and said errors are going to be made. That's just life. There are human beings involved. Errors would be made, but when I stepped back and looked at the cumulative number of errors here, I was not comfortable.

You said in answer to a question from Mr Hodge that you had undertaken some analysis of your own, apart – that is apart from the break-even analysis that was conducted by the banker. What analysis did you undertake?---I was interested to understand what would have been the impact of using a COGS figure of 30 per cent. So I just – I made a spreadsheet of my own using the figures in the cash flow that were provided, and then varied that assumption to see what the impact would have been. And so I – I can say that if they had used a COGS figure of 30 per cent, then the business would still have been profitable.

The COGS figure is the cost of goods - - -?---The cost of goods sold. That was the figure that they - - -

THE COMMISSIONER: I have been listening, Dr Collins. I have been listening. Let's get on.

DR COLLINS: Thank you, Commissioner.

And that – the 30 per cent, though, was derived from the range in the ATO benchmark document to which you were taken?---Yes.

And did you make any other adjustments in conducting your analysis?---I did. I found there were some other errors in the cash flow when I went about the process of creating it. For instance, the cash flow assumes whole of month figures in the month of November, but the business plan said they were going to open the business on 20 November. So I adjusted the revenue and the relevant expenses to reflect that. And then I also wanted to give regard to what was the impact of the break-even analysis, and so I looked at what – if you increased the cost of goods sold to 30 per cent and you decreased the owner's drawn salary to 25,000, which was what the assessor had been basing it on, how much would the sales have reduced to get to the break-even figure, and it was to 70 per cent of what was in the – the cash flow forecast.

Thank you, Ms Gibson. Nothing further.

THE COMMISSIONER: Yes.

MR HODGE: Commissioner, there is just something I think that arises out of those questions from Dr Collins.

THE COMMISSIONER: Yes.

MR HODGE: And I just want to avoid us debating this in closing.

<FURTHER CROSS-EXAMINATION BY MR HODGE [11.36 am]

MR HODGE: Ms Gibson, Dr Collins asked you some questions about whether you had formed a view, looking at the overall file, as to whether this demonstrated the care and skill of a prudent and diligent banker, and you referred to the level of errors, and you said – you accept that there's – "Human beings are involved. There are going to be errors that are made", and then you said, but having regard to the overall level of errors, on your review of this file you weren't comfortable. Is that a fair summary of the things – the points you made a moment ago?---Yes.

And what might just be lost there is Dr Collins thought that you had answered his initial question, which is do you think ANZ has demonstrated the care and skill of a prudent and diligent banker in this case, by saying "yes", that is, you do think that ANZ has demonstrated the care and skill of a prudent and diligent banker in this case, and then you went on to explain this issue about errors. So can I just ask you the question again: do you think that, in this case, ANZ has demonstrated the care and skill of a prudent and diligent banker?---No.

Thank you.

THE COMMISSIONER: Thank you very much, Ms Gibson. You may step down and you are excused, I think, further attendance.

<THE WITNESS WITHDREW [11.38 am]

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

MR HODGE: Commissioner, the next witness will be Mr Welsh again. Could we break for 10 minutes and we will - - -

THE COMMISSIONER: So, again, we're changing at the Bar table. If I come back shortly before quarter to midday.

MR HODGE: Thank you, Commissioner.

ADJOURNED **[11.38 am]**

RESUMED **[11.44 am]**

<ALASTAIR DEREK DAWSON WELSH, ON FORMER OATH

<EXAMINATION-IN-CHIEF BY MS NESKOVCIN

MR HODGE: Commissioner, Mr Welsh is back. I will hand over.

THE COMMISSIONER: Yes, Ms Neskovcin.

MS NESKOVCIN: Commissioner, Mr Welsh has already been sworn.

THE COMMISSIONER: Yes.

MS NESKOVCIN: Mr Welsh, have you received a summons to attend the Commission hearing today?---Yes.

Do you have the original summons with you?---Yes.

I tender that, Commissioner.

THE COMMISSIONER: Yes. Summons to Mr Welsh will be exhibit 3.21.

EXHIBIT #3.21 SUMMONS TO MR WELSH

MS NESKOVCIN: Mr Welsh, do you have a statement with you in relation to Rubric 3-11?---Yes.

Is that the statement in front of you there?---Yes.

Thank you. Do you have any corrections to make to the statement?---No.

Mr Welsh, is your statement true and correct?---Yes.

I tender that also, Commissioner.

THE COMMISSIONER: Exhibit 3.22, the witness statement of Mr Welsh concerning Rubric 3-11.

EXHIBIT #3.22 WITNESS STATEMENT OF MR WELSH CONCERNING RUBRIC 3-11

MS NESKOVCIN: Thank you, Commissioner.

THE COMMISSIONER: Yes. Yes, Mr Hodge.

<CROSS-EXAMINATION BY MR HODGE [11.45 am]

MR HODGE: Thank you, Commissioner.

Mr Welsh, I just wanted to begin by asking you some questions about – some general questions about Westpac's business banking and to work through a few aspects of that to understand changes in the small business market over the last few years. So can we start by bringing up your statement, and if we go to page 10 of the statement – I'm sorry, my version doesn't have a doc ID on the top, but, presumably, it's .0010. Thank you. There's a table, Mr Welsh, that you have set out as part of your statement dealing with the number and quantum of business loans submitted to and approved by Westpac's business bank division in the period 2012 through into 2017; do you see that there?---Yes.

And I want to first just break down what is meant by the business bank division. You have explained in your statement that the business bank division provides banking services to what you've termed micro-SME, SME and commercial banking customers?---Yes.

And micro-SME customers are customers who are sole traders or businesses with less than four employees and have lending requirements of up to $250,000?---Yes.

And SME customers are businesses with a turnover of less than $5 million and lending requirements of up to $3 million?---Yes.

And you were, as I understand it, for a period of time the general manager in relation to business banking; is that right? Not – you're not now, but you were back in 2006 to 2008?---Yes.

And just so I can understand, the business bank is lending to micro-SMEs; that's right?---Yes.

It's lending to SMEs?---Yes.

And are there also commercial business customers that the business bank lends to?---Yes, they do.

And when we look at the figures that are set out here, these are the figures not only for micro-SME and SME loans, but also for commercial business customers?---That is correct.

Okay. And what we can see is that between 2012 and 2017, there has been some growth – about 10 per cent growth in the number of facilities submitted for approval by the business bank division?---Yes.

And some growth more than 10 per cent in the number of facilities actually approved?---Yes.

And growth – relatively significant growth more than 10 per cent in the total limit approved?---Yes.

And growth, perhaps, of about 30 or 40 per cent of the average size of facility approved?---Yes.

And then you've also got a table in paragraph 29 that goes through changes in the number of quantum facilities submitted and approved for franchise businesses?---Yes.

And that, I assume, just means the franchisee business. It's not a franchisor business?---Yes.

And we see, again, some growth in the number of facilities submitted, some growth in the number of facilities approved, relatively significant growth in the total limit approved, and relatively significant growth in the average size of the facility approved?---Yes.

And what I want to understand, just at the beginning, is your view as to changes in the market for lending to small businesses and I think you've used the term micro-SME and SME customers, given that they would have up to $3 million of facilities. I might just refer to those as small business customers, if that's acceptable to you?---Yes.

And this information – I'm not sure that we can necessarily draw conclusions about what's happened just in relation to small business lending for Westpac, because it includes commercial lending for higher facilities. I'm just interested in your view about that?---So, broadly, in the market we've seen since 2012 improving growth in – in SME, in the SME segment that you referred to. So that's more small businesses backing themselves to – to invest. So we – we have seen that and that's been a – a pretty consistent trend where – in the growth.

So for Westpac, you've seen growth in the number of loans being applied for, for that SME market?---Yes.

And, obviously, growth in the number of loans being approved?---Yes.

And in terms of your position in the market, do you have a view as to how Westpac's position in the market has changed over the course of the last five years in relation to SME lending?---Our market share growth has been nominal, it oscillates a bit, but nothing out – nothing extraordinary there. Just in line with market would be the best way of putting it.

Have you seen increased competition from lenders for, effectively, giving dollars to small businesses?---Yes, that's correct. The – the – a – a number of lenders have focused on the – the SME market to – to help small businesses and – and we have seen more competition there as our competitors support Australian businesses.

And is that – when you're talking about the competitors there, I – if we can just segment them up, does that include increased competition from the other three majors?---The three majors and also some of the – the other banks.

Yes. So I just - - -?---Yes.

- - - want to break it up because - - -?---Please.

- - - it seems like there's a few different categories of competitors that you would face in relation to lending to the SME market: one are the other three major banks, one is the non-major banks, one is non-bank lenders?---Mmm.

And so I just want to work through each of those categories. Have you noticed any change in the appetite for small business lending of the other three majors over the last five years?---I think they've all got a clear strategy to try and support this market and – and improve in it and back businesses. So you can read the annual reports and they show that, and my read of some of their investor presentations show they're focused on – on the SME market. So, yes, the – if the question is around competition - - -

Yes?--- - - - yes, the – the competition has increased there.

And in relation to the non-major banks, have you noticed any change in the appetite of the non-majors in relation to small or medium enterprises?---That tends to be more focused on their particular state or area. Some of the – the non-majors, as you call them, are – are based in a – in Queensland, for instance, and – and they're pretty hot competition there because that's where most of their branches and – and their bankers are. So you tend to find in – in areas there, they're particularly strong or they may focus on a – a particular segment. But I – you know, other than that, I wouldn't call that anything exceptional.

And what about non-bank lenders to SMEs? Have you noticed any change from competition from non-bank lenders over the last five years?---Probably more latterly, rather than as broad as the last five years. There's emerging fintech where there's – you know, financial technology. Where they're looking more at supporting small business. So there – there's more – a lot more of them popping up, yes.

And that's, what, more like in the last couple of years, rather than in the last five years?---More so – more so than five, yes.

All right. And are there different observable approaches to different segments – so I will explain that a little bit more?---Mmm.

If we take just property development, for example, has there been – is there a difference in what you can see in competition for lending to property developers, as distinct from the broader SME market?---There's always distinctions in each bank based on their risk appetite, based on what their start position is, based on their view of the market. So, yes, you do – you can see differences in the market, yes.

And in relation to property development then – and I just want to get an understanding of this, because, as you put this into some context – now, 10 years ago, as we sort of came into and out of the GFC, there are obviously a number of issues that arose for property developers, and a change in the risk appetites of banks in relation to property developers?---Mmm.

And what I'm trying to get some sense of, to assist the Commissioner, is where are things at now in relation to that sort of market – and it may be, and I should say, that when it comes to property development, calling it SME if we limit SME to facilities up to $3 million is inaccurate anyway?---Typically, with the price of Australian property today, it's a little outside the - - -

Yes?--- - - - the 3 million for the property developers. So property developers more in the commercial business, and that's a pretty closely watched market, both by a number of regulators and also by banks because it's – it's something that we're very sensible about how we approach that market. And the – the – it does evolve. You – you watch it very carefully, though, and you're very thoughtful about the – the market, the amount of developments happening. You also look at concentration risk for builders. So – and – and banks have different appetite at different point in times because it depends where their – where their book is positioned and – and how they view the market, but you do a fair bit of research for the broader market on that.

All right. And when you say it's closely watched, is that synonymous with being cautious and very careful, or does it mean something slightly different?---I think we're cautious and careful for all of our loans on – on that.

Sure?---But to be clearer on the – the property, you break it down into a number of Anzac codes, and – and we – we look at that quite closely. There's a number of committees that you might focus – that focus on property. Well, there's one particular committee for us that focuses on property that – that looks at it and – and we look at our – our book. Because the way we think about our property and the way you typically think about a portfolio is you look at the institutional exposure. Westpac has a – a very strong institutional bank, so we look at that.

We've also got our St George group that is particularly strong at – at property, so you look at that and – and you look at your overall shape of the book and how that's performing, and – and to the future.

And just again, to help the Commissioner with that?---Mmm.

When you talk about the shape of the overall book, you mean one of the things you're calling out is you want to look at how much of your book is allocated to property development, how much is allocated to hospitality, how much is allocated to retail, that type of thing; is that - - -?---You tend to look at property development, investment, residential development. They're – they're some of the headings that you – you look at.

And to make sure that you're not – your book is not overweight in lending to those – into one particular area; is that - - -?---One of the reasons, yes.

And what are the other reasons that would be relevant?---You want to look at how your book might be performing in – in terms of geographies. So then – and you might want to look at Melbourne market, Sydney market. They're the – all the markets are slightly different and – and at different trends at different times. So you – you look at a – you might look at a market, you might even break it down and look at inner city – inner city Melbourne and to – to outer, for instance. So you – it depends on the degree of analysis you – you want to do, and – and – and, you know, a property book is a – is a bigger book for – for the Westpac – the Westpac group. So by definition, when you have bigger books, you typically would put more analysis around a – a bigger exposure.

And, again, just to bear down on a little bit of that, are you talking about even just the level of scrutiny within that property book of where is it located; how much of our lending to property is in Melbourne; how much of our lending to property is in Perth; how much of it is in Brisbane? Is that the type of thing you're calling out there?---On the – property is somewhat unique, in that it's quite a large – it's a large book. So the way Westpac structures in the commercial business is that we have specialised property bankers, and there are a number of them. And there's – there's teams – they're in a – they're under one leadership team. So, often, the complexity in banking is to get the data is – is often quite – more challenging than what we would want. So you – by doing that you can, therefore, have a bit stronger view on the – on the market, and then you have to provide an overlay where a leader is accountable for that team, and they would typically look at a – at a business plan of – of what they wanted to do in the year which looks forward, but also looks back, and looks at how much of their book is running off, how much of their book is on investment, and how much of the book is on commercial property.

And tell me if these questions are going beyond what is within the specifics of your experience, please, but if – the last thing that I'm interested in is, in managing the shape, presumably, one of the things that you're keeping an eye out for is, "Are we overexposed to lending in one particular area", and that might be a particular industry, it might be to a particular physical or geographical area. There's different ways that you might be over exposed, but if that's identified as a problem or a potential problem, how is that managed?---Hypothetically, you're looking at the market, and – and look – trying to look forward and predict what's going to happen. So that's probably the – the first thing. Then you're looking at your – your current book, and – and trying to understand the dynamics of – of how that would typically – typically work over the next period. And then the – the main control point, to come back for the clarity of your question, is that you would then typically look at an appetite for there where you might – might say, for instance, in a particular state, you – you were – were wanting to limit the amount of – of growth there, and there's a number of ways of doing that.

And, for example, you might impose a cap on the amount of new lending in a particular area; is that one way?---That – that's a blunt way. We would like to think we're a little bit more sophisticated than that. You know, your - - -

No, no, that's all right. Please expand on - - -?---Well, your – your preference – you always back your longest standing customers. So you back the ones that have been with you for a long time. They're your – they're your first, you know, primary one. Then there's a range of – that follows from – from that. You tend to want to be backing – if you're a bit worried about a sector, you tend to want to back a bit more of the experienced players that – that are there. And you may well tilt your business a bit if you've got a bit more inner city apartment, for instance, you may look to some outer – outer region apartments.

And that, I think, involves the idea that you could be out there sort of looking for these opportunities, and I'm just – I'm just trying to understand whether that's what you mean or whether it's something different?---You – just to - - -

That is the bank – sorry, the bank could be out there – rather than the customer?---I'm not out there.

- - - coming to the bank and saying to the customer, "I've got this particular property development", that, instead, the bank would be out there looking for customers who might be trying to do that sort of thing. But I wonder if I had misunderstood the point you made?---No, no, it's a combination of both. It will be, obviously, the bank looking for new business. It will be clients that you have already. It will be referrals from – from other clients or – or partners such as solicitors or accountants that – that know – know your – your market, and also introducers in – in the broker market.

And that, I think, sounds like what you might try to do is to just – to steer away from using the blunt instrument of putting in a cap, you try to incentivise bringing in lending in the areas you're trying to build up; is that a fair summary of it?---You – you try and put your energies focused on the – the markets that you're targeting and the types of deals that – that you're – you're targeting.

Right?---So you can – that once you've got the deal on, you have to back – you want to back your client through the cycle. So you tend to focus more on the, what we would call, the front book, the – the new business, and then – then you're sort of looking at the shape of the – the new business and making calls on that. And sometimes they're tough calls because your banker might be saying, "This is a great market", and you will look at some other data and data points. We'd say, "Well, I think we want to slow that – slow our origination in that new market for new business."

Right?---So it's just – it's as much – there's a bit of an art and a science on it. It's – it's not as blunt – it's not as clear as just looking at some numbers and standing back and making a call. You – you try and – you want to use judgment.

Yes, and judgment over a period of time. That is, it's not something you can judge at any particular point in time. You have to be constantly thinking about this and strategizing over the medium to long term?---You'd like to think so, yes.

I want to then turn to some issues about franchises and we're going to move into the particular case study that you're dealing with?---Mmm.

You gave some evidence either on Monday or Tuesday – the days are starting to blur together, I suspect, for both of us, Mr Welsh – but you gave some evidence about the accredited franchise program and how that works?---Mmm.

I don't want to return to that other than to note that if there's an accredited franchisor from Westpac, then you obtain past financial performance information about the accredited franchisor?---Yes, that's correct.

And you want to have that information in order to decide whether or not they should be an accredited franchisor to begin with?---The financial information is one part of it, yes.

Yes. And, sorry, what are the other types of parts to it that you would be concerned about?---Not so much concerned. If – maybe if I just go a little higher more broadly is why a franchise system might come about is they – you know, the normal life cycle, the franchise system is they – they start out with someone starting out a – typically, a good – a business that's in one particular area, and then they're looking to – to expand and to grow that. So we would look at their plans and part of that is you would look at who their management are and what their capability are, what their experience is. You would look at what their strategy is. You would look at what their point of difference is, if they've got any unique proposition. You would look at how they're going to bring on franchisees and the training they would give them, for instance. You would look at their – their aspiration, their growth aspiration, and – and you would look at how they would be – would – would be funding themselves in the future because any business that's going through growth needs to – needs to fund themselves. And they're usually growing at – starting to grow at a – at a quicker rate. So you have to look through the – the numbers quite carefully.

And I think the evidence that you gave earlier was, as a result of that accreditation process, Westpac gains a better insight into the financial state of the franchise; is that fair?---Yes, you do.

And that insight into the financial state of the accredited franchise systems is kept up to date by annual reviews that Westpac undertakes?---It is now.

And could we just clarify that qualification. When you say, "it is now", why do you say that?---I say that because in 2010/12, we tended to not – it was once every three years that you had to review for a long – a longer form, and we might do shorter form reviews. We've – we've brought that into – to more regular annual reviews now.

All right. And we're going to come, as you know, to Pie Face which had been accredited as a franchise with Westpac back in, perhaps, 2011. I think there's - - -?---Yes.

- - - some ambiguity about it, but something like that?---Yes.

And at – as at 2011/2012, did Westpac's policy require annual reviews?---No, it didn't.

I see. It only required reviews every three years, as you understood it?---Long form reviews, yes.

All right. And – sorry, is there a distinction then between a short form review and a long form?---Yes, there is.

Okay. And could you just explain that distinction?---The – the long form review would typically be the – the review that you would do that – for an origination of a – a new franchise system. So you would want to have much more – you want to have your full approach at looking at it. The short form review tends to be a particular – focusing on a particular issue, if some circumstances had – had changed. So if they had changed their strategy to – to grow quicker, or to enter into a different market, so it might be a review on that basis.

I see. And by doing the – or by initially obtaining the financial information from the franchise, Westpac then seeks to develop the sector to value ratio?---Yes, that's correct.

And you've told – as I understood the evidence that you've given – and I think this was dealt with a few times – your evidence is the sector to value ratio is a percentage which is used to calculate the maximum amount that Westpac will lend to the franchise in an accredited franchise system against only cash flow. Is that – have I

- - -?---If it – thank you. If it's the cash – if you're lending against the cash – as a going concern with no other security, other than – than guarantees from the directors, which is a – a normal course – sorry, from the shareholders.

We might just turn up the policy. I just want to make sure I haven't misunderstood the point that you're making. When you say "without guarantees" – let's take a hypothetical?---Mmm.

Let's say that you've got – let's say that the SVR for a particular franchise is 60 per cent?---Yes.

And if the SVR for a particular franchise is 60 per cent, does that mean that Westpac, under its policy, could lend up to 60 per cent of the turnkey price of the business just against the cash flow of the business?---The – the debt sizing, as we term it that, you would lend 60 per cent to that.

I see?---You would then want to make sure that the interest costs cover and debt service cover ratio has worked as well because you want to then – because one is the amount of debt, the other is the – the cash flow.

All right. Let's – can we bring up WBC.410.001.2092, and - - -?---Which tab is that, please?

That is – it should be tab 25?---25. Thank you.

If we just pop out the paragraph that begins:

> *Lending under this policy.*

It's the second paragraph under Target Market?---Mmm.

And I think - - -?---Thank you, that's easier.

I think the way in which I defined it was the ratio of the loan amount to the turnkey purchase price of the business - - -?---Yes.

- - - but let's assume turnkey purchase price of the business is synonymous with turnkey value of the business. Is my understanding correct, or are you saying something slightly different?---No, your understanding is correct.

So if, for example, the business was going to cost – the turnkey value of the business was $300,000, and the SVR ratio was 60 per cent, then Westpac would be prepared to lend up to $180,000 just against cash flow?---Correct.

Or that would be - - -?---Subject to the cash flow.

Sorry?---Subject to the cash – checking the cash flow as is further in the policy.

That’s right?---Yes.

And then I think you referred to the next point, which is:

> *Any borrowing in excess of the SVR is to be supported by other tangible security in terms of the acceptable security rules.*

?---Yes.

And that would mean, would it, that if you wanted to lend – if the borrower wanted to borrow 100 per cent of the purchase price of the business, they could borrow 60 per cent unsecured other – assuming the relevant criteria were satisfied – against the turnkey value of the business, against the cash flow? Sorry, I have put that badly?---No, no.

I will say it again?---Please.

They could borrow 60 per cent of the turnkey value of the business secured only against the cash flow, but the balance of 40 per cent, they would need to secure against, for example, residential property or something else?---No, that’s not correct.

Okay. And so could you just explain what is the thing that I have misunderstood there about that paragraph?---So there’s – so you – you either fall into the sector – the franchising policy. And if you don’t, then it’s the business credit manual that would apply. So you don’t get a – you don’t – and I – I thought I heard you say you take – you can borrow 60 per cent under the franchising policy and then another 40 per cent under the – under the – if you wanted to borrow the whole lot under the normal – the business credit manual. So if you – if you don’t qualify for – if you don’t – if you are above the 60 per cent, then the franchising policy is off the table.

I see. And if you – if you are borrowing an amount above the sector value ratio - - -?---Yes.

- - - then the accredited franchise policy can’t apply to you?---Thank you. Far better put.

Is that right?---Yes, it is right.

And because, read literally, that paragraph we’re looking at appears to say that you can lend against the cash flow for the sector value ratio and any borrowing in excess of the sector value ratio is to be supported by other tangible security?---No, that’s not how it should be read.

But that’s not how - - -?---That’s not the practice. And that’s - - -

Or, at least, that’s not how it’s applied?---Yes, indeed.

And what is the reason for that?---Because the – the policy is a going concern policy. And as a going concern policy, you want slightly higher interest costs cover and there's more risk around that. So if you take on more debt, then there's – without potentially looking at other cash flows and – and other security, then the risk profile changes. So it's a risk-based decision.

I see. The point is you've taken on debt greater than whatever is the sector value ratio, and simply having a real tangible security for that extra amount of debt - - -?---Yes.

- - - above the sector value ratio doesn't mean that you've eliminated the extra risk involved in that extra debt. That's the point?---Yes.

And, hence, the reason why what – the willingness that Westpac has to lend in relation to accredited franchises – sorry, franchisees of accredited franchise systems against cash flow really is just limited to the sector value ratio because it has satisfied itself that cash flow up to the – based on the – is sufficient to service debt up to the sector value ratio?---Well, you – you apply your financial covenants.

Right. And so that's the reason why, when we get to this particular case study, the – and the borrowing that we've already heard about, it was done not under the accredited franchise policy - - -?---Yes.

- - - but under the general business, because - - -?---Yes.

- - - it was for greater than whatever the relevant SVR was for a Pie Face franchise?---Yes.

All right. And I think you explained in your statement that the borrowing didn't comply with the accredited franchise policy for Pie Face. That's – that, I take it, refers solely to borrowing more than the SVR?---Yes, correct.

Okay?---Can I just correct one thing, I think I heard you say - - -

Yes?--- - - - because, while we're here, I wouldn't want to – there still is security for a going concern. You can see that on the – the second page of that there at the bottom of the second page.

Where - - -?---Because I – I thought you said – I might have misheard you, but I thought you implied that it might been unsecured. There's still a fixed and floating charge at the language at that time. First mortgage – there's appropriate guarantee from directors and franchisees and other tangible security as may be necessary. So it's not a – the – I wouldn't want you to – I wouldn't want the Commissioner to think it's a completely unsecured loan once that – that ..... is still secured. There is still some security there.

Yes. It’s secured – it’s secured against the businesses. So that is you’ve got a fixed and floating charge over the property. If there has been a purchase of property for the purposes of the business, you will have a mortgage over that property. You will also take a guarantee from the directors?---Yes.

It’s not – your point is this is not unsecured borrowing?---Thank you.

Yes. I understand. And so then, in practical terms, how, if we come to this case study, in relation to the borrower Marjo, would there have been any difference in approach you would expect in relation to assessment if this was done under the accredited franchise policy, rather than under the general business lending policy?---Well, they would have to comply with the franchising policy that we – we have just been over.

Well, we – in relation to – the interest cover and things like that?---SVR, it’s a higher interest cover, yes, so that – that – that would apply.

All right. Can we bring up exhibit 30. So this is the franchise system profile for the Pie Face franchise as at July 2011?---Yes, that’s correct.

And as we understand it, this wasn’t updated – well, it – this was the policy that the profile that would have been in place as at the time that Marjo made its borrowing?---Yes.

All right. Then if we go to page .0333?---Mmm.

So this sets out some benchmark trading results for franchisees in the Pie Face franchise system?---At July ’11.

Yes?---Two thousand – yes.

When you say that, is there some update that you’ve seen to those figures that would have applied as at - - -?---No, there’s not.

Okay. And if a borrower came and wanted to borrow only up to the relevant sector value ratio to buy a Pie Face franchise, would these franchise trading results and projections be something that would be relevant to assessing the borrowing?---Yes.

And how would they be relevant?---Well, they’re – they’re the guide for as, we’ve called here, low, average and – and high benchmarks and that’s determined more by the – the sales at the top and they’d be the – the benchmarks you – you would be looking for from – from the business. Gives the banker a – a guide.

All right. And can we put that then on – actually, I’m sorry, just before you move off that, can we go to page .0346. So this is the recommendation that was made by the New South Wales franchise and development manager and appears to then be accepted and approved. You can see that if you turn ultimately over to page .0348. I'm sorry, it's – yes, .034 - - -?---Yes, it does.

I think we should just check one thing which is you see that recommendation in the box is 60 per cent SVR?---Agreed.

And for existing stores, it's a 1.75 multiplier applied to EBITDA capped at 60 per cent?---Yes.

The – and I just want to clarify. As I understand it, that is what is accepted and approved; is that right, or - - -?---No, as you can see in the – on .0348 – or we can see, I think it's - - -

It changes?--- - - - redacted here, it changes to a lower ratio.

All right. To 50 per cent SVR and 1.75 times EBITDA capped at 50 per cent; is that right?---Yes. Yes.

Sorry, are you concerned that this is - - -?---No, no. I just have it redacted on mine, but that's - - -

No, but it's – well, the version we have doesn't seem to have been - - -?---Okay. That's okay.

- - - redacted?---Sorry. That's why – there – that there was a concern.

No, I appreciate the worry. I get lots of blue highlighting. It concerns me too, Mr Welsh, I can assure you?---I'm just getting used to it though.

It's much more concerning when just black pages pop up on the screen. That's because I'm fearful of somebody else. Now - - -?---I understand.

So I want to just make sure I've understood the detail of this then which is that if Marjo had come along and said we want to – we want to buy this existing Pie Face franchise, to go under this accredited – approved and accredited policy, they could have borrowed up to 50 per cent of the purchase price; is that right? That is, is the purchase price taken to be equivalent to the turnkey value of the business?---Yes.

And a further limit would be that they could only borrow 1.75 times the EBITDA for the established business?---Yes.

And that would additionally be capped at 50 per cent of the purchase price of the business?---For the existing stores, yes.

And that reflects, I take it, the level of risk that Westpac would be comfortable with in relation to a Pie Face franchise, under this policy?---Yes.

And the relevant parts of the policy, as you point out, are it's lending against cash flow, but it still requires security over the entirety of the business?---Yes.

And it also requires, as you pointed out, guarantees to be given by the directors of the business?---Yes.

And presumably then, assuming that these sorts of franchises are being bought by an individual or a couple, or a small group that are looking to run a small business, the giving of the guarantee will – by the directors will effectively then mean it's being secured by their personal assets?---It could, yes.

And in giving a guarantee, would it also be necessary for a mortgage to be obtained from the director to secure the guarantee?---Not necessarily, if they complied with this – this policy.

I see. But in any event – no, that's all right. I withdraw that. So that would be one potential difference - - -?---Yes.

- - - which is they don't need to have a mortgage to secure the guarantee, but they still have to give the - - -?---?---Unsupported guarantee.

But they still have to give the guarantee?---That's the normal practice, yes.

Yes, and this is really a risk balancing exercise - - -?---Mmm.

- - - for Westpac. It gathers a lot of financial data. It makes an assessment as to what level of risk it's willing to tolerate up to that particular amount of security?---Yes.

And is an advantage of having this sort of accredited franchisor policy that it makes for some ready rules to be able to facilitate lending to what are going to be small businesses?---Yes, it does.

Does Westpac see it as something that is favourable or facilitative to having lending to small businesses?---Yes, it does.

All right. And are there advantages to Westpac in having these types of accredited franchisors?---I think it's a – it's a risk-based approach, and it gives the guidance to – to our banker and – and also gives guidance to the market of – of what we might be looking to do. And – and – as you were talking about before, it shows some – on one of those pages there, it shows the results and projections. It also shows the – the franchising set-up costs. So it gives a number of what you would expect would the – the cost would be for a low, average and high as well. So it – it helps with the risk-based decision. It's a risk-based management approach.

And one of the things I wonder about then is, is it – is an advantage of this that a potential small business owner might come to the franchisor and the franchisor would, in turn, direct that potential small business owner and, therefore, potential borrower to Westpac for their loan to buy the business?---Yes, there is an advantage to a franchisor of having accredited banks, because then the banks will typically understand what they're doing and what their strategy is, and – and it will help in a risk-based decision.

But also for Westpac, there's an advantage, isn't it? Doesn't – it sets up some potential of referrals coming from the franchisor to the bank?---It – not – not necessarily. That's – but they will – they will publish and – and say that Westpac is accredited or bank X is accredited. So they will – they will – they will use that, yes. They will use that information to share it with potential franchisees.

Do you know whether Pie Face was accredited with any other bank?---No, I don't.

Okay?---That – no.

Did you listen to Ms Messih's evidence yesterday?---I listened to the majority, but not all of it. A few dropped out a little bit.

All right. Did you – she gave some evidence which was that when she had spoken to the franchisor, the franchisor had suggested to her that it would be necessary for her to move all of her borrowings over to Westpac. Did you hear that - - -?---I did hear that.

And do you have a view about – I should perhaps break it down. First, is that – would that have been correct?---No.

Other than – I suppose I should qualify, other than that if, for example, it was necessary that there be security over her house and there was already a first mortgage over her house, then – with another institution, then it may have been an issue for Westpac if it was only the second mortgagee, I assume. But other – other than perhaps some issue around that, it's not a requirement - - -?---There is no requirement.

And does it surprise you then that the franchisor would be saying something like that to the franchisee, or potential franchisee?---Yes, it does surprise me.

Perhaps one possibility here is there's just some misunderstanding of what it is that the franchisor was saying to the franchisee. You just can't comment on that?---Hard to speculate. Very hard. I wasn't there.

And then can we go back to the page .0334?---Mmm.

Sorry, .0333. Now, I will just leave that there for a moment and we will come to it shortly. You know that Ms Messih applied for – well, applied for finance and was ultimately granted finance?---The – the company, yes.

Yes, the company Marjo?---Yes, Marjo did, yes.

And before we come to the detail of that, is that something that you've reviewed – or you reviewed the documents for to form a view about whether or not the loan should have been made?---Yes, I have.

And have you formed a view about whether the loan should have been made?---Yes.

And what is your view, Mr Welsh?---The loan should have been made.

Should have been made?---Yes.

Okay. And do you want to just explain to us – you're aware, obviously, of the FOS decision – FOS determination?---Yes, I am aware of that.

And I take it from what you say then you disagree with the FOS determination?---I disagree with the way the – the FOS made the determination, but I do agree that we are bound by the FOS determination, and – and we are – have – have met that determination. But I disagree with – in two main ways, with the FOS determination.

Of course. And so to be fair to you, of course, Westpac has complied with the FOS determination. It was binding on Westpac?---It is. We are bound by them, yes. Yes.

And you've complied with it?---Yes.

And all you're raising here then to assist the Commissioner are the two ways in which you disagree with the reasoning of FOS?---That is correct.

And do you want to – perhaps if we take them one at a time. Do you want to explain the first way in which you disagree - - -?---Yes.

- - - with the reasoning?---So, Commissioner, in assessing the serviceability, one of the normal practices is to provide what we call a buffer on the interest rate. So that's a higher level of – of interest rate for the serviceability. The implication of that is it makes – takes it through the cycle, it makes it obviously a little bit more conservative in our approach. FOS' determination was that they used a 50 per cent – another 50 per cent on top of the interest rate. And I think that is – my personal view is that is very high. They used a three per cent buffer for a business loan.

So your – the buffer that had been used by Westpac was 1.5 per cent?---Westpac's policy is to – is to either take the higher of the actual interest rate or a – at that point in time, what we called the BSR, which was the 6.5. So it was the higher of.

Right?---So the more conservative approach.

I thought when you were saying they took a 50 per cent, it was 50 per cent higher, that was because the buffer that was used by FOS was three per cent, and the buffer that had been used by Westpac was 1.5 per cent?---Sorry, let me clarify. FOS used a three per cent buffer.

Yes?---Above the loan.

Yes?---Yes.

And you said a 50 per cent higher, or do you mean 50 per cent higher than the interest rate?---Sorry, I'm muddling numbers here. For clarity, let's – let's call it six per cent. They added another three per cent.

Yes?---So my 50 per cent in my statement was three on six.

Yes. All right?---Thank you.

I understand. And your point is the buffer that you would have added – or that you would have considered appropriate would be, what, one and a-half per cent on top - - -?---Well, I – I think the rate was five point something at the time and we took the higher of 6.5.

Okay?---Three per cent buffer in our view would – would prohibit a lot of business lending.

All right?---And that is – that is a – that would be very concerning for me.

All right. And are you able to explain to the Commissioner two things. The first is when Westpac goes about figuring out what buffer should it allow, what's the process that it goes through to figure that out? There must be some judgment involved in that?---I don't know the technicalities of it. Apologies. It's not my area of expertise. There's some smart mathematicians that – that work that out.

All right. And when FOS went about coming up with its three per cent, could you understand what the rationale was for picking three per cent?---No.

Okay. And so the judgment that you're making is to say, in your experience as a banker, to start using a buffer which equates to 50 per cent of the interest rate is likely to have a significantly detrimental effect on the ability of the bank to lend to small businesses?---That's one argument.

Yes?---There's also another.

And what's the other argument?---The – the other argument is small businesses are – when they're gearing up, you know, it's pretty – it's a pretty challenging environment for businesses out there, and if – if they're gearing up and the banks – the banks are adding another three per cent on their ability to – to back themselves and get a loan, that would – that would mean a lot of businesses would struggle to get finance at – at that 50 per cent buffer mark. So I think it would – would limit a – a lot of the businesses in that growth phase.

And was there another – have you covered the two areas - - -?---No - - -

There's a second area that you want - - -?---But wait, there's more.

There's more. Could you, perhaps, then tell the Commissioner what's the second way in which you disagree with the FOS determination?---It – it was to do with the – the amortisation. So, Commissioner, typically, the – the approach is you obviously have to have interest and the amortisation over the term of the loan. FOS deemed that it was appropriate to amortise a overdraft. And we describe an overdraft as a come and go working capital facility. So in a normal operating business through a normal cycle, that should go up when – when that needs to and then be paid down as the funds close – come in and out. So when you're looking at the establishment of a business, you – you want to make sure the overdraft is intended to be come and go. So that was the first part of it. The second part of it is FOS also determined that the banker undertaking – and, effectively, it was a – a guarantee for the rent – they amortised that. Our approach is to take the – the fee for the – the fee for – six-month fee as the – as the charge, they're not amortise a contingent liability. So they were – they were the two fundamental views that we – that we took.

All right. And what I would like to do now is - - -

THE COMMISSIONER: Can I just understand. What time horizon is relevant to those inquiries? You are saying, "Look, we've got to cope with the fact that interest rates may move. We've got to look at questions of should I take account of amortising the overdraft to zero"?---Yes.

What's the relevant time horizon - - -?---Thank you.

- - - that should be in mind in your view when you're making these assessments?---Well, in my view, I don't think you should be amortising the overdraft or the guarantee – the contingent liability. So there is no time horizon. I don't – don't think you should. So that's that one. The – the time horizon for looking at your BSR, as we call it, but the – that – that is a rate that we will assess. You know, the facts are that I – I don't think interest rates have gone above that rate over the period. We're in a low growth – low interest rate environment and to sort of – so that the – the – it hasn't moved. You would want to move it as the – as the market moved, and – and look at it dynamically. Yet, it's not something you're moving all the time, particularly in this low growth interest rate environment.

Yes. Go on.

MR HODGE: Any more questions you had about that, Commissioner?

THE COMMISSIONER: Go on.

MR HODGE: Thank you. Mr Welsh, what I would like to do now is I might keep that document on the screen and move it to one side?---Mmm.

And I would like to have a look at the credit assessment memo for this particular application. Can we bring up what is tab 38 to Mr Welsh's statement. It's WBC.404.001.1016, and if we go to page .1018.

This is the Dynamic Deal Build Request Form Output?---Yes.

We've looked at one of these already. I want to go first to page .1023?---Mmm.

And can we blow up the section called Transaction Risk. And you see it is explained:

> *The transaction risk is medium.*

I should probably ask you to begin with, are there different grades of transaction risk that would be used for these types of deals?---There's different grades, yes.

And what does "medium" indicate?---From memory, 100 per cent LVR was at the medium.

Okay?---Yes.

And it explains:

> *The transaction makes sense to the bank. The facilities requested will be fully secured by residential properties. LBB recommend –*

And sorry, what's LBB. Is that local business banker?---Yes, it is.

Continuing:

> *… local business banker recommending to take out fixed and floating charge over the business as we are relying on business income when serviceability was calculated.*

?---Mmm.

And then:

> *The transaction makes sense to the customer. This will be an opportunity for them to manage and owned their business with a possibility of acquiring more Pie Face business in the future.*

?--- Yes.

And in that sense, is it fair to say one of the things that you would probably point to looking through this is there is a – there's a consideration not just of something that's in the interests of the bank, but also of understanding what the desires and goals are of this small business – or these small business people?---That is correct.

And then if we go over to page .1024 and blow up the section Serviceability/End Clearance Risk. So this explains that the:

> *Local business banker calculated two serviceability scenarios.*

?---Mmm.

And it's based on profit and loss provided, but it explains:

> *Please note that there is no current financial available. Business is only eight months old.*

And can I ask what – from your review in looking at the documents, what's your view as to the appropriateness of making a loan in circumstances where the business has been going for eight months but apparently there's no current financial available?---What is my – can you – just the question - - -

What is your view as to the appropriateness or the significance of that in making the loan?---I think it's a factual statement. So if there – if that was – that's factual statement, so you have to rely on that, if it had only been going for eight months. As was – as we will uncover further, that was not correct. The business had been running for a six-month period and then another nine-month period. Then there's further dialogue on the file on that.

Setting, though, aside the detail of that, I just want to – take the hypothetical of it which is:

> *The business has only been going for eight months. There's no current financial available.*

Is that something that is significant or insignificant in the context of making the lending decision?---I think it's an important part of making a lending decision if you've only got eight months' financials, and – and you've got them.

Right?---You would want to review them and be very clear on them.

And then if we go to page 1026, and you see at the bottom of the page - - -?---Mmm.

- - - there's something which is – or it's under a section called Sector Policies?---Yes.

And does this – it says that the sector policy is franchise?---Mmm.

Does that connect to that – back to the franchise data that we were looking at on the left-hand side of the screen for Pie Face, or is that something different?---My assumption is it does connect.

Okay. And we see that it said:

> *Sales as per projected cash flow $525,000 which is below benchmark.*

?---Yes.

And then:

> *Gross profit –*

I'm not sure why that's redacted. It's not subject to a non-publication direction, but the:

> *Gross profit is 63 per cent.*

?---Yes.

And it's noted there that that's one per cent more than benchmark. If we can just pull that down again so we can actually see the benchmark. So the benchmark at the low, average and high scenario is 62 per cent?---Mmm.

So this is just pointing out it seems to be one per cent higher than that benchmark?---Yes.

And then at the bottom of the page:

> *Average weekly sales of $10,750.*

It says:

> *... which reflects to the above, but not within the benchmark.*

And we can see over on the left-hand side, looking at the detailed financial information that Westpac had available about Pie Face franchises?---Mmm.

That the low – the low average weekly sales is $13,000 and the average is $17,000 and the high is $21,000. Is that something that – so that difference, then, between the average weekly sales being shown and what Westpac knew or had available to it from its benchmarking, is that something that you would expect to have been of concern?---It should be noted, and it was.

And I just want to chase that through. How far does that go, though, from your perspective? If you're being a responsible banker, what are you supposed to do with that information?---Well, the – what the – what the banker did note here was that:

Not within the benchmark. However, as mentioned before, this is due to the store being a small store and all figures reflect on each factor.

So it's – so they were recognising in the submission that this was a kiosk-type store, and I've read that somewhere else – apologies, I can't recall where – so it was a – and I'm not sure why, but, you know, I think the deal was slightly changed a little bit. It was of the smaller end of their stores because it was kiosk.

If you just turn over the page to .1027. This might be the part you're referring to. At the top of the page - - -?---Thank you.

Continuing:

This is a small store in the shopping centre. Kindly note that the store is a kiosk style store.

?---Mmm.

Were there many – although having said that, were there many Pie Faces that weren't kiosk styled stores?---I'm not going to be able to help you there, sorry.

I take it you never ate at Pie Face, Mr Welsh. It turns out not enough people did. So the – what I want to just understand, though, is when you look at this transaction assessment, the way that it's put is that the assessment is lower than sector policy benchmark for Pie Face. And then it said – well, that's explained by the fact that the store is a kiosk-styled store. And it said:

Our customer is purchasing the Pie Face. However, this will be fully secured by their residential homes.

And does that suggest that the comfort for the bank in this is that the residential homes are available as security, and so that makes the bank more relaxed about the fact that the performance is not in line with the franchise benchmarks?---I'd use slightly different words but what it – what it signalled to the banker is you – you start to look for other mitigations. So my read of what the banker was saying here, the other mitigation is that you have other incomes and other security. So you moved away from just looking at this transaction and you look at the broader – what's involved in the transaction. And then that's quite a normal part. You expect risk come up and then the – you expect the banker to mitigate them and look more broadly around what the – what the mitigants might be.

All right. And I take it, apart from the things that were concluded by FOS, looking back through these documents, there's nothing in it from your perspective that suggests that there was something inappropriate on the part of the banker in accepting the information that was provided and the way that information was assessed and then, ultimately, in the making of the loan?---Broadly I'm – I'm happy with it. There's a few things that I've read that I'm not – that I would have liked to have seen more information. There's a few gaps there that – that I would have liked to have seen filled and – and a bit more explanation around. And you can see that later in the file where there's a bit of toing-and-froing from the credit – the credit officer on a number of options and questions coming back. So there was, obviously, lots of discussions going on as the deal got built up and bits of information was flowing around, but there were – there's – there's still a few gaps there, though.

All right. And we can go to these documents, if you wish. I assume you've looked at them – or they've been provided to you. You know that Westpac hadn't conducted a review of the Pie Face franchise system in 2012?---Had not – sorry?

Had not conducted a review in 2012?---Correct.

And in 2013 – I'm assuming you have seen there are some internal notes or emails where it's noted that no review had been done in the preceding year?---Yes.

And at that time, Westpac decided that it was – it would suspend the accreditation of Pie Face?---That is correct.

And in suspending the accreditation of Pie Face in 2013, Westpac was concerned about two aspects, I think. One was the risk of any – of lending it had made to Pie Face, the franchisor; is that right? Or is it only concerned about the second aspect, which is that there's – it's whether it should lend to additional franchisees having regard to its concerns about Pie Face?---There were – there were two bits. It was the lending – any lending to the franchisor - - -

Yes?--- - - - that was parked and kept separately. Then it was the – typically, when you are looking at a portfolio like this, you're looking at future – future – whether you're going to be accrediting future franchisees. So at that point, we determined to remove the accreditation.

And the concern is, as to the second part, that, having regards to your concerns about the system at that time, that it's no longer – it's no longer safe, I think, might be one way of putting it, to be lending in accordance with the policy to franchisees?---Well, the – the specifics on this one was that they had a tax liability, and tax liabilities are a signal that – that all might not be going as well, and they had had a number of calls on some guarantees. And – and that's – when you're getting those, there's – there's – there's – it's – it's a trigger that something's up. And we made the call until we could remediate that position or got more comfortable with it that we wouldn't allow any further lending to franchisees under the sector policy.

All right. And I think, perhaps just to – so that we can nail this down to a time period, can we bring up WBC.404.014.0582.?---Give me a hand on the tab.

That's not in your folder?---Okay. I don't know that number.

And I think this is the – this might have been one of the types of documents you were referring to. You have had a look at these chain of emails before you have given evidence, I assume?---Yes, I have.

Okay. And so what happens is that the – if we take the – we don't necessarily need to do the earliest email in time, but if we take the email at the bottom of the page on 26 July 2013, it said:

> *Franchisor has gone* - - -

?---Can I just go down to it, so I can see what you're reading.

Yes. Sorry?---Thanks.

Continuing:

> *Franchisor has gone E35 due to tax arrangements. Franchisor facilities are fully cash secured.*

What does "E35" mean?---E35 is a risk grade that we use for our watch list clients.

All right. And it's then explained that:

> *While there may be reasons around this, I consider the situation completely unacceptable for a franchise/intangible lend.*

?---Yes.

And then the response is:

> *I agree. There are enough warning signs here which effectively mean we have little choice, but to remove accreditation.*

?---Yes.

I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 3.23, emails between Skujins, Jacquier and others, 26 July '13, WBC.404.014.0582.

EXHIBIT #3.23 EMAILS BETWEEN SKUJINS, JACQUIER AND OTHERS DATED 26/07/2013 (WBC.404.014.0582)

MR HODGE: And then if we go to .0003 – I'm sorry, WBC.416.004.0003. So this is another chain of emails, but I just want to deal with the email on 30 July which is at the top of the page which is the next day, and you will see again that what this is confirming is that:

> *It will be prudent at this point to suspend Pie Face accreditation until a review is completed to the satisfaction of credit policy.*

?---Mmm.

It sets out various warning signs including, by this stage, franchisee legal action, and then says:

> *If we as a bank are not prepared to lend to the franchisor, it does not seem wise to lend to the franchisees on an intangible security basis.*

And that reflects the decision that was made, and I think recorded in your – or you explain in your statement – by Westpac to suspend the accreditation?---That's correct.

And the point of this is at this point in time, by suspending the accreditation, what's happening is that the bank is no longer lending on what's described here as the intangible security basis. It's no longer just sticking to that sector value ratio approach?---A – a banker is no longer to utilise that policy for new business.

But that policy, in any event, was not used for the loan to Marjo?---That is correct.

All right. And - - -

THE COMMISSIONER: Is that email chain going in?

MR HODGE: Yes, I tender that, Commissioner.

THE COMMISSIONER: Exhibit 3.24, email Jacquier, Watt and others , 30 July '13, WBC.416.004.0003.

EXHIBIT #3.24 EMAIL JACQUIER, WATT AND OTHERS DATED 30/07/2013 (WBC.416.004.0003)

MR HODGE: Commissioner, is that a convenient time? I won't be that much longer with Mr Welsh, but perhaps if we just bring him back at - - -

THE COMMISSIONER: 2 pm.

MR HODGE: - - - 2 pm. Thank you, Commissioner.

ADJOURNED **[12.59 pm]**

RESUMED **[2.00 pm]**

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner.

Mr Welsh, I just wanted to go back to something you were explaining before the break, or before lunch, about that annual versus three-yearly review. Can we bring up tab 4 to your statement, which is WBC.409.004.0206. This is the Franchise System Accreditation Standards?---Yes.

And you explain in paragraph 53 of your statement that reviews were governed by this standard?---Yes.

And I thought, before the break, you were referring to short-term versus – sorry, short form versus long form reviews?---Yes.

And under the Franchise System Profile at the bottom of the page, you see there's a reference to:

> *Annual reviews long form.*

And then a further reference to:

> *Franchise system annual review.*

And it explains that there's – you are to do an annual review if it doesn't meet the requirements for a short form annual review?---Mmm.

And is that the point that you were making before lunch, or were you suggesting something slightly different as to your understanding of how the policy - - -?---No, no, that's the point I was making.

Yes. That if you satisfied the – if a franchisor satisfied the criteria, there would just be a short form review done annually; is that right?---Yes. Yes.

So there would always be a review, but it would be either short form or long form?---No, that's - - -

If you go, perhaps, to page .0209. You will see there is the two type short form annual review and long form annual review?---Mmm.

Is that – that's slightly different from your understanding, I take it?---It is.

You had thought it was only necessary to do – at the time, that is back in 2011/2013, you only needed to do a review every three years?---Under the short – franchise system can only qualify for short time reviews, two years – every three years, each system must be reviewed in the long form.

Yes?---Yes, that's the - - -

So each year, there's to be either a short form annual review or a long form annual review?---Let me just – sorry, can you just give me a moment to – to clarify that.

Sure?---Sorry, my – my understanding of – of this is – you can see on the – the page you drew me to, 0209, you see that on the last dot point in that first box:

> *Every three years is the long form review.*

That's where – from there. So am I following you correctly?

No, I think we're in disagreement?---Okay.

What that box says is:

> *Franchise systems can only qualify for short form reviews two years in succession.*

?---Yes.

Continuing:

> *Every third year each system must be reviewed in the long form.*

?---Yes, yes, in the long form

So there must be a long form every three years?---Yes.

And each year there's to be an annual review; you agree with that?---I – the – the practice that we adopted, there was a material change. You know, if there was a change. That's what – that's what I thought occurred there. I might have got that wrong.

And, again, just to clarify, the short form annual review, when you look at the requirements of it, it's pretty limited?---Yes.

It would only require updating the franchise system profile document with current details provided by the system?---Yes. Yes.

If provided necessary?---Yes.

And within the general comments section - - -?---Yes.

- - - of this document:

> *The FDM is to provide an undertaking and confirm that no adverse features are known.*

?---Yes. That did not occur.

And – that didn't occur?---Yes.

And so let's just break that down. The first thing is there was no undertaking given by the FDM, who is the franchise – is it franchisor development manager?---Franchise development manager.

Franchise development manager. The franchise development manager didn't give an undertaking in 2012 that no adverse features were known?---That's correct.

In – and I should – in respect - - -?---I – I haven't seen - - -

In respect - - -?---Sorry.

- - - of Pie Face?---Yes, I – I haven't seen one, so I – I don't know whether they did or they didn't, but we weren't able to – to find one, but I wasn't able to sight one.

And under this policy, in the absence of that undertaking, a long form annual review was to occur?---Yes.

And the long form annual review should have occurred for Pie Face in 2012, but it didn't?---I'm getting a little confused, please.

Yes. Let me break it down. A phrase I think I'm using quite a lot. The – not just with you. The franchise development manager had to provide an undertaking that no adverse features were known; that's one of the requirements?---Yes. Correct.

And if you look up the page under qualifications for short form annual review, one of the qualifications was the provision of that undertaking?---Yes.

If you didn't qualify – if a franchise system didn't qualify for short form annual review, then the franchise had to be reviewed under the long form annual review?---If it didn't qualify – meet those hurdles, yes.

Yes. Pie Face in 2012 didn't qualify under the qualifications for short form annual review?---I – I don't know.

Well, they could only qualify if there was an undertaking that had been given?---I – I haven't seen an undertaking. I couldn't find it.

And no one could find an undertaking?---Correct.

And, therefore, it would appear as if what was necessary was a long form annual review?---If a short form wasn't done, but 2012, we weren't able to find one.

And had a long form annual review been done, then it would have been necessary – it would have been required that necessary documents and financial information be obtained from the franchise system?---A long one, yes.

Under the long form; that's right?---Yes.

All right. And then can we bring up WBC.409.003.0240. So this is the deal header in respect of Pie Face. That's the franchisor; is that right?---Yes.

Or the franchise system?---Yes, it is.

And if we go over to page .0241, and the type is quite small. If we just - - -?---If you could use that blow-up technique, that would be useful.

Yes. If we blow up the section under the – in the first box dated 9 February 2012, if we blow up the paragraph at the end of that box beginning, "CRAA indicates." So who is the CRAA?---Don't know. Sorry.

Okay. Well, what does it stand for, or you're not sure?---Not sure.

Credit risk assessment something?---It might be. I - - -

And - - -?---Not so good on 2011 acronyms.

And it explains there has been a default that's been loaded in respect of Pie Face and then concludes by saying:

> *We will also require financial statements to ascertain trading position and reassess CRG.*

?---Yes. That's correct.

And then if we - - -?---Yes.

- - - take that down and blow up under the section 28 February 2012?---Mmm.

And blow up the section under Housekeeping Issues, in the middle of the page. Where it – so this is as at February 2012:

> *Upon receipt of latest financials deal to be submitted and background/business risks section in sponsor memo, updated with relevant information to fully*

understand how the business operates including details/location of retail stores, directors/shareholding details.

?---Remind me of that date, please?

That's 28 February 2012?---Thank you.

And then if we come down to 27 March 2012, and then we blow up the section – if we just note there's a phrase which is:

Default against Pie Face was dealt with via TLW deal number 1013555049.

Do you know what that means?---Yes, I do.

And what does that mean?---That's reference to another credit memo like this. So this is – this is the banker's credit memo. The banker of the Pie Face franchisor.

Right?---So this is the – the banker's notes. This is the banker's TLA record of that, which is the lending origination system – lending system.

And it means what had been a default against Pie Face had been dealt with by a TLW deal. What does TLW deal mean?---That's a previous – one of the – so what – what we're working through here is the previous background of the decisions. So there'll be another submission like this that will have – where they would have worked that through. So if you track down that deal number, that would be – there would be another submission that would cover that.

That deal number is the very first one on 9 February 2012?---It's hard to follow, but - - -

That's all right. And then as at 18 October 2012, if we blow up the last four lines at the bottom of the page. You will see it is said:

Pending current financials being reviewed.

?---Mmm.

So as at – it appears as at 18 October 2012, the financials hadn't yet been – the review of them hadn't been completed?---For this submission for – at that time?

Yes?---Yes.

And have you seen any record of the receipt of all of Pie Face's financial statements in – or financial statements from Pie Face in 2012 by Westpac to ascertain – effectively, to carry out an annual review during that year?---No, I haven't looked into the franchisor records.

Okay?---Apologies, I – I didn't think that was part of - - -

No, that's all right?--- - - - what was required.

And then by beginning of 2013, if we go over the page to .0242, and by 27 February 2013, if we pop out the first line underneath that, beginning, "Deal declined." See:

> *Deal declined by DE –*

what's DE stand for, do you know?---Don't know.

Continuing:

> *Deal declined by DE due to connection –*

and the connection is Pie Face; is that right?---Correct.

Continuing:

> *Pie Face not being in good standing. One default and two judgments listed against the company in CRAA.*

?---Yes. Yes.

And then - - -

THE COMMISSIONER: Possible view may be that that's Credit Reference Agency Australia.

MR HODGE: Thank you, Commissioner.

You agree? You think that's what it means?---I think so, but I don't know.

He's much better than I?---Yes. No, no, no, I - - -

THE COMMISSIONER: Flattery will get you nowhere, Mr Hodge.

THE WITNESS: I am, but I'm being a little more careful on - - -

MR HODGE: I mean, I would say that, but - - -

THE WITNESS: - - - on what I call on this now.

THE COMMISSIONER: Flattery will get you nowhere, Mr Hodge.

MR HODGE: That's not been my experience, Commissioner.

THE COMMISSIONER: Well, I won't go there.

MR HODGE: The – and then subsequently, as we know, we come then four months later to when the suspension occurs from Pie Face?---Yes. Yes. Yes.

Now, what I'm interested in is, from the bank's perspective, does it – is its reflection that not having conducted an annual review in 2012 was a failure on its part? Something it ought to have done?---No, no, I don't – I don't think – sorry, an annual review – a short form review of the financials?

Well - - -?---A form – short form review of the franchising operating system, are you asking about?

No, at the moment, I'm asking about a long form – I think I should be more specific?---Okay.

Does the bank regard it as a failure or oversight not to have conducted a long form annual review in 2012?---I think we're muddling a few things here. Maybe if I can just clarify something of my understanding on this. This – this here is the record of lending to the franchise system. So this is our banker writing their normal deal. And so those references there for overdue accounts are quite normal as you're getting their accounts to make an assessment of the – the guarantees and the facilities that we find. So that's an independent assessment of the – the franchisor as – as it just so happens that we are the – we were the banker to them. So that – that's at one end, and it – it needs to be split quite differently from what the franchise development manager would do. What the franchise development manager should do is do a short form report and I was not able to find that short form report. So I don't know whether one was done or not done.

I understand. What you're – and let me put it back to you to see if I've correctly understood it. You're saying you have to draw a distinction between, on the one hand, the lending by the bank to the franchisor?---Yes. Yes.

And on the other hand, the lending by the bank to the franchisees to the franchisor?---Yes, I am.

That's the first part. And the second part is this document that we're looking at which is identifying problems, and problems dating back to the beginning of 2012, that's problems in relation to lending to the franchisor?---Yes.

And there's a separate process or a separate person who ought to be responsible for managing the franchise system and lending to the franchisees?---Yes.

And under the policy, that person doesn't appear to have given the necessary undertaking, so that only a short form annual review is required?---I – I don't know.

You haven't been able to find it?---I haven't been able to find it - - -

But in any event, it's not evident that any long form annual review was carried out in 2012?---Correct.

And the fact that no long form annual review is carried out in 2012, to return to my question from a few minutes ago, is that something that Westpac regards as a failure on its part?---Well, if the short form review didn't occur, it would be, yes.

All right. And beyond that, is it fair to say what the consequence of that might or might not have been for any franchisees that Westpac was prepared to lend money to in 2012 and the first half of 2013 is, from Westpac's perspective, just a matter of pure speculation?---Sorry, can you – I'm – I'm not quite sure – I'm - - -

Let me put it another way?---Thank you.

We have no idea what it is that would have happened if Westpac had performed a long form annual review of the Pie Face franchise in 2012?---Correct.

We just don't know?---You don't know.

And whether it would have resulted in the action from mid-2013 being brought forward a year earlier and suspending accreditation, we just don't know?---That's correct.

And if Marjo had come in August of 2013 to Westpac, rather than in 2012, and sought money to buy an existing Pie Face franchise – so take that as the hypothetical?---Mmm.

Having regard to the suspension of the franchise system, would there have been a different outcome as to whether the money was loaned out to Marjo?---Hypothetically, yes. And if they were borrowing under the franchise policy.

Because they weren't borrowing under the franchise policy?---No – yes.

But when it came to the assessment of whether to make this loan or not, would it have made any difference at all?---Well, I think the – the benchmark still would have stayed the – the – the benchmarks would have been relative. So it may have made a difference, but it's hard to speculate.

Yes. Was the point that when it came to the income, when you were dealing with it in 2012, you had the benchmarks but they weren't being assessed under that franchise policy that required assessment with respect to the benchmarks; that's the first point?---We don't know that because we couldn't find the – the short form.

No, I'm sorry. I've confused things. In 2012, when Marjo applied for money - - -?---Yes. Yes.

- - - it wasn't assessed under the franchise policy?---You got me back. Yes. Yes, I'm on that.

And yes, there were benchmarks within the franchise policy, that it's obvious that credit people within Westpac took into account in looking at Marjo's facility, but they weren't determinative in deciding whether to make the loan to Marjo?---I think the – the bench – the benchmarks would have been looked at, and one of the things that was – was factored in, you'd use a number of different things to pull information, historical accounts, forecasts, the benchmarks. So you're trying to put together the puzzle.

All right. And – well, the way in which, ultimately, the cash flow was tested was by evaluating cash flow and serviceability in two different ways for Marjo?---Yes.

And are you able to – I can take you to the FOS determination if that would help. Maybe just as a reference point?---Mmm.

If we go to WBC.404.012.0507 which should be tab 58 of your document, and if we go to page .0518 and blow up the part at the bottom of the page which is:

> *Cash flow projections relied upon by the FSP showed there was net cash available for debt servicing.*

?---Sorry, just – there we go. Thank you. Yes.

So there's this reference to the two different cash flow projections?---Yes, yes.

Are you able to just explain to the Commissioner, what's the process that's involved here for coming up with these two cash flow projections by Westpac?---So the – these are the two cash flows that the – that the company provided through their accountant. So they're the – in one of the previous tabs there, the – the cash flow, and that's the top line revenue of 300,000 as a – as a base case, and the second one, cash flow 2, is the other alternative. They provided two cash flows through their accountant.

And these were the two that were provided by the applicant to Westpac, and then used by Westpac in order to decide whether or not to make the loan?---Along with a number of other things, yes.

All right. And one of the things that Westpac did was to do a – attempt to do some sort of stress test of these? I'm not – I'm using the word stress test. I'm not sure that's Westpac's word, but is it – that's what was - - -?---And a – a number of different scenarios. They looked at a number of different scenarios and tested those assumptions, and the credit – you see that these were the two that the – the banker did and the credit officer did. It's a number to – a number of them.

Yes. If we go to page – I'm sorry, to tab 38, which is WBC.404.001.1018 and go to page 1024?---Mmm.

This is something we looked at before under the heading Serviceability and Clearance Risk. Can we just blow that up. And this, as I understand it, are the scenarios done by the banker, rather than by the credit officer; is that right?---That's correct.

All right. And the banker's second scenario seems to be that ICR which is – is that interest cover ratio?---Yes, it is.

Continuing:

> *Interest cover ratio is below requirements. Loan requested will be fully secured by residential properties.*

And I think that might – I just want to be clear about this. That might be the banker's – the way in which the banker has framed it, but from Westpac's perspective, there are two different serviceability scenarios that have been done by the banker?---Yes.

That's the first point, and the second point is there are other ways – this hasn't just been left by – just automatically accepted by the credit officer. The credit officer has also looked at this as well?---Correct.

And the fact, therefore, that the effective level of the lending is effectively 125 per cent of the purchase price of the business, or something in that – or perhaps 110 per cent of the purchase price of the business, because – I'm sorry, $330,000 plus the – a further 32 and a-half thousand dollars for various things?---Mmm.

That – that's not lending that is simply derived from the fact that there is an asset. That's the first point. It's not from a residential asset?---Sorry, I don't understand the question.

I'm sorry, I've put that very badly. When you read this note, what I'm trying to get you to confirm is, perhaps, what's obvious, but we ought to make clear, and that is this isn't something where somebody is prepared to do this just because there are residential properties available as security?---That is correct.

There are a lot of other things that are taken into account in trying to assess the serviceability by Westpac?---Yes.

And it's certainly not the case that Westpac was comfortable just lending money without being satisfied on various scenarios that it was possible to service this loan?---Yes.

And as it turned out, this loan failed – or the business failed and the loan couldn't have been repaid?---Yes.

But, as we heard yesterday, there were many factors that went into the failure of that business?---Yes.

And that's certainly the view that Westpac takes, that it was prepared to back a business to lend money, and as it turns out, it's unfortunate that it failed, but as you've said, you don't think there was anything wrong in the way in which you went about doing it?---That's correct.

Now, the other thing that I want to ask you about then is the collections notices. Is this something you do accept Westpac got wrong, the collection – the sending of the collection notices?---Yes, I do.

All right. And if I can just summarise a few elements of this. Ms Messih made a complaint to FOS and the consequence under the Terms of Reference is that the SFP – that is Westpac – ought to have stopped sending the collection notices?---Yes.

After the complaint had been made, Westpac's records are of 13 text messages being sent between 17 November 2016 and 3 December 2016?---Yes.

And I will just get up the document that you've exhibited. I just want to ask you a couple of questions about this. It's tab 68. If we go to WBC.404.012.4242. So this is the internal record that Westpac has kept; is that right?---This is one of the records.

All right?---This is the one that tracks the texts.

All right. And are you able to actually just explain to us what it means? What's the SMDES2. And then once we get over the page, DST?---No, I'm not able to explain the detail.

All right. Somebody has told you that it means that 17 text messages were sent?---13, I think it was, wasn't it? Or was it 17?

I'm sorry, 13 text messages over the course of - - -?---No, no, I – we did – this – this is – this isn't a great format of that, but, yes, there are – there were 13. Sadly, there were 13 text messages that shouldn't have been sent.

Yes?---They shouldn't have been sent to Ms Messih.

And there's two things I want to ask you about?---Mmm.

Now, one is this is obviously a breach of the Terms of Reference of FOS that Westpac had signed up for, and that's a problem?---Yes, that's correct.

Would it be a problem to send this many text messages to a customer trying to collect a debt if they hadn't made a complaint to FOS?---Making a complaint to FOS isn't the determination for us. This shouldn't have happened.

I see. So the problem is not simply the fact that it was a complaint while the FOS – sorry, it was sent while the FOS complaint was on foot, the complaint was also sending this many automated collection notices?---Yes.

All right. And do you know whether there has been investigation as to why it is that Westpac's systems did this?---The – I don't know whether there was an investigation, but I – I asked that question, and there was an explanation.

And what was the explanation?---The – the explanation was that we had been working with Marjo and the related parties and we tended to be focusing on the business. This was Ms Messih's own home loan, and that was not connected to the business, an error by us. So that's where we – we made an error by not having to manually load up the "do not contact code" for her for – for her home loan. We had it on the business and those sorts of things, but not on her home loan. We made that error.

Yes. I'm not sure that quite addresses the issue. So you're pointing out that she made a complaint to FOS and the complaint included her home loan and, therefore, the "do not contact" flag should have been put up with respect to the home loan; but it wasn't; is that right?---That is – yes.

And that the manual error is failing to load the "do not contact" flag in in light of the FOS complaint?---Yes.

But that means what otherwise happened was just the usual automated consequence that would happen without a FOS complaint?---I – I don't – I didn't investigate that, sorry. I didn't look at that, so I don't know.

And do you know whether anybody has investigated why it is that this would occur absent a FOS complaint?---I – it wasn't an area I – I explored here.

But, certainly, from your perspective, that's unacceptable behaviour by Westpac to be sending debt collection text messages to a customer, in effect, 13 times in the space of 17 days?---It's not an area of my expertise, the collection side, but I – but I – but yes, that – that seems a lot to me.

Thank you, Commissioner. I don't have any further questions.

THE COMMISSIONER: Thank you. Yes, Ms Neskovcin.

MS NESKOVCIN: Just two matters, please, Commissioner.

<RE-EXAMINATION BY MS NESKOVCIN [2.32 pm]

MS NESKOVCIN: First of all, Mr Welsh, you were just asked some questions a moment ago about the FOS determination and the reference in the FOS determination to two cash flows. Would you like me to bring that up again so that you can have a look at that?---Yes, please.

One moment. It's tab 58 in your folder, Mr - - -?---Which one?

It's tab 58 in your folder?---58, thank you.

It's WBC.404.012.0507?---Yes, I have it.

And it's at page 0518?---Thank you.

There's reference there to two cash flows. I think you said they were cash flows provided by the Marjo accountant?---Yes.

And could you now go to the other folder, tab 34. This is document WBC.404.001.0302?---Yes.

Is it your understanding that – if the operator could just scroll through that document and –

Mr Welsh, you have seen this document before?---Yes.

Is it your understanding that this is the cash flow referred to in the FOS determination?---Yes.

And did you satisfy yourself from your review of the file that that was the cash flow projections provided by the Marjo accountant?---Yes, I did.

Secondly, you were asked some questions a short while ago about an annual review of the Pie Face franchisor in 2012?---Yes.

And whether or not there was a long form or short form review conducted?---Yes.

If the operator could please call up WBC.409.002.0418.

THE WITNESS: Thank you.

MS NESKOVCIN: You see that's a franchise system profile for Pie Face in August 2012. Do you recall when the Marjo loan was applied for and granted?---Around that period.

Or was it shortly before?---Yes.

And if the operator could go to the next page, please. And to the page after that, please.

I don't mean to rush you through this, but perhaps just to assist with timing, I might just direct you to the next page, 0421. Just so that you get an idea of what's in this document?---Mmm.

If you could – if the operator could move to 0425.

You see this – you were shown a similar – a document with a similar profile, but it was a different document?---Yes.

You see this document also has the benchmark results in categories low, average and high?---Yes.

And you will see the reference to "the last review and this review", and you note that the date for this review is 30.8.2012?---Yes.

And if we could go over to 0427. Mr Welsh, are you able to say whether this is a short form or a long form review. There are further pages if you need to look at those?---This would be the long form one.

So do you believe based on this document that a long form review was conducted in August 2012?---Yes.

Nothing further, Commissioner.

THE WITNESS: Thank you.

THE COMMISSIONER: Was this document in evidence, Ms Neskovcin, or not?

MS NESKOVCIN: Yes, please, I tender that.

THE COMMISSIONER: Exhibit 3.25 will be Franchise System Profile – of what date, Ms Neskovcin?

MS NESKOVCIN: August 2012.

THE COMMISSIONER: August 2012, WBC.409.002.0418.

EXHIBIT #3.25 FRANCHISE SYSTEM PROFILE DATED AUGUST 2012 (WBC.409.002.0418)

MS NESKOVCIN: Thank you, Commissioner.

THE COMMISSIONER: Yes.

MR HODGE: Can Mr Welsh be stood down, Commissioner?

THE COMMISSIONER: Yes, thank you, Mr Welsh. We will see you again, I think, later in the week, will we not?

<THE WITNESS WITHDREW [2.38 pm]

THE COMMISSIONER: Mr Hodge, where do we go from here?

MR HODGE: The next witness is Ms Separovich. She will be very brief, Commissioner.

THE COMMISSIONER: Yes.

<CAROL SEPAROVICH, SWORN [2.38 pm]

<EXAMINATION-IN-CHIEF BY MS NESKOVCIN

THE COMMISSIONER: Do sit down. Yes, Ms Neskovcin.

MS NESKOVCIN: Thank you, Ms Separovich. Is your full name Carol Separovich?---Yes, it is.

And your business address is 275 Kent Street, Sydney, New South Wales?---That's correct.

And your occupation is Head of Reward and Performance Management for consumer bank, business bank and support functions at Westpac group?---Yes, that's correct.

Ms Separovich, did you receive a summons to attend the Commission today?---Yes, I did.

If I could tender that. That's the original of the summons.

THE COMMISSIONER: Exhibit 3.26, summons to Ms Separovich.

EXHIBIT #3.26 SUMMONS TO MS SEPAROVICH

MS NESKOVCIN: Ms Separovich, you've prepared two witness statements. Do you have both of those with you?---Yes, I do.

The first witness statement is in relation to Rubric 3-10?---Yes.

Do you have that?---Yes.

Can I ask you to go to paragraph 17, please, Ms Separovich?---Yes.

You will see that paragraph 17 is under a heading Local Business Managers with the definition LBMs?---Yes.

And you see that paragraph 17 begins:

> *I set out the KPIs that applied to RMs.*

?---Right.

Is that an error?---Yes, I think it is.

Do you have a pen? What should it be?---It should be LBMs.

Could you just mark that and initial it, please. Is your statement otherwise true and correct?---Yes, I'm comfortable with it.

I tender that, Commissioner.

THE COMMISSIONER: Exhibit 3.27, witness statement Separovich concerning Rubric 3-10.

EXHIBIT #3.27 WITNESS STATEMENT SEPAROVICH CONCERNING RUBRIC 3-10

MS NESKOVCIN: Ms Separovich, you also prepared a statement in relation to Rubric 3-11?---Yes.

Do you have that in front of you?---I do.

Are there any changes you wish to make to that statement?---No, I don't.

Is the statement otherwise true and correct?---Yes, it is.

I tender that statement, Commissioner.

THE COMMISSIONER: Exhibit 3.28, witness statement Separovich concerning Rubric 3-11.

EXHIBIT #3.28 WITNESS STATEMENT SEPAROVICH CONCERNING RUBRIC 3-11

MS NESKOVCIN: Thank you, Commissioner.

THE COMMISSIONER: Yes, Mr Hodge.

<CROSS-EXAMINATION BY MR HODGE [2.41 pm]

MR HODGE: Ms Separovich, you're presently the Head of Reward and Performance Management for the consumer bank, business bank and support functions at Westpac?---Correct.

And you've been in that role since June of 2015?---So, principally, yes. I did have a short stint in the consumer bank as the head of HR there for about 10 months in 2016.

Right. You might just need to move in slightly closer to the microphone. Thank you?---Yes.

And you've given two statements. I'm just going to talk to you about one of them, which is in relation to the Marjo case study. And I just want to focus on some changes in performance – or key performance indicators between 2012 and 2017?---Mmm.

Is it fair to say there have been – Westpac has made a number of reforms to the performance indicators that it uses for its bankers?---Yes, over that time, yes, we've certainly made some changes and evolved our frameworks.

All right. And perhaps if we do this just by reference to some exhibits. Can we go to exhibit number 3, which is WBC.104.002.2449?---Yes.

This is the first half of 2012 scorecard review?---That's correct.

And does this explain what the role based scorecard is for a, amongst other things, Westpac local banker for the period of – I think 1 October 2011 to 31 March 2012?---That's correct.

And if we go to page 2462?---Mmm.

So this is the local business banker scorecard metrics and weightings?---That's right.

And perhaps if we just start with what the "gate openers" mean. So one of the gate openers, the last one Sales, is:

Achieve 80 per cent of revenue portfolio growth.

?---That's correct.

And another is:

LBB portfolio NPS.

What does NPS stand for?---So that's net promotor score which is our customer advocacy measure.

And is that a score that's arrived at by obtaining feedback from customers based on their dealings with Westpac?---Yes, that's correct. It – it would be, in this case, specific to that LBBs. Rather than the broader brand or branch, it would be specific to the banker.

Because there's two different – am I right in thinking there's two different ways in which you – or there's two different inputs into a net promotor score. One is the brand – or can be the brand score, the other is the individual employee score, and then they will get averaged?---So for – for this year, it was just the business banker score.

But at this time, it's only the banker that's - - -?---Yes, that's correct.

- - - taken into account. And if, for example, they get three people, let's say they've done an excellent job and one person that says they've done a satisfactory job and one person that says they've done a poor job, then there's a calculation that's made to determine what their score is?---That's correct, yes, yes.

All right. And what does it mean that there's these red boxes around two of those gate openers?---I don't know why the red boxes are around there.

They apply to all – so all four gate openers need to be satisfied; is that right?---Yes, all of the gate openers there would need to be satisfied to be eligible for variable reward.

And then in terms of that – I'm sorry. Go on. Were you saying something?---No, I was just saying they need to be satisfied to be eligible for a variable reward payment.

And the calculation of the variable reward payment is then done by reference to the balance scorecard?---That's correct.

And at the time, the balance scorecard weighted very heavily towards financial measures?---Yes, that's correct.

And in – well, if we take the first column, second half of 2011, there were two types of financial objectives which were portfolio revenue growth and branch revenue growth from SME, and then there was also a customer metric which also seems to be concerned with bringing in more customers; is that right?---So that was – well, it was growth in connections with eight plus products. So yes.

Or, I suppose, rather than bringing in more - - -?---If we - - -

- - - it's really a cross-selling - - -?---Yes, it reflects the depth of relationship with that customer.

A connection is a customer?---Yes.

And eight plus products means that they have risen up to taking at least eight products from Westpac?---Yes.

All right. And so this is measuring how many products the banker has managed to cross-sell to the connections?---It would take into account areas that the banker would have specifically supported that customer, plus other parts of our – our group may have also met those needs.

I see. And then, as you know, there was an independent review conducted by Steven Sedgwick in 2017 in relation to banking remuneration?---Yes.

And Mr Sedgwick concluded that financial gateways such as those that were in place in Westpac were a high-risk practice?---Yes, he recommended that they be removed.

And there have been changes that Westpac is now making to its KPIs and scorecard and gateways to try to reflect that?---Yes, we've already removed any financial gate openers in all of our arrangements.

So if we go to exhibit 9, which is WBC.107.003.1047?---Sorry, what was the exhibit?

It should be number 9 to your statement?---Number 9. Yes.

And go to page 1064?---Yes.

And this is – or this seems to now be the performance framework for a local business banker. It looks a lot more complicated. Can you explain how it works?---So we continue to have the same sort of gate openers around behaviours and our risk and compliance requirements as a start. Then the overall determination of their performance and their variable reward is determined by the leader taking into account their behaviours, their performance against our risk requirements, as well as the role-based scorecard. So, historically, the role-based scorecard was sort of the key component that would calculate their variable reward. It's now only one of the elements that the leaders will consider, along with their behaviours and risk sort of performance.

All right. And the changes that have been made over the last few years, they reflect - - -

THE COMMISSIONER: I think you need to go back over that. You lost me. Go back over the answer you just gave and explain it again, I'm sorry.

MR HODGE: Let's take it in a few pieces?---Yes.

So let's start with the behaviour and compliance gates?---Yes. So - - -

So the first point you were making was you keep, as part of your behaviour and compliance gates, behaviours and risk considerations?---Yes. The compliance gate is the mandatory training and the 10 days' consecutive leave. So if they don't comply against those, they're not eligible for variable reward. And then - - -

That's – and, sorry, just to pause, that's the – again, because it's a difficult diagram to follow. That is set out in the box down on the bottom left-hand corner:

> *To participate in variable reward these are the thresholds. The only thresholds are compliance and behaviour gates.*

Is that right?---That's correct. We no longer have any financial gates.

All right. And the part that is under Holistic Performance Assessment, that's the part then relevant to dealing with the actual amount or – of potential - - -?---Variable reward.

- - - variable remuneration that might be paid?---Yes, that's correct.

All right. And do you want to then just, again, take us through the process that this is setting out as to how that's assessed?---Yes. So the role-based scorecard, you know, continues to be in place for these roles, and the leaders will consider performance against both the financial and non-financial components and measures. But on top of that, we also wanted to give consideration to positive adjustments in variable reward for behaviours, and – and risk performance as well. So leaders actually take a more holistic view of how that banker's performed to determine their final variable reward, and – and we do have quite objective reporting and data to support the – the risk considerations component.

THE COMMISSIONER: You're going to have to explain that to me in words of one syllable, I'm sorry?---Sorry.

You are going to have to take it much more slowly?---Okay. So the final variable reward, Commissioner, is determined by looking at the scorecard outcomes.

Yes?---As well as how the banker has performed against clear risk requirements for their role. As well as have their - - -

An assessment made by the immediate line manager or leader?---So the risk considerations are actually determined by our second line risk team. So they will monitor and report and determine whether somebody has, you know, performed appropriately against that, but the leader will, you know, have access to that information. And then behaviours is in line with our Westpac Group values and also our Westpac code of conduct. Our leaders would consider how our bankers have behaved over the course of - - -

Now, pausing there. Those are subjective assessments made by the relevant manager; is that right?---Yes, that's correct.

And how are they recorded? Are they recorded as a score, or a grade from - - -?---Yes, historically, there has been an assessment for the behaviours, and it was recorded in our performance system.

Yes. Go on.

MR HODGE: So can we – I'm not sure whether this will help or hinder attempting to explain this a little bit better. If we go back to page 1057. And I wonder whether we – this is generic, rather than specific to the role?---Yes, it's the overall framework.

I wonder whether it's easier if we work backwards, which is, ultimately, the amount of variable remuneration that is going to be paid to a Westpac employee is done by a recommendation being made to what I think is – well, and then approved by the Divisional Remuneration Oversight Committee; is that right?---Yes, the overall spend.

And for each role, there's what's referred to as a target variable reward?---That's correct.

And is that the maximum – is the target variable reward the maximum amount of variable remuneration that an employee can earn?---No, it can be higher than that.

They can earn higher than the target variable reward?---Yes.

And is the target amount capped at one times the salary of the employee?---No, so the maximum variable reward is capped at one times salary.

Okay. An employee of Westpac can't earn more than 100 per cent of their fixed salary as a variable reward?---Yes, in these roles, you cannot earn more than one times salary.

And so for each role, there's, separately, a target variable reward that is set, and in order to earn that target variable reward, you have to have first passed through the behaviour and compliance gateways, otherwise, you get no variable reward?---That's correct.

And then when it comes to actually figuring out what part of that target variable reward you get, what is the mathematics that goes into that?---So, again, there would be some overall guidance provided to our leaders within the available pool that we have, in terms – in terms of variable reward. So if somebody was a good performer across all those elements, then we would give some guidance around how much of that VR target they could – they could, you know, vest for that individual. And, equally, if there was a higher performer, we'd provide a range for that high performance as well.

Okay. So there's – I don't know whether this is ultimately going to help us to understand this, but when you look at the scorecard goals on the right-hand side of the page - - -?---Mmm.

- - - where it's 50 per cent customer and 50 per cent financial, that is the only component or one component of what goes into this assessment being made of whether somebody is a high performer or not?---So it's one component.

Okay. And then a second component is the outcome of individual performance goals for the employee?---Yes. If there were some separate performance goals agreed, the leader would consider that as well.

And then the third component is the leader's assessment of whether or not the employee has met the role – what are referred to as the role deliverables and development goals?---Yes.

And that could also be a – that could be, I think you were saying, a financial goals or include financial goals?---Yes. The majority of the financial goals do sit within the scorecard.

Under the 50 per cent financial?---Yes.

But some financial goals will sit within the role deliverables and development goals?---So for – for these roles, the scorecard goals tend to represent the majority of the goals. It's – it's unusual to have anything else in role deliverables or individual, but it could happen.

And then behaviours and risk considerations are also taken into account in some way?---Yes.

And how is that?---So that is a discretionary determination by the leader.

Okay. And so there's guidance. Is that guidance set out in this document anywhere?---No. So the – the guidance would come once, you know, the business performance period has completed and we know exactly how much variable reward pool we have, and then we would give the guidance to our leaders to help them make those decisions.

All right. And is it – did I understand you correctly before to say it is possible to earn more as variable remuneration than what the target remuneration is for the role?---Yes, it's possible.

And if that's if you are assessed as performing exceptionally well?---Yes.

Okay. And the – what I think you referred to before as second line of – effectively, second line of defence assessment?---Yes, second line risk, yes.

Is that the internal risk and compliance section?---Yes, our internal risk function.

Okay. And what – could you just explain what the role is of the internal risk function in relation to setting remuneration?---Yes. So in terms of our framework they actually set the – the risk considerations for the role, and – and the appetite. Over and above that, they also will independently work with our reward governance committee to consider any matters, from either operational risk incidents, or outlier reporting that we might do, or misconduct that we're – we're aware of to make sure that we're comfortable with that leader assessment, and there's no further adjustment that's required for what we know through the second line team.

And is the idea of these various changes that have been made to deemphasise financial goals as part of assessing variable remuneration?---It's – it's certainly to reflect a balanced sort of set of considerations for these roles.

THE COMMISSIONER: Well, let me look at the right-hand box:

> *Scorecard goals will remain a strong indicator used in assessing performance.*

What am I to take away from that, Ms Separovich?---So it absolutely is still, you know, the key components of how we measure success for those roles and - - -

50 per cent of those are financial?---Yes, that's correct, but it - - -

Can I cut to the chase, Ms Separovich? When I go through the language, I see a lot of words there, but I am struck by the fact that scorecard goals will remain a strong indicator used in assessing performance and that, of those scorecard goals, 50 per cent are financial?---Yes.

Now, what am I missing?---So the variable reward is really our mechanism for people to share in our business success. And – and these roles, you know, play a key role in contributing towards, you know, achieving those – those goals. You know, we can measure their contribution down to an individual banker level. It's – it's a very objective view of their performance and contribution, and we know we can afford the variable reward if we've achieved that business performance. So there's a number of considerations around, you know, alignment to business performance, as well as, you know, a fair and consistent way for our people to be rewarded for how they've contributed to our success.

MR HODGE: Can I, perhaps, try to help you to contrast the way it was with the way it is. When we were looking at the scorecard as it was five years ago, there were a number of different criteria, and each of them would have a particular percentage allocated to them; you recall that?---Yes.

And was the way that it used to work that there was an amount – a maximum amount of variable remuneration that you could earn, and you – what percentage of that that you would get would depend upon what percentage you managed to achieve in each of those categories?---Yes, it was mainly a formulaic calculation.

And so a change from your perspective is that this is no longer a formulaic calculation of variable remuneration?---That's correct. It is more discretionary and more holistic than it was back in 2012.

And one significant change then, you would say, is that if you looked at the old scorecard five years ago, selling, either by selling to new business or cross-selling, was the fundamental way in which you went about earning the maximum amount of variable remuneration; do you agree with that?---Yes, it was the way we determined the variable reward we would pay to our bankers.

And in terms of that idea of encouraging what you want out of your bankers, at the time, it was inevitable that what you would be encouraging them to do was to sell?---So, I mean, selling is a – yes, and supporting customer needs is their role.

But what you're trying to do now is – I'm not trying to trick you, I'm trying to sort of help you and explain and answer the Commissioner's question – what you are trying to do now is to change the incentives and encouragements that you're giving to your staff; is that fair?---Well, I – I think what we're saying is – is we want to reward on a more holistic set of considerations, and historically, yes, it was anchored in the business performance outcomes and they were heavily financial.

Saying we want to do things in a more holistic way can be, from a lawyer's perspective, sound like management speak that doesn't necessarily carry a lot of meaning, but can I go – and I think that might be one of the things that we're just struggling with, but can I just try to highlight one thing that you're wanting to point out, which is – I think you're wanting to point out – five years ago, if you were an employee of Westpac, you knew unequivocally that 80 per cent, 85 per cent of your variable remuneration depended on things that were, effectively, financial goals?---It was the way we calculated that outcome.

And, now, if you're an employee of Westpac, you at least don't know that. You don't know that 85 per cent of your variable remuneration depends on hitting financial goals?---Yes, so it's not formulaic. Yes.

That's right. So on any view, you would say that – regardless of what exactly somebody understands from "holistic", there has been a de-emphasis on that intense focus on a sales culture?---Yes, but what I would say also is that the only time that somebody is considered for variable reward is where they meet our behavioural expectations and where they also meet the risk and compliance requirements for the roles. So they are only eligible to receive a bonus if they've done that in the right way.

All right. Commissioner, I don't have any more questions for Ms Separovich.

THE COMMISSIONER: Yes. Yes, Ms Neskovcin.

MS NESKOVCIN: Nothing for Ms Separovich. If she could be excused.

THE COMMISSIONER: Yes, thank you, Ms Separovich. You may step down.

<THE WITNESS WITHDREW [3.05 pm]

THE COMMISSIONER: Now, Mr Hodge.

MR HODGE: Commissioner, we're now going to change case studies. Could we adjourn for five minutes to switch the parties around.

THE COMMISSIONER: I will come back at shortly before 3.15.

MR HODGE: Thank you.

ADJOURNED [3.06 pm]

RESUMED [3.13 pm]

THE COMMISSIONER: Ms Dias.

MS DIAS: Commissioner, the next witness is Ms Riches. She is in the witness box.

<SUZANNE GAIL RICHES, AFFIRMED [3.14 pm]

<EXAMINATION-IN-CHIEF BY MS DIAS

THE COMMISSIONER: Thank you very much. Do sit down. Yes, Ms Dias.

MS DIAS: Your name is Suzanne Gail Riches?---Yes, that's correct.

Ms Riches, you have provided your home address to the Commission?---Yes.

Ms Riches, did you receive a summons to attend and give evidence before the Commission today?---Yes, I did.

Do you have a copy of the summons with you?---Yes.

I tender the summons, Commissioner.

THE COMMISSIONER: Exhibit 3.29 will be the summons to Ms Riches.

EXHIBIT #3.29 SUMMONS TO MS RICHES

THE COMMISSIONER: Yes.

MS DIAS: Did you make a statement to the Commission, Ms Riches, dated 18 May 2018?---Yes, I did.

When you prepared your statement, did you have regard to emails and documents that you had sent or received that you had retained?---Yes, I had retained them on my personal computer.

And did you refresh your memory about dates and other details by looking at those documents - - -?---Yes, that's correct.

- - - when you prepared your statement?---That's correct, yes.

Now, Ms Riches, can I ask you to turn to the bottom of page 3 of that statement and, specifically, paragraph 16. Are there any changes you would like to make to that paragraph?---Yes. Paragraph 16 should – should read that:

> *I submitted a formal offer from Sue Riches to the vendor for 275,000, not the 280,000.*

Do you have a pen there, Ms Riches?---Yes.

Can you please make that change and initial it?---Yes.

And with that correction, Ms Riches, is your statement true and correct?---Yes.

I tender the statement, Commissioner.

THE COMMISSIONER: Exhibit 3.30, the statement of Ms Riches of 18 May.

EXHIBIT #3.30 STATEMENT OF MS RICHES DATED 18/05/2018

THE COMMISSIONER: Yes.

MS DIAS: Ms Riches, what is your occupation?---My occupation is primary school teacher.

How long have you been teaching for, Ms Riches?---42 years.

In your statement, you refer to a decision to buy a franchise. When did you start looking into that?---It was early in 2012, around April, end of March/April. My husband had received an inheritance from his mother's estate and wanted to secure his financial future and was looking at purchasing a business.

And can you tell the Commissioner the franchise opportunities that you looked at around this time?---We looked at a couple of franchise opportunities: a Subway, in the southern suburbs of Adelaide in a very small shopping centre complex; two Wendy's outlets at the Westfield Marion shopping centre and another Wendy's outlet in the Myer City Centre.

And which franchise did you decide to buy, Ms Riches?---We decided to go for the two Wendy's outlets at Westfield Marion.

And were you given any documents at this time about those outlets?---Yes, from the sales consultancy, we received a business profile of the two Wendy's outlets at Westfield.

And can you recall anything from the documents – or the outlets themselves that made you want to buy those outlets?---We had – once we received the business profile, we passed it over to our accountant to do the due diligence on the figures and to let us know if it was a viable proposition or not.

And did you intend to work in the business yourself, Ms Riches?---No, I did not. I intended to keep working so that my wages would cover the current house mortgage and our living expenses for the family.

Do you recall becoming aware of the lease terms of the outlets?---We noted the lease terms in the business outline profile, yes.

And do you remember what they were?---The – the outlet downstairs was due to expire in September 2013, and the kiosk outlet upstairs in January of 2015.

And can you explain to the Commission a bit about the leases or who had the head lease, and then what the sublease was. Can you explain a bit about that?---Yes. The Wendy's Supa Sundaes organisation held the head lease with the Westfield organisation, and as franchisees, we sublet from the Wendy's.

Now, Ms Riches, did you need a loan to purchase the business?---Yes, we did need a loan.

And did you approach any banks about getting a loan?---Yes. We first approached the bank that my husband banked with, the Commonwealth at Westfield Marion and spoke to their loans – business loans officer and handed the necessary paperwork at a – at a short meeting.

And what did the bank say to you, the Commonwealth Bank, about the loan?---Excuse me – a couple of days later we contacted the bank again and went down there and she was – she indicated that they were unable to service the loan for us based on the information we had supplied them.

Was there any other reason given or - - -?---She did mention the short nature of the leases as a factor.

Now, you describe in your statement approaching the Bank of Queensland after that?---Yes.

And you went to a branch in Adelaide?---Yes.

Which branch was that?---That was the Pirie Street branch.

I see. Now, you describe about – in your statement about speaking with a branch manager there. There is a non-publication direction, Ms Riches, in relation to the name of that branch manager?---Yes.

So I won't refer to his name. I will call him the branch manager?---Me too.

Can you do the same?---Me too.

Thank you. So is that the person you spoke to when you first went to the branch?---Yes, we spoke with the branch manager.

And do you remember what you discussed when you first met the branch manager?---We discussed that we were very interested in purchasing the two

Wendy's outlets at Westfield, and through our son, an acquaintance of our son, who worked for the Bank of Queensland, that the Bank of Queensland were looking for customers and they might view our – our application favourably.

Did you discuss at this point how you would repay the loan with the branch manager?---No, it was basically to ascertain what document – the documentation that was, perhaps, required, and I guess we – we did mention that because the house and the block of land at Normanville was in my name only that it would have to be a loan taken out with myself as the sole director or applicant.

When you refer to sole director, which was the entity that you were referring to that you would be director of?---We were going to set up through our accountant a business Suerich Proprietary Limited ATF the Riches Family trust.

And you referred to securities before: a house and the Normanville lot?---Yes. Yes.

Can you tell the Commissioner?---We had a block of land in the Links Lady Bay golf precinct at Normanville and the family home at Hallett Cove.

And did you discuss the security in that the first meeting or - - -?---Yes, we did.

Okay. And did you provide the branch manager with any documents at that time?---I don't believe it was at that meeting. It might have been at the next meeting which was very shortly afterwards.

And do you remember what documents at that next meeting you provided to the branch manager?---I provided the deeds for the block of land and our house, taxation returns, PAY bank account statements with the credit union. Yes, I believe all the necessary documentation that they needed to ascertain my financial status.

And was any information about the outlets provided at that time?---I – I can't be certain whether we had the – at that – at that meeting whether we did have the business profile at that stage, but I know that it was very shortly delivered to the bank and to the accountant on the same day.

You've mentioned the accountant. Is that your accountant?---That's my accountant, yes.

And you discussed with him the business profile; is that right?---Yes, yes.

And what did he - - -?---He made a copy of it.

Okay. What did he say about that?---He made a copy of it and he wanted to review the figures that had been supplied by the vendor, and he was going to perform the due diligence on those figures for us.

Okay. Now, in June of that year – so approximately a few weeks later – did you get some further advice about the purchase from your accountant or your lawyer about the outlets?---Yes. The accountant wanted to also seek some advice from a noted lawyer in Adelaide. So I passed on the business profile to their firm to preview, and we received, via the accountant, notes after his perusal of the document.

Now, you don't exhibit this to your statement, Ms Riches, but it is an email that you received. I will pull it up. It's FOS.0012.0001.1249. You have seen this before, Ms Riches?---Yes.

And I know you can't see – this has been redacted, but you have been copied into this email. It's your email address in the CC field?---Yes.

Now, there's some handwriting on here. Whose handwriting is that?---That's my handwriting, my notes.

When did you put that handwriting on that email, Ms Riches?---I put that handwriting on the email before I forwarded it to you as part of the evidence that I had.

So this email – you didn't put the handwriting on this email during the FOS process?---No.

No. Okay. And the highlighting, is that - - -?---I'm sorry?

The highlighting, is that your highlighting?---My highlighting, no.

No. Okay. Now, you can see in that email, that the lawyer is saying:

> *Before committing to purchase, the Riches need to find out or confirm that new five-year terms are agreed for both the franchises and the leases from current expiry dates - - -*

?---Thank you.

Continuing:

> *- - - and what costs will be involved in the renewal. In particular, it will be important to find out what Westfield will raise the rent to and whether a refurb of the stores will be required on renewal.*

I will just pause there. So with the lease terms, did you conduct any further inquiries around this?---We did, through – we did through the Wendy's legal department. They indicated that it wouldn't be appropriate, seeing as we weren't the new owners of the business, to seek five-year extensions putting the vendor – the current vendor in a – in a situation.

Do you mean by that because the current vendor has the legal relationship - - -?---Yes.

- - - at that point?---Yes.

I see. And then in the bottom paragraph, the email says:

> *The bottom line profits already look skinny to me, especially if deemed salaries for proprietors working in the business have not been included in the salaries expense figures. I think large rent increases or large capital cost on refurbs would hurt these businesses.*

What did you think when you read that comment?---We were advised by our accountant that there was a – a small margin in the businesses. However, in discussions with the Wendy's franchise manager and other franchisees that we visited in the Wendy's franchise in other shopping centres, we were aware that Wendy's had a training program and protocols and strategies in place to be able to improve the profits by 10 per cent, and they were tried and true strategies that had worked for the company before. With my husband's expertise in the hospitality industry, as a – as a chef and a caterer, he was very confident that he had the means to be able to improve – improve that, the percentages.

Okay. Ms Riches, you made an application to the Bank of Queensland for the - - -

THE COMMISSIONER: What are we doing with the email, Ms Dias? Are we tendering it or what?

MS DIAS: Sorry. I apologise, your Honour – Commissioner. I tender that. I tender that email.

THE COMMISSIONER: Exhibit 3.31, email between Riches and Vlassis, 15 June 2012, FOS.0012.0001.1249. Exhibit 3.31.

EXHIBIT #3.31 EMAIL BETWEEN RICHES AND VLASSIS DATED 15/06/2012 (FOS.0012.0001.1249)

MS DIAS: Thank you, Commissioner.

Ms Riches, you applied for the business loan - - -?---Yes.

- - - at the Bank of Queensland; is that correct?---Yes.

And what loan amount did you apply for at that time?---280,000, I think, is on the loan application.

Okay. Now, before you made an offer to purchase the business you had a discussion with the branch manager about whether you could make the offer - - -?---Yes.

- - - without it being subject to finance. Can you tell me about – tell the Commissioner about the discussion that you had?---I was made aware that there was another possible person interested in one or both of the Wendy's sites, and so I was anxious to – to find out whether we would be granted a loan by the Bank of Queensland. So my son accompanied me and my husband, and we made an appointment with the manager. And after going through something – some discussion, I specifically asked him, "Given the information you've been supplied with and your calculations, are we in a position to be viewed favourably for this loan?" And I remember asking two or three times and specifically saying, "I am going to ask you a question. Will the Bank of Queensland be able to supply a loan for us?" To which he answered, "Yes."

And then you made an offer to the vendor?---On the basis of that, I – I then said – asked again, "So I can make an offer to – on the – on the two west – Wendy's outlets that isn't subject to financial approval?" He said, "Yes."

And did you make an offer?---Yes, I did.

And then you later signed a contract of sale?---Yes.

Your offer was accepted?---Yes.

Now, did you provide a copy of the contract to the bank after that?---Yes. The day I – I supplied the contract – I signed the contract of sale, I went straight to the Bank of Queensland and our accountant and they both made copies of the document.

Do you remember approximately the date that you did that?---It would – it would be around 4 July, because I took a day off school to do that.

Okay. Now, do you remember receiving a conditional letter of offer from the bank?---Yes, I received one in August.

And you've exhibited that to your statement at tab 7. That's BOQ.0001.0023.1417. And you see there, Ms Riches, the term is 84 months and the repayments are $4420 per month - - -?---Yes.

- - - for the indicative monthly repayment amount. Did you discuss these figures with your accountant?---I passed or forwarded this onto our accountant so that he had those figures to enable him to determine the affordability, but – and he – he said that we – it fitted into his figures, his calculations.

Okay. And after that, you did some training at Wendy's?---Yes. We commenced four weeks of training with the Wendy's organisation.

And you refer in your statement to a cooling-off period in respect of the purchase – the contract?---Yes.

When did you find out about that?---We knew that before we started the training with Wendy's. We knew that we had to do three weeks in stores working, and one week of administration at their head office. At the conclusion of which, there was a 14 day cooling-off period on the franchise agreement.

And do you remember signing the franchise agreement with Wendy's, and when that was?---Yes. We were given the franchise agreement in the second week of our training. And we were asked to initial the pages to save time, and then when we – I'm not clear, but I'm pretty sure the – the franchise agreement was forwarded to us by mail once the cooling-off period had elapsed.

And when do you think you provided a copy of that to the bank?---I know I was very expedient with all of the documents that I had to supply to the bank. It would have been after 5 October.

Now, the settlement date under the contract was varied. Do you remember what it was originally and what it was varied to, approximately?---It was around 5 October or 6 October originally, and I did sign an amendment – no, it was earlier than that. And I did sign an amendment to be around 8 October. Sorry.

Do you remember having discussions with the branch manager about what was causing up – causing the hold-up with the loan finalisation and the delays to the settlement?---Was this after the settlement date? Are you referring to after the settlement date had elapsed?

No, well, prior to that. Did you have any discussions prior to that, leading up to 8 October?---Prior – prior to that on 3 October, we visited the bank to speak to the manager to ascertain when we should pay the deposit money and the moneys that we had to put towards the settlement, the final settlement figure, and to which account they would have to be put into.

And did the branch manager tell you about what was happening with the loan at that time in getting final approval?---It – it was sort of at this point that he said there was a difficulty. I think I can remember him saying that perhaps the credit – the person who organised or oversaw the credit facility was away and he was awaiting him to come back.

And as you got closer to the settlement date of 8 October, did you make inquiries with the branch manager then as to what was happening?---Yes. I – I would have made a number of phone calls, and I know I did send a number of emails, reminding him of the settlement date and that the money needed to be in the conveyancer's account at that time.

And could you meet that settlement date of 8 October?---Had - - -

Did it take place on 8 October?---No, the settlement did not take place on 8 October.

And do you know why that happened? Why there was that delay?---I guess the – the final loan application hadn't been processed.

So after that, did you have any further discussions with the branch manager about trying to get the settlement on?---Yes. Many phone calls and emails, and I was assured that they hadn't exhausted all the possibilities.

What was the branch manager referring to in that regard, "possibilities"?---I don't know. I'm not sure, but it sounded as though they were – they were trying to find out a way to be able to service the loan.

And did he talk about what the credit department was doing or what might have been holding things up?---No. He did mention the nature of the leases, the short-term of the leases, and I was surprised at that because that would have been in the business profile that was supplied to – to the bank much earlier before the loan application.

Now, on 15 October 2012, you received the final letter of offer, and that's at tab 12 of your statement, BOQ.0001.0023.0014?---That's correct, yes.

Did you go to the branch to receive this? Is that where you received it?---Yes, I was – I was telephoned and told that the loan documentation was ready to be signed.

Now, at this stage, you hadn't met the settlement date?---Correct.

Had you had communications with the vendor about that?---Yes. The vendor's conveyancer sent – I believe it's a notice of default, and – and I was being charged interest for every day that we were late in settlement.

Now, if we just pan forward a couple of pages in that final document. You will see on the next page .1115, the facility amount is $280,000, but the repayments are now $8696.89 per month?---Yes. That's correct.

And the term of the loan is three years?---That's correct.

Were you given an opportunity to read all the documents in the branch at that time when you went in that day?---Yes, I was given – I was given the folder, and I read through the pages and came to that final letter of offer and noted that the amount and the term for the repayment was different.

Did you mention that to the branch manager?---I did mention it to the branch manager. I was alarmed that the amount had almost doubled from the 4400, and that the term of repayment was only three years.

What did he say?---He said that was due to the nature of the leases. That was the only way that they could get the loan through.

Did he say anything else about that?---He did mention that there could be a review after a year of the interest rates, and the repayment term.

Now, you went ahead and signed that offer and accepted that offer, Ms Riches; is that right?---Unfortunately, yes.

Why did you do that?---I felt I was in between a rock and a hard place. The cooling-off period had elapsed on 5 October. I had no way to get out of the contract. There was threat – threats of legal implications. Yes, I – I sort of felt I was in a no-win situation.

Now, after you took over the business, how did it – how did you travel with making your repayments?---It was very difficult because the delayed settlement date meant that we missed out on a very lucrative two weeks of school holidays, the Marion Shopping Centre is overloaded and crowded with school children and people on – on the basis of the figures from the previous year, we missed out on $40,000 worth of revenue which we were very – which made it very difficult when we were buying – buying stock and also to furnish the – the rent that was required for the next month. We only had a week to try to get the money together; whereas, had we gone in at the beginning of October, we would have had three weeks' trading, plus those two lucrative weeks of the school holidays.

And how did you travel in 2013? Were you able to make your repayments then on the interest and - - -?---I tried to make payments where possible when possible. I don't have the bank statements with me that verify actually how much I was able to put in, but it was very, very difficult to make those repayments.

And you mentioned that you had the Normanville lot. Did you end up having to sell that?---After – yes, that was after some time when the Bank of Queensland sent a notice of default on – on payments that we spoke with our accountant – or the – the notice came through the accountant's office as our registered office, and he – we had a meeting and discussed that the – perhaps, the way forward was to sell that Normanville lot.

And did you continue operating the two outlets in the Marion Shopping Centre?---We did until the lease on the downstairs shop ran out. Under advice from our accountant and looking at the figures compared to the figures that we were supplied with from the previous vendor, we decided that it was losing money and that it was probably better to let the lease go and concentrate on the kiosk upstairs which was a larger and a busier outlet.

And how long did you keep operating the kiosk for?---We kept operating the kiosk until mid-2015.

In July 2014, you commenced a complaint in FOS?---Yes, I did. That was after we tried through a financial agent to refinance the business loan.

And did you also make a complaint to the bank about the loan?---I did in the early stages, not long after we had started the business because I wasn't at all happy with the way that we were dealt with, and I felt I was concerned at the delay and the loss of revenue, those – I think paramount was the – in my mind was the loss of money from those school holidays and that we were behind the eight-ball, so to speak, trying to play catch-up all the time with our finances. Regrettably, I didn't include in that letter about the surprise at being presented with the loan document folder that the term was reduced to three years and the repayments were doubled.

And during the FOS process, you received documents from FOS including some of the documents the bank - - -?---Yes.

- - - had provided to FOS?---Yes.

And did you note anything about the documents that you received?---We noted on their calculations of – of – that some items had been omitted and crossed out.

What are you referring to, Ms Riches, on the - - -?---On – on their calculations of, perhaps, our ability to service the loan, that there were things crossed out that we didn't feel it was right for them to cross out without, perhaps, contacting our accountant or us.

And crossed out from where, Ms Riches?---From the figures of the previous vendor - - -

I see?--- - - - that they would have used.

And FOS ultimately found that the bank hadn't delayed the settlement, but had misled you about the monthly repayments, but you would not have exercised the cooling-off period. What did you think about that when you read that?---My husband and I didn't feel that that was – that was up to them to – to decide on that. We - - -

Who do you mean by "them", Ms Riches?---FOS to decide that we wouldn't have cooled off. We referred all our financial dealings to our accountant and had we known the increased payments and the short term, we would have referred that to him straight away, and we would have been able to go through the training period knowing that at the end of it that it was not financially viable to repay $9000-ish a month, and we would have reneged on the franchise agreement.

Did you discuss with your accountant what his advice would have been if it he got those figures?---After – after the – yes, we did, after – he indicated that he would not have let us go ahead with it had he – had he had those figures.

I see. Initially, you wrote back to FOS about the recommendations and expressed your disagreement - - -?---Yes.

- - - which you've just outlined?---Yes.

And then, subsequently, the company was placed into liquidation; is that right?---That's correct. Yes.

And FOS made a determination. Did you accept that determination?---I guess the determination was more in our favour than the first determination, and we felt as though it was the best that we were going to get.

But, ultimately, was it the liquidators that accepted the determination?---Yes, I did get a phone call to say that I wasn't – because the business was in liquidation, that I wasn't in a position to accept it, so the liquidators rang for my advice and they accepted it on my behalf.

And after that, what happened with your loans? What did you do about them? Did you receive more demands?---In accordance with the requirements of FOS, I sent two financial – two letters to the Bank of Queensland in the school holidays to let them know my financial position and a proposal for some sort of repayment.

And what's the status of the loans right now, Ms Riches?---The loans, I've been able to refinance through the ANZ Bank.

When did you do that?---We did that – I think that was 2016. In around about March.

Okay. Now, Ms Riches, I want to ask you about - - -?---I think it – yes.

Do you want to check that date, do you?---Yes, I - - -

Do you want to check your statement, yes?---Yes, I just do – I would like to check that date.

Yes?---Yes.

Could it be the following year?---Sorry, 2017, I'm sorry. I apologise.

Yes. Okay. Now, I wanted to take you to some letters that you received this year. Now, you exhibit a few of these to your statement. One is at tab 24, BOQ.0001.0030.1955. That's dated 22 March 2018. Do you remember receiving this?---Yes, I do.

Now, what did you understand this to be in relation to?---I was quite ..... at receiving it because, as far as I was concerned, we had met all the requirements in the deed of forbearance, paying out the business loan and re-mortgaging the house, so I believe there was a nil balance owed.

Okay. And then the next letter that you received, SGR-25. That's tab 25 of the folder in front of you, Ms Riches. BOQ.0001.0032.0001. So this letter says:

> *We refer to our letter dated 22 March 2018.*

The letter we just saw:

> *Our letter was sent in error. We withdraw the letter and confirm that no amount is owed by you to us.*

Now, did you have any other communications with the bank at this time?---No. Not – sorry, not – not then, but I did receive an SMS, a friendly reminder on my phone, to say that the account was in arrears. So I contacted the bank straight away.

You telephoned the bank and spoke to someone?---I telephoned the bank, yes.

And what did they say?---And the person I spoke to had said that he was aware of the letter that was – that was sent and he was sending another letter confirming that there was a nil balance there. There was no debt.

And was that before you received this 16 April letter?---No, that was after.

After, okay?---After.

Well, we will go to the next letter. That's at tab 26. RCD.0024.0009.0001. So this letter says:

> *Urgent reminder, 17 April 2018.*

It's the next day after – well, dated the next day?---Yes.

And this says your account is overdrawn or in arrears, and it's essentially in the same terms as the 22 March letter?---Mmm.

So you received this - - -?---Yes.

- - - did you?---Yes, I did.

And what – so what did you take to be happening at this time?---I think this is – after 17 April, I think it was, perhaps, 19 April that – that I got the text message, and I made that phone call to the Bank of Queensland.

I see?---I think it was two days later.

Okay. And then you received another letter, and this is at tab 27, RCD.0024.0009.0002. This is on the 19th – this is dated 19 April?---Yes.

Do you know – remember what date you might have received this? Was this received around that same time, before the text message?---I think it was – I think it was received a few days later after the 19^{th}.

Okay?---Yes.

And was it before or after the phone call that you had?---Now, I can't be certain on that, I'm sorry.

Okay. And this letter says:

> *Our letter was sent in error –*

it refers to the 22 March letter:

> *We withdraw the letter and confirm that no amount is owed by you to us.*

Now, Ms Riches, have you received any other correspondence since this time?---Yes, last – last Friday.

Is that Friday, 18 May?---Friday, 18 May. I received a – an urgent parcel to be delivered before 9 am, and a follow-up phone call later that afternoon from a Brendan Kennedy – I'm not supposed to say. I'm sorry - - -

That's a bank employee. That is – that's acceptable, Ms Riches?---It's okay.

Now, we – you don't have an exhibit to that letter because, obviously, it was received after you swore your statement?---Yes.

Signed your statement, but we've got a copy of that. It's BOQ.0001.0093.0112. And you refer to receiving a parcel or something by registered post; is that correct?---Yes, registered post, yes.

And what was in that? What was that?---There was a letter and a cheque for an amount of $11,381.30.

Okay. And do you know what that cheque is for?---Reading – reading the letter, we made the assumption that, at the time of servicing the deed of forbearance, that we attempted to pay it first of all, and then we were alerted to – we were told not to pay a cheque or any more money because they had to calculate the amount owing, and there was a $10,000 amount – $10,969 amount that was added to that deed of forbearance amendment.

But you didn't hear about it – you didn't hear anything further about that until Friday?---No. No, we paid the 10,000 so that we could clear the account, and I didn't hear any more about this until I spoke with Brendan Kennedy when he rang me about – to assure me that there was a nil balance, there was not $7000 owing, and

I asked him to check on this statement that I keep getting, the investment account that had this credit amount in it.

And have you banked the cheque yet?---Yes, I did bank the cheque.

Okay. Thank you, Ms Riches. No further questions.

THE COMMISSIONER: Yes, Mr Hutley.

MR HUTLEY: I don't know if your Honour is proposing to – what time - - -

THE COMMISSIONER: How long do you expect to be, Mr Hutley?

MR HUTLEY: Your Honour – I'm sorry, Commissioner.

THE COMMISSIONER: Those days have gone, Mr Hutley.

MR HUTLEY: It's a habit, sorry, and I will stop it. I want to ask one or two questions because something arose in the course of the witness' evidence which has been the subject of discussion between ourselves and those instructing Counsel Assisting about the availability of Mrs Riches' documents which we don't understand were delivered to the Commission, yet she appears to have referred to them for the purposes of her statement. And as I understood, the matter was – would usually stop at this hour. I am in your hands completely, of course, Commissioner.

THE COMMISSIONER: We stop at anywhere between 4 o'clock and quarter to 5, I'm afraid, Mr Hutley. So - - -

MR HUTLEY: I was told it was quarter to 4.

THE COMMISSIONER: We can be so lucky.

MR HUTLEY: I'm a new boy. So that's – what I was going to say, because I understood the hour, is that Mrs Riches seems to have had access and referred – refreshed her memory by reference to documents which are not in the possession of the Royal Commission. And, therefore, I thought it was appropriate that I get access to that material before I ask her any questions. I had not particularly intended to ask her questions for the reason we hadn't had access to the totality of material, and I thought it was, quite frankly, inappropriate, to be cross-examining witnesses in a matter such as this until I had had proper – if I hadn't had proper to access to all that was before her. Therefore, we're in a bit of a catch 22, or as we perceive it.

What I was going to propose to you, Commissioner, is that if Mrs Riches could produce to the Commission this evening all the emails, because there must have been quite a lot, for reasons which I don't want to belabour you with, which we haven't seen, such that we could see them overnight and then I would be in a position to see what, if any, cross-examination I wish to develop. I don't want – it's not an inquiry, of course, into Mrs Riches.

THE COMMISSIONER: No.

MR HUTLEY: It's an inquiry into the bank, and it was only purely if they went to matters concerning the conduct of the bank that I proposed to ask any questions and, as currently, they would be of a very limited compass, if at all. That's to be completely frank with you, Commissioner.

THE COMMISSIONER: Yes. Mrs Riches, you have come over from South Australia. True?---Yes, I have.

That's the difficulty I'm facing.

MR HUTLEY: She may have access to her email accounts. That's the – which may be – which we, of course – she has - - -

THE WITNESS: No, I don't.

MR HUTLEY: - - - referred – particularly referring to emails, and it seems the correspondence, on the whole, took place, so far as we can infer, by email, Commissioner, and I was hoping that that might be a means of getting access to the bank material, but I'm completely in the Commission's hands, of course, in that regard.

THE COMMISSIONER: Well, I don't want to cut you off, Mr Hutley, from something that you think needs to be investigated in the interests of the bank.

But it may be better, Mrs Riches, if you would be good enough to leave the hearing room for the moment and just wait outside?---Do I leave this here?

If you wouldn't mind just taking a seat outside the hearing room, Mrs Riches.

<THE WITNESS WITHDREW [4.00 pm]

THE COMMISSIONER: Thank you. The chief focus of her evidence seems to be on what she would say was a change in the arrangement between one conversation and a final letter of offer.

MR HUTLEY: It actually went through three evolutions.

THE COMMISSIONER: Yes.

MR HUTLEY: You've only heard of two, I think. There was a further letter which hasn't been brought out in her evidence, but that's a – in effect, a repetition of another letter.

THE COMMISSIONER: And then there is a series of steps she refers to as occurring, in effect, post liquidation, and post closure of the business. Now - - -

MR HUTLEY: I accept that. I think there is a confusion in the witness which is becoming all too apparent when – about what's called a cooling-off period. I think, in fact, there were – there was one Wendy's cooling-off period.

THE COMMISSIONER: Yes.

MR HUTLEY: And there was a statutory cooling-off period which is a different cooling-off period. And that's a cooling-off period, I think as a matter of law, which only arose when the agreement with Wendy's was consummated, and I think that, on the evidence, was only on 6 October. And one of the things that is apparent – and that I'm inferring from the evidence and what I have seen and her evidence about when the agreement was entered into, which makes, I think, perfect sense now. That raises the issue that her opportunity, in effect, to get out of this contract as a matter of law, appears to have commenced on the 6th, not ended on it.

THE COMMISSIONER: Be it so. Let's assume for the purposes of debate that was right - - -

MR HUTLEY: Fifth or sixth.

THE COMMISSIONER: - - - and I have no view about that one way or another yet.

MR HUTLEY: Quite,

THE COMMISSIONER: What then follows about what I should end up writing in a report about conduct that is either – might be misconduct or conduct falling short - - -

MR HUTLEY: I understand.

THE COMMISSIONER: - - - concerning your client.

MR HUTLEY: I understand completely and that's why – we didn't propose to go into these matters for that, but the FOS attributed a proportion of responsibility. And I don't know, at the end of the day, for example, whether you, Commissioner, will be considering, in effect, particularly in a small business field, where one has people who are anxious to go forward and who are often have deep belief that they are able to achieve things which, perhaps, their advisers might have told them is really unachievable. And that's the commercial reality and, in effect, that's the wonder of entrepreneurial enthusiasm.

THE COMMISSIONER: Yes.

MR HUTLEY: And what does become, perhaps, of some little importance, perhaps, is that if Mrs Riches and her husband were in contact with their lawyers and accountants from the 6th – or 5 or 6 October onwards, what they were saying, what they were thinking, and – for example, Mrs Riches says in her statement had she – there were delays in the settlement. And with the benefit of hindsight, if she knew, in effect, she had the opportunity to get out at the time, if she had the opportunity, she may well have got out at that time. Now, she may have been – and she appears to be – and we don't suggest she's anything other in this regard – and I'm – not because of in contradistinction to ..... other than being honest, she may well have been inadequately advised by her lawyers, her accountants, and Wendy's about - - -

THE COMMISSIONER: Be it so. Assume all of that were to turn out in that way, what then would follow about what I should or shouldn't write in a report?

MR HUTLEY: Your Honour – sorry, again, Commissioner, you may well view in this particular area the position of banks cannot become akin to that of a custodian of the interests of the small business holder, because they need to, and should be looking to their own advice, because, on the whole, they have the intelligence and sophistication to, in effect, protect their own interests, and whilst the banks may well have many policies to protect their interests, and obviously the banks can't engage in anything which is sharp practice, misleading conduct, or the like, but you are being asked, as I understand, to, in effect, consider the position of the banks being put in some overarching or, in effect, almost custodial position quo ad certain classes of their clients.

THE COMMISSIONER: What I'm being asked to consider in this – at least so far as I can see from the way the evidence has come out – that the bank, through its manager, says one thing at day one, it changes, it changes, whether it's day 2 or day 3, whether it's offer 2 or offer 3 – at some later point, the bank manager says, "There's the final offer. It's different from."

MR HUTLEY: I accept that in point of fact. What you say, Commissioner, is completely – your role, as I understand it, will not solely be to deal with the case studies.

THE COMMISSIONER: No.

MR HUTLEY: You will have to look at a much broader - - -

THE COMMISSIONER: Yes, yes.

MR HUTLEY: - - - question as to how banking should be, on one view, conducted going forward. The detail of your case studies, and as I said, particularly in this field, the human character of the engagement, the types of, as it were, advisory positions which are to be expected to be involved may be something that bears upon your evaluation as to where, if it is to occur, some balance is to be set. I put it no higher than that. And that would be the only reason we would investigate it, if we considered it appropriate tomorrow.

THE COMMISSIONER: Well - - -

MR HUTLEY: That's the sole matter because I accept that the overwhelming thrust of your undertaking is, of course, to look at what we did, as it were. I put it no higher than that, Commissioner.

THE COMMISSIONER: Now, whatever this is, it isn't adversarial litigation.

MR HUTLEY: Precisely that's why we come not here – and I'm quite frank - - -

THE COMMISSIONER: Well - - -

MR HUTLEY: - - - we do not come to have determined what might be a legal outcome between ourselves and Mrs Riches. We are not interested in that and the bank is not being adversarial. We merely raise this issue to expose - - -

THE COMMISSIONER: Nor are you entitled to have discovery of her documents.

MR HUTLEY: We're only entitled to have that which you tell us we're entitled to have.

THE COMMISSIONER: Well, that's putting it crudely, but bluntly and accurately.

MR HUTLEY: And I accept that absolutely, but I merely raise it because of the hour.

THE COMMISSIONER: Yes.

MR HUTLEY: And counsel assisting may be able to find out whether the emails can be produced overnight by a short questioning of Mrs Riches.

THE COMMISSIONER: I should – you have access to her emails? Why should you have access to her emails, in the sense that if they're emails to and from your client, you've got them. If they're emails to somebody else, why should you have them?

MR HUTLEY: Commissioner, often, emails to third parties - - -

THE COMMISSIONER: I've got to do natural justice to your client.

MR HUTLEY: No, no, of course. No, no, I understand it. I understand it.

THE COMMISSIONER: I'm – and I need to know why I would not be doing natural justice if I said, no, you can't have what she has gone to someone else.

MR HUTLEY: Because, often, in the communications to third parties that one finds out the detail of one's dealings with both the bank and one's own thought processes.

THE COMMISSIONER: Yes.

MR HUTLEY: That's the reason why, as you would have – in your experience - - -

THE COMMISSIONER: Well, there are things I haven't seen; there are things I can't use to form my views, why should you have them?

MR HUTLEY: Because – and solely this – matters may be being advanced critical of my client in relation to these transactions. And, legitimately, I say, what's saying may well be, and anything which reasonably should – that might, as it were, ameliorate the possibility that my client is not being, as it were, exposed, the true milieu would be a matter which you, Commissioner, might think was fairly put before us, if it can be conveniently done without interfering the proper flow of the Commission, and I put it no higher.

THE COMMISSIONER: Well, what do Counsel Assisting want to say? Mr Hodge.

MR HODGE: Commissioner, could I deal with this; although, ultimately, Ms Dias may or may not need to ask some more questions. It's unclear what exactly it is that Bank of Queensland wants and what Mr Hutley is seeking, and, frankly, if it's now going to be suggested that the Commission needs to issue notices to produce to other customers of Bank of Queensland in order to bring in documents so that they can then be disclosed over to Bank of Queensland, so it can then consider some process that it's going to adopt, we're going to need much more specificity about what it is.

THE COMMISSIONER: No, I think it's said I should issue a notice to produce requiring Ms Riches because I can't – I'm not going to ask her to do anything. If I'm going to – if anything needs to be done, it's going to be done compulsorily. Because unless I do it compulsorily, she does not have the benefit of the protection. So what I'm being asked to do is either issue a summons or issue a notice to produce for her – the content of her email account as to communications with her lawyers, her accountants – don't know whether they go beyond that – in relation to this transaction.

MR HODGE: And so as – thus far, as best I've been able to follow it, there have been at least three possible lines that have been suggested the Bank of Queensland might like to pursue. The first line, which I understand it is something that apparently was already apparent to them on the basis of Ms Riches' statement which is that they thought there were things on her statement that indicate that she must have had reference to some documents, and, presumably, they could identify now what those things are. The second thing is that they then – there was then the shadow raised of the possibility that the advice that Ms Riches had received from either her solicitors or from her accountants was, in some fashion, negligent or problematic, and it has to be assumed that, therefore, the purpose of that would be to seek to get access to any emails that had been exchanged between Ms Riches and her accountants and solicitors.

About that can I say two things: first, of what possible relevance could that be to the conduct of this inquiry? How does that help in any way, given that it's not raised at all, whether – as it is as to the conduct of the bank to consider whether or not there is some negligence on the part of the solicitors or accountants acting on behalf of Ms Riches, if, as has already been said, there's no challenge to the belief of Ms Riches as to the fact that there was no cooling-off – there was no further cooling-off period that she could exercise? And the second point is, this presumably is not a matter of accounting advice; it's a matter of legal advice and that's going to be covered by privilege anyway. Which means, Commissioner, that even if you were to issue a notice, the consequence is if there was hypothetically legal advice – and it's not been suggested that there is any – it wouldn't be something that could be produced in any event.

And then the third thing that seemed to be raised at the end was the idea that there needed to be some inquiry into Ms Riches' thought processes, and, presumably, the implication of this is that the Bank of Queensland would like to try to seek access to some other documents that they think exist that might reveal something that Ms Riches has said to some other person at a contemporaneous time that is, in some fashion, relevant to what her thought processes were. And with respect, it's just very difficult to see why it is that any of that needs to be pursued. But much of this can be bedded down. If there are already documents the Bank of Queensland has identified that they think are missing, they can tell us now what they are, and if we have them and they are relevant and they are within the Commission's records, then, presumably, they can be provided to Bank of Queensland.

And if they think they exist but they're not sure, then Ms Riches can be brought back to the stand and asked about those particular documents. As I understood it, the question that she was asked at the very outset, which was, "Have you had reference to some other documents", was a reference to she's got very specific dates in her statement, and I had assumed, perhaps wrongly, that that was a reference to the types of emails that would record meeting – that is, a meeting is to occur on a particular date. But I may have misunderstood and it may be that there are other documents that Mr Hutley is trying to raise, but all of this just requires some greater level of specificity.

THE COMMISSIONER: Yes. Mr Hutley.

MR HUTLEY: As I said at the outset, Ms Riches said, freely and frankly, she has had regard to her emails and records for the purposes of giving evidence today. Now, I don't know what the full panoply of those are. It is a Rumsfeldian known/unknown in that regard. And, therefore, I'm unable, as my learned friend would know, to particularise what I don't know. Now, it's just the fairness or otherwise which arises out of that circumstance which I am directing – seeking the Commission's indulgence in relation to the production of the materials to which she has had reference.

THE COMMISSIONER: Do you accept that I could act only by compulsive process and should act only by way of compulsive process?

MR HUTLEY: If you – I accept that, Commissioner. You feel that that's – that's the appropriate course, and I would not suggest, for a moment, to the contrary.

THE COMMISSIONER: It's only things produced in response to compulsive process that attract the privileges prescribed by the Act.

MR HUTLEY: I accept that.

MR HODGE: Commissioner, I am sorry, could I just be heard about one matter because I think there has just been a qualification to the position of Bank of Queensland. If the only thing the Bank of Queensland is interested in is understanding what the documents were that Ms Riches had reference to in the preparation of her statement, then presumably we can just bring her back in, she can say what they are, and then Mr Hutley can indicate what his position is.

THE COMMISSIONER: Like of those examination objections - - -

MR HODGE: Rather – well - - -

THE COMMISSIONER: - - - where there's a debate for three hours and then the witness is asked the question, the witness says, "I don't remember."

MR HODGE: The difficulty is this isn't about – this is now a totally different track from this idea of we're going to investigate what legal and financial advice she was provided.

THE COMMISSIONER: Let's cut through this. Let's have Mrs Riches back. Somebody go out and get her.

<SUZANNE GAIL RICHES, RECALLED [4.17 pm]

THE COMMISSIONER: Mrs Riches, in your line of work, sending somebody out of the room is usually seen as a particularly - - -?---Am I in trouble?

- - - nasty thing to do?---At least I don't have a - - -

It was not intended in that fashion?---I don't have a dunce's hat on, so that's all right.

So, Mrs Riches, you were asked a question at the start of – or early on in your evidence whether you had looked at or taken to account any other records that you may have access to in giving the evidence that you have given today. Do you remember being asked - - -?---Yes.

- - - a question about that?---Yes.

To what documents or records did you have regard when preparing to give your evidence today?---I had emails between the bank manager and myself, and our accountant, and the conveyancer which helped me ascertain which month and which date certain things occurred.

Yes. And you say that those matters helped you identify which month events occurred. Was there any other material in that material you examined that assisted you in your recollection of events as you have described it in evidence today?---I guess the – you know, the sequence of events and the nature of what the meetings were about.

Yes. In light of that, Mr Hutley, why should I issue any further compulsive process?

MR HUTLEY: I will say nothing further.

THE COMMISSIONER: Yes. Do you wish to cross-examine Mrs Riches?

MR HUTLEY: No.

THE COMMISSIONER: Thank you. Yes. Then thank you, Mrs Riches, for your attendance. You may step down. You are excused further attendance.

<THE WITNESS WITHDREW **[4.19 pm]**

MS DIAS: Commissioner, there was one further correspondence or document that wasn't tendered which I should do as a matter of housekeeping.

THE COMMISSIONER: Yes.

MS DIAS: That was BOQ.0001.0093.0112, the letter that was received on Friday, 18 May by Mrs Riches from the bank.

THE COMMISSIONER: And is that the same as RCD.0024.0009.0003, which is the last of the documents - - -

MS DIAS: No, no, Commissioner. This is not an exhibit. This has to be tendered.

THE COMMISSIONER: This is another one.

MS DIAS: Yes, that's right.

THE COMMISSIONER: So how do I describe it?

MS DIAS: Letter received by Ms Riches - - -

THE COMMISSIONER: Letter from BOQ to Riches dated - - -

MS DIAS: From BOQ to Suzanne Riches – it is not dated, but received on Friday 18 May, 2018.

THE COMMISSIONER: Will become exhibit 3.32. That's BOQ.0001.0093.0112.

EXHIBIT #3.32 LETTER FROM BOQ TO SUZANNE RICHES RECEIVED ON FRIDAY, 18/05/2018 (BOQ.0001.0093.0112)

MS DIAS: Thank you, Commissioner.

THE COMMISSIONER: Now, Mr Hodge, where do we go from here? Not tonight. We're going nowhere tonight except out, but - - -

MR HODGE: Commissioner, the next witness will be Mr Snell from the Bank of Queensland. So we will start him - - -

THE COMMISSIONER: Yes. So we start with him at 9.45 tomorrow.

MR HODGE: Yes. And we may make a slight adjustment tomorrow afternoon just depending on – we have a consumer witness, so we will just switch case studies around depending on maybe - - -

THE COMMISSIONER: 9.45 tomorrow and expect to begin with Mr Snell.

MR HODGE: Thank you.

THE COMMISSIONER: Very well.

MATTER ADJOURNED at 4.21 pm UNTIL THURSDAY, 24 MAY 2018

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