

**Royal Commission into Misconduct in the Banking, Superannuation
and Financial Services Industry**

**SUBMISSIONS OF THE FINANCE SECTOR UNION IN RELATION TO THE
CONSUMER LENDING ROUND OF CASE STUDIES**

Contents

A	OUTLINE OF SUBMISSIONS	1
B	A PRELIMINARY SUBMISSION ON REMUNERATION PRACTICES....	2
C	A PRELIMINARY SUBMISSION ON THE REDUCED RELIANCE ON EMPLOYED BANK LABOUR.....	3
D	NAB INTRODUCER CASE STUDY.....	6
E	CBA BROKER CASE STUDY	11
F	AUSSIE HOME LOANS	14
G	ANZ CASE STUDY.....	15
H	CBA CCI CASE STUDY	17
I	CBA PERSONAL OVERDRAFT CASE STUDY	19
J	ANZ OVERDRAFT CASE STUDY.....	20
K	ANZ PROCESSING ERRORS	21
L	WESTPAC CAR LOANS CASE STUDY.....	22
M	ANZ CAR LOANS CASE STUDY	23
N	CBA CREDIT CARDS AND LIMIT INCREASES	23
O	WESTPAC CREDIT CARD LIMIT CASE STUDY.....	24
P	CITI FEES CASE STUDY	24

A Outline of submissions

1. These submissions deal with the first round of case studies.
2. The submissions address the matters on which the parties with leave to appear were permitted to make general submissions.¹ Some of the matters identified by Counsel Assisting are not within the Union’s knowledge or experience. The Union makes no submission on those matters.
3. In these submissions the Union wishes to direct the Commission’s attention to three themes arising from behaviour considered in Round 1. These themes are:
 - (a) the widespread use of incentivised remuneration and employment practices;
 - (b) the extent to which reliance on automated systems and processes, and an associated reduction of human involvement and assessment, has driven poor conduct. This is, in turn, associated with a loss of the sense of professionalism for employees working for banks;
 - (c) the tension between instantaneous “customer satisfaction” and compliance; and
 - (d) the common practice by banks of only selectively applying their published policies, and, correspondingly, selective tolerance of conduct in breach of policies.
4. The submissions respond to each of the questions posed by Counsel Assisting by reference to each of the case studies.

¹ T P968-980; Closing Submissions of Counsel Assisting addressing Personal overdrafts, Processing Errors, Car Loans and Credit Cards (CAS - R1) [RCD.9999.0003.0001].

B A preliminary submission on remuneration practices

5. A number of the questions posed by the Commission and addressed in these submissions involve a consideration of remuneration practices.² Such practices and their effect are referred to in the Letters Patent establishing the Commission,³ and were the subject of evidence in the first round of hearings.
6. The Union submits that the Commission should not limit its assessment to remuneration practices such as Short Term Incentive payments (often known as STI payments) above salary or commissions.
7. Rather, the Commission should also be cognisant of the powerful corollary, target-based performance management, where failure to meet benchmarks in performance reviews results in adverse employment consequences. The Union believes that a significant set of behaviours that sustain a culture of misconduct, and conduct below community standards within banks, is management of performance against targets with threats of disciplinary action if targets are not met.

Performance targets based on sales and revenue

8. Staff are generally eligible for incentives if they achieve in excess of benchmarks. Staff may also be subject to performance counselling if they fail to meet the same benchmarks. For many front line workers available incentives are modest, measured in the hundreds of dollars a year, and often not of sufficient magnitude to influence behaviours.⁴ However, in the Union's experience, the desire to avoid imperilling their employment is a significant driver of behaviour; many of the same behaviour distorting features result from the threat of performance management as are typical of incentive based remuneration.
9. The Union acknowledges that there have been some changes to the practices of the large banks as a result of persistent criticism of revenue based KPIs. Most banks have moved to a "balanced scorecard" model, which rather than simply focusing on revenue, also includes key performance indicators (KPI) for customer service, compliance, "values" and reducing customers' reliance on branches.
10. In the course of his examination, Mr Waldron gave evidence as to the operation of balanced scorecards.⁵
11. The Union submits that the "balanced scorecard" model gives a misleading appearance that sales are no longer the determining factor used to assess performance. Exhibit #1.18.53 is a balanced scorecard for a NAB Banking Adviser 2 (a seller in a branch). This scorecard clearly shows that 40% of the scorecard is linked to the achievement of sales.
12. However, a second KPI referred to as "customer/community" measures cross-selling products, signing up customers to internet banking and referring the customer to another specialist within the bank such as a financial planner for potentially further sales opportunities. Prior to the introduction of a "balanced scorecard" model, these items would have been included within revenue targets. This category is worth a further 30% of the "balanced" scorecard.
13. A total of 70% of the 'balanced' scorecard has direct links to the sale or potential sale of financial products. Only 15% of the scorecard is dedicated to the effective compliance of the

² See for example sections B1, B2, C1, C3, J2, K2 of this Submission.

³ Letters Patent Establishing the Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Sector, 14 December 2017.

⁴ For front line staff in more specialised sales roles, incentives can be significantly higher.

⁵ T153-154.

employee. In the Union's experience having most of the "balanced scorecard" be directed towards sales or potential sales is typical.

14. The Union's experience is that the cultural and behavioural effects of such performance structures include, for all levels of bank employees:
 - (a) a prioritisation of sales over compliance;
 - (b) aggressive sales practices;
 - (c) the selective application of policies; and
 - (d) at a local/area level, a blind eye being turned to events and actions that do not meet compliance requirements but generate significant profits for the bank, and an associated failure to report and remediate.

Management incentive payments

15. Remuneration systems in all banks offer higher rewards for those who manage the culture and performance of the bank, than to those who actually sell the products.
16. In each of the financial entities examined in the first round, the remuneration of all layers of management involved substantial financial incentives or performance bonuses. The performance components generally increase as a percentage of base salary with the seniority of the employee.
17. Typically, in the Union's experience, tellers are able to obtain a payment of up to an additional 5-10% of base salary on the basis of performance. This rate (in addition to the quantum of the base salary) increases to additional 40-60% for branch managers, and 60-100% for area and regional managers. For senior executives, the performance component is likely significantly more than 100% of base salary. In dollar terms this means that possible annual STIs range from about \$40,000 for the most junior branch managers, to more than \$100,000 for area managers, to hundreds of thousands for more senior employees.

C A preliminary submission on the reduced reliance on employed bank labour

18. A common theme in most case studies is that tasks once performed by local bank employees are now performed by automated systems, or by individuals not employed by the bank and not subject to the training and compliance systems of the bank, or based offshore and employed by subsidiaries or foreign labour hire companies.
19. This theme applies to the issues around brokers, introducers and car yard finance on the one hand, and failures attributed to systems around overdraft, credit card and other products offered by the banks on the other hand.
20. Reducing the number of local employees (as they have grown as institutions) has been one of the significant features of the Australian banking industry over the last 30 years. The rationale is clear – automated systems and employees paid only on successful sales are much cheaper than a trained salaried workforce based locally. The Union submits that such an approach has been at the cost of community respect for Australian banks, because it has led to repeated instances of the type of misconduct examined by the Commission in the first round of hearings.
21. The Union submits that bank employees have an important perspective on bank processes and procedures. Bank employees have front line experience of day to day community expectations of banks, and understand where banks are meeting those standards and where they are falling short. It is therefore critical that there are processes for bank employees to be able to contribute to bank policies and procedures, including in relation to remuneration and staffing.

Automated systems and benchmarks

22. Several of the case studies arose as a result of, or featured, failures in automated systems and processes. Other issues within case studies, such as the reliance on HEM, involve a consideration of the use of benchmarks in the place of interrogation and verification of customer financial information.
23. The Union identifies a common pattern in such matters – the increasingly reliance on computer systems for assessments and processes that were previously performed by people. This change has gone hand in hand with a massive reduction in employees within banks, and an explicit effort (called technological education by the Commonwealth Bank) to shift customers from branch processes to automated processes. This shift has had particularly adverse effects on the elderly, the less computer literate, and those based in regional areas where branches have closed.
24. The Union submits that the attempts by the banks to make savings by transferring functions from people to computer systems has created identifiable risk of systemic (as opposed to incidental) errors occurring. It has been evident that these errors are often built into the code of the system: this was the explanation for the initial failures in each of the credit card increase case studies, in the credit offer case study and the account administration case study.
25. Many of the errors discussed in the case studies involved very small amounts of money for each customer which were unlikely to be identified by the customer. It is possible that there are numerous other unidentified coding errors in place, losing customers money.
26. The extent of reliance on automated processes was evident in the “solution” in the add-on insurance case study: the explanation provided by the Bank was that the system would be coded so as to prevent unsuitable customers being offered the products. This “solution” is consistent with the experience of bank employees who describe their agency and discretion in decisions as having been removed in favour of automated processes.
27. The use of benchmarks and automated processes effectively removes the requirement for the bank employee or other assessing party to properly undertake this aspect of their work. Knowing that the system will automatically default to a certain figure removes the incentive to correctly determine a figure.
28. Bank employees report (in a variety of different situations) ceasing to exercise judgment as they previously had, because they are aware that the system will simply overwrite their assessment if it deviates in a manner considered inappropriate by the system. As an example, bank employees report no longer turning their mind to whether a credit product is appropriate to customers, but rather simply delegating such assessment process to the computer system.
29. This is supported by the examination of Mr Ranken in connection with the ANZ’s verification of customer expense information. Mr Ranken’s evidence was that the cost of undertaking thorough verification was such that the ANZ elected not to do it and instead undertook “indirect verification”, which as Counsel Assisting observed, is not verification at all.⁶
30. The suggestion that ANZ is not able to effectively verify customer information should be rejected. Banks are required to verify information, both from a legal and prudential perspective. Banks were able to do this for many years without the added benefit of the capacity to electronically access and assess customer spending. This verification work is the day to day work of bank employees.

⁶ T463, T466

31. The ANZ Bank has recently announced further cuts to staff numbers: having reduced its workforce from 50,142 to 44,896 in the two years between 2015 and 2017.⁷ The jobs cut include roles in compliance and verification functions.
32. Counsel Assisting put to Mr Ranken that the election made by ANZ was between “administrative convenience and obeying the law”.⁸ This tension is, in reality, between having sufficient resources (including employees) to do the job and obeying the law, or alternatively delegating a variety of functions to systems which are vulnerable to coding errors, and often default to guesses disguised as benchmarks, and being consistently exposed to breaches of responsible lending obligations.

Offshoring

33. Simultaneous with increasing use of automated systems, and increasing reliance on external labour (introducers, brokers, etc), a number of banks have offshored functions, including loan verifications and contact centres.
34. The Union’s experience is that offshored functions (which are operated by both subsidiaries and contracted external entities) tend to operate on a more inflexible and rigid basis, in a manner far more similar to automated systems than a trained human system that utilises discretion and judgement.

External labour

35. A number of the case studies concerned the actions of individuals not employed by banks. These individuals included introducers, brokers, and car yard employees. The banks offer a system of reward to these individuals who generate work and profit for the banks. There has been an extraordinary growth in brokers and introducers over the last 25 years which mirrors a corresponding reduction in directly employed labour within banks.
36. In relation to each of these individuals, the remuneration structure in place (in so far as it relates to the bank) involves no salary or guaranteed remuneration. Rather any payment is available on an entirely contingent basis in the event of a successful sale.
37. The nature of these external relationships creates a clear risk of poor customer outcomes, given:
 - (a) the individuals are not subject to the same oversight and control as direct employees of banks;
 - (b) the individuals are not subject to the same training or compliance standards as direct employees of banks;
 - (c) the individuals do not have the same opportunity for promotion within the bank, or the same interest in the long term success of the bank, and are accordingly incentivised toward short term goals over longer term priorities such as compliance and institutional reputation.
 - (d) the individuals have a strong incentive to ensure successful sales as payment is contingent on sales;
 - (e) the work/reward equation in relation to these individuals is skewed. Because they are essentially selling a referral, very little work is required on each successful sale. The difficulty is in obtaining the individuals to be referred;

⁷ <https://www.theaustralian.com.au/.../anzs.../ce118e74d5ad75e7775ec1e2624a54da>
⁸ T466

- (f) the incentive to achieve a sale will mean individuals will be drawn to vulnerabilities in bank systems which permit sales that otherwise would not occur; and
 - (g) there is no effective moral hazard in place for these individuals to ensure compliance with appropriate systems. Instances where external individuals have been subjected to adverse consequences are very rare.
38. Aside from the impact of targets on the behaviour of bank employees, none of these factors are operative for bank employed labour.

D NAB Introducer Case Study

D-1 Do remuneration and incentive policies that reward bank employees for volume of sales of loans create an unacceptable risk that bank employees will prioritise the sales of loan products over first the bank's responsible lending obligations; second, the bank's statutory obligation to provide loans to customers in a manner that is efficient, honest and fair; and third, the bank's statutory obligation to have adequate arrangements to ensure that customers are not disadvantaged by any conflict of interest that may arise; fourth, the bank's obligation to ensure that the conduct of its employees in connection with the provision of loans is not misleading, deceptive or unconscionable?

39. The Union submits that remuneration and incentive policies that reward bank employees for completed loans⁹ create an incentive towards the sales of such loan products against various obligations owed by the bank to the customer. In this regard the Union makes no distinction between the four sets of obligations (that may arise in different situations) identified by Counsel Assisting.
40. In relation to this issue generally the Union repeats its submission at Part B, above (paragraphs 5 to 17) to the effect that:
- (a) Targets based on revenue/sales which place employees at risk of performance management if they fail to meet the target create similar undesirable behaviours as incentivised remuneration practices;
 - (b) Such undesirable behaviours include a prioritisation of sales over compliance, aggressive sales practices, the selective application of policies, and on occasions a blind eye being turned to events and actions that do not meet compliance requirements but generate significant profits for the bank;
 - (c) Managers and senior managers, who manage the culture and performance of the bank, generally have significantly more to gain from incentivised remuneration practices both as a percentage of salary and in dollar terms.
41. NAB bankers and managers implicated in the Introducer case study were likely conflicted in two distinct ways – for the bankers directly involved, by corrupt payments made by introducers; and for all bankers and managers, including particularly area managers and regional managers, by Short Term Incentive (commonly known as “STI”) payments obtained as a result of revenue targets being met as a result of these loans.
42. The Union notes that the extent to which such policies have a corrupting effect on employee behaviour is a function of:
- (a) the size of the reward; and
 - (b) cultural factors such as the tolerance (and implicit support) for conflicted or inappropriate conduct, and prioritisation of sales over other obligations.

⁹ In this context we understand “volume of sales” to be a combination of size and number of sales.

43. These cultural factors are significant. The Union notes, in connection with the NAB introducer study:
- (a) Initial concerns in April 2015 appear to have been ignored;¹⁰
 - (b) It is not clear that the first whistleblower triggered significant action;¹¹
 - (c) It seems that not all staff members in the affected branches were implicated. It is concerning that staff not implicated did not feel sufficiently confident in the whistleblower protections to raise concerns;¹²
 - (d) NAB did not allege that the first staff member terminated, apparently a teller, obtained any ongoing financial benefit from the transactions. The Union does not seek to defend her conduct. The evidence was she had been offered payments on two occasions and had accepted the payment once before returning it a day or two later. Assuming her conduct was as outlined in the evidence, it appears more consistent with an individual operating in a bad culture who acted inappropriately under the supervision of a manager and more senior colleagues acting even more inappropriately. It appears that the cultural problems within that branch, and potentially the area more generally, were significant.
44. The effect of remuneration and incentive policies is more widespread. The current practice in all financial institutions is for each level of management to receive incentive payments based on the performance of staff who report to them. Further, other staff are also entitled to incentive payments based on the performance of their branch, or team.
45. Such practices create a second layer of incentive to prioritise sales, and a disincentive against strictly enforcing compliance measures, reporting concerns, or resisting behaviour that other staff members may find unethical.
- D-2** *The second question is whether introducer programs create an unacceptable risk that banks will breach, first, their responsible lending obligations; second, their statutory obligation to provide loans to customers in a manner that is efficient, fair and honest; third, their statutory obligation to have adequate arrangements to ensure that customers are not disadvantaged by conflicts of interest; and fourth, their obligation to ensure, again, that the conduct of their employees in connection with the provision of loans is not misleading, deceptive, or unconscionable?*
46. The introducer programs provide a significant payment (the NAB payment of 0.4% of the loan value is typical across the sector). The payment is a little less than that made to brokers (typically 0.54%) in return for negligible effort – simply the referral of loan value.
47. The Commission heard that in the 2013-17 period introducers were paid a total of about \$100,000,000. The evidence was that there were 8,000 introducers at a peak, but that this had been reduced to 1,400. The 1,400 came from appropriate professions, and had provided repeated introductions over the preceding period. Assuming that 75% of the introductions came from these 1,400, the average amount received for each was in excess of \$50,000. On each \$500,000 loan, the introducer would receive about \$2,000.00. It is evident that introducers will take steps to assist the loan they introduced be approved.
48. The evidence of the NAB witness was that the introducer would do no more than advise the potential borrower of the existence of the NAB as a bank that lends money, and advise the

¹⁰ T46
¹¹ T98
¹² T96

NAB of the name and phone number of the borrower¹³. This evidence is not credible. In circumstances where the introducer stands to earn thousands of dollars, the introducer has a direct interest in ensuring the borrower takes out the loan with NAB.

49. Moreover, the introducers tend to be (but, for example in the case of NAB are not always) professionals associated with the potential borrower such as lawyers/conveyancers, estate agents, architects and builders. It is further likely that there will be inequality of knowledge about the loan and the associated process, and expertise in the relationship between the between the introducer and the borrower. This makes it easier for the introducer to do more than simply identify NAB as a lender
50. The Union submits that introducer programs create an inevitable risk of introducers acting in a manner that is contrary to customer's interest.

D-3 Do banks have adequate policies to deter and, if necessary, detect fraud by employees and third parties such as introducers in connection with loan applications?

51. Each of the banks maintain an enormous array of policies that, in both general and specific terms, prohibit fraud. The policies change frequently. Employees report feeling intimidated by the volume of policies, and concerned that policies operate not for compliance purposes, but to catch staff out in the event a failure is later identified.
52. The experience of the Union is that policies and procedures are selectively applied, and often only when a significant problem has been identified. The amount of time and resources devoted to training employees on policies has reduced significantly over time. Where previously employees attended regular training sessions, they are now required to undertake most training as internet-based activities. There is limited time allocated to training, and employees are generally expected to fit training and compliance around their usual role. Particularly in a retail and contact centre environment, this means that training is a low priority, which is completed around other duties. Ultimately, this leads to staff whose focus is on completing the minimum compliance training necessary to comply with their KPIs.
53. This deterioration in training coupled with the frequency of policy updates leaves employees feeling exposed, as they are often left with inadequate knowledge of current policies, and an inability to apply the policies they do know.
54. By way of example, the union is aware of a former NAB employee who worked in the loans verification department and reported that she was regularly required to verify a person's income. To do this, she requested pay slips which could be sent to her electronically. Training to identify a fraudulent pay slip was limited to a single, short, team session where they were told to look out for things like differences in font. Colleagues not rostered to work on that day received no training on the issue. This employee said that she did not feel like she had the skills to detect a fraudulent pay slip. She was concerned at the prospect of being subject to performance management in the event she failed to detect the existence of a fraudulent pay slip.
55. Further, as banks have reduced staff numbers, increasingly important compliance functions have been allocated to more junior and inexperienced staff. A number of banks have "offshored" important elements of the loan application process, leading to concerns about the validity of the assessments made. Banks have moved elements of the verification and compliance process to benchmarks and automated processes. In so doing the expertise and role of staff is reduced: compliance becomes little more than a "box ticking" exercise.

A further Competing Priority – Customer satisfaction

56. A number of banks use the Net Promoter Score (NPS) as a key measure of customer satisfaction. Calculating the NPS involves each bank customer rating their experience with a bank employee out of ten. If a bank employee declines a loan, or rejects verification documents for a loan, they may receive a poor NPS rating which negatively impacts their performance appraisals (and potentially their ongoing employment). These types of ratings function to influence bank employees' behaviour to err on the side of writing business, rather than strict compliance with policies.

57. The culture of banking has a powerful impact on levels of compliance. While performance measures mention compliance, the key determining factors of whether someone will keep their job are the sales and customer satisfaction measures.

D-4 *Do banks have adequate policies to address customer detriment occasioned by misconduct of bankers or third parties such as introducers in connection with home loans and in a timely fashion?*

58. As previously stated, bank employees' performance is assessed on a number of measures, with a strong weighting in favour of sales/revenue and customer satisfaction. This means that if a customer were to raise an issue with an individual banker, the banker's priority is to resolve the issue on an individual basis as quickly as possible. In retail branches at most banks, for example, each banker has an allocated monetary amount which they can apply to a customer's account to resolve any issues. This has the effect of potentially hiding systemic issues, as issues are resolved individually to avoid customer dissatisfaction.

59. While a number of banks do have systems to raise issues which may be systemic (such as incorrect interest rates being applied), the focus for bankers is on resolving individual complaints. This means that spending time on raising potentially systemic issues is not a priority.

60. The Royal Commission also heard evidence from Anthony Waldron that even after whistleblower complaints, there was some delay in launching an investigation¹⁴. This leads to a lack of faith in whistleblowing processes, and therefore people being unwilling to disclose issues that arise in their workplace. This has significant potential to increase customer detriment by hiding ongoing misconduct.

61. An ongoing concern is that whistleblowing policies and procedures are not adequate to protect people making disclosures. The Union notes that such policies and procedures may be onerous for the person making the disclosure, and are designed to deal with disclosures of the most serious nature.

D-5 *How do financial services licensees ensure that they comply with the obligation in section 912D of the Corporations Act to make a written report to ASIC of any significant breach of the obligations within section 912A of the Corporations Act within 10 days?*

62. The evidence reveals delays in the reporting of significant breaches. In some cases, such delays are unexplained, and in the Union's submission, not defensible. In other instances, the tension between an obligation to only report *significant* breaches on the one hand, and an obligation to report within 10 days of becoming aware of the breach (as opposed to identifying the breach as significant) is evident.

63. The evidence from the NAB Introducer case study reveals an unacceptable delay in reporting the breach. In that case study, the Bank first became aware of potential significant issues in the introducer program in April 2015.¹⁵ The significant issues were identified by internal

¹⁴ Transcripts of Proceedings, Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Sector (Commissioner Hayne) 13 March 2018, P 9 (Rowena Orr).

¹⁵ Exhibit #1.5

audit and compliance processes and involved serious potential issues for which a legitimate explanation seemed unlikely. As was confirmed in the examination of Mr Waldron, no action was taken until two whistleblower complaints were made about five months later.

64. This delay is consistent with the Union's more general experience in each of the banks – that there is a failure to investigate issues while they continue to generate significant profits for the institution. The NAB Introducer case study is an example of this. Loans worth \$24 billion were issued in the relevant period.¹⁶
65. Notwithstanding the obligation is to report breaches or likely breaches as soon as possible and within ten days, no report was made to ASIC under section 912D until February 2016. Given ASIC guidance that fraud by employees constitutes a significant breach, there is no identifiable justification for the failure to notify ASIC later than the decision to terminate the employment.
66. The delay/failure in making a report under s.912D was similarly evident in other case studies. For example:
- (a) CBA made an s.912D report in respect of the Credit Card Plus Issue in October 2017, two years after becoming aware of the issue;¹⁷
 - (b) CBA identified systemic errors in how it assessed new overdrafts in September 2015 and did not ever make a s.912D report on the issue despite it meeting the definition of a significant breach;¹⁸ and
 - (c) In connection with an issue in their Break free packages, ANZ became aware of a breach that may have required a s.912 report in June 2017, but did not make such report until October 2017.¹⁹
67. The Union considers that such delays increase the risks of employees acting inappropriately. Compliance failures inevitably imperil the position of employees. Appropriately quick action with reporting obligations is a key element of compliance.
- D-6** *Is the practice by banks of defaulting to use of the HEM benchmark when a customer declares living expenses that are less than the HEM benchmark consistent with the statutory requirement to take reasonable steps to verify a customer's financial situation before entering into a home loan with that customer?*
68. The Union repeats its submissions at Part C above (paragraphs 18-32) and G-5 below (paragraphs) to the effect that:
- (a) banks increased use of automated or rigid processes reliant on pre-set benchmarks are becoming used as an alternative to verification of information;
 - (b) the increased use of automated or rigid processes reliant on pre-set benchmarks removes or minimizes the exercise judgement by bank workers on individual circumstances as the system has already pre-determined an outcome.
 - (c) time pressures and workloads have meant that bank workers spend less time with customers investigating or confirming financial situation if the system has pre-determined outcome.

¹⁶ T66
¹⁷ T552
¹⁸ T578
¹⁹ T580

D-7 *Do banks too readily permit waivers of their policies in connection with the assessment of home loan applications, including policies in relation to the assessment of serviceability of the loan?*

Increasing use of waivers in loan applications

69. The Union believes that there has been an increase of waivers in connection with home loan applications.
70. The Union submits that this increase has been contemporaneous with, and caused by the increasing reliance on benchmarks, and automated systems.
71. By way of example, an assessment system will seek information on the number of dependants a potential borrower may have. The borrower may provide an estimate of living expenses in connection with children less than HEM. In the event the borrower is a non-custodial parent, child support payments, rather than HEM, are the appropriate assessment tool. Waivers are then used by Banks to override the automatic application of Benchmarks in favour of actual verified figures.
72. The Union repeats its submissions at Part C above (paragraphs 18-32) and G-5 below (paragraphs 112 to 115).

Conduct consistent with the banks' behaviour toward policies

73. The waiver of policies is however consistent with the inconsistent application of policies and procedures the Union and its members frequently see and are subject to. The most prevalent form of this conduct is around the tolerance of behaviour that is contrary to assessment policies that achieves sales and targets. The Union has assisted many members subjected to disciplinary action for conduct that they admit to doing, but say was known, tolerated (and often condoned) by local management. On many occasions members insist that their conduct was commonplace within their branch or contact centre.
74. In most such instances the conduct in question involves the writing of new business that will assist with the meeting of the sales target imposed on the individual, branch (or contact centre), or obtains revenue towards STI. It is part of the same cultural framework that promotes staff 'gaming' systems to obtain products for customers.
75. The Commission was provided, incidentally, with insight into this issue in the NAB Introducer Case Study. Several the employees subjected to disciplinary action in connection with this issue were found to have breached NAB process where members of the assessment team have different levels of authority to waive elements of the policy. The policy in question was a prohibition on customers sending emails to private email addresses of staff members. The evidence of NAB was that this had occurred because NAB's own computer systems were incapable of receiving large emails from customers, and the solution identified by workers was to use their personal email accounts.
76. The Union was not involved in disciplinary matters involving NAB bank workers in Western Sydney. However, it seems likely that this practice was commonplace (multiple employees were disciplined on the issue) as a known local solution to a systemic problem.

E **CBA Broker Case Study**

E-1 *Does the use of upfront and trailing commissions for remuneration of head groups and the brokers who submit loans through head groups lead to poor customer outcomes?*

77. The Union draws a distinction between two elements of the question:
- (a) firstly, does the use of brokers and aggregators (as opposed to employed bank labour) lead to poor customer outcomes, and

- (b) secondly, does the use of upfront and trailing commissions (as opposed to a different remuneration model) for brokers and aggregators lead to poor customer outcomes. In respect of this question, the Union refers to its submission in response to question E-2.
78. The Union submits that contingent pay, which is a fundamental element of the broker model, is a most significant driver of poor customer outcomes.
79. The Union repeats its submissions at paragraphs 35 to 38 (in relation to external labour), and 83 to 90 (in relation to mortgage brokers). Specifically:
- (a) the broker's incentives are less aligned to the long-term interests of the customer and the bank than the short-term goal of obtaining a loan for the customer;
 - (b) brokers are not subject to the same training and systems;
 - (c) there is significant confusion on the question of whose interest the broker is acting on. The Union submits that consumers may believe that brokers have a stronger obligation to act in their interest than is in fact the case.
- E-2 Should upfront and trailing commissions be replaced with an upfront flat fee payment?***
80. The Union repeats its submissions at paragraphs 95 to 97 **Error! Reference source not found.**, specifically, that flat fees, as opposed to value-based remuneration structures, reduce the extent to which the customer's interest may be compromised. Incentives based on the loan size work operate so as to incentivise the broker to promote larger loans, while trailing commissions operate to incentivise interest only or longer loan periods. Neither incentive is generally in the interest of the customer.
- E-3 Is the first mover issue identified in CBAs evidence a genuine commercial impediment to change in respect of the structure of broker remuneration? If so, what can and should be done to overcome that impediment?***
81. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.
- E-4 Will the program of reforms in the mortgage broking industry, announced by the Combined Industry Forum in 2017, ameliorate the conflicts of interest or any other issues that have been referred to in this case study?***
82. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.
- E-5 Who does a mortgage broker act for?***
83. A great deal has been written about the development of mortgage brokers, and aggregators over the last 20 years. There have been reports commissioned by, and prepared by regulators, such as ASIC and APRA. The Background paper issued by the Royal Commission is one of the most recent and useful contributions to this area of discussion and debate.
84. Despite this discussion the Union submits that there is no clear answer to the question posed by the Commission. This uncertainty is illustrative of the potential for poor consumer outcomes.
85. The Union understands the relevant relationships as follows (noting there will be variations and exceptions):
- (a) Lenders contract with aggregators, who manage software and other systems for use by brokers. Lenders' contracts with aggregators include of the loan products to be

- offered through the aggregator's platform, along with of the fees payable in respect of the loan. Aggregators typically contract, in similar form, with multiple lenders;
- (b) Brokers contract with aggregators. Pursuant to these contracts, brokers obtain access to the aggregator's platform and systems, and accordingly the loan products offered through the aggregator. Brokers tend to work only with one aggregator;
 - (c) Brokers develop expertise in the lending practices of different lenders, and the cost and satisfaction requirements of the various loan products;
 - (d) Brokers work with borrowers to make an application, via the aggregator's platform, for loans. There is generally no contract in place between the borrower and the broker, or the borrower and the aggregator;
 - (e) Borrowers can make an application for a loan to a lender with the assistance of a broker, or directly to the lender. While borrowers can work with multiple brokers, most rely on a single broker who can offer multiple products, from different lenders;
 - (f) Borrowers do not pay anything to the broker or aggregator;
 - (g) As a result of such application, lenders enter into a contract with borrowers in respect of the loan. At such time, brokers and aggregators become entitled to payment as provided for under the contracts detailed at (a) and (b) above.
86. The Union submits that for customers, the expectation is that the broker is acting in the customer's interest in a potential transaction with the lender. The broker is ostensibly agnostic as to which lender the borrower selects to make application to. This expectation may be contrasted with the relationship between a borrower and a bank lending officer.
87. From the borrower's perspective they are a customer of both the broker and, ultimately, the bank. However, the truism that "*if you are not paying for it, you're not the customer, you are the product being sold*"²⁰ applies. The central transaction in the broker relationship is the sale of the customer referral (in the form of an application) to the bank.
88. In ASIC report 516 which deals with broker remuneration, the results of surveys of why customers use brokers are detailed.²¹ The two most common reasons – access to a wider range of loans (32% of general consumers), and to obtain a better interest rate or deal (27% of general consumers), are both indicative of an expectation that the broker is acting in the interest of the customer, or at least that the broker is not acting for the lender.
89. Other reasons provided include that the broker is expert (22% of general consumers), that the broker is independent (17% of general consumers). 17% of general consumers also indicated that they believed a loan obtained from a broker was more likely to be approved, than with a direct approach to a lender²².
90. The responses of various banks in the first round of the Royal Commission have been illuminating. Mr Rankin of the ANZ Bank essentially asserted that brokers, as the primary source of verification of customer information, were acting as the banks agent²³ The CBA were clear that brokers were the customer's agent.

²⁰ Generally attributed to Andrew Lewis <https://www.metafilter.com/user/mefi/15556>

²¹ Australian Securities and Investments Commission, *Review of Mortgage Broker Remuneration* (Report 516, March 2017), Figure 33, 176

²² Australian Securities and Investments Commission, *Review of Mortgage Broker Remuneration* (Report 516, March 2017), Figure 33, 176.

²³ T467.11. Mr Ranken also gave evidence that the broker acted for the customer.

91. Contrary to the expectations of customers, the Union submits that brokers do not act for either lender or borrower. They are not agent of either lender or borrower. There is generally no contractual obligations owed by brokers to lenders or borrowers. Rather, they owe customers minimum obligations imposed by statute. The most significant of these is that the loan product not be “unsuitable” for the customer²⁴. In this context “unsuitable” means no more than an assessment that the product meets the customers interest, and that the customer can afford it. It does not come close to an obligation to offer the most appropriate product.
92. The Union submits that the actual obligations owed by brokers to customers are significantly less than most customers would expect. Whereas a rational customer may shop around to multiple lenders for a better deal, a rational customer may expect that the broker has performed this role on their behalf.
93. In reality, the Union submits that, having met minimum legal obligations, brokers act on the basis of a series of drivers and incentives.
94. Firstly, and most significantly, the broker is only paid if a customer obtains a loan. Such payments can be significant²⁵ – typically on a \$500,000 loan the broker would receive a flat fee of \$2,700 plus an annual trailing commission of up to a further \$700.00. Absent a loan, the broker will receive nothing. The broker will therefore focus on those lenders (and products) which they believe the customer will be most likely to obtain. For marginal borrowers, this will lead to a focus on lenders with weakest compliance practices, or who are most likely to loan money to a particular potential borrower.
95. Much of the discussion around broker remuneration is on the relative merits of value-based payments versus flat fee payments. While the Union agrees that flat fees are less likely to lead to poor customer outcomes, the Union submits that contingent payments - the “no loan, no fee” payments - element has a far more significant impact on behaviors.
96. Once the gate of being able to obtain a loan has been satisfied, two incentives operate:
 - (a) As to which product is best for the customer; and
 - (b) As to which product will lead to the greatest reward for the broker. Such reward may not simply be in respect of a single product. For example, lenders offer “*soft dollar benefits*”,²⁶ as well as potential concessions for better and quicker access.
97. The Union submits that flat fees, as opposed to value-based remuneration structures, reduce the extent to which the customer’s interest is compromised. Similarly, other incentives based on the loan size work operate so as incentivise the broker to promote larger loans, while trailing commissions operate to incentivise interest only or longer loan periods. Neither incentive is generally in the interest of the customer.

F Aussie Home Loans

F-1 Do remuneration structures that reward mortgage brokers for volume of sales of loans create an unacceptable risk that mortgage brokers will prioritise the sales of loan products over their responsible lending obligations; their obligation to recommend loans to customers in a manner that is efficient, fair and honest; their obligation to have adequate arrangements in place to ensure that customers are not disadvantaged by conflicts of

²⁴ National Consumer Credit Protection Act 2009 (Cth) Division 4.

²⁵ Australian Securities and Investments Commission, *Review of Mortgage Broker Remuneration* (Report 516, March 2017), page 76.

²⁶ Australian Securities and Investments Commission, *Review of Mortgage Broker Remuneration* (Report 516, March 2017), page 78.

interest; and their obligation to ensure that the conduct of the brokers is not misleading, deceptive, or unconscionable?

98. The Union submits that remuneration structures that reward brokers for volume of sales, a fundamental element of the broker model, creates risk for consumers in the provision of suitable loans.
99. The Union repeats its submissions at paragraphs 32 to 35 (in relation to external labour), and paragraphs 84 to 98 (in relation to mortgage brokers). Specifically:
- (a) the broker's incentives are less aligned to the long-term interests of the customer and the bank than the short term goal of obtaining a loan for the customer;
 - (b) brokers are not subject to the same training and systems;
 - (c) there is significant confusion on the question of whose interest the broker is acting on. The Union submits that consumers may believe that brokers have a stronger obligation to act in their interest than is in fact the case

F-2 Do credit licensees, whose representatives engage in mortgage broking activities, have adequate systems and processes to prevent fraud, to detect fraud, to respond to fraud, and to identify and address any detriment to current and former customers occasioned by the fraudulent conduct of its representatives?

100. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

F-3 Should those who hold ACLs, as distinct from AFSLs, be made subject to a system broadly similar to the 912A plus 912D reporting obligations of part 7 of the Corporations Act.

101. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

G ANZ Case Study

G-1 Do credit providers have adequate policies to ensure that they comply with their obligations under the National Credit Act when offering broker-originated home loans to customers, insofar as those policies require them to make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract, to make reasonable inquiries about the consumer's financial situation, and to take reasonable steps to verify the consumer's financial situation?

102. The Union's experience is that there is a spectrum of approaches taken by different credit providers. In practice this spectrum extends from a substantial delegation of obligation under the *National Consumer Credit Protection Act* [the NCA] to brokers, to active steps being taken by the Bank to ensure the NCA obligations are met.
103. The Union notes that the delegation to a third party of banks' statutory obligations is more widespread than simply in connection with broker originated loans. It arises also (as was seen in the evidence) in the context of Introducer schemes,²⁷ as well as in the context of car financing.
104. The Union submits that this forms part of a pattern where core bank functions are delegated to external individuals whose remuneration is tied to the loan being obtained, who are not subject to the same compliance obligations as bank employees, and who do not have the same

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REPORT 516: Review of mortgage broker remuneration, <http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf> at Fig 33

- access to resources such as training, policy documentations and other guidance as bank employees.
105. The reported experience of union members is that broker supplied information may be of lower quality, and more prone to errors, than information gathered directly by bank employees from customers. While some of these errors may be relatively benign and typographical, others common errors seem designed to have gamed the bank into providing loans. For example, union members report common errors including reducing or omitting the number of dependants, and the listing of a property as an investment property (with associated predicted rental income) when it is actually a place of primary residence.
106. Further, for reasons discussed below, the primary driver on brokers – to obtain the loan - will mean that they will be drawn to the banks most likely to offer a loan. It follows that when acting for lenders on the margin of serviceability, they will be drawn to the bank that is most lax in terms of proving serviceability requirements. The Union submits that the banks that most rely on brokers, and do least to independently interrogate and verify customer information, will be the most at risk.
107. This observation is consistent with:
- (a) the surveyed opinion of customers reported by ASIC (that customers are more likely to be approved for loans through broker channels);²⁸
 - (b) a more generalised perception among bank employees that brokers know how to present or “massage” a customer’s loan application for it to be approved;
 - (c) that brokers maintain personal relationships with relationship managers within banks; and
 - (d) that brokers are able to directly contact the home loan assessments team.
- Together, these factors suggest that the broker channel is an effective way to avoid the usual bank loan assessment processes.
108. Together with increasing reliance on automated systems and benchmarks, the pattern reduces reliance on trained and employed staff, to the detriment of consumers. The pattern operates as a driver away from compliance with obligations under the NCA. This effect was evident during the examination of Mr Ranken.²⁹

G-2 *Is the use of the HEM benchmark appropriate in assessing whether a loan is unsuitable for a customer?*

109. The Union has no insight as to whether HEM (as opposed to some other benchmark) is appropriate. In relation to the use of benchmarks generally, the Union repeats its submission as paragraphs 112 to 115.

G-3 *Is the HEM benchmark too conservative a measure of a customer’s living expenses?*

110. The Union repeats its submission as paragraphs 112 to 115.

G-4 *Does the widely-known use of the HEM benchmark as a default for customers’ living expenses create an unacceptable risk that brokers will fail to make reasonable inquiries about a customer’s financial situation, instead opting to declare an amount of living*

²⁸ Australian Securities and Investments Commission, *Review of Mortgage Broker Remuneration* (Report 516, March 2017), Figure 33, 176.

²⁹ Transcripts of Proceedings, *Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Sector* (Commissioner Hayne) 19 March 2018, page 453-489

expenses for the customer that is known by the broker to be in the vicinity of the relevant HEM benchmark?

111. The Union repeats its submission as paragraphs 112 to 115.

G-5 *Commissioner's further question as to the suitability of a bench mark, per se.*

112. The Union note the further question posed by the Commissioner, which was to the effect:

- (a) is the use of any benchmark suitable and
- (b) given that individuals are poor historians, how appropriate is it assessing home loans by reference to UMI?

113. The Union has limited insight on this issue.

114. The Union notes that the increasing reliance on benchmarks is part of an ongoing trend away from active and engaged verification and towards the automation of decisions.

115. The Union repeats its observations at paragraphs **Error! Reference source not found.** to 32, above, specifically that:

- (a) banks increased use of automated or rigid processes reliant on pre-set benchmarks are becoming used as an alternative to verification of information;
- (b) the increased use of automated or rigid processes reliant on pre-set benchmarks removes or minimizes the exercise judgement by bank workers on individual circumstances as the system has already pre-determined an outcome.
- (c) time pressures and workloads have meant that bank workers spend less time with customers investigating or confirming financial situation if the system has pre-determined outcome.

H CBA CCI Case Study³⁰

H-1 *Are the processes that financial services licensees have in place for the sale of add-on insurance sufficient to ensure that those entities comply with their obligations under section 912A(1)(a) of the Corporations Act, the obligation to do all things necessary to ensure efficiently, honestly and fairly?*

116. The Union's experience is that add-on insurance products (along with other forms of insurance) has been a significant sales focus in each of the banks, and have been regarded as a lucrative source of revenue. All banks have, within their revenue target models, promoted the sale of insurance products and particularly add-on insurance.

117. The Union notes that at the time the CCI product was being strongly promoted by the CBA:

- (a) the sale of such add-on products was one of the identified targets for front line staff;
- (b) that staff were directed to attempt to sell the add-on products with each new product;
- (c) staff were issued with prompts by the CBA computer system to attempt to sell add-on products;
- (d) staff had no discretion to not sell (or at least promote) add-on products; and
- (e) staff could be subjected to performance management if they failed to meet sales/revenue targets or comply with computer system prompts.

118. The Union notes s.912A(1)(f) of the *Corporations Act* places an obligation on financial services licencees to ensure that its employees are adequately trained and are competent to

³⁰ T p.699 li##

provide financial services. In this context, competence should be understood to extend beyond simply having the requisite skills, but also include having sufficient decision making power and discretion.

119. The Union's experience is that there has been very limited training and education of bank employees around the suitability of such products. They have been generally regarded as a standard adjunct to the sale of the underlying product.
120. Further, the Union submits that the Commission may be concerned at the initial response (that is, before the decision to withdraw from this market) of CBA to this issue. The evidence of the CBA was that they modified internal systems to introduce a "gate" that would prevent such products being sold to obviously inappropriate customers.
121. There was no evidence from CBA that concerned a change to processes, or provision of additional training to staff such that they would be aware of when a product like this was not appropriate, would have systems in place to escalate concerns about inappropriate products being sold, and would have a discretion to ignore system generated prompts to sell products.
122. As the Commissioner noted, banks are very large organisations and errors will occur. While the issue in connection with CCI at the CBA has now been remedied, it is almost certain that a similar issue is currently occurring, or will soon occur, in one of the banks. A failure to properly train and empower staff will risk breaches of s.912A.

H-2 *Are existing legal mechanisms considered in light of the regulatory changes which are anticipated to come into effect under the deferred sales model sufficient to address the issues associated with the sale of add-on insurance to customers identified by ASIC in its report 256?*

123. The Union has limited insight on this matter, and does not make submissions on the effect of likely regulatory changes.
124. The Union submits that ASIC Report 256 failed to properly identify the drivers that led to issues around credit card and like insurance.
125. As was noted in the evidence of Mr van Horen, the remuneration and STI conflicts on most front-line bank workers because of CCI and LPI insurance were negligible.³⁹The Union's experience is that conflicted remuneration models have limited effect on the actions of tellers and sellers.
126. However, the prevalence of a culture that focuses on sales targets, with failures creating risks of performance management, do impact on staff behaviour. Report 256 make no mention of bank culture, or of targets in its assessment of risks, and its recommendations for change.
127. When bank staff are required to sell a certain number of credit card insurance policies to remain employed, compliance obligations will be subjugated in favour of sales.
128. The Union repeats its submission at paragraphs 5 to 17 above.
129. The Union repeats its submission at paragraphs 5 to 17 above. Those submissions apply equally here in relation to the target and performance regime of banks.

H-3 *How do financial services licensees ensure – this is a question we posed in another case study as well – that they comply with their obligation under section 912D of the Corporations Act in relation to reporting significant breaches?*

130. The Union notes a number of factors that pose a challenge to the bank's abilities to comply with these obligations.

- (a) For bank staff who work directly with customers, both within branches and contact centres, there is an intense focus on customer satisfaction. This means that bank employees will attempt to resolve customer complaints and enquiries quickly and at a local level. Employees in retail branches and call centres have authority to provide limited financial relief to customers, including by forgiveness of debts and small credits to accounts. There is no incentive or pressure in this system for concerns or enquiries to be escalated, or to identify patterns that may reveal a systemic problem. This reduces the likelihood that more senior elements of the bank will become aware of potential issues in a timely manner, or at all.
- (b) The compliance function in the banks has become increasingly reactive, individualised, and imposed on branches and call centres. All banks have reduced staff numbers in compliance functions. For most staff, a satisfactory compliance record is required to meet KPIs, and to create an entitlement for STI payments. The effect of this is similar to the effect of the focus on customer satisfaction: to seek to resolve the issue locally, and avoid, so far as possible, the escalation of the issue. There is no reward or benefit for the staff member in escalating compliance matters.

H-4 *What should the Commission make of the fact that CBA has chosen to withdraw from this – or from large parts of this market?*

131. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

I **CBA Personal Overdraft Case Study**³¹

I-1 *In circumstances where banks rely on automated serviceability calculators, are their automated processes adequate to ensure that they comply with their obligation under s 133 of the National Credit Act to only provide a customer with a credit contract that is not unsuitable for the customer?*

132. The Union submits that practices involving pre-approvals, the automation of assessment and verification systems, and the use of benchmarks particularly in the context of overdrafts and other “small amount credit contracts” are antithetical to compliance with ss128 and 133 of that Act.
133. The Union notes the enormous expansion (at least within the CBA) of these products as a result reduced reliance on automated decision making.³²
134. Responsible lending obligations involve:
- (a) reasonable inquiries being made about the consumer’s requirements and objectives;
 - (b) reasonable inquiries being made about the consumers financial situation; and
 - (c) a prohibition on banks entering into “unsuitable” credit contracts. In this context, unsuitable means either where the contract does not meet the consumer’s requirements and objectives, or, the consumer would be unable to meet the cost of the contract or only do so in substantial hardship.³³
135. The Union submits that verification that is no more than customers being asked to review and confirm pre-entered estimates of income and expenses is verification in name only and would not discharge responsible lending obligations. Similarly, so called “short form applications”

³¹ “Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards”, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 2.

³² T584.18

³³ *National Credit and Consumer Act 2009* (Cth) s 133.

- (short, populated applications issued to customers where the customer simply ticks boxes and signs) are little more than pre-approval offers with an illusory change to the initiating party to the transaction.
136. The factors relevant to this case study involved overdrafts being offered to customers on the basis of a review of the customer's transaction history, and an assessment against an automated system to determine if the customer could meet the cost of the contract. The coding in the automated system included significant errors in that some known expenses were excluded.³⁴
137. The Union submits that the decision making in the CBA process is an entirely automated process. The existence of "manual controls"³⁵ do not mean that there is any manual involvement in individual assessments being made.
138. Although not addressed, the Union notes the absence of evidence that the CBA assessed whether the product met the consumer's requirements and objectives.
139. The subsequent case study (Case Study J), in relation to overdrafts by the ANZ Bank, also involved a failure to properly determine suitability of consumers. In that case, there was an absence of any assessment of the reasons why the customer may want such an overdraft, or meaningful interrogation of the customer as to their capacity to meet the repayment requirements under the overdraft.
140. The failures in these approaches are, in the Union's submission, either inevitable, or near inevitable consequences of:
- (a) the automation of inquiries, verification and assessment; and
 - (b) pre-approval regimes.
141. The automation of inquiries, verification and assessment means that any error in coding will likely have systemic consequences. Pre-approval regimes, including the use of unsolicited short form applications, are likely to be associated with a failure to make reasonable inquiries being made about the consumer's requirements and objectives.
142. The Union's experience is that pre-approval, and prompted suggestions in loan applications, remain prevalent in the sector for products like overdrafts, credit card increases and other small amount credit contracts. Only the manner in which such products are offered has changed – previously such products were offered in unsolicited correspondence whereas now they are discussed, unsolicited, during visits to branches and cold calls from banks.
143. The Union's experience is that, during such conversations, bank employees are not generally required to have meaningful discussions with the customer about why they would like such a product or obtain additional information for verification of the customer's financial position.
144. The Union submits that it not possible to effectively delegate a bank's responsible lending obligations to a set of automated systems or policies. Rather, to comply there is a need for an active assessment of the customer.

J ANZ Overdraft Case Study³⁶

³⁴ T589

³⁵ T584.16

³⁶ "Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards", *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 3.

J-1 *Do banks have adequate policies to ensure that they comply with their obligations under s 128 of the National Credit Act before offering overdrafts to consumers, including by making reasonable inquiries of customers about their financial situation?*

145. The Union repeats its submissions at I-1 (paragraphs **Error! Reference source not found.** and 144) and Part C above (paragraphs 18-32) Those submissions apply equally here [paraphrase in dot points].

J-2 *Is it acceptable for a bank to decline a request by a regulator to identify and remediate customers who obtained an overdraft facility in circumstances where the lender had not complied with its responsible lending obligations?*

146. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

K **ANZ Processing Errors**

K-1 *Are banks' internal systems and procedures adequate to detect processing errors that result in customers failing to receive their entitlements under the terms and conditions of their accounts?*

147. The systems and incentives in place for front line staff are unlikely to assist in picking up customer identified error. It was noteworthy that in relation to each of the processing error case studies:

- (a) the error was initially detected by the customer;
- (b) the error was reported to the bank by the customer;
- (c) the bank failed to deal with the error;
- (d) the error was then escalated to an external organisation who again raised it with the bank; and
- (e) the error was then addressed.

148. Most system errors are initially identified and reported to the bank's front-line staff. None of the banks has in place incentives, systems or processes that promote such errors being reported. Rather the incentives in the bank are to:

- (a) deny the existence of an issue. As compliance is assessed retrospectively, admission of an error creates a risk of failing to meet the compliance standard; and
- (b) solve the issue locally. Staff are focused on immediate customer satisfaction. Each bank permits local branches capacity to resolve small disputes by waiving fees or making small payments to customers. In the event of an identified error this response, rather than an escalation is most likely.

149. Most banks maintain an integrated structure where their distribution or retail arms are distinct from product ownership, which is distinct against from systems development. In the Union's experience this acts as an inhibitor to identifying and resolving system generated issues.

K-2 *Are banks' internal systems adequate to provide timely and full remediation to customers who have suffered detriment as a result of failing to receive their entitlements under the terms and conditions of their accounts?*

150. The Union repeats its submissions at D-4. Specifically, in the Union's experience:

- (a) the priority for bank employees is to ameliorate individual customers when they identify a concern or problem with their banking.

- (b) resolving customer complaints at local levels may mask a systemic issue that is broader in application, but only identified by limited customers.
- (c) the priority of front line bank employees is to remediate/ ameliorate the concerns of individuals who identify problems and not spend time in raising systemic issues for customers who have yet to identify the problem.

K-3 *Are banks' remediation and review processes adequate to prevent a repeat of identified processing errors and to ensure that structural, as opposed to interim, changes are made in response?*

151. The Union repeats its submissions at K-1 (paragraphs 147 and 148) and and D-4 above (paragraphs 62 to 67) to the effect that:

- (a) the predominance of issues being resolved at local levels means that review processes may not identify systemic problems that require structural changes.
- (b) Internal bank structures mean that resolving and remediating on issues are often prioritised over an examination of, and resolution of root causes.

K-4 *Are banks' processes adequate for assessing whether an error such as a processing error (or a series of such errors) is of a systemic nature and meets the criteria for a significant breach that must be the subject of a written report to ASIC within 10 days?*

152. The Union repeats its submissions at K-1 (paragraphs 147 and 148) and and D-4 above (paragraphs 62 to 67) to the effect that:

- (a) the predominance of issues being resolved at local levels means that review processes may not identify systemic problems that require structural changes.
- (b) Internal bank structures mean that resolving and remediating on issues can be done at the expense of examining and fixing root causes.
- (c) Internal bank structures focus on resolution of individual issues, at the expense of identification of systemic ones. This inhibits detection of significant breaches.

L Westpac Car Loans Case Study³⁷

L-1 *Are the structural arrangements between banks and car dealers for the provision of car loans to consumers likely to result in the contraventions of the banks' responsible lending obligations under the National Credit Act?*

153. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

L-2 *Do remuneration and incentive structures that reward car dealers for increasing the volume of their sales of cars or insurance policies, or the interest to be charged to the customer, create an unacceptable risk that: (i) dealers will prefer their own interests to the interests of customers; and (ii) as a result, customers will suffer detriment?*

154. The Union repeats its submissions in Part C above, and to the extent they are equally relevant in this context as they are to mortgage brokers, at

- (a) the remuneration structure in place (in so far as it relates to the bank) involves no salary or guaranteed remuneration. Rather any payment is available on an entirely contingent basis in the event of a successful sale of the car, and the credit contract

³⁷ "Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards", *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 6.

This gives rise to a risk/reward environment that does not necessarily favour the interests of customers

- (b) there is no effective moral hazard in place for these individuals to ensure compliance with appropriate systems.

M ANZ Car Loans Case Study³⁸

M-1 Are the arrangements between banks and car dealers for the provision of car loans to consumers likely to result in the contraventions of the banks' responsible lending obligations under the National Credit Act?

155. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue beyond the submissions at Part C paragraphs 32-35 above, to the extent that:

- (a) that the arrangement between banks and car dealers is not subject to the same oversight and control as banks have over their direct employees
- (b) that car dealers are not subject to the same training or compliance standards as direct employees of the banks
- (c) car dealers have a strong incentive to ensure a successful sale as they receive the payment for the sale of the car, alongside a further payment from sale of the credit contract.

M-2 Do remuneration and incentive structures that reward car dealers for increasing the volume of their sales of cars or insurance policies, or the interest to be charged to the customer, create an unacceptable risk that: (i) dealers will prefer their own interests to the interests of customers; and (ii) as a result, customers will suffer detriment?

156. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue beyond the submissions at Part C above.

N CBA Credit Cards and Limit Increases³⁹

N-1 Do credit providers have adequate policies to ensure that they comply with their responsible lending obligations under the National Credit Act when offering credit cards and credit card limit increases to consumers, insofar as those policies require them to: (i) make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract; (ii) make reasonable inquiries about the consumer's financial situation; and (iii) take reasonable steps to verify the consumer's financial situation?

157. The Union repeats its submissions at I-1 (and 142) and Part C above (paragraphs 18-31). The Union submits that automated assessment and decision-making processes are antithetical to responsible lending obligations.

N-2 More specifically: (i) what policies might be appropriate to ensure that reasonable inquiries are made into consumers' discretionary expenditure (including in relation to the categories identified in [209.33] of ASIC's Regulatory Guide 209)? (ii) in circumstances where a bank has access to information about a customer's spending, by reason of the fact that that customer has other accounts with the bank, is it necessary for bank to inquire into the

³⁸ "Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards", *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 10.

³⁹ "Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards", *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 19.

expenses incurred in respect of those accounts to comply with its responsible lending obligations under the National Credit Act?

158. The Union has limited insight on this matter other than to express that in line with our previous submission at I-1 and Part C (paragraphs 18-31) bank policies to ensure adherence to responsible lending obligations should provide bank employees sufficient time and authority to inquire as to the financial needs and position of a customer in line with ASIC's Regulatory Guide 209

O Westpac Credit Card Limit Case Study⁴⁰

O-1 How should a bank assess the unsuitability of a revolving credit card facility, in particular whether it will meet the customer's requirements or objectives?

159. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

O-2 How should a bank assess the unsuitability of credit card limit increases, in particular what is the appropriate level and period of repayment that ought to be taken into account, including having regard to the legislative reforms that are to take effect from 1 January 2019?

160. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

O-3 Can a bank utilise an automated system for determining eligibility and suitability of credit card limit increases in order to comply with their responsible lending obligations under the National Credit Act?

161. The Union repeats its submissions at I-1 (paragraphs **Error! Reference source not found.** and 144) and Part C above (paragraphs 18-32).

O-4 How should banks respond when ASIC issues guidance to entities by way of correspondence or a Regulatory Guide?

162. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

P Citi Fees Case Study⁴¹

P-1 Are the terms and conditions provided to consumers in respect of credit cards specifically, and credit products generally, too complex for consumers to understand the circumstances in which they will be liable to pay fees?

163. The Union's experience is that the manner in which PDSs are provided to customers is often not consistent with the customer reviewing and understanding the terms and conditions of a product including liability to pay fees.

164. The Union does not believe that this is simply a matter of complexity. Rather, limited time (for example where a customer is given an application to complete and completes it within a short period) and opportunity is often given to the customer to review, question and comprehend terms and conditions. There is, on occasions, a sense that such documents and

⁴⁰ "Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards", *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 22.

⁴¹ "Closing Submissions – Personal Overdrafts, Processing Errors, Car Loans, Credit Cards", *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 23 March 2018 (RCD.9999.0003.0001) 24.

information are provided to the customer so as to inoculate the bank against later complaints, rather than so as to ensure the customer understands what they are signing up for.

165. The Union further observes:

- (a) Terms and conditions are provided to consumers in many circumstances in life without ill effect. There is often a perception that reading or understanding terms and conditions is optional, and there is no real detriment to not reading them;
- (b) Consumers have a general expectation that banks will operate in particular ways – for example, interest on a credit card balance will not be charged until after the interest free period ends. Union members' experience is that consumers often believe that they know what is in the terms and conditions and therefore that there is no need to review them;
- (c) Terms and conditions generally are too long and complex for consumers to be able to comprehend them in any meaningful way to ascertain their rights and obligations;
- (d) There is often a relationship of trust between bank employees and their customers. Consumers may have an expectation that the bank employee is acting in their interests, so will draw their attention to any important aspects of the terms and conditions.

P-2 What steps could, and should, banks take to ensure more transparency in respect of the circumstances in which customers are charged fees in connection with credit products?

166. The Union identifies two possible steps:

- (a) the Union submits that training and expecting staff to discuss customer obligations (including in connection with fees) is a sensible and obvious step. Such conversation should occur as part of the bank's compliance with responsible lending obligations.

Banks need to adjust expectations of staff, particularly around targets and average handing times, so as to facilitate this.
- (b) Banks should be required to publish as an adjunct to PDS documents, a clear and concise overview of what obligations will be imposed on the consumer, including as to fees, as a result of this product.