

Westpac Banking Corporation

Overview of misconduct

- 3.1 The Royal Commission has exposed serious and widespread cases of misconduct and conduct falling below community expectations by Westpac and its subsidiaries.
- 3.2 It was revealed that it was 'common practice' to fill in documents for loan applicants or guarantors at Westpac. The practice led to an elderly disability pensioner losing her home after acting as a guarantor for her daughter and partner.¹
- 3.3 Furthermore, the Interim Report noted that despite the customer's hardship application to the Financial Ombudsman's Service and her 'expressed desire to negotiate what would be, in effect, a life tenancy in the property, Westpac rebuffed the approach and insisted upon exercising its rights under the guarantee.'² Westpac ultimately allowed the customer life tenancy of her home, but only after being contacted by Legal Aid New South Wales. Westpac admitted it should have reached this result sooner and had inappropriately applied its hardship policy.³
- 3.4 In September 2018, Westpac was fined \$35 million for breaching responsible lending laws. Westpac admitted it wrongly assessed people's ability to service mortgages written between December 2011 and March 2015, instead relying on a benchmark for customer expenses. The issue

1 C Yeates, 'Westpac fought pensioner's hardship plea', *Sydney Morning Herald*, 22 May 2018, p. 6.

2 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 260.

3 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 260.

- affected approximately 260,000 home loans that were approved by Westpac's automated decision system.⁴
- 3.5 Westpac's loan controls came under scrutiny at the Royal Commission after it admitted it does not independently verify the expenses of car loan applicants applying for finance through car dealerships. The Interim Report noted that 'a licensee's responsible lending obligations are non-delegable. The subcontracting, in effect, of its sales activities to intermediaries cannot be allowed to obscure this fact.'⁵
- 3.6 The Royal Commission heard that Westpac mailed letters to more than a million customers offering to increase their credit card limits without verifying their incomes or whether they were employed. Despite receiving guidance from ASIC that its processes were inadequate, Westpac maintained practices that were contrary to the guidance provided by ASIC. The Interim Report commented that 'in doing so, Westpac may be seen to have exhibited a preference for profit over what ASIC considered to be appropriate practice.'⁶
- 3.7 A preference for putting profits before customers was again revealed during the Royal Commission's examination of the conduct of two financial advisers employed by Westpac. The case studies showed that several customers paid Westpac for advice that left them in a worse off financial position.
- 3.8 The Interim Report noted that one of the causes for the inappropriate advice was 'Westpac's remuneration practices for its employed financial advisers.'⁷ This remuneration system rewarded the poor advice provided by the two advisers and incentivised 'only the generation of revenue'.⁸
- 3.9 To make matters worse, in one case Westpac made 'inadequate offers of compensation' and did not discipline the advisor until almost two years after the initial complaint.⁹ In another, Westpac did not report the advisor to ASIC under its statutory obligations, despite the advisor's consistently poor audit ratings and record of policy breaches.¹⁰ During earlier hearings,

4 Australian Securities and Investments Commission (ASIC), 'Westpac admits to breaching responsible lending obligations when providing home loans and a \$35 million civil penalty', *Media Release 18-255*, 4 September 2018

5 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 91.

6 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 114.

7 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 186.

8 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 182.

9 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 186.

10 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 186.

Westpac was identified as the most resistant of the four major banks to ASIC's supervision.¹¹

Financial Services Royal Commission

3.10 Examples of Westpac's misconduct were the subject of six case studies in the Royal Commission's interim report.

3.11 In response to the Royal Commission's interim report, Westpac CEO and Managing Director Mr Brian Hartzler stated the case studies were confronting and sad. However, given Westpac had provided information to the Royal Commission some of the findings were unsurprising.

3.12 In a previous hearing, Mr Hartzler rejected the need for a Royal Commission, about this position, Mr Hartzler noted:

Westpac has been involved in some of them [case studies] and not involved in a number of them – there have been case studies and issues that have come out that we didn't anticipate. Reading the report and looking at the detail, particularly in hindsight, and at some of the observations that the royal commissioner has made, I clearly see the value in that process now.¹²

3.13 The committee pressed Westpac to explain the measures it had taken to rebuild customer trust following the Royal Commission. Mr Hartzler informed the committee Westpac had held a half day training session where 'we played tapes of customer complaints to everybody, so you could actually hear the emotion in the voice of people of what they'd gone through'.¹³

3.14 Mr Hartzler noted Westpac already has policies such as a code of conduct and a service promise but rules could not replace the judgment of staff when he stated:

Rules can't answer all these things, and we have to rely on our people, as the culture bearers, to exercise good judgement and to demonstrate that they are interested in the long-term success of that customer – and, ultimately, that's in the long-term interest of the bank.¹⁴

11 B Butler, 'Westpac plays cards badly: ASIC', *The Australian*, 26 March 2018, p. 17.

12 Mr Brian Hartzler, CEO and Managing Director, Westpac, *Transcript*, 11 October 2018, p. 53.

13 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 37.

14 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 37.

- 3.15 The committee noted this response but continued to pursue questions regarding Westpac's efforts to improve remuneration practices and accountability.

Reforms to remuneration

- 3.16 Issues regarding the incentives created by remuneration structures were raised throughout the hearing, as the Royal Commission made critical observations regarding the role of remuneration. For example:

All the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned.¹⁵

- 3.17 Westpac noted it had made changes to remuneration to implement the Sedgwick review and as a result referrals and sales targets have been removed from the remuneration structure for tellers.
- 3.18 Further questions were asked about what changes had been made for middle management. Westpac stated there are other traits that must be displayed such as compliance, accreditation and passing audits described as 'gate-opener' behaviours in order for staff to be eligible for variable remuneration.
- 3.19 However, Mr Hartzler did not accept the claim that remuneration was the sole cause of misconduct highlighted by the Royal Commission when he stated:
- I think it's clear that, in many of those cases, remuneration can and did play a role in what happened there. But, to answer the question fully, though, I don't agree with the characterisation that the only causal factor here in all of these issues is remuneration.¹⁶
- 3.20 The committee criticised the level and composition of the CEO's salary and questioned if the Royal Commission had resulted in any reductions in Mr Hartzler's salary.
- 3.21 Mr Hartzler admitted a proportion of his variable pay has been 'zeroed out' in the past few years as a result of Westpac's overall performance.
- 3.22 Perhaps unsurprisingly, Mr Hartzler did not agree with the idea that the variable component of the salaries of bank executives should be regulated. Instead Mr Hartzler noted regulation of this type could make it difficult to recruit high quality candidates given the level of international competition.

15 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, Vol 1 p. 301.

16 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 60.

Customer remediation

- 3.23 In Westpac's initial submission to the Royal Commission it indicated that \$12.6 million was paid to 205 clients to compensate for bad advice, with a further \$1 million in compensation offered but not accepted (as at 29 January 2018).¹⁷
- 3.24 Westpac also remediated \$2.75 million to 1,996 customers who were affected by the improper conduct of BT advisers between 1998 and 2012.¹⁸
- 3.25 During the hearing, the committee asked Westpac how much it had paid out in compensation and how much was set aside for future compensation associated with the wealth management division. Mr Hartzler responded:
- Over the last couple of years, we have made provision for about \$117 million for the ongoing advice matter and another \$80 million for what we call the advice compliance program.¹⁹
- 3.26 The committee asked Westpac to reflect on the consequences for shareholders and the resources devoted to repairing the extensive damage to its reputation as a result of the misconduct exposed during the Royal Commission. Mr Hartzler was frank in his response when he stated:
- I'm sure they're deeply disappointed. The value of Westpac and other banks has fallen dramatically over the last 12 months. There's a variety of reasons for that. Some of it is the P&L impact of the remediation work that we're having to do. I can assure you they're not happy about it.²⁰

CEO actions to address customer complaints

- 3.27 The committee pressed Mr Hartzler on the number of aggrieved customers he had met. Mr Hartzler admitted he had not met with any of Westpac's customers with long standing issues, but agreed that face to face meetings were not a bad idea.
- 3.28 The committee noted Mr Hartzler's resistance to the label 'bank victim'.
- 3.29 The committee intends to follow-up at future hearings on efforts of CEOs to improve complaints handling mechanisms and the pace of remediation.

Complaint handling mechanisms

- 3.30 The committee asked Westpac about reforms to improve a customer's experience when resolving a complaint. The committee particularly

17 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, Vol 1 p. 115.

18 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, Vol 1 p. 120.

19 Mr Brian Hartzler, CEO, Westpac, Transcript, 11 October 2018, p. 61.

20 Mr Brian Hartzler, CEO, Westpac, Transcript, 11 October 2018, p. 39.

sought to scrutinise the speed and level of resources devoted to complaint resolution processes.

- 3.31 As part of his opening address, Mr Hartzler noted many of the Royal Commission's case studies were the result of inefficient and slow responses to customer complaints and a lack of understanding of the main causes, in particular Mr Hartzler stated:

We worked very hard on dealing with the root causes of complaints, and our complaints volumes have come down dramatically. But what we missed was that, in the percentage of complaints that were still there, there were vulnerable customers or customers where the consequence of what had happened was severe or where the process was stuck in the system and taking too long.²¹

- 3.32 To improve, Westpac had also reinvigorated its complaints handling training for its frontline staff and created a central team to deal with complaints across all business groups. Mr Hartzler reported that these measures had helped Westpac to provide clear communication to its customers regarding complaint resolution processes.
- 3.33 In addition, Westpac introduced a new group executive managing a team with well over 100 staff and a centralised internal record keeping system to ensure greater consistency across the organisation.²²
- 3.34 The committee was not satisfied with this response, probing for further detail on what customers should expect from the enhanced complaints handling process.
- 3.35 Mr Hartzler noted Westpac is escalating longstanding or complex cases to more senior levels of the organisation in order to resolve these cases more quickly.
- 3.36 Mr Hartzler explained this takes the form of a 'long-dated matters' committee which meets at least once a week. The new group executive responsible for complaints handling reports to the board each month on the progress of difficult cases.
- 3.37 The committee was very interested in the rate at which past cases are being processed. Mr Peter King, Westpac's Chief Financial Officer, provided the following detail:

To give you a sense, there are about 450 that have been identified and 380 have been closed, so there are still 70 to go, but they're

21 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 38.

22 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 50.

working on them pretty quickly, and 120 days is broadly the rule of thumb for a long-outstanding issue.²³

3.38 Mr Hartzler emphasised, where possible, determinations were made in favour of the customer but this is not always possible, particularly in some complex situations.

3.39 To assist customers to resolve their disputes Mr Hartzler noted Westpac created a customer advocate role, independent of the business area, to give customers an avenue to review their complaints.

3.40 Mr Hartzler also acknowledged the value of an external complaint resolution process when he noted:

We are certainly supportive of the fact that it's important that there is a regime that allows people to get cost-effective access to a legal process in the event that they don't feel like they've gotten a proper hearing.²⁴

Bank Executive Accountability Regime

3.41 Westpac was positive about the introduction of the Bank Executive Accountability Regime (BEAR) as it helped to clarify areas of mutual responsibility. Mr Hartzler linked the BEAR to the issues highlighted in the Royal Commission when he noted:

...I think that's probably where the BEAR regime has been a positive development... One of the learnings out of this royal commission has been that, when we dig into some of the cases and things that have happened, there's been a level of diffused accountability or the accountability hasn't been entirely clear as to who was supposed to do what and so things have fallen between the gaps.²⁵

3.42 Mr Hartzler stated about 13 or 14 Westpac executives are directly covered by the BEAR. However, Westpac is using the principles across the company more broadly, particularly to improve the judgment of staff as Mr Hartzler noted:

We continue to look for ways to expose our broader management team and our frontline people to the things that go wrong, giving them a sense of what they need to watch out for and reminding

23 Mr Peter King, CFO, Westpac, *Transcript* 11 October 2018, p. 54.

24 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 57.

25 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 37.

them about how they need to exercise judgement and empathy in these situations.²⁶

- 3.43 When asked to elaborate on an example of shared accountability that created risks prior to the introduction of the BEAR, Mr Hartzler cited financial crime.
- 3.44 The technical nature of managing financial crime and understanding anti-money laundering regulations were specific skills. However, front-line staff needed to be made more accountable for monitoring customer transaction.
- 3.45 The BEAR required Westpac to define this shared accountability but the committee was critical of Westpac for not making senior executives more accountable for systemic failures prior to the introduction of the BEAR.

Relationship with regulators

- 3.46 The committee asked questions about the nature of Westpac's relationship with the Australian Securities and Investments Commission (ASIC) and whether it was adversarial.
- 3.47 To back this claim, the committee cited evidence provided by ASIC to the Royal Commission as part of a case study on unsolicited credit card limit increases offered to Westpac customers.
- 3.48 Mr Harter strongly refuted the claim Westpac was dismissive of ASIC stating ASIC is in regular contact with Westpac's Board. Although, Mr Hartzler admitted he does not often directly liaise with representatives of ASIC.
- 3.49 On the interpretation of responsible lending laws, with regards to the Royal Commission's case study, Westpac admitted it had interpreted the laws differently to ASIC.²⁷
- 3.50 Mr Hartzler defended Westpac's interpretation as a legitimate difference of opinion given the high-level nature of the laws. However, Mr Hartzler also stated in future Westpac would not seek to debate the interpretation of laws and regulations with ASIC, rather it would take direction from the regulator.

26 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 51.

27 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 63.

Competition in the financial system

- 3.51 Westpac was also asked about the state of competition in the financial system, specifically whether a lack of competition created an inertia that benefits Westpac.
- 3.52 In response, Mr Hartzler asserted relatively few people chose financial services solely based on price. Mr Hartzler also drew on his experience in other jurisdictions noting consumers in the United Kingdom and the United States also consider factors other than price when he stated:
- My experience shows that a relatively small portion of people in financial services are driven solely by price. For people who are, there are lots of choices out there and they can switch – and technology is going to make that even easier over time. In some cases, obviously, it reflects inertia but in other cases it reflects the fact that people view the bank as a service not just as a product.²⁸
- 3.53 The committee pressed Westpac about its profitability and on the higher level of margins Australian banks can maintain compared with the rest of the world.
- 3.54 Westpac refuted the claim that margins for Australian banks are much higher than the rest of the world. Mr Hartzler asserted ‘returns of banks have fallen; the margins have fallen. Customers are benefiting from that.’²⁹

Small-medium enterprise lending

- 3.55 The committee was interested in examining Westpac’s view on the threshold at which non-monetary default clauses cannot be applied to small business loans.
- 3.56 Mr Hartzler noted that loans above the \$3 million threshold established by industry could indicate sophisticated borrowers which meant careful consideration of the level of the threshold was required.
- 3.57 Mr Hartzler also noted the Australian Banking Association has agreed to review this aspect of the banking code which could result in an increase in the threshold.
- 3.58 When asked about increases in interest rates when the risk profile of SME borrowers changes, Mr Hartzler stated he was comfortable that Westpac was performing within established legal practices.

28 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 43.

29 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 69.

- 3.59 The committee was critical of this response and probed this topic at each hearing.
- 3.60 Westpac also refuted the claim that it has withdrawn from small business lending. Mr Hartzler stated:
- Westpac serves, one way or another, just over 50 per cent of all Australian businesses. It's one of our target businesses. It's a good business. We're investing in that business. We're investing in technology to bring the cost of borrowing down.³⁰

Access to credit

- 3.61 Westpac was asked to comment on the case for simplification of regulation as a potential response to the following observation in the Royal Commission's interim report:
- Good culture and proper governance cannot be implemented by passing a law. Culture and governance are affected by rules, systems and practices but in the end they depend upon people applying the right standards and doing their jobs properly.³¹
- 3.62 Throughout his testimony, Mr Hartzler argued more regulation would not necessarily prevent the misconduct highlighted by the Royal Commission. Instead of prescriptive responsible lending laws Mr Hartzler was in favour of improving the judgment of Westpac staff, stating:
- When you have an enormous list of specific things you have to do, in an organisation where you're trying to replicate that many thousands of times, it can lead you down a path of a tick-the-box approach. Unfortunately, sometimes the reality of life is that that can lead people not to exercise judgement – 'Wait a minute; I've got all these rules but this customer is in a situation where, forget the rules, I need to do the right thing here.'³²
- 3.63 While Mr Hartzler accepted a role for regulation, he also stated policy makers should be careful about adding more regulation as this could restrict access to credit, including to small businesses, which often use houses as collateral.
- 3.64 When asked if Westpac was concerned about the high proportion of interest-only lending on its books Mr Hartzler responded he was not,

30 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 45.

31 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, Vol 1 p. 320.

32 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 68.

noting 'statistically, for most people with an interest-only loan, the loan amortises at the same rate as a P&I loan.'³³

- 3.65 Mr King also noted Westpac had previously pursued investors requesting interest-only loans as part of a particular strategy and since abandoning that strategy the interest-only share of Westpac's mortgage book fell from 50 to 35 per cent in 18 months.³⁴

Westpac retaining its wealth management business

- 3.66 When asked about the decision to retain its financial advice arm, Mr Hartzler noted Westpac had divested its insurance business and BT Investment Management.
- 3.67 The decision to divest BT Investment Management was taken to alleviate the perception of a conflict of interest given these products were sold to clients of Westpac's financial advice business.
- 3.68 Mr Hartzler defended Westpac's decision to retain its wealth management services, as Westpac customers wanted a range of services.
- 3.69 Mr Hartzler also defended the commercial nature of Westpac's business when he said:
- We are a commercial organisation. We want to grow. For people who represent us, part of the job is to help us grow the business – absolutely. But the strategy here is around encouraging people to consolidate their business with us.³⁵
- 3.70 When pressed about the need for further separation of wealth management and lending businesses Mr Hartzler pointed out that misconduct issues were not limited to financial planning.
- 3.71 Mr Hartzler acknowledged the transition under Future of Financial Advice (FOFA) from product commission payments to a fee-for-service model should have been managed better. However, he noted Westpac was also the first to remove grandfathered commission payments attributable to BT products.

33 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 66.

34 Mr Peter King, CFO, Westpac, *Transcript*, 11 October 2018, p. 52.

35 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 42.

Mortgage brokers

- 3.72 Mr Hartzler was asked about the size of mortgage broker commissions and noted in general around 60 basis points are paid up front and around 15 basis points in a trail commission.³⁶
- 3.73 Westpac noted that brokers contribute to competition in the banking system and they provide services that customers value in terms of greater visibility (or transparency) across the whole market.
- 3.74 Mr Hartzler also argued that some mortgage brokers rely on the long term relationships they build with customers while others are more transactional.
- 3.75 When asked whether a best interests duty should be applied to mortgage brokers, Westpac noted that FOFA style reforms may work but that adding further regulation would increase compliance costs and potentially threaten the viability of some brokers, which may not necessarily benefit consumers.

36 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2018, p. 65.