Westpac's Brian Hartzer & Peter King appear at Parliament House - 11.10.18

Summary:
Hansard Transcript - The Treasurer has asked the Standing Committee on Economics to inquire into and report on a Review of Australia's Four Major Banks. This is Westpac's appearance at the fourth review. Members of the BRN team were in attendance to bear witness. The MPs on the committee did a magnificent job. The CEOs were not able to bluff their way out of being accountable. We have saved the transcript here for you.

Article Information**Category:** Banking News
Banking Company: Westpac
Author: Standing Committee on Economics
Source: Federal Government
Date First Published: 11 Oct 2018

Posted ByPeter Brandson
13 Oct 2018 - 12:15am

Standing Committee on Economics - 11/10/2018 - Review of Australia's four major banks - Westpac's Brian Hartzer & Peter King

HARTZER, Mr Brian Charles, Chief Executive Officer and Managing Director, Westpac Group

KING, Mr Peter Francis, Chief Financial Officer, Westpac Group

CHAIR: We will now resume this hearing of the House of Representatives Standing Committee on Economics. In the second session of today we have representatives of Westpac present for today's hearing. I remind both of you that although the committee does not require you to give evidence under oath the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. We shall begin by inviting you to make an opening statement. I understand you have circulated a copy to the committee members, as well, which is appreciated.

Mr Hartzer : Thank you, Chair. 2018 has been a year of unprecedented scrutiny for banks. Along with the royal commission, we've seen multiple legal actions by ASIC, AUSTRAC and the ACCC; the Productivity Commission's review of competition; and the introduction of the BEAR regime by APRA. The impact of these actions on banks is significant and ongoing. The issues they've raised are confronting, and, on behalf of Westpac, I'd like to once again apologise unreservedly to the customers that we have let down.

The royal commission has been a valuable and rigorous process, and the interim report has raised a number of important issues. Before taking your questions, I'd like to offer four brief observations on what we have learned and, importantly, what actions we are taking to restore community trust.

First, on remuneration, the industry needs to continue to improve remuneration practices in ways that incentivise good behaviour while minimising the risk of behaviour that is not in customers' interests. These changes need to cover both the structure and transparency of incentive schemes and consider the role of third parties such as mortgage brokers, auto dealers and financial advisers who deal with customers directly. At Westpac, we have continued to evolve the way we pay our employees. We removed all product incentives for our branch staff and have fully implemented the Sedgwick recommendations for our people from the first of this month, two years ahead of schedule. This means that 70 per cent of frontline incentives are now non-financial measures. We were also the first institution to remove grandfathered commission payments attributable to BT products.

My second observation is on the importance of good complaints handling. Many of the case studies examined by the commission could have been avoided if firms more effectively and rapidly responded to customer complaints and their root causes. This is particularly true when it concerns vulnerable customers or where the consequence of a service failure is potentially severe for the customer. That's why I'm increasing the visibility of customer outcomes, and complaints in particular, at the highest levels of the organisation. I've appointed a new group executive, reporting directly to me, who oversees complaints handling across the group, and we are investing in people, policies and technology to make sure we resolve complaints in a fair, consistent and timely way.

My third observation relates to financial advice. The transition under FoFA from product commission payments to a fee-for-advice model should have been managed better. As an industry, we did not implement sufficient record-keeping and file oversight at an adviser level to monitor the added requirements of the best-interest obligation and ongoing advice arrangements. We also know that we weren't quick enough to identify and fix the problems, and we accept the consequences of this delay. Last month, we announced increased provisions for customer refunds, with interest, associated with certain advice fees charged by the group's salaried financial planners. We have also now implemented stronger controls to ensure that services are in fact delivered where advice fees are being charged. This is in addition to providing customers with annual fee disclosure statements and a biannual opt-in process.

My fourth observation is on culture. New regulations and tougher sanctions alone are not going to solve the risk of poor conduct. In this, we fully support Commissioner Hayne's observation that simplifying current regulations could assist in reducing the potential for poor customer outcomes. All of us want a strong banking system that delivers good outcomes for customers and the economy as a whole. To achieve this, we need our bankers to exercise good judgement in a world that is often grey, where the most important question is, 'What should we do?' rather than, 'What can we do?' At Westpac, we recognise that building a strong service culture is essential to winning back trust, one where everyone in the bank feels safe to speak up, knows what's expected of them and is supported to make the right decisions for customers. That's why, over the last month, the entire company—nearly 40,000 people—has downed tools for half a day to review and recommit to our purpose, our values, our service standards, our code of conduct and our expectations around ethical behaviour and the treatment of our customers.

In making these four observations, I recognise that there are other questions to address and there will be further changes from the royal commission. However, in striving to address the issues that have led to misconduct, it's important that policymakers remain alive to the potential second-order effects of new legislation and regulation. While overall economic growth remains sound, we are seeing increasing uncertainty, especially among the consumer and small business sectors. House prices are falling, income growth has been low and consumer spending is likely to be affected by peoples' confidence in the value of their home. Therefore, regulatory changes that impact how much individuals can borrow, the cost and availability of credit for business or the availability and affordability of suitable financial advice should be considered carefully.

I'd like to conclude by assuring the committee that the stories related to Westpac, unacceptable as they are, do not represent who we are. Banking is fundamentally an annuity business. The value of a bank primarily relates to the size and sustainability of its customer franchise—in other words, the quality of its customer relationships and the health of the Australian economy. That means that in the long run there is no conflict between doing the right thing for our customers, by our community and by our shareholders. With that, Peter and I are very happy to take your questions.

CHAIR: Thank you very much for your opening statement. You hit, towards the end, exactly the issue that I think is concerning a lot of Australians, including a lot of the members' questions that have been raised already in the questions to the CBA this morning. That was particularly around incentives and whether companies are doing the right thing, rather than just doing what they can. I presume you've read the royal commission's interim report?

Mr Hartzer : I have.

CHAIR: Having gone through the report and looked at the stories of average Australians who have been taken advantage of by major banks, how did the report make you feel?

Mr Hartzer : Well, it's incredibly confronting and the stories are very sad. From a Westpac point of view, obviously we were aware of all the stories because we had submitted them to the commission in the first place. I'd have to say, I was surprised by some of the breadth of other issues that have come out. How it makes me feel is that it's really clear that we have a lot of work to do to restore community trust. Having worked in this industry my whole career, it's really disappointing to find that people have come to these conclusions about banks and about the industry. We clearly have a lot of work to do. As I go through the report, which I think is an excellent report, there's tremendous amount of insight and detail in there. It really also makes me feel very determined to get on and fix the things that are addressed in there.

CHAIR: In terms of the incentive structures within your bank, before the royal commission's report and any action you've taken recently, to what extent do you think incentives were aligned to the best interest of bank customers over the best interests of people receiving bonuses and profits?

Mr Hartzer : That has been an issue that we have been working on for quite a while and it absolutely predates the royal commission. Our strategy, based on my observations in learning over time while working at three different banks, has been that banking is a service business. By that, I mean that our job is to help people achieve something important to them. But, for many years, banks saw themselves as retailers or consumer product manufacturers. Linked to that has been my view that we needed to, as much as possible, get an alignment between our people and the customer outcomes. That has been an evolving approach with evolving insights.

Going back a number of years ago we moved away from product-specific measures—you have to sell this many of that product or whatever—to saying, 'We want you to have lots of high-quality conversations with the customer.' That's the way I've always talked to our people about it. We don't mind what we do for them. Yes, unashamedly, we'd like people to consolidate their business with us, because that's how we can build relationships, but we don't want to sell people something they don't need, we don't want to sell people something that's inappropriate for them. Our concept of how to do that was to focus on the number of conversations and the quality of conversations. Part of that was about helping them with the service aspects as well—are they using internet banking; have they tried mobile banking; are they using our contactless payments; are they managing their accounts in the right way?

As this has evolved and as we've reduced the financial aspects in peoples' scorecards, we still have seen examples—and clearly the royal commission has highlighted some of these—where people still, despite our best efforts, have prioritised their own interests over the customer. We've tried to root that out wherever we can. We've continued to make changes, including in this year. I alluded to that in my opening statement. We've now completely removed anything to do with the number of products or even the perception of that in the way we measure our people on the front line.

CHAIR: You said you did a half-day session earlier this year looking at the company's culture and organisation and, I think, a mission statement. In terms of the issues that arise out of incentive payments, it isn't just about the structure of products—though that's obviously a critical part of it. The other part of it is the lived culture of the bank. What was the conclusion of that half-day, or that down-tools half-day, to revisit the values of the bank and where trust sits at the heart of that or not?

Mr Hartzer : It goes without saying that trust is critical in banking, and everyone recognises that. What we tried to do with the session was bring to life for people the impact that some of these issues have had on customers. 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. We also played tapes, by the way, of good experiences—and many of our customers have actually had great experiences as well. But then we really tried to focus on judgement. We reminded people of what they already knew. We reminded them about what the values were, the code of conduct and the service promise that we've put in place, but we tried to make it clear to them that no core process, no set of policies, no set of rules, can ultimately answer every possible situation that comes up. And the nature of banking is grey. There are always going to be judgements to be made. Take responsible lending, for example, which has been one of the topics. There are going to be cases where a customer comes in and they really want to buy a house and, on paper, the numbers say they can afford it but, for a variety of reasons, we may feel that that's actually not the right thing for them to do. It's trying to have people have that conversation. How do you make that decision? How do you make that judgement? 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.

CHAIR: The values of a bank need to be lived from the board and the CEO down to the branch level. To what extent do you believe that the board and yourself and the executive team are leading those values of the bank?

Mr Hartzer : I think we do, absolutely. I've had the conversation with our board, that choices around character are some of the most important choices that we make—for example, when I was appointed and in the choices I make about the people that are on my team. But what we've clearly seen with the royal commission process, for example, is that intent is one thing; the other is then: are you engineering that to cascade through the company, effectively? That's where, clearly, there've been a number of areas where we have failed.

CHAIR: Do you think there's been a failure of leadership within Westpac?

Mr Hartzer : I think in the sense that our intent has clearly not manifested in the good outcomes for all customers that we would have liked.

CHAIR: Respectfully, Mr Hartzer, one of the challenges we've had throughout the day has been around accountability and whether the Australian people feel that there's been accountability within banks for misconduct. So the question I'm really asking is: do you think ultimately the buck stops with you?

Mr Hartzer : Absolutely. As the chief executive, ultimately, I'm accountable for everything that goes on at the company. I understand the attention on this. I'll just reassure you that my executives feel the same way and our board feels the same way. Within that context, I reiterate that through this process every bank is in a different position, the nature of the issues that have happened over long periods of time are different and the extent to which banks have been proactive, as I believe we have been in trying to identify and address these issues over multiple years, is different. Yes, we're accountable. As I said earlier, I absolutely feel responsible and very disappointed, and I apologise, for our failures to individual customers. I should also say that I know that most of our people overwhelmingly come to work trying to do the right thing by customers and a lot of great service gets delivered, but I know we've got a long way to go to make sure the community recognises that we do take it that seriously.

CHAIR: I know you've spoken about it as whole of bank, but what has the executive leadership team done in terms of reviewing their own activity and their own performance against the expectations and results out of the royal commission?

Mr Hartzer : I think that's probably where the BEAR regime has been a positive development. We have always had a very structured approach. For many, many years the way we've evaluated people has been based on a balanced scorecard that includes risk assessments and the like. 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. The

BEAR process, which has been an incredibly intensive process, has been making sure we document very specifically who is on the hook for what and when there are overlapping responsibilities. For example, with risk or operating risk or compliance and the businesses, it's clear who has to do what and so forth. The consequences of those failures then become much easier to work through and apply.

CHAIR: To what extent has there been a review of the consequences of failure, particularly where misconduct, or in some cases, criminal action could potentially arise?

Mr Hartzer : Are you referring to the executive level, because that's a broad question.

CHAIR: Going back to the point around accountability, what I think people want to know is that people are being held accountable and there are serious repercussions as a consequence of poor behaviour. The question is not just at the executive level—that's critical—but what flows down through different parts of the organisation proportionately, because what we found—and this certainly came up this morning—is there seemed to be a high degree of accountability and punitive measures applied to people at lower levels of the organisation in some banks than at the higher levels where, yes, there's more distance but, ultimately, there's a higher degree of responsibility.

Mr Hartzer : Yes. I think it's a really important point at all levels. Clearly, we set out what our code of conduct is and what our expectations are and when people break that we can and do take action. If they've broken our code of conduct, they're exited. People get fired from this company. It's a very formal process. Then, as issues arise, we also look at if it's a deeper issue or if it's a systemic thing? We try and figure out where the failure has been, and that includes up to and including me, as CEO.

What I would say is, I've worked in three different banks. The process that I found when I came to Westpac was much more formal and structured than the other places I'd worked. With BEAR, we've made that even stronger, but it is a very formal process. At least annually, whenever there are incentive discussions that go on, we formally review risk outcomes for individuals, compliance outcomes and the like before we make a determination of any sort of reward.

CHAIR: So you're saying that in your experience that's been absent in other banks?

Mr Hartzer : Not absent, but not as formal.

CHAIR: Not as formal meaning? It might be factored or it might be—

Mr Hartzer : It might be in a conversation, it might be embedded in a review document someone has put on someone or it might be factored into a judgement. Cascading through the company, we have formal committees that meet at year end specifically to look at whether there are any behavioural, compliance or risk issues that need to be taken into account. Any recommendation for incentives has to go through that process.

CHAIR: In the remaining time I just want to go through some of the issues you raised around your second observation of the importance of good complaints handling towards resolution for customers. There is a lot of nice words on the page, but it's quite verbose in terms of what it practically means for a customer. If a customer had a complaint of Westpac today, in comparison to what they experienced before the review of these mechanisms and what's necessary, how would it be different?

Mr Hartzer : We've made it much clearer, through our website and through the phone numbers, exactly where they go. In the past, some of that was a bit buried or dispersed across the businesses. That's one thing. The second thing is that the complaints handling teams, which sat in our different businesses, have been centralised. They are all now managed by one group executive, who reports to me, and she is putting consistent policy, process and reporting across all of those areas. Thirdly and I think most importantly—and this is the subtlety that I was alluding to—we are much more proactively looking at those complaints for the ones that are long outstanding and the ones where there's a potential vulnerable customer or significant impact. We're diving in to try to escalate and resolve those more quickly, and that's the piece that I think was missing.

Complaints handling is something I've personally been focused on for a long time. I worked in the UK after the GFC. We had massive issues in the economy and with customers there. We realised that we weren't staffed and organised to manage complaints, so we worked on that a lot. When I came to Westpac six years ago, that was a big priority I put on it. 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. I deeply regret that, but it's been a really important learning. That's why this change we've made in the way we manage complaints and the way we proactively, systematically—there's literally a committee, which meets more than once a week, that looks at the list of long outstanding items, goes through them and says, 'How do we resolve this?' That's working really well.

CHAIR: When a customer complaint does trigger an internal review around whether there's been wrongdoing on behalf of the bank, what is that trigger, along a process or a complaint, to make sure that not just customers but issues are being resolved—they have a complaint, but then there's internal action to make sure that, if it comes from wrongdoing, there's appropriate responsibility and accountability?

Mr Hartzer : You've got a lot of overlapping responsibilities that try to look at that from different angles. It depends on how it's picked up. If it's come through the complaints team, they look at the root cause of every issue and meet regularly to think about whether there are themes that are coming up. Those are then passed to the relevant area to look at. And then, through our risk processes—operating risk, compliance and audit—issues that have surfaced, either through complaints or other means, are then tracked and reported to risk committees, including my executive risk committee, which meets pretty much monthly, or are ultimately tracked at a board level. They go into a process that we track. We have an internal system called JUNO, and compliance issues of any sort across the bank go into that system and get reviewed regularly.

CHAIR: What do you believe has been the view of your shareholders as a consequence of the royal commission and what that means for the bank and also the resources that they chip in as part of an investment being allocated to repair, frankly, so much damage in which they've had no part?

Mr Hartzer : 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.

CHAIR: How do you see the capacity for the bank, not just with the PR but in the public sphere and with the broader public, to rebuild that sense of trust that once sat with Westpac?

Mr Hartzer : It's going to take a long time. We look at this from a lot of different angles. What I've been trying to do over the last little while is deal with all these issues. Our No. 1 priority right now is to close out the remaining issues that we need to deal with. We're working incredibly hard and putting a lot of resources into doing that. At the same time though, we recognise that the bank industry is changing a lot and customers' needs are changing a lot, and we're continuing to invest in our service quality and innovation and the general agenda that we're driving at the bank. When we look at overall customer satisfaction, it's actually held up pretty well, and we're getting very good feedback on some of the service quality initiatives and innovations that we're delivering in the market. From an overall reputation point of view, this is obviously going to take years to restore, but I think most of our customers also consider what's their actual experience with us, and we know from the feedback we get that, day to day, overwhelmingly the experience that customers are getting is pretty good and, in fact, improving.

CHAIR: Thank you.

Mr THISTLETHWAITE: Mr Hartzer, when you last appeared before the committee, you said that you were opposed to a royal commission. The words you used were:

We do not see a whole lot of value in spending several years to run a process that ends up with a document and then recommends actions which we can take now.

Do you still hold that view?

Mr Hartzer : I think it's very clear, with all the things that have come out and the quality of that work that's been done, that the royal commission has been a very valuable process. It's been a very painful process for banks. When I made those remarks, it was based on what we knew about the issues that we had and the situations that we were in. As I said in my opening statement, there have clearly been broader issues that have come out. I have read the report twice. It's searing, it focuses the mind and it's been clear that it's added a lot of value in pointing out things we need to do better, and we will.

Mr THISTLETHWAITE: So do you now admit that you were wrong, the bank was wrong and others who opposed a royal commission were wrong to oppose it?

Mr Hartzer : I think it's worth remembering that in the end, we did recommend it and wrote to the government to say that it should happen. I certainly acknowledge, as I just have, that it's been a valuable process.

Mr THISTLETHWAITE: The commission's received close to 10,000 submissions. A lot of them are from aggrieved bank customers and victims. Do you believe that they deserve to have their stories heard, given that only 27 of them have been given the opportunity to give verbal evidence?

Mr Hartzer : Well, I think it's a matter for the royal commission as to how to run the process. We certainly want to hear from any customer who has an issue with Westpac to give us a chance to resolve it. I think it's certainly important that the study be comprehensive so that the root causes of issues that need to be addressed are addressed.

Mr THISTLETHWAITE: How many victims have you met with personally?

Mr Hartzer : As I said earlier, I have been in this business a long time. My experience in the UK with the impact on customers has made it clear that focusing on complaints is a huge issue, so part of my basic operating process is that I meet with customers all the time. That includes interacting with customers who have complaints. I probably interact with a customer one way or another every day. Often that's a complaint related issue. I listen to phone calls. In the sessions that we ran earlier this month, we played phone recordings. We had customers share their stories by video so that we could bring it to life. I just think that a fundamentally important part of making sure that you're driving a service culture is to understand the impact of that.

Mr THISTLETHWAITE: Specifically, how many of those who put in submissions to the royal commission and were victims of the behaviour of Westpac have you met with?

Mr Hartzer : Personally, I've watched the videos of the ones that were in the royal commission, and I'm aware of many of the stories. If the issue is that people specifically want to meet with me, I'm happy to meet with them.

Mr THISTLETHWAITE: Have you met with any of them?

Mr Hartzer : Personally, of the ones that were in the commission, no, but I've made sure that I understand where their situations are at and what we've done about them. But, as I say, I meet with customers all the time. If there are specific issues on which people want to meet with me, I'm happy to do that.

Mr THISTLETHWAITE: Okay. I just wanted to ask you some questions about conflicted remuneration. What proportion of Westpac employees are subject to the FOFA regulations?

Mr Hartzer : Proportion?

Mr THISTLETHWAITE: Yes, roughly.

Mr Hartzer : About 800 planners. The only reason I hesitated was that I just wanted to make sure there aren't elements of FOFA that apply more broadly than the planners. That's why I was hesitating.

Mr THISTLETHWAITE: So it's mainly the planners working in the financial management space.

Mr Hartzer : Yes.

Mr THISTLETHWAITE: What about intermediaries? Are there any bank intermediaries that are subject to FOFA as well?

Mr Hartzer : Well, we have aligned planners, so we have these aligned planner groups that would also be subject to that regulation.

Mr THISTLETHWAITE: So they work as agents on behalf of Westpac, do they?

Mr Hartzer : I'm not sure I'd describe it that way. They operate under our licence and they provide financial planning, but they're not agents in the sense of being there to necessarily sell our product.

Mr THISTLETHWAITE: It would be a similar answer, wouldn't it, for the Sedgwick review—the number and the proportion of people who would be covered by that?

Mr Hartzer : No. Sedgwick applies much more broadly to our frontline banking staff. There you're talking about probably 15,000 people.

Mr THISTLETHWAITE: The royal commission looked at the issue of the remuneration structures in the banks. You've said on previous occasions, when you've appeared before us, that you've changed the nature of the remuneration structures and that there's not as much at-risk element in the payments that can go to employees for reaching specific targets. But the royal commissioner made the point—and I thought he made it very well—when he said:

If customer facing staff should not be paid incentives, why should their managers, or those who manage the mangers? Why will altering the remuneration of front line staff effect a change in culture if more senior employees are rewarded for sales or revenue and profit?

Do you agree with that observation of the commissioner?

Mr Hartzer : I think that, if you simplistically thought that just changing frontline sales targets was going to magically solve culture in banking, I would agree with that—obviously not. The way that I think about it is that businesses that are really successful over time have an alignment between the strategy of the company and what they're trying to do, the kinds of people they hire, how they measure them and how they reward them. Then that needs to flow through the whole company. At different levels, the nature of what people are actually there to do all day will differ. Ultimately you're trying to get an alignment. What we've been trying to do over time is get an alignment around service in the sense of helping customers and building strong, long and enduring relationships. In that context, we started with tellers by removing all referral targets and sales targets. We then looked at the personal bankers. And we've made further changes all the way through the company. That's always going to be an ongoing process. There's no magical formula where someone says, 'This is the simple answer.' It's something we continue to work on. But the objective is alignment all through the company.

Mr THISTLETHWAITE: I'm looking at the witness statement that was provided to the royal commission from Carol Separovich, who is the head of performance and reward management for the consumer bank and business support functions. This statement was provided in response to questions that were asked by the royal commissioner about remuneration structures and the elements of people's remuneration that were at risk. She goes into quite a bit of detail about the total reward approach and that there is still a variable reward and an opportunity for employees to gain financial advantage from elements that are at risk, if you like, that are related to certain targets and meeting certain obligations. Roughly, for frontline staff, what proportion of their salary is at risk?

Mr Hartzer : It depends on the role, but for tellers it's very, very small—a couple of per cent. For personal bankers, I think it's 10 or 15 per cent. If you've got someone who's in a very focused sales role, like a home finance manager, it's probably around 20 per cent. It's not a huge proportion.

Mr THISTLETHWAITE: Does that element of performance related pay components increase as you move up the levels of management in a branch and then beyond a branch?

Mr Hartzer : Probably, but not necessarily linearly. It depends on the role.

Mr THISTLETHWAITE: Isn't that the point that the royal commissioner was making: a lot of the banks have changed a lot of the practices with frontline staff, and sales targets and referrals and things like that are being linked to pay, but those who are managing them still have quite an element of their pay linked to performance targets and at-risk elements?

Mr Hartzer : I don't think the issue is necessarily the percentage that's at risk. It's more about the structure of what drives the at-risk piece. I think the point he was making—which, as I said earlier, I would agree with—is that, if you had specific product sales targets for a regional manager or a state manager but your frontline person doesn't, that's obviously going to cause a tension. With the fact that we have an at-risk component, the structure within that is balanced across a bunch of things. Just to bring this to life: if you have someone who is running a business, they may have an at-risk component based on the overall success, one piece of which would be the overall profitability of the business, but the drivers of that could be around expense management; they could be around customer retention; they could be around growth in customer numbers. It doesn't follow necessarily that the increase in the percentage that's at risk implies that that increase is just to do with sales targets.

Mr THISTLETHWAITE: Ms Separovich, in her statement, points out:

To be eligible for variable reward, the relevant employees must first satisfy certain basic criteria, referred to as 'gate openers'.

It's interesting that the CBA witness statement that was provided on the same topic refers to it in exactly the same terms—'gate openers'. It appears to be that this is the trend throughout the industry. Can you explain what those 'gate openers' are? As far as I understand it, you have to meet certain criteria to open the gate to then be eligible for the at-risk component and the sales targets, if you like.

Mr Hartzer : Right. I referred earlier to the evolution of thinking about these processes. The issue of the potential danger of mis-selling or the like is something that people have been concerned about for many years. The 'gate opener' concept, which I guess is a phrase that's become fairly common, is basically trying to say to our people, 'You must do certain things properly, and they are non-negotiable.' Those are typically: being up to date with your compliance, having been accredited to talk about whatever it is that you talk about, demonstrating the right level of behaviours, not having failed audits of your files against you—those sorts of things. What we are trying to do is to say to people: 'There's a set of non-negotiables, and if you don't pass any of those things then there's no way you're going to be considered for an incentive payment.' So that's what that's about.

Mr THISTLETHWAITE: What are those non-negotiables?

Mr Hartzer : As I say, they're behavioural, they're compliance, they're passing audits—it depends on the role—accreditation levels and those sorts of things.

Mr THISTLETHWAITE: When you say 'behavioural', can you elaborate on that? Does that mean OH&S requirements?

Mr Hartzer : Absolutely. Yes. I mean, depending on the role, absolutely. There could be OH&S

things—staff safety—or obviously if someone had a poor-behaviour complaint against them for bullying or some sort of other issue. The Motivate framework—we call it 'Motivate' internally, which is our people management framework—starts with quarterly conversations with each individual about behaviour, and it goes through a series of elements, to give them feedback and talk about, 'How are you treating other people? How are you managing yourself?' and so forth.

Mr THISTLETHWAITE: So once you get through the gate then you're eligible to participate in this scheme, and Ms Separovich has gone through and outlined what she calls key performance indicators for various roles. For personal bankers, they include things like 'total branch first party net home loan and deposits growth', 'total net growth percentage in branch customers', 'referrals to specialist business partners—for example, wealth, business, premium'. They're still there, aren't they? Admittedly, it might not be as big, but they're still there—those referral opportunities and growth in the value of home loans. For lenders, one of the KPIs is 'the value of home loans provided to customers'. In terms of credit card product and marketing teams, one of the KPIs is 'consumer finance revenue targets'. The second one is cards systems growth. It appears to me that you've done a bit of window-dressing, but they're still there. There's still that notion, within branches, within banks, that an element of your job is to try and push some of these products onto customers, and, if you do and you do it well, you'll be rewarded for it.

Mr Hartzer : I certainly wouldn't characterise it as 'window-dressing', and I wouldn't characterise it the way you just did. 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. If I could pick one example you mentioned there, you talked about net home loan growth. The reason the word 'net' is there is because we have to look after the customers we've already got. It is really important that we are delivering good service to those people; that people, when they're refinancing, are well looked after; that we are keeping in contact with the customers and the like. One of the big drivers of growth is if we are doing a bad job of serving customers and they are leaving us, those numbers are then going to go down.

I'm not saying that we have the perfect answer to this, but what you can see in the changes—and the changes predate the royal commission—is that we have been working on this for many years to try to get this right. It is to get the balance of being willing to reward the people who work hard and do a great job looking after customers and, as a result, their business grows and allowing them to benefit from that success but, at the same time, not creating perverse incentives that cause them to push an individual product on someone who doesn't need it. We very clearly changed the structures so that people are agnostic as to which product it is that they're talking to someone about.

Mr King : I might just add that the scorecards that were referred to there were historical as well. As we have implemented Sedgwick, certainly the ones we used in this financial year, which has just started on 1 October, have moved again.

Mr THISTLETHWAITE: I understand that. But in the appendix that was provided to that witness statement, there's a handy little table that I understand that you sent to your staff about lenders, incentive schemes and what's changing. For lenders, it's still there in the wealth cross-sales segment. The net revenue target increased to $17,500 per full-time equivalent per quarter. The home and contents net revenue increased to $500 in net revenue per sale. They're still there.

Mr King : The ones that we are using for FY19 have evolved again. It might be worth us—

Mr THISTLETHWAITE: Perhaps you could provide those to the committee. I found that quite handy, actually. It demonstrated what had changed. You could outline for us what had changed. I just want to ask a few questions about Carolyn Flanagan's hardship request. I'm sure you are aware of this case. It was provided in evidence before the royal commission. I just want to know why the bank fought that case. It doesn't make sense.

Mr Hartzer : That is, for me, probably one of the most devastating of all of the cases that we saw. It's a really unfortunate situation. We should have done a better job handling that. It has raised some really important questions about how we deal with guarantees and, importantly, how quickly we respond to people in hardship. It's an example of the sort thing that I would hope, with the new process we have put in place, we would deal with differently.

Mr THISTLETHWAITE: Have you put procedures in place to prevent circumstances like Ms Flanagan's happening again?

Mr Hartzer : Yes, we have. We are in ongoing discussions about the guidance to our people about what they need to do around when people can give a guarantee. The guarantee issue is a subtle one. Even Commissioner Hayne, in his report, talks about—this is one of these judgement questions—parents' willingness to support their children through a guarantee. But it's very clear that we should have done more on that one to make sure that everybody was clear on what was going on. Most importantly, when it did go wrong, we should have handled it better and more rapidly. We have now tried to make amends to Ms Flanagan, but we have absolutely used that as an important learning in how we deal with these things in the future.

Mr THISTLETHWAITE: Do you understand the pain and suffering that someone goes through in a legal battle such as that? She had to go to the Financial Ombudsman Service to get justice. She suffered from a range of medical conditions. She suffered a stroke. She was legally blind.

Mr Hartzer : It's a really sad case.

Mr THISTLETHWAITE: Surely you understand the suffering that you put someone through?

Mr Hartzer : Absolutely. No-one could watch that video and not be incredibly moved at what a horrible situation it was. All of us feel terrible about what she went through. That's why we have made the changes that we've made; it's to try to make sure this never happens again.

Mr THISTLETHWAITE: I'm running out of time, and I've got one more question. The Australian Banking Association have announced, a couple of days ago, some changes that they are going to agree to around deceased estates and are also seeking to amend FOFA to ensure that legacy commissions, or grandfathered commissions, are now outlawed. Is that a reform that your organisation and you support?

Mr Hartzer : We were the first company to announce the elimination of grandfathering. Yes, absolutely, we support that.

Mr THISTLETHWAITE: You'd like to see that passed by the parliament?

Mr Hartzer : If that's what it takes, yes.

Mr THISTLETHWAITE: Okay, thanks.

Mr FALINSKI: I'd like to go to the heart of the interim report that has been released, which seems to be a finding that there is a lack of competition in the Australian financial services market, highlighted by the fact there is so little switching between financial institutions by consumers, even when there are better products at better prices that better fulfil the needs of those consumers. As one of the beneficiaries of that lack of switching, what do you put that down to?

Mr Hartzer : This is an issue that's come up many times over the years. I will give you my own view, and some people will have a different view on this. 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. Bankers themselves have contributed to the problem here, I think. For many years banks looked at themselves as packaged goods companies and they advertised their products on the basis of futures and pricing.

The way we approach our business is we're actually a service business, and you come to Westpac because of the quality of people there, because of the institutional strength and our willingness to sort things out if they do go wrong and because of the quality of the technology that we provide—we've got world class mobile banking capabilities, we've got world class payments capabilities. So our strategy is to say, 'Sure; you can compare just the price, but the bundle of services that you get when you bank with us is worth staying for.' I personally think that is the way a lot more people see it.

Mr FALINSKI: Would you say that this 'inertia', as you describe it, is innate to Australian consumers or is something that is a function of this market?

Mr Hartzer : In my experience—I've worked in three major markets—it's pretty consistent. When you look deeply into the psychology about how people think about their banks, money is a scary topic for a lot of people—and that's implicit in some of the issues we've seen from a customer point of view in the royal commission. They value convenience, they value security and they value service, and a lot of people value the frontline banker that they get to know who looks after them. So people often get surprised because, if you purely look at product futures and pricing, this is confusing. But, if you actually reflect on the number of people who will say, 'I've banked with Westpac my whole life; they've always looked after me. I recommend Sally in the branch; she's terrific,' that's the sort of thing that actually drives the majority of behaviour.

Mr FALINSKI: According to the report, there are over 4,000 types of residential mortgage products in the Australian market. There are over 85 brands. How many brands does your organisation sell under?

Mr Hartzer : Five.

Mr FALINSKI: Do you think, on reflection, it was a good idea for the government to allow you to take over St George?

Mr Hartzer : The alternative was that St George would have failed.

Mr FALINSKI: So you're saying that the capital adequacy of St George at the time—

Mr Hartzer : St George would have failed in the GFC if it had not been taken over. That's a simple fact.

Mr FALINSKI: On that basis then, should you have been allowed to continue to sell under that brand?

Mr Hartzer : Yes. The proposition that we offer under St George, Bank of South Australia and Bank of Melbourne is a particular proposition. It's different than Westpac. Customers value that.

Mr FALINSKI: If I'm an average consumer of a mortgage product, how is it different? What are the differences between a Bank of Melbourne mortgage and a Westpac mortgage?

Mr Hartzer : The functionality of the mortgage generally would not be different, but the service proposition of the people that you deal with, the way the branches are structured, the simplicity of what we offer, the way people—

Mr FALINSKI: Mr Hartzer, can't you see that this blizzard of brands and products adds to the confusion in the market and is adding to the fear that you described that makes consumers less likely to want to switch?

Mr Hartzer : If I can step back slightly from what you're saying: I agree with a big part of what you're getting at, which is that there is too much complexity. I absolutely agree with that, and I absolutely agree with the observation that too many products has led to customer confusion. That's why we have a major program internally to reduce the number of products. We have dramatically reduced the number of products we have on sale. We're eliminating features that people don't understand and don't value. That is good for customers, and it's also good for us. We're absolutely doing that.

Mr FALINSKI: But, ultimately, that's not your job, is it?

Mr Hartzer : Our job is to make the service quality of what we offer to people as good as it can be, and to be as competitive as we can be.

Mr FALINSKI: If I go to open a savings account at Westpac today, how large is the product disclosure statement?

Mr Hartzer : I couldn't tell you off the top of my head.

Mr FALINSKI: Would it surprise you to hear it's about 120 pages?

Mr Hartzer : That would surprise me. We've certainly got a lot of work going on to reduce it.

Mr FALINSKI: How can it take more than five pages to describe a savings account?

Mr Hartzer : I assure you: we don't like the documents to be that long. Those documents have evolved over time as a function of our interpretation of what we needed to do to comply with the law.

Mr FALINSKI: Greg Medcraft, the former chair of ASIC, has given evidence to the corporations committee that CLERP 9 led to unintended consequences in the sense that it created confusion and sent a signal to consumers that, while they may not understand the product, a shortcut to knowing if the product was good or not was how glossy the paper was and how thick the PDS was. Would you agree with that?

Mr Hartzer : At a broad level, yes. I certainly wouldn't object to the—I'm not sure if I would—

Mr FALINSKI: Do you have any research on how many consumers actually read the PDS?

Mr Hartzer : Not quantitative but we know that many don't, obviously.

Mr FALINSKI: So this is an expensive, complex adding to inertia, and that inertia has allowed the big four banks of Australia to have some of the highest margins in the world.

Mr Hartzer : You've got a couple of different points in there. I absolutely agree that the documentation is too complex. We're doing everything we can internally to reduce it. We have substantially reduced the length of many of our application forms and disclosures. We're working on that. We want to do that, believe me. We don't like these things—

Mr FALINSKI: But part of your evidence seems to be that that's driven by legislation that this parliament has produced.

Mr Hartzer : It is. I mentioned simplification of regulation in my opening statement. This is absolutely something we'd be happy to work with you on; that's good. I'm not sure I would accept that that extensive documentation is particularly leading to inertia—personally, I think that's drawing a long bow. But it can't hurt, and we certainly don't object to it.

Mr FALINSKI: Does it make it harder or easier for people to compare products?

Mr Hartzer : A lot of the documentation that we have to provide has summaries of key things. For example, there are effective interest rates that we have to disclose. Those are all designed to make it easier to compare.

Mr FALINSKI: You have to do that because it is so difficult to wade through the documentation in order for a consumer to compare products, even sometimes, within the same institution, who is doing that under their own brand or different brands.

Mr Hartzer : We have an obligation that we are working on to try to simplify the number of products that we have and make it really clear. My philosophy is that we should have one product for each customer-need category full stop. That's what we're working towards.

Mr FALINSKI: Would you accept that, in a normal operating market, when the price of a product goes up, new market entrants come into the market or producers already in the market try to produce more of that product?

Mr Hartzer : In an industrial market, if you have a generic product, that's true, because that's basic economics. In a service business, where the proposition and the choices people are making are more complex, then, only being driven by price, there can be other dynamics.

Mr FALINSKI: According to the Productivity Commission, the big four banks' share of the small business market has decreased from about 81 per cent to just over 40 per cent. At the same time, your share of the residential market did the opposite. How does that make sense, given that profitability and margins in business lending increased over the same time? Why are you willing to give up market share in a profitable segment?

Mr Hartzer : I'm not familiar with that number about market share. I think I saw the chart that you published, if I'm not mistaken. I'm happy to engage on the fundamentals of your point, but I didn't recognise that data. I'm not sure it's correct to say that our market share of small business has fallen. With business lending, we always find it very difficult to do market share in business lending, because a lot of institutional customers are included in those numbers, and you could have the issue of institutional businesses raising money in capital markets instead from the banks. So I'd be a little careful about that.

The general point is that we want to grow our market share. 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. I don't recognise the premise of the question. We want to grow in that business.

Mr FALINSKI: I believe the chart was from the Productivity Commission's report on competition in the financial services industry; I assure you I didn't do my own numbers on it. One of the key conclusions that the royal commission seems to be pointing to is banks are more incentivised to keep their rates and their prices higher because there is such little movement in customer market share that trying to attract greater doesn't actually work on price. Basic behavioural economics says that we've reached this position because of the complexity in the market that has been created either by the banks themselves or the regulations that this parliament has introduced. Do you agree with the royal commission on that or not?

Mr Hartzer : Not entirely. This is a complex topic. There are a couple aspects to that. First of all, margins in banking have come down over time in Australia. The assertion that Australian banking margins are higher than the rest of the world doesn't actually stack up. The returns are good, but that's also a big function because of our efficiency. If we can go to the broader point of your issue about market share and margins though, we make money by lending. Our job is to try to lend to businesses and consumers. We feel that it's very competitive. We work really hard to do that. Banking is a little different to other businesses because we have to balance up the balance sheet aspect. We have to trade off the funding costs and the availability of long-term funding with the demand for borrowing. The margins that we earn and the choices that we make from time to time on pricing strategies reflect, as a starting point, what our view is on our balance sheet and the availability of funding and the cost of that funding. The reason it is called a balance sheet is because we are trying to balance the demand on the lending side on the one hand and the deposit side on the other. In that regard, I would say that it's important to—

Mr FALINSKI: So you mean assets and liabilities.

Mr Hartzer : Yes, absolutely. One of the things that gets lost in a lot of these discussions is most of our customers do not borrow. Most of our customers are depositors. One of the things that we have to keep bearing in mind is how we make sure that we can compete and be successful on the deposit side, not just on the lending side.

Mr FALINSKI: I'm looking at figure 3 in the overview document of the royal commission, which says, 'Major banks are using their market power to keep interest rates high on loans and low on deposits.' Do you fundamentally disagree with that statement?

Mr Hartzer : I do on the basis that it is a competitive market. The fact that funding in the Australian market is constrained does translate a bit into where the margins are, but my experience in banking is that, depending on the interest rate environment, profitability on deposits versus loans can switch around a fair amount. At the moment, we're in a very low-rate environment, and that means that banks are more reliant on earning their money on the asset side, the lending side. As and when interest rates start rising, that pressure will probably shift a bit.

Mr FALINSKI: But you are above averages globally and for high-income countries. You're above other Australian owned banks and ADIs.

Mr Hartzer : On what, sorry?

Mr FALINSKI: I think it's the margin. He hasn't really gone through it.

Mr Hartzer : If you look at the net interest margin of Australian banks, it is not higher than a lot of banks around the world.

Mr FALINSKI: This is coming from the Productivity Commission for groups of different banks. It's the Lerner index, which shows the extent to which prices—or in the case of banking interest rates—exceed marginal costs.

Mr Hartzer : I'd have to look at that. As I said, I think it's a pretty easily demonstrable issue. One of the subtleties—I'm sorry that this is getting a bit technical—in Australian banks is Australian banks hold their loans on their balance sheet. In a lot of other markets, mortgage loans are sold off. The dynamics of how an Australian bank manages its net interest margin mean—

Mr FALINSKI: You're talking about securitisation.

Mr Hartzer : Right. In other markets, a lot of mortgages are securitised, so that can play into the comparability of margins.

Mr FALINSKI: Why don't you securitise your loans?

Mr Hartzer : We do securitise some of the loans, but the capital markets in Australia are not as deep for that.

Mr FALINSKI: In all of this, though, we have a situation where we've got a market not operating according to fundamental economic principles. When prices go up, we've actually got the major providers of capital in our economy either withdrawing from the market or restraining their lending. Is that because there's been extra risk added to your lending activities over the last few years?

Mr Hartzer : I'm not sure I totally follow the premise of your question.

Mr FALINSKI: I'm saying that obviously when you loan money out you do it on the basis of risk weighted assets and the likelihood of it being returned. But is it just financial risk that you're looking at, or are you looking at other forms of risk?

Mr Hartzer : The starting point is actually funding and the availability of funding, particularly deposit funding. One of the issues Australia has—and it's an important characteristic of the Australian financial system—is that, as a country with a current account deficit, the major banks are importers of capital and funding, and what we learned through the GFC was, if we become too dependent on foreign sources of funding, that can be a real problem if it dries up. We're conscious—and these are changes APRA and the Reserve Bank have driven over the last couple of years—of making sure we have a really strong deposit base and secure long-term funding. That constrains how much lending we're willing to do.

Mr FALINSKI: So why are you lowering your interest rates on deposits at the moment?

Mr Hartzer : We're constantly trying to deal with what's going on with open-market rates and the alternatives costs on funds as well as the demand side of margins on the lending side. It's an ongoing balancing act that we're trying to do to maintain a reasonable margin and return and balance up the funding demands and the lending demands.

Mr FALINSKI: Thank you for your time.

Mr KEOGH: I want to return to the Flanagan case momentarily, if I can. You and the commissioner talked about how dealing with guarantees is a difficult situation and how there's been further training within the bank about how to deal with guarantee situations. The thing that troubles me about that is that the case of Amadio was from 1983. The case of Amadio was dealt with in the High Court, and it was a fundamental case that decided the common law around guarantees and when banks can enforce them. The commissioner refers to that case in his interim report. So I did struggle to understand—and I think the person who gave evidence on behalf of the bank in relation to this case referred to everything having been done 'technically' correctly—how it is that, given the bank was aware of some of the red-flag issues around this case and given that the case law has been pretty settled for over 30 years, somehow there were process problems in the bank. This isn't some sort of new FOFA legislation. It's not CLERP 9. This is something that's been settled for over 30 years.

Mr Hartzer : I'm not sure I understand what your question is.

Mr KEOGH: How were there process problems in the bank when it came to complying with legal requirements that have been in place for over 30 years? This is not, 'Oh, we didn't get around to implementing FOFA in the last five years.' This is, 'How do we properly treat people who are putting themselves up to be a guarantor, when the High Court dealt with these sorts of matters over 30 years ago?'

Mr Hartzer : My understanding is—and I think this is the nature of the evidence that our witness put on this case—that we did comply with the law in this case. Again, this is one of these judgements where, although all the legal steps were taken about whether or not a guarantee should have been taken from Mrs Flanagan, nevertheless there should have been a better judgement overlay, and we should have done more in hindsight to consider whether or not that should have been taken. But, from our perspective—

Mr KEOGH: She was in the nature of a vulnerable person, which is exactly the sort of scenario that was dealt with in the Amadio case over 30 years ago—that is, your internal processes should have meant that the bank in dealing with her should have red-flagged these issues. I thought it was quite amazing that the person from Westpac said that this was done technically correctly—

Mr Hartzer : Yes, so—

Mr KEOGH: because, technically, I don't think it was.

Mr Hartzer : That's a debate. My reading of Commissioner Hayne's assessment of that case is that it was legal to take the guarantee in that case but that the real failure was—and we would put an overlay of just—

Mr KEOGH: You could legally take it. The question would be: would you ever be able to enforce it? And then that's where you ran into difficulty in that you did try to enforce it in these circumstances.

Mr King : The key issue there was that we ended up with an arrangement with Mrs Flanagan for lifetime tenancy of the house.

Mr KEOGH: That's where you got to, and that's—

Mr King : We took too long. We took way too long to get to that point.

Mr KEOGH: Absolutely. My point is that all of these flags in the bank's processes should already have been geared up for dealing with these sorts of issues, given that the situation of dealing with vulnerable guarantors is one that has been well settled in this country for almost as long as I have been alive.

Mr King : One thing that Brian pointed out in his opening statement was the changes to the customer pieces, including the customer advocate. And elevating risks higher in the company, where judgement has a different context, is important in this case—

Mr KEOGH: Absolutely

Mr King : because I think that, if left, these types of issues can—

Mr KEOGH: Absolutely. It's clearly important. My point is that it seems odd in this particular type of case, as opposed to others where the law has been changed more recently.

Mr Hartzer : I think you've got a fair point. My reflection perhaps is the circumstances of Mrs Flanagan. Her health had clearly deteriorated over time, so what happened at the start versus what happened later may have changed. The second point is that this sort of circumstance, thankfully, wouldn't happen all that often, so there may have been a failure because people hadn't been looking out for that issue enough.

Mr KEOGH: I hope it is the case that this doesn't happen too often, but that does drive me to the next issue I want to raise with you. Commissioner Hayne, in his interim report, made extensive comments about the initial submissions that Westpac made to the royal commission. He said that generally the response was lacking and it showed that you looked at misconduct in a piecemeal way. What do you have to say about that, and what's being done about it?

Mr Hartzer : There are two aspects to that. It is absolutely fair to say that historically the management of compliance incidents and the like was dispersed into different business units. While people would report them up and they would get aggregated and shown at various risk committees, it is true that they sat in different systems. About 18 months ago we implemented a new system, called JUNO. It is a common system across the company, where we require everybody to log everything, even if it's just a suspicion that it might be an issue. So for the—

Mr KEOGH: Does that apply across brands as well as business units?

Mr Hartzer : Yes, the entire company. That system was implemented 18 months ago, and since that time it's been much easier to pull things out and sort them and the like. The time frame Commissioner Hayne was looking for went previous to that, so that made it a little more complex.

The other thing that I think's really important is that the requests were about misconduct and things falling short of community standards. That is not a well-defined measure. It's a judgemental measure. We were trying to comply with that and exercise judgement, plus we were given 50 pages to get it into. We did our best at that, and that's been an evolving level of understanding. So it was those two factors that contributed to the difficulty we had.

Mr KEOGH: I want to go to the compliance gateway matter that was raised before. It was observed in the interim report that in some cases these compliance gateways:

… require no more than attendance at mandatory training—

and a leave requirement. So in terms of ensuring that customer outcomes are being met, that there's no misconduct involved, the only gateway is that some training has been attended.

Mr Hartzer : I'm not sure we totally agree with that assessment. We have read that. We are aware that he's made that point. Our understanding—and this will be something that we'll address in our response to the committee—is that gateways are more substantial than that. They include behavioural assessments and the like.

Mr KEOGH: So there's an individualised assessment of each staff member?

Mr Hartzer : It is absolutely individualised, yes. It depends on the role. It's probably true to say that the nature of the gateways will depend on what the role is. If you have a role that's got more potential risks about it, you probably have more detailed gateways.

Mr KEOGH: Yes. And I think the commissioner talked about what the minimum gateway is depending on whether, as you say, it's further down the chain. But even then it seems to be a particularly low level. But what you're saying to me is that that may be a mischaracterisation of what actually occurs?

Mr Hartzer : It may be. We need to work through that one, and we will. It's one of the things we've flagged that we need to address. But I'll speculate here. If you think about a teller, for example, where they aren't getting any sales payments and the like, the gateway there may just be whether they have done the training, whether there are any incidents against them and the like.

Mr KEOGH: So there being no incidents is a critical issue?

Mr Hartzer : Yes, I can absolutely confirm that it's an individual-level assessment.

Mr KEOGH: Based on your opening statement, you're saying that 70 per cent of frontline incentives are now non-financial, the implication being that there's still a 30 per cent financial measure.

Mr Hartzer : It's 30 per cent, which is then divided into several different components.

Mr KEOGH: I understand it's in several components, but aggregated they're related to financial performance measures.

Mr Hartzer : Yes.

Mr KEOGH: Just in relation to that, one of the issues that have arisen historically—we've dealt with this in previous hearings, and it's come up in the commission as well—is the pushing of credit cards, particularly the unsolicited pushing of credit cards. Removing financial incentives from these remuneration structures is supposed to reduce or remove the incidences of these sorts of activities occurring. But I'm aware of an incident very recently where a customer went into the Bank of Melbourne to arrange an increase in payments on their mortgage because they could afford to do that—none of their transactional banking was with the Bank of Melbourne; there was no way for the bank to be able to assess their overall capacity to pay or anything like that—and, upon doing that, the people at the bank offered this customer a credit card with a $19,000 credit limit.

Mr Hartzer : I'm not aware of that incident.

Mr KEOGH: Aren't these changes supposed to be removing all of that from occurring in your banks?

Mr Hartzer : I don't know that case. I don't quite know how that would've happened if we didn't have the transactional information already. I'm happy to look at it. If you want to give me details, we can come back to you. As a general statement, of course if a customer comes in for one thing—unashamedly, we'd like people to consolidate their business with us. But I don't recognise how the scenario, as you've described it, would happen. I'm happy to look into it.

Mr KEOGH: So, on that basis, that's not the sort of thing that should be happening?

Mr Hartzer : No. I would like our people to be saying, 'Gee, you've got this with us; why wouldn't you consolidate the rest of your business?' and that could include a credit card. But it's not obvious to me how, purely on the basis of that loan, a banker would then have said, 'Oh, and here's a credit card with a $19,000 limit.' They might have encouraged them to apply. I don't know.

Mr KEOGH: It's shocking to me as well. To that end, is there any reason why senior executives within a bank, your bank, shouldn't be held personally accountable for where there are systemic breakdowns within the system that affect customers? I don't think we necessarily agree anymore that there are bad eggs or individual people within a bank that might do the wrong thing. But where there's clearly a breakdown of a system within a bank—there are multiple instances of noncompliance within a particular area of the bank and customers are being taken advantage of—should not the senior executives and the executives within the bank responsible for that area take on personal responsibility for that?

Mr Hartzer : Absolutely. I, as CEO, and the senior executives of my company are responsible for what goes on in the company, and that includes where there's a systemic breakdown. All I would say is that in each case there can sometimes be multiple contributors to that. When something happens, we have to look at it and understand what went wrong and to what extent someone should have done something different, and we make that assessment on each individual. But the short answer is yes.

Mr KEOGH: I think you're looking at it through the prism of how you deal with that within the bank, internally. My question is: is there any reason why that should not occur as a point of law as well such that, where there's a systemic failure within an area of the bank that is affecting customers and is effectively resulting in breaches of licensing requirements and everything else, those individuals who are supposed to be responsible for making sure that doesn't happen can also be held personally responsible?

Mr Hartzer : My understanding is that's what the BEAR does.

Mr KEOGH: If that's your understanding of what the BEAR does, if there were an extension of that regime so that it explicitly picked up things that were customer-conduct related, you would have no difficulty with that?

Mr Hartzer : No.

Mr KEOGH: Can I turn to some observations by APRA in respect of its review of the Commonwealth Bank. In that review APRA also said that it expects other banks to be able to demonstrate how they have considered the issues that were raised within that report. Has that happened with Westpac?

Mr Hartzer : That's currently underway.

Mr KEOGH: Do you have a time frame for when that's going to be completed?

Mr Hartzer : I believe we're expecting to deliver a report to APRA in November.

Mr KEOGH: Will that report be publicly available in terms of what steps Westpac would be taking?

Mr Hartzer : We'll certainly be happy to talk about it. I would imagine it's something that we would talk about at our annual meeting. I haven't seen that report, so I don't know yet what's in it. I'm sure there'll be a lot of interest in it and we'll consider it when it comes out.

Mr KEOGH: Will that report go to matters of what things need to be remediated within the bank, in terms of any changes required and by when those changes would be made?

Mr Hartzer : I don't know, because I haven't seen the report.

Mr KEOGH: I presume you were involved in setting the parameters for what the report's doing?

Mr Hartzer : Absolutely. We've been asked to look at the report that was done on the CBA to have a think about how we look at our own company and to say if there similar learnings in it. That's what we're doing.

CHAIR: Matt, do you have any—

Mr KEOGH: I've got many more questions.

CHAIR: I'm sure you do, but you're out of time. I will hand over to Mr Evans, and you'll get time later, perhaps.

Mr EVANS: Thank you, Mr Hartzer and Mr King, for being here again. Can I assume that you were listening in to the questions and answers given by the Commonwealth Bank this morning?

Mr Hartzer : Some of them, but not all of them.

Mr EVANS: Okay. I hope you understand that we've identified that there are clearly a number of people out there, including a number of people in this room here today, who believe very strongly that they're not being heard by the banks, including yours. You said in an answer about half an hour ago that Westpac wants to hear from any of its customers who believe that they've been wronged by it. When it comes to ensuring that people are having their cases considered properly and ensuring that people who've been wronged under the law are being fairly remediated, I gather from your opening statement that Westpac's answer to that question is when you talked about the importance of good complaints handling, you mentioned you formed a new group executive reporting directly to you who oversee these matters. Can I get you to be a bit more specific about that? What is the size of this new group's capabilities? How have you resourced this side of Westpac?

Mr Hartzer : We've centralised all the different complaints handling teams that sit around the group under one executive, Carolyn McCann. She's got extra resources now, and a number of people, and is setting up new functions to make sure that we've got the right common reporting. She now delivers a monthly report that goes to the board on all these matters. She is working through root cause analysis. Probably one of the most important things, which I didn't mention before, is the long-dated matters committees. That committee meets at least once a week, but generally two or three times a week. It always has a group executive there. It has people from compliance and risk. It has Adrian Ahern, who's actually here in the room, who is our customer advocate. They go through each individual matter. They look at the time frame it has been outstanding and they prioritise based on what's been there. They've made a substantial reduction in the number of outstanding matters as a result.

Mr EVANS: That second piece of work is distinct. It sounded like the first piece of work that you were talking about, bringing all of those functions into one place, is more of a business-as-usual, ongoing move, whereas the second one is specifically to ensure that the case load of people who feel like they haven't been heard will be heard. Is that a fair characterisation?

Mr Hartzer : It's both, because it's also been about putting better standards through the existing complaints teams around proactively identifying vulnerable customers or where there is the risk of significant harm and about making sure that the protocols are in place to better and more rapidly escalate those items.

Mr EVANS: What does this mean in terms of the size of the capabilities? Are we talking about 10 people or 100 people?

Mr Hartzer : We would have well over 100 people, probably a couple of hundred people, working across all of these areas.

Mr EVANS: From the perspective of a customer in that situation where they feel like they aren't being heard by you but they've just heard your commitment to ensure that their cases are heard if they come to you, what should they expect? What would they experience?

Mr Hartzer : This is not new, by the way. We've had our customer advocate in place for two years. We've advertised his details. They can contact the customer advocate directly and then someone in that team, which is a relatively small, high-quality team, will talk to the customer and work through the details of the issue. That's completely independent of the businesses to try to make a judgement. Typically it's a review function. If someone has been through a process and isn't happy with the outcome, we encourage them to go to the customer advocate and get the matter reviewed.

Mr EVANS: Can you give us any sense of time frames that people could expect?

Mr Hartzer : It usually happens pretty quickly. It depends on the nature and urgency of the issue. I don't want to give you a number that's not right, but the answer is that we would come back quite quickly on those.

Mr EVANS: I'm happy for you to take it on notice and give us some more specifics about that. In your opening comments you said that you are increasing the visibility of customer outcomes and complaints in particular. What does increasing the visibility actually mean?

Mr Hartzer : It's at several levels. One level is the reporting on complaints, the numbers, the root causes, the changes in those, how long it's taking us to resolve things and how many long-outstanding matters there are. That gets reported to my executive team formally every month and goes as part of our report to the board, which was a good recommendation made out of some previous work.

Mr EVANS: That wasn't happening previously?

Mr Hartzer : We were talking to the board about overall complaints numbers; we weren't giving them the same level of granularity. Now we are giving them examples as well, case studies, particular situations.

Mr EVANS: They are getting visibility of the particulars of individual cases and they weren't before.

Mr Hartzer : They are, yes. The other piece is having a group executive responsible for that area. It means that in my weekly meeting with my team and in our formal monthly executive team meetings we touch on the progress we are making, more rapidly highlight issues that have emerged and therefore are putting more attention into spotting things and dealing with them quickly. I mentioned earlier the sessions that we did with our people. 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 them about how they need to exercise judgement and empathy in these situations.

Mr EVANS: I will come back to the topic of accountability in a moment. I want to ask a few follow-up questions on the topic of the lack of competition in your industry and some of those questions that Mr Falinski asked before he had to leave. Part of your answer to his questions had you insisting competition is strong and is occurring in your industry. As part of that you mentioned that new technology will enable customers to more easily switch banks into the future. I take it, but I should never assume, that you are talking about open banking?

Mr Hartzer : That's one of the elements, but it doesn't have to be open banking. You can become a Westpac or St George customer, for example, through your mobile phone in three minutes today, fully authenticated. We launched through Bank of Melbourne a paperless electronic digital mortgage. It takes a couple of minutes to get a mortgage through Bank of Melbourne that way. Those are examples of the capability that's increasingly available from all providers, which means that the traditional impediments in the form of all the paper, documentation and identification requirements increasingly can be done digitally. That makes it much easier for people to switch around. By the way, we can switch people's payments as well, which has been one of the impediments.

Mr EVANS: Can you confirm on the record that you are in favour of open banking and you believe it is going to help customers to switch, and understand and compare different products?

Mr Hartzer : I am and I do.

Mr EVANS: If you believe that technology is so important here for customer empowerment and you have no problem, presumably, with the competition it could enable, why do you think so many commentators and critics are saying that the major banks, including Westpac, have been tardy and slowing down progress towards the adoption of new technology like the new payments platform, open banking and so on in the industry?

Mr Hartzer : We have been in favour of all of these things. The challenge is the agenda and where we saw the relative priority as to the impact they would have. Open banking will be a good thing for consumers predominantly in their ability to add value through the data that they share among their providers, but putting investment into creating a digital mortgage has been a bigger priority for us and something which directly leads to more competition. The investments required in these technology projects are enormous. Open banking is probably going to cost us in the first instance somewhere between $150 million and $200 million to implement, because of the complexity of our systems environment. There is only so much investment and so many technologists who can work on all these things at once. It has been a prioritisation issue.

Mr EVANS: That being said, the reports to us, including from some of the regulators that we've had in front of us, are that the smaller banks, mutuals and so on—despite being much smaller than you and presumably having even less resources to draw on in that prioritisation process—are beating you to a lot of the milestones that the industry is taking on when the industry does try to come together to enable future advancements in technology.

Mr Hartzer : I don't know what that's alluding to. If, as I guess, that's related to NPP, what I would say is that a smaller bank with less capability to offer to its customers and fewer products will find it easier to do something than a larger bank with a complexity of products and systems like Westpac.

Mr EVANS: You'd also concede, though, that their reserves and their capacity to resource those sorts of investments are far less than yours?

Mr Hartzer : Yes.

Mr EVANS: Moving back to the topic of accountability and our government's Banking Executive Accountability Regime, I judge from your commentary both today and previously that Westpac has been more welcoming of the BEAR than maybe some other banks. You've definitely conceded again today in your answers that the lines of accountability did need better clarity and it has been a rigorous process complying with it. Can I confirm with you today that it is now crystal clear for Westpac as to where responsibility falls within the bank for this?

Mr Hartzer : Yes. If I could just add one element to it, though—it's just to put a bit of nuance on this point—one of the things that we do grapple with is that there is nevertheless some shared accountability in banks, and we operate in a matrix environment at some levels. One of the things we found challenging in implementing the BEAR was to deal with that fact, because in fact you want, and consumers would want us, to collaborate across businesses, functions and the like. So sometimes it's not quite as neat as having a single point of accountability. We've gotten there and it's documented. I'm just highlighting that the issue is a little more complex.

Mr EVANS: Can I drill down into that a little bit, because I did reflect on some of the comments that CBA made along the same lines earlier this morning when they talked about shared accountability. It did strike me on reflection that there is a risk here, isn't there, that, as soon as you are in the space of sharing accountability, I guess it also allows for some ambiguity going forward and, in the event of a future breach, you could have a situation arise where multiple executives are pointing the finger at each other and saying, 'I thought that they were the one responsible'. In practice, how do you get around that?

Mr Hartzer : The point of the BEAR is to minimise the possibility of that, and we're in a much better place having gone through the BEAR process.

Mr EVANS: Can you give us any practical examples? Can you draw this out and make it real for us?

Mr Hartzer : Sure. Financial crime is a good example. On the one hand, particularly where you have a technical expertise, the whole issue around how you manage financial crime and anti-money-laundering regulations is a very complex, pretty technical area when you get into it. As a consequence of that, you have a relatively small number of people who are real experts on it. You tend to have those people sitting, say, in your risk department focused on it. That's good, because you have a level of expertise, but, on the other hand, the people that you need out monitoring and watching what's going on with the customer are people out in the front line, and they ultimately are on the hook for making sure that things get checked. So you get this slight tension around that, but what we've done now is work through those issues and make it really clear so that the frontline people do understand what they're on the hook for doing. Where there's been a bit of greyness—'I thought they were doing it,' and, 'No, I thought you were doing it'—that's now been more clarified.

Mr EVANS: But the clarity is especially important not just at the front line but the executive level. Obviously the BEAR applies to executives. How many executives does Westpac have captured by the BEAR?

Mr Hartzer : I think it's about 13 or 14. It's all of my direct reports plus the treasurer and group assurance.

Mr EVANS: When you did that accountability-mapping exercise internally, what were the biggest areas of either ambiguity or gaps that you identified?

Mr Hartzer : It has typically been around operating risk and technology and those sorts of areas.

Mr EVANS: So you've come to a landing with those?

Mr Hartzer : We have. It's fully resolved. I should also say, while we're on the BEAR, that we didn't just stop with our executives. We've pushed that process more broadly through the general manager layers. We've filed the BEAR statements with APRA for the top executives, but we're using that as the basis on which we define accountabilities more broadly through the company.

Mr EVANS: CBA told us earlier this morning that they have about 90 executives captured by the BEAR. By comparison—

Mr Hartzer : I did actually hear them say that. I don't know exactly what they meant with that, as to whether they have filed 90 statements with APRA or not. We're using the principles of it very broadly in the company.

Mr EVANS: I will have to put some questions on notice, including in relation to small business lending practices and a couple of specific cases. Just one very specific question: Westpac, why is your interest-only book so much higher than the other banks? What does that mean?

Mr Hartzer : Peter, maybe you can talk to the history.

Mr King : The interest-only book was 50 per cent 18 months ago; it is around 35 per cent now. We had a particular strategy in investors who like interest only, so that was a big part of it, and we were also offering it in the owner-occupied market. The performance of that book has been what we expected and it has reduced quite quickly, when you think it is 15 percentage points in 18 months.

Mr EVANS: It is still 10 points or more greater, as a share of your book, than the other major banks?

Mr King : It would still be higher. But as time goes through, as people end their contractual periods, repayments happen and new flow is low, it will come down.

Mr Hartzer : Historically, it was effectively a product feature rather than a risk choice. We had a very affluent customer base and, as Peter said, we had a lot of investors. They liked the flexibility of interest only. Typically, they would have an offset account. Those loans amortise at basically the same speed as a principal and interest loan. It was a feature that was offered to customers to manage their loans as opposed to, from our perspective, a fundamentally different risk profile.

Mr EVANS: Thank you both.

Ms O'NEIL: Thank you, Mr Hartzer and Mr King, for being with us this afternoon. I'd like to pick up on a couple of issues that the Deputy Chair asked about just so I can get a clearer understanding of your view about a couple of things. You were on the record, as many were, saying that they didn't want to have a royal commission. Mr Thistlethwaite has read out your quote there about how you would prefer to get on and take action instead of having a report written. You are saying that you actually now think the royal commission has been very valuable. I feel like I'm hearing different things from you. I'm not trying to trip you up; I'm genuinely interested in how a bank CEO is receiving what is going on here. You are saying that you knew a lot of what has come out of the royal commission because the bank has provided many of the cases and the details that have been shared but also that you are somehow finding this surprising. Could you just share a little bit more about what it is that you knew that has come out of the royal commission and what it is that you didn't know?

Mr Hartzer : If I could go one step previous to that, which hopefully gives some of the context of my statement: when I came back to Australia from the UK, after the financial crisis, I had spent several years focusing on conduct risk, dealing with customer complaints and the remediation of product issues that were historical in the UK context. When I came to Westpac, one of the messages that I brought was, 'We really have to get to on to this stuff. Conduct risk is going to be a growing issue. We need to get proactive. We need to look start doing product reviews. We need to be looking at complaints and making these changes.' We had started down that path. The part of the quote you read was me saying, 'We get it. We get that we need to do better, and we're on to it.' That was what we were trying to say.

In terms of the royal commission, the point I was trying to make was that the case studies that were put in were all things submitted to the royal commission as examples. We went through what we already knew and said, 'Here are the examples.' The final part of what I was saying is: clearly, as you look at the different sessions that royal commission has gone through—and Westpac has been involved in some of them 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. Obviously, it has been a painful one for all of us, but I recognise that it has been of good value.

Ms O'NEIL: Are you saying that you feel that you had your arms around the issues within Westpac but, outside of Westpac, you feel the issues weren't well understood?

Mr Hartzer : I think, broadly, that's a yes; but I wouldn't want to overstate that. There is no question that the case-study process and some of these things have highlighted areas where, with the benefit of hindsight, we should have been more on top of things than we were.

Ms O'NEIL: I'm assuming that we can agree that you accept that some of your bank's conduct prior to the royal commission did not meet community standards?

Mr Hartzer : Yes.

Ms O'NEIL: People were hurt by that conduct. Do you accept that also?

Mr Hartzer : Yes, and I regret that very deeply.

Ms O'NEIL: Thank you. I'd like to understand in a bit more detail how you're dealing with the backlog of people that were hurt by that conduct. We talked with CBA this morning about some of the worst instances where people have been hurt by bank misconduct. They're not frivolous concerns. They're deep-seated, life-changing impacts that have altered the course of people's whole world. You've talked a little bit about your attitude to customers. I say this as politely as I can: you're saying the right things and it sounds good; could you share with us, though, this backlog of people who have been mistreated? Tell me what you are doing to try to rectify some of that.

Mr Hartzer : We have a list that we've pulled together of the long-outstanding customer concerns. I think from memory there were 400 or 500 of those when we pulled all that together. This is going back over quite a long period of time.

Ms O'NEIL: Just share with us: what do you define as a long-outstanding issue? What were your criteria there?

Mr Hartzer : I'd have to come back with the exact number, but generally something that's been going on for six or 12 months or longer. Some of these have been going on for years. For me, honestly, one of the most valuable learnings out of the royal commission was the realisation that, whereas we'd been focused on complaints, we'd been focused on the mass, we hadn't been focused on the ones at the edge. That has been a really important learning for us. We went out and looked at complaints, obviously. We also looked at the collections department and said: 'Are there outstanding collections issues? Which are those?' We've been pulling these together from wherever we can. That group has been meeting regularly and has closed out well over 100 of those items since we started doing this a couple of months ago. We're working through those as fast as we can. Wherever possible, we are making a determination in favour of the customer, if that makes sense. I'm sure you'd understand that there are some cases where the situation is a little more complex. Some stories have two sides to them, but we are absolutely approaching this—and hopefully it's evident from the fact that this whole process is incredibly public and incredibly painful: we don't enjoy this. We want this to be done as quickly as possible. It is in our interests to resolve these matters rapidly. Therefore, wherever it makes sense, we are defaulting in favour of the customer.

Ms O'NEIL: That's good. It would be, I think, helpful for us to have a little bit more information about how you're working through the backlog and the pace at which you're working through those customers. I say that not only to keep your bank accountable; it's important that all the banks are doing this and doing it transparently, so we'd appreciate some information on that.

Mr Hartzer : Very happy to provide that.

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

Ms O'NEIL: Okay, thank you very much. Mr Hartzer, we talked with the CEO of the Commonwealth Bank about the importance of talking with bank victims. You've mentioned some of the ways that you are trying to keep in touch with your customers, which I commend you for. Could you tell us, though, how many bank victims you've sat down and met face-to-face in, say, the past three months?

Mr Hartzer : I haven't had a lot of face-to-face meetings like that in the definition that you're talking about.

Ms O'NEIL: Could you tell me how many?

Mr Hartzer : I don't know what the definition is. It depends on which ones we'd be talking about, but I've interacted with a lot of people through email. I've spoken to people on the phone.

Ms O'NEIL: I understand. I'm not trying to trap you, but is it possible that—

Mr Hartzer : If your suggestion, as I interpret from your question, is that more in-person meetings would be a good thing to do, I'm very happy to take that on board and do that.

Ms O'NEIL: No, it's not; it's to try to be fair to all the bank CEOs. We've pinned down the CEO of the Commonwealth Bank on how many bank victims he has met with, and I'd like you to provide us with a number. Over the past three months have you met face to face with any people that could be described as bank victims?

Mr Hartzer : I struggle with the definition of victims. I've certainly spoken face to face with people who are unhappy and have had complaints with us.

Ms O'NEIL: Could you tell me why you can't deal with the definition of victims? You've acknowledged that people have been hurt by misconduct within your bank. I am asking if you have sat down and met with any of them over the last three months. It is not a very difficult question, if I can be quite—

Mr Hartzer : The answer would be no if you're thinking about the ones in that longstanding group, but I'm very engaged in the process of understanding where we are with specific cases.

Ms O'NEIL: I understand. Mr Hartzer, I want to raise with you one of the concerns I have, that's very deeply felt, about the royal commission process. I'm happy that it is on foot but unhappy that so few people have had their opportunity to tell their story, because the government did not give the royal commission the time that it would need to do that. So we've had 10,000 people make submissions and only 27 people have had their stories told. I have a case here that I think would have been nice to hear about in the royal commission. I can't run my own royal commission but I can share with you some of the facts of this case and I'd appreciate the opportunity to work with you on whether there can be a resolution for this person. The woman's name is Nicola. I am not sure if you are aware of the case.

Mr Hartzer : I have become aware of the case.

Ms O'NEIL: Nicola is a disability pensioner who, despite being on a low income, was able to borrow $31,000 by coming into the bank with someone who was later struck off from being a mortgage broker by ASIC. Do you believe that you might have breached the National Consumer Credit Protection Act in lending her that money when she was on a disability pension?

Mr Hartzer : I am familiar with the details of this case. I would rather not speak about the specific case in a public forum; however, I would be very happy if you would like to go into private session to share the situation around that case.

Ms O'NEIL: Thank you. I would appreciate the opportunity to do that. I think for the interests of this forum—although I accept, of course, that the bank has had interactions with this woman that I wouldn't be aware of—as I understand it, there was a hardship agreement made with her which was then removed a little bit later down the track and then her debt was sold to a debt collector and she has been pursued for 4½years by the bank or the debt collector for this loan, which I think, under community standards, probably shouldn't really have been given.

Mr Hartzer : I would just say that I think there is more to this story, and I'd rather not deal with it in a public forum.

Ms O'NEIL: That's absolutely fine. This is a case where we've got, I would describe, a vulnerable consumer. We also heard in the royal commission the case of another vulnerable consumer that related to your bank. Can you tell us about any changes that you have made towards dealing with populations that might have some additional risk factors when they are borrowing from a big bank?

Mr Hartzer : This has been a really important topic we have been talking about under Carolyn McCann's team. What we have been trying to do is to document more specifically the cases where someone would be identified as vulnerable and doing analysis on our portfolio to be a little more proactive in identifying where there might be a risk factor, even if it hasn't necessarily shown itself. As you'd understand, frankly, that raises some interesting questions around privacy and how you deal with people. But it's something that we are very live to and we think that part of us addressing the underlying frustration and anger that people have about what's happened with banks over the last little while is for us to really nail this issue. So it is one of the highest priority topics for us to get right.

Ms O'NEIL: Have you made changes to how you manage these customers and their requests?

Mr Hartzer : Yes, we have. We have changed policies. We have reiterated practices with collections. We've provided more training to our frontline staff. We have a big program around complaints handling that's going out to staff now. It's a big focus for us.

Ms O'NEIL: Mr Hartzer, is Westpac still providing flex commissions?

Mr Hartzer : Yes, but we expect that to end very shortly—I think from 1 January, I believe.

Ms O'NEIL: I think that you are going to run into an ASIC ban if you don't fix it before then. As I understand, ASIC is banning the product and—

Mr Hartzer : On flex commissions, we approached ASIC proactively before that came up to say that we thought this was a concerning practice in the industry that should stop.

Ms O'NEIL: I'm glad to hear that. For those of you that haven't been watching this very closely, flex commissions are where the car dealer can essentially sell a different interest rate to a borrower and they get to set the interest rate essentially. Is that an accurate description of the product?

Mr Hartzer : Within a framework, yes.

Ms O'NEIL: I think there is plenty of evidence that that's leading to people who are quite vulnerable ending up paying higher interest rates because the car dealer deems that they will pay it?

Mr Hartzer : It's not a good practice and it should stop.

Ms O'NEIL: So why are you still providing the product?

Mr Hartzer : We have some ongoing contractual arrangements that we are working through, but it has absolutely been our intent to push the industry to get rid of this.

Ms O'NEIL: Aren't you the only bank still providing the product?

Mr Hartzer : No; my understanding is that Macquarie Bank does it as well.

Ms O'NEIL: But ANZ has managed to stop the product?

Mr Hartzer : ANZ got out of the car lending business.

Ms O'NEIL: Oh; okay. It's a good example for us. I'm sure there are a lot of complexities to shutting down a product line that you're not happy with. But it's one thing to say that you're taking these things seriously; when you're still selling the product, it's harder for us to believe that, so—

Mr Hartzer : I do understand. All I can say is: we're committed to getting rid of it, and, again, we were the ones who raised it with ASIC. The issue is: we're one of the only banks that's actually in car lending. A lot of the auto financiers are nonbanks, and so our ability to influence what was a practice that went beyond banking was somewhat limited, and that has been one of the complexities of this one.

Ms O'NEIL: I'll leave it there, Chair. I've got a meeting at three o'clock.

CHAIR: That's fine. It's three o'clock now, so we'll suspend the hearing for 10 minutes.

Proceedings suspended from 15 : 00 to 15 : 10

CHAIR: We'll resume the hearings, now that it's 10 past three.

Mr CRAIG KELLY: Mr Hartzer, does the bank have education and training programs for staff in regard to the laws on unconscionable conduct, misleading and deceptive conduct, provisions such as what is an illegal penalty and requirements under the Corporations Law? What sort of education and training programs do you have?

Mr Hartzer : We have formal training for all staff, and staff are required to re-accredit themselves on a regular basis. It depends on the role as to the depth of that training, but the short answer is yes.

Mr CRAIG KELLY: Have you changed that training over the last one, two or three years? Since the royal commission and since a lot of the activities of the banks have been in the public spotlight, and there have been admissions by yourself that the banks have engaged in wrongdoing, have you upped that training and that education program, or is it something that was set years ago and you're still doing the same?

Mr Hartzer : We've continued to add more training, we've done special one-off training exercises and we've updated some of the existing courses to reinforce lessons. It's an ongoing process.

Mr CRAIG KELLY: What would a typical course on the provisions of unconscionable conduct involve?

Mr Hartzer : It depends. There could be an online course where people are presented with what the rules are, they are taken through a series of scenarios and then they have to pass an online test that demonstrates that they understand it.

Mr CRAIG KELLY: Is the reason that you've upgraded this education and training program that you are concerned that some of your staff may inadvertently not have been complying with the provisions of the law?

Mr Hartzer : We have clearly seen examples of misconduct, haven't we? We're an organisation of about 39,000 people. There is reasonable turnover in those staff every year. You've got new people coming on board, and we have to keep at it. One of the biggest challenges in any large company is culture and maintaining awareness and understanding, and particularly in a highly regulated environment like ours training is a critical element in making sure we can fulfil our obligations.

Mr CRAIG KELLY: Where did you feel that there were breaches of the various provisions of law, of the common law and the various statutory provisions? How many of those cases actually went through to the courts? For example, where a case was raised by a disgruntled customer who felt they had a dispute, who felt the bank had acted improperly, either by a breach of a contract term or by acting unconscionably or by misleading or deceiving them about some type of provision, how many of those complaints actually ended up in the courtroom?

Mr Hartzer : I suppose it depends on how you define 'courtroom'. We have FOS, which is the court of appeal in a sense of lots of them. We have many items that go through our internal processes and then would go to FOS for a determination—it is an independent body that has been less and we have the new system coming in in November. Also, depending on the nature of the issue, we would report it to ASIC. ASIC will take action against individuals. We've recommended people to be banned. In other cases, if we find an example of real criminality we might report someone to the police, and we can and do do that. Some of those people face charges and end up in jail.

Mr CRAIG KELLY: With the royal commission, there seems to be a very large volume of customers who have raised issues before the royal commission who feel that they haven't been able to get access to justice in some way. Would you agree that there is a volume of customers who feel that they haven't been able to have their complaint, issue or dispute with the bank adequately resolved?

Mr Hartzer : There's clearly a cohort of that. There are a variety of categories. There were people who got stuck in the system and weren't treated properly by us or other banks, in terms of addressing their complaints—a lot of the items we were talking about in the previous session, I'd put in that category. There were people who gave up and didn't go through to the next step, in terms of going to FOS and the like. There have been people who, particularly when you get into a larger business situation, FOS hasn't had jurisdiction over, and so they've felt like they were out of luck. So there's a question about making sure there's accessibility—

Mr CRAIG KELLY: When you say they were out of luck—what, they simply couldn't afford to proceed? So they felt that the bank may have breached a contract or breached some legislative provision but they were unable to proceed with their case through the existing legal system that we have?

Mr Hartzer : Or chose not to for the reason you highlight; they may have found it was too expensive. 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.

Mr CRAIG KELLY: Would it be fair, in that case, to say—I'm talking about the past now—that in the past there wasn't a level legal playing field between the banks and someone that had a dispute with the banks?

Mr Hartzer : It depends on the categories. We would say that the ability to speak to ASIC and to go through the FOS process did provide a cost-effective mechanism for many people. But we would absolutely accept that there would have been cases that for whatever reason didn't fall into one of those categories, where people would have found it too expensive to go through the courts. Clearly, there have been examples of that.

Mr CRAIG KELLY: Do you think that the new provisions that the government has put in—with a one-stop shop for complaints, albeit the threshold is $3 million—will somewhat level that legal playing field?

Mr Hartzer : I think it's an important advancement, and we are very supportive of that change.

Mr CRAIG KELLY: Do you think that that is likely to change the banks' culture, in that the banks will now be more likely to be accountable? In the past they could have said, 'Good luck; try and sue us in the courts,' knowing that that was beyond the financial resources of someone who felt they had been wronged. But because people have that opportunity now, do you think there is now the potential for the banks to say, 'Hang on, we have to be more accountable because of these changes'?

Mr Hartzer : I would be really disappointed to find that we had made a determination to, in a sense, use our financial resources to stop someone from seeking justice. That would be really disappointing to me. I think it's absolutely a positive development to provide a more cost-effective and efficient avenue for people to raise issues where they've been through the internal process and still aren't satisfied or still don't agree. In terms of the way you phrased your question, I think it's incumbent on us to do a better job of identifying and managing people who are in those situations. I would say that there are going to be times when we don't agree. There are going to be times when, ultimately, we can't come to an agreement but our intent is to think about things from the customer's point of view and, wherever possible, make a determination in their favour.

Mr CRAIG KELLY: I understand the point but—I'm probably making a comment here rather than giving you a question—there seem to be people who feel that they haven't had fair access to justice. I think that's why there's so much public sentiment surrounding it. They just feel they haven't had the opportunity to have their cases heard.

Mr Hartzer : I agree. At the risk of extending this, one of the things I really believe, and something I've felt for a long time, is that underneath a lot of the issues that we've been seeing is clearly the perception of a power imbalance between the banks and the customer.

Mr CRAIG KELLY: Do you think it's been perception or reality? Hasn't it been more reality than perception?

Mr Hartzer : In some senses, yes, of course. We've made it worse for ourselves in the way we've written to customers, the way we've treated customers like a number sometimes and those sorts of things. That's an ongoing thing that we need to address if we're ultimately going to restore community trust.

Mr CRAIG KELLY: What do you think of the threshold limitations of the new one-stop shop?

Mr Hartzer : I think it's a good step forward.

Mr CRAIG KELLY: Do you think those thresholds may need to be raised at some time in the future?

Mr Hartzer : Potentially, and we'd be open to that. We would say, however, that, as you raise those thresholds around businesses in particular, it gets more and more grey about the complexity and sophistication of the customers that you're dealing with. We saw this in small business lending and the like—that you can have businesses which are actually very sophisticated but not that big, and can you have businesses that are pretty big and not that sophisticated. I just think that that's something that needs to be worked through thoughtfully. I think we should start where we've started and let it run for a while, and then we can certainly review it later and see: what are the cases that are falling out of that, and should we change it?

Mr CRAIG KELLY: In respect of late payment penalty fees that you charge, or a hike in interest rates for someone that may have been in breach of one of their covenants, where do you see the common law applying in that provision?

Mr Hartzer : There are clearly limits around unfair contracts and usury levels above a certain point at which those things become inappropriate. I would also say: in our case—particularly if you take farmers, for example—we haven't charged penalty interest, as a matter of policy, for, probably, 10 years.

Mr CRAIG KELLY: Is that just for farmers?

Mr Hartzer : Well, particularly for farmers in drought situations and the like. There are cases where penalty interest may be appropriate, but it's something that we wouldn't use as a first choice.

Mr CRAIG KELLY: Given that there was a rather widely publicised case as to the late payment fees on credit cards—I think there was a class action case that went for a while—do you think there's enough clarity in where that law actually stands?

Mr Hartzer : On that one I would say: I probably do. I think that case ended up going to the High Court and getting resolved. So I don't see an issue with that specific item.

Mr CRAIG KELLY: But, from the fact that a litigation funder was prepared to stump up quite a few dollars to run the case, they obviously had a different interpretation of what the law potentially was from what the High Court eventually decided.

Mr Hartzer : I wouldn't want to speculate on why they thought they might win.

Mr CRAIG KELLY: But, because of that, I put it to you that there's still not a lot of clarity around that particular provision of law, even though it's a common law provision rather than a statutory provision. My question then to you is: would it be better to clarify that, by putting those provisions in some type of statutory law?

Mr Hartzer : I'd have to say you're entering into a level of legal subtlety that is probably beyond my professional skill set. I would say, as a practical commercial matter, we always felt that that matter was quite clear and what we were doing was reasonable, and, having had it ruled that way in the High Court, it hasn't really been on our radar as an issue.

Mr CRAIG KELLY: I just want to ask you about the drought. Where farmers may technically be in breach of a covenant of their terms and arrangements with the bank and that would give you the opportunity to charge some type of late penalty fee or have some type of interest rate hike, you're saying those provisions are actually probably in most contracts but you haven't been enforcing them?

Mr Hartzer : We're highly sensitive to supporting farmers who are in drought and through difficult periods. We've got a really good track record at Westpac on this. As a matter of practice, we have not enforced those provisions for over a decade.

Mr CRAIG KELLY: So where is that decision made? You've got a contract here, and it says you can enforce this particular provision, and, if you're abiding by the black letter of the contract, that would entitle you to do so, and probably your shareholders would argue that you should be enforcing that provision because that will increase the bank's profits. Where is the decision made not to enforce that provision—as you say you aren't, with the farming community and the current droughts?

Mr Hartzer : There's a policy view that we would take at a senior level but, practically, the relationship manager usually does that. I just want to challenge one premise in your question, which is that, from a shareholder point of view—and this is particularly true with farming—our view is that we want to build long-term relationships. Our view—and if you talk to wise, experienced bankers they will tell you this—is that, when a customer is in difficulty, that's the time when you can really build a long-term relationship. That's what we tell our people and overwhelmingly that's what our people do.

Mr CRAIG KELLY: What level of the managerial pyramid is enabled to do that? Is that basically the loan manager or—

Mr Hartzer : It would typically be the manager of the customer. Every single farming customer who is in difficulty has had a personal visit on their farm from our banker to talk to them about how we can help them through it. That is the way we approach it.

Mr BANDT: My question is to Mr Hartzer. Do you deserve to get paid as much as you do?

Mr Hartzer : I recognise there's a lot of interest in the pay of CEOs, particularly in this climate. I'm not going to comment on my individual pay.

Mr BANDT: What is your total remuneration?

Mr Hartzer : My pay is fully disclosed every year. Last year my pay was $5½ million.

Mr BANDT: And about $1 million of that is fixed as a base component; it doesn't shift?

Mr Hartzer : No. The structure of my pay—and this is true for all of our executives—is that one-third of the pay is fixed and two-thirds of it is variable.

Mr BANDT: Has there been any significant decline in your pay as a result of what has come out in the royal commission?

Mr Hartzer : As I said, two-thirds of my pay is variable. I certainly understand peoples' interest in this. As a matter of fact, a third of that pay has been zeroed out over the last couple of years as a result of the overall performance of the company. That includes the costs associated with some of the things we've been dealing with. We are currently in the end-of-year process at the moment. As I said earlier in some of my other responses, we have a very formal consequence management process. All the risk issues, reputational issues and the like, as CEO, are considered in my pay and I have no doubt that will be a factor this year.

Mr BANDT: A lot of people would say that $5 million or $6 million is a lot of money to receive, full stop, let alone when there have been so many findings of wrongdoing by your organisation. What would you say to those people?

Mr Hartzer : I would say that I absolutely understand that it's a lot of money. I recognise that and I understand the interest in the issue.

Mr BANDT: Wouldn't you expect that, for so much money, the organisation that one was running would be spotless and wouldn't be subject to so many allegations?

Mr Hartzer : Spotless would be ideal in a very large company, and we are a large business. We have a balance sheet of about $750 billion. We have 39,000 employees. We have probably 28 different business units. We operate globally. It is a big, complex business and things are going to go wrong. Should we have done better? Absolutely. Do I regret that? Absolutely. Do I expect to be held to account for that? Absolutely.

Mr BANDT: The royal commission, so far in its interim report, has made what you might call a finding, but I guess it is more of a principle, saying, 'Every piece of conduct identified and criticised in the report can be connected directly to the relevant actor gaining some monetary benefit from engaging in the conduct.' Do you agree with that assessment of the items of wrongdoing looked at by the royal commission?

Mr Hartzer : I'm sorry; could you say the question again?

Mr BANDT: 'Almost every piece of conduct identified and criticised in this report can be connected directly to the relevant actor gaining some monetary benefit from engaging in the conduct.' Is that a fair characterisation of the case studies that have been looked at by the royal commission, at least as far as your organisation's concerned?

Mr Hartzer : 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. I recognise that it is attractive to try to find a single thing to blame. My experience is that there are multiple factors that contribute in these issues. REM is one of them, and it is one we need to do better on, but I don't think it is the only factor.

Mr BANDT: The royal commission is clearly saying it plays a role. Do you disagree with that characterisation?

Mr Hartzer : I don't disagree that it plays a role.

Mr BANDT: If it plays a role, that principle doesn't stop at manager level or at middle manager level; presumably that principle runs all the way to the top?

Mr Hartzer : Yes.

Mr BANDT: In that context, isn't it reasonable to draw the inference, with so much of your remuneration being variable and being linked to the bank's performance, that, in the same way as an individual manager or agent had an incentive because of their remuneration structure to do something that was geared towards profit rather than what was right, that would also apply at your level?

Mr Hartzer : The general principle, yes, but I come back to something that I said in an earlier answer, which is that the way that I think about growing the value of Westpac is that we need to build the quality of our customer franchise over time. That means from time to time we sacrifice short-term profitability in the interests of the long-term success of our customers and the company, and that's the way I and my executive team try to run the business. We don't focus purely on what's going to drive the short-term result; we focus on what's the right long-term decision for the company. And, yes, we hope that over time that will drive more value for our shareholders.

Mr BANDT: The royal commission has been making the point that that clearly hasn't been happening. All of these elements of wrongdoing haven't come about because of assessments people are make about the long term; they're coming about as a result of short-term profit-motivated decisions that are in many instances—almost every instance—linked to remuneration.

Mr Hartzer : Again, I accept that, in some of the case studies we've looked at, that's clearly been a feature.

Mr BANDT: Drawing from that, if, as the royal commission is saying, that is a fundamental problem—one might say a structural problem—why shouldn't we be regulating to reduce the variable components of bank executives, including yours, given that it's clearly about dangling a honey pot that invites people beneath you to engage in behaviour that breaches community standards if not the law?

Mr Hartzer : The structure of the pay for our senior executives is as much as possible geared around the long-term success of the company, not around making short-term decisions at the expense of customers.

Mr BANDT: But part of your variable remuneration is based on what happens to the share price over a period of time, without going into details. Would that be right?

Mr Hartzer : It's deferred over a long period of time, and my point is that the share price—

Mr BANDT: And profitability over a given year?

Mr Hartzer : Sorry?

Mr BANDT: The short-term performance of the bank clearly contributes to your variable remuneration. Other things might—the long-term performance might as well, but the short-term motivations are clearly also there.

Mr Hartzer : We have to demonstrate good performance along the way. If you look at an investor who buys a share of Westpac stock, the next three years dividends in total add up to about 18 per cent of what they're paying for, which means that 80-plus per cent of what they're paying for is what's going to happen in the future. And that's the way we think about how we run the company.

Mr BANDT: If it applied across the board to all banks, would you have any objection to parliament passing a law regulating how much could be paid in bonuses to bank executives, given what we've heard coming out of the royal commission?

Mr Hartzer : I think we operate in a market economy, and banking is an international business. I myself, as you can tell from my accent, grew up in the US. I've worked in the US market. I've worked in the UK. I'm an Australian citizen. I've lived here now for 25 years on and off. Members of my executive team have come to us from different markets. The reality is that banking is an international business and we draw on an international talent pool.

Mr BANDT: So, in an environment where, in Australia, you are required to have a bank account because you can't survive without one and in an environment where there is compulsory superannuation, a lot of which you guys hoover up, you are saying that the only way we can possibly afford to have someone running a bank is if we pay them $6 million a year?

Mr Hartzer : No, I'm saying there is a reality, which is: our banks are large and complex. The economy is dependent on a strong and well regarded banking system that raises capital from overseas. An important component—not the only element—of our ability attract and retain high-quality executives is the ability to pay them competitively for the skills that they have.

Mr BANDT: Other banks are getting out of wealth creation, wealth management. You're not. Is that a fair characterisation?

Mr Hartzer : There are aspects of the broader investment and insurance business that we have gotten out of. Our premise is that our customers' needs go beyond banking. We would like to support the financial needs of our customers through their lives. BT, which is our wealth management business, has been a very successful business. We have a view that our customers have ongoing needs and that the way that we are seeking to go about supporting them is responsible and appropriate for the long-term needs of our customers.

Mr BANDT: In millions of dollars, how much have you either paid out or provisioned to be paid out by way of compensation for people associated with your wealth management division?

Mr Hartzer : 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.

Mr BANDT: Again, coming back to the central point of the royal commission, doesn't that substantial amount of money reflect the fact that, in these vertically-integrated businesses, there are businesses that are owned by you where the people who are working in them have an incentive, because it is linked to their remuneration, to sell people products that might not be fit for them but might be good for you as the owners of those organisations?

Mr Hartzer : If you think about the elements of the investment market—one of the things you alluded to before was about us staying in wealth management. We had an asset management business called BT Investment Management which manufactured investment products that, among other things, were sold by our financial advisers. We were concerned about the perception of a conflict of interest around that, and we exited that business. Our financial advisers had no ongoing incentive to sell a particular product. They were charging a fee for service for what they did. As I said in my opening statement, the transition to—

Mr BANDT: But can I just ask: with respect to what you're holding onto, you don't see any potential for conflict of interest?

Mr Hartzer : All businesses pretty much have a potential for conflict imbedded in them.

Mr BANDT: Isn't this where some of the worst stories have arisen? It's simply because, as other countries have recognised at various points in history, there is a fundamental difference between you, on the one hand, having access to people's deposits and writing loans for them, and, on the other hand, having divisions that are based on selling them products that are good for you but are not good for them. That's presumably driven some of the other banks to say, 'We're going to sell them off.' But you seem to be suggesting to us that somehow you're going to be able to manage this, despite everything the royal commission says, and you should be allowed to hold onto both. Why should you be allowed to hold onto both?

Mr Hartzer : I make the observation that the issues we've seen in financial planning have not been limited to banks. Financial planning as an industry has—

Mr BANDT: But the fact that someone else is doing it isn't an excuse.

Mr Hartzer : No, and it needs to be improved. But, equally, the solution you're suggesting seems to be that the bank ownership has caused the issues in financial planning, and I don't accept that. I accept that there are issues in financial planning and that they need to be addressed. FOFA went a good way towards that, but clearly more needs to be done. Whether in the long run financial planning is a business that we will continue to engage in and whether the economics of that and the risks associated with that stack up is something we will continue to consider.

Mr BANDT: As the other banks pull out, are you getting any financial benefit from that? Are you seeing those parts of your businesses grow?

Mr Hartzer : Not as a function of that, no.

Mr BANDT: What would be the objection—and I would suggest the royal commission seems to be heading down this road, but we'll find out in the final report. In the context of where I think you said you're provisioning over $100 million as a result of compensation for the cases that have been discovered to date and where there is a fundamental conflict of interest between selling someone a product that is good for the bank or the entity versus selling someone a product that's good for them—and others are getting out of it—why shouldn't we, as policymakers, understand that this is the guts of the problem, that this is what is underlying it all, and that, to get rid of this greed culture, we need to say to a bank, 'You can have people's deposits or you can engage in more speculative financial products or you can sell them wealth management products, but you can't do them all, because there is too much potential for conflict'?

Mr Hartzer : It's a good question. Our conclusion on this was that the conflict existed when you had financial planners selling managed investment products that you were manufacturing. Our view was that, when you have a best-interest duty and a fee-for-service approach, it should be manageable. It's been clear in hindsight that we needed to do a better job on the controls of understanding what was going on with individual planners and on monitoring the way fees were charged and services delivered. I would actually argue that a large organisation that has the ability to invest in that is more likely, in the long run, to be able to do it in a sustainable way.

Mr BANDT: Out of the backlog of 400 or 500 that you were talking to Ms O'Neil about, how many come from the wealth management divisions and subsidiaries?

Mr Hartzer : I don't have that number off the top of my head.

Mr King : We'd have to take it on notice.

Mr BANDT: Would you be able to get back to us on that?

Mr Hartzer : Sure.

Mr BANDT: I want to ask about something that was raised by ASIC at the royal commission. Over 2012 and 2014, about half a million Westpac customers received unsolicited credit card limit increases. Just under 50,000 of them took up the offer. You eventually paid out $11 million to more than 3,000 customers who were affected. ASIC said to the royal commission that it had sought to raise those issues with you—with you personally as well as with other executives within the bank—it felt unsatisfied with that and so it went to the chair of the board. It approached Mr Maxsted in 2015 about the matter. ASIC tabled notes to the royal commission that said:

Of the big four banks, Westpac seems most resistant to ASIC and the laws we administrate. They only tell us about issues when they think we are likely to find out through other means and then they only provide us with limited information.

As I understand what came out through the royal commission, it took two years to address the issue, and only after ASIC threatened legal action. Is there anything in the sequence of events I've outlined that I've got wrong?

Mr Hartzer : Yes. The point I would distinguish there is, I think, your characterisation that they raised the issue with me, I didn't deal with it, and then they raised it with the chairman. That's not correct. The notes you are referring to were notes of an ASIC meeting with the board. ASIC comes in regularly to speak to the board. I was present at that meeting and they raised that issue, which we were all surprised by. We took it very seriously, we dealt with it, and I think ASIC today would say that our relationship with ASIC is much improved since then.

Mr BANDT: So—

Mr Hartzer : I just wanted want to make that subtlety. I didn't want to leave that.

Mr BANDT: I understand, but is ASIC's characterisation that they raised it with you—taking on board what you said about who they raised it with within the bank and when—that it wasn't resolved for two years, and—

Mr Hartzer : Yes, that is true. I just wanted a caveat. You characterised it that they raised it with me personally, and that's not true. Can I just address the issue? This is an area where we did not cover ourselves in glory. We should have done better, and I'm very happy to explain it.

Mr BANDT: But my question is about your relationship with ASIC. Is the reason you felt comfortable about ignoring ASIC for two years and then not doing anything until there was a threat of legal action that you knew you could string ASIC out for that long and ASIC wouldn't take any action against you?

Mr Hartzer : Absolutely not.

Mr BANDT: It invites the inference, doesn't it, that the regulator comes to you and raises an issue but you feel you've got it sufficiently under your thumb that you can spend two years running around, knowing that nothing is going to happen to the bank?

Mr Hartzer : Absolutely not.

Mr BANDT: So why did it take two years?

Mr Hartzer : That's why I was trying to explain the context of that issue. There are two aspects to it. The starting point of that issue was that when the responsible lending laws came in a very substantial project was done to try to interpret the law as: 'What do we need to change about our processes to make sure we are compliant with the law?'

We had compliance and credit risk people involved in that project. We put in a bunch of changes, which our people genuinely believed were consistent with the law. Subsequent to that, ASIC issued regulatory guidance where they said, 'You have to do things a certain way.' Our credit people and our product people didn't agree that the regulatory guidance was the right interpretation of the law, and there was a discussion with ASIC about that. I think it's important to distinguish. The law is sometimes written at a pretty high level, and it sometimes takes a while before the regulator comes out and says, 'We interpret it as meaning that you have to do it this way.' In this case, we had a legitimate difference of opinion about what the law required. However, where we got it wrong—and we absolutely did get it wrong—was that our teams—and this was more at a mid level; it was certainly not at my level—did not respond rapidly enough to the fact that ASIC wanted us to do it a different way. If that issue happened today, we would absolutely do it a different way, which is that we would say: 'Okay, we can have a discussion and we can have a legitimate debate, but in the end they are the regulator. If they want us to do it a certain way, we will do it that way.'

Mr BANDT: In admitting that you got it wrong, do you agree with ASIC's characterisation that you were resistant to ASIC and the laws that they administer?

Mr Hartzer : I don't agree with that as an overarching statement. Our intent has always been to be compliant with the law and to work with ASIC to give them the outcomes that they want. In this case, it was not well handled, and we absolutely accept that.

CHAIR: I'm sorry, Mr Bandt. That is the end of your time. We have been generous in giving you about 20 minutes, so I will now hand it back to Mr Keogh.

Mr KEOGH: Mr Hartzer, the ACCC has been doing a review, or did a review, into the major bank levy and the cost of mortgage products. In its March interim report, it said:

We have observed consideration by some Inquiry Banks of a mix of possible strategies to recover the cost of the Major Bank Levy. These include having shareholders bear the cost of the Major Bank Levy or recovering the cost of the Major Bank Levy through a mix of stakeholders including customers, staff, suppliers and shareholders. One Inquiry Bank has considered different stakeholders bearing the cost over time. That Inquiry Bank considered that shareholders could initially bear the cost of the Major Bank Levy, followed by customers and suppliers beginning to bear the cost of the Major Bank Levy later, including at a time that is after the conclusion of the ACCC's inquiry.

Is that your bank?

Mr Hartzer : I suspect that that is referring to our bank, but I would characterise it this way: when the bank levy came in, it was a very significant increase in cost. Understandably, our product teams looked at a whole bunch of options about how to deal with that extra cost. That may have been an option that was put in a paper. It was never an option that I considered, and we have not sought to recover the cost from customers, nor do we have any intent to do so at any time.

Mr KEOGH: Do you have any comment—this may or may not have been your bank, and you can let me know—about the idea of recovering some of the major bank levy from staff?

Mr Hartzer : The point there, I suspect, is that, as with any business cost impost, you ask yourself, 'Okay, where are the possible ways you can recover that?' You can increase charges to customers. You can reduce cost. You can pass it on in various ways. I'm not familiar with that statement. All I would think that would mean would be looking for how you would reduce your costs around the company to offset it.

Mr KEOGH: By either reducing staff or not giving pay rises to the same level?

Mr Hartzer : Again, I don't know what that refers to. Maybe it's just a generic point.

Mr KEOGH: Thanks.

Mr EVANS: Mr Hartzer, I want to follow up about the adoption and rollout of new technologies in banking and the competition that could foster. I think that, as part of your answers to me before, you indicated that you weren't quite sure about the details or the particulars when it came to criticisms that some of the big banks were slower than some of the small banks and mutuals when it came to meeting milestones. I've just taken some time to look up the source documents. It was the Governor of the Reserve Bank himself who raised it with this committee just a couple of months ago, in August, and it was in relation to the launch of the New Payments Platform. At the time, the committee asked some follow-up questions and it was reported in the press. The RBA told us:

They had many, many years to get on top of this and so to discover, as we were going live, that they weren't ready, was a bit disappointing really ...

They followed that up with this quote:

... the key to this is that, because it is a network, unless you have everyone on board, it is really not going to get used because I'm not going to be interested in joining it if I can't pay someone who banks with someone else. It's critical that we have everyone on board and, in the next month or so, we will have all the majors on board and I think that will be a big stimulus.

That's the RBA, one of your most important regulators, complaining about delays coming from major banks and saying that the whole industry really needed to be keeping up to ensure those competition benefits flowed properly. Westpac definitely is one of those two singled out as being one of those not ready to go live at the launch date. It was because some of your brands, like St George Bank and Bank of Melbourne were behind the pack. Is that right? Is that jogging your memory?

Mr Hartzer : That sounds familiar.

Mr EVANS: Do you have any response to those criticisms?

Mr Hartzer : The NPP is a program that's been imposed by the regulator on the industry to lift the underlying plumbing of the system. Theoretically, down the road, that can support competition, but you characterise that as an item that was holding back competition. I'm not sure it's convincing to me yet that it is going to do that. I think it's a good development technically. Yes, it's taken us longer. We have always been committed to implementing the NPP. Our systems are complex. The fact that we have the legacy of the St George acquisition means we have quite a number of very old, complex systems. We have spent many hundreds of millions of dollars implementing this for no return, and we will do that. It's taken us longer, and I wish it hadn't, but we're doing it and we are now live.

Mr EVANS: I also want to take a couple of minutes back on that topic of small business lending practices. Over the last year or so, in previous hearings here and in other places, Westpac has committed to making quite a number of changes to its practices around small business lending. They're recommendations and changes of this committee from the Australian Small Business and Family Enterprise Ombudsman, from ASIC and from others. Some of those, which I consider to be quite important, are obviously the removal of unfair contract terms and the removal of non-monetary default clauses. Can I just get you to confirm: has Westpac met all of the commitments you've made in respect to those small business lending changes?

Mr Hartzer : Yes.

Mr EVANS: So there are no areas where you haven't yet implemented changes you've committed to or where you're running over deadlines or are delayed?

Mr Hartzer : Not that I'm aware of.

Mr EVANS: I'm happy for you to take it on notice.

Mr Hartzer : I'm happy to confirm that, but I'm not aware of any issues.

Mr EVANS: That includes you now giving small businesses at least 90 days notice where you don't intend to rollover their loans or continue their access to finance.

Mr Hartzer : I'm not sure on the exact time frame. We're certainly working to meet all the deadlines associated with doing that. Perhaps I could take on notice specific clauses, but I can assure you that we will meet all the deadlines around that.

Mr EVANS: All right. There's one thing you might be able to speak to just off the bat. I think Westpac was different to the other banks from memory in that you were considering applying some of those changes to a larger pool of small businesses. I think you told this committee last time you were here that you were possibly looking at a wider net than just that $3 million threshold in certain circumstances. Where did that come to? What was the landing?

Mr Hartzer : That was part of the whole debate that was going on at an industry level. As a reminder, the question here was, in a sense, what is the definition of a small business? We kept looking at customers to say, 'Once you get above about a $3 million threshold, the complexity started making that harder.' Our recommendation was that we, as an industry, move to the $3 million threshold, lock that in, implement the changes and then, over the next couple of years, have a review period where we would look at whether there was a way to lift that threshold to more customers. We continue to be able to do that but, I think, in response to your question, we did analysis which continued to reaffirm that we thought $3 million was the right point. I guess most of our energy went in to getting consistency at an industry level and getting that signed off by ASIC.

Mr EVANS: In other words, you are in line with the rest of the industry and you're using the $3 million threshold.

Mr Hartzer : We are, yes. We are just implementing this new process and the new threshold. Over the next couple of years, we will be very happy to continue to look at whether that can be lifted. But the point we have been making is that, once you start lifting beyond that, the kinds of companies that get into period, we would argue, are actually a lot more sophisticated.

Mr EVANS: One of the other important topics that we covered in those hearings was around providing better visibility/transparency to small-business customers, particularly giving them access whenever Westpac has created or prepared valuations or investigations or accounting reports and so on. There was some obligation or some commitment to provide transparency to businesses in those cases. Is that happening, do you know?

Mr Hartzer : I remember that particular issue, but I must that I can't remember exactly where we landed on that one. I'm happy to take it on notice. As a general principle, I'm certainly amenable to the idea of sharing it. In the back of my mind, I'm thinking there may be some reasons, depending on certain circumstances, where it mightn't be appropriate to do that. But I think it would be better if we came back to you with a written response on that.

Mr THISTLETHWAITE: Mr Hartzer, I have some questions about mortgage brokers. Can you inform the committee of the value of the up-front commission and the trail commission that a mortgage broker would typically get from an application for a loan with Westpac?

Mr Hartzer : It varies by broker, as you can imagine. Typically it's around 60 basis point up-front and a trail of around 15 basis points—so 0.15 per cent, from memory.

Mr THISTLETHWAITE: So the customer pays that through the interest rate they're charged for the loan?

Mr Hartzer : In effect.

Mr THISTLETHWAITE: The royal commission, in the interim report, has hinted at and raises the question about whether or not that's appropriate ongoing and whether fees for service should be considered in lieu of commissions and trail commissions on the basis of transparency and accountability. What's your bank's view on that?

Mr Hartzer : This is a complex one, unfortunately. We recognise that brokers are an important part of competition in the market and creating the perception for customers that they can see the market more effectively. Brokers provide some price transparency. They provide a service in terms of convenience of going through paper processes and the like. In many cases, they provide an ongoing relationship with a customer as circumstances change. We are certainly in favour of more transparency. I've been on the record as saying that I certainly think it's worth considering whether brokers should charge customers directly and explicitly. It gets tricky, though, and I know this is one of the things that the royal commission is grappling with: is the broker effectively acting as an adviser to the customer or are they acting as a broker? So there have been some questions about what the obligation of the broker is to the customer and whether there should be more obligations?

We would say that's worth considering but the word is kind of in the name 'broker'. They are essentially, at one level, a shopping service for the customer, helping them navigate as opposed to advising them explicitly what they ought to do. It might be that you have different kinds of brokers. Some brokers operate in different ways. Some brokers operate in a real relationship sense—they try to build relationships with customers over multiple years and help them through their life—and others are more transactional. I wish I could give you a more definitive answer. I would just say that there are moving parts in this. We think it's absolutely worth examining. We think, at a minimum, more transparency is a good thing, but there are pros and cons. This is a tricky one.

Mr THISTLETHWAITE: It is a tricky one. The notion of a broker, if it operated in a pure sense, would be a good one—you go and see someone because you wish to get a home loan and that person would then, using their expertise and their contacts, shop around and get you the best deal. But, based on the evidence that's come out of the royal commission, it doesn't appear to be operating that way in practice. The evidence of bonuses that were paid to brokers—holidays to Bali and places like that—for having their clients sign up to particular loans with banks and reach certain milestones has really muddied the waters about whether or not the broker is acting in the best interests of the customer, and I think that's the problem. Perhaps this could be solved—and I ask your view on this—by extending that FOFA best-interests duty to mortgage brokers.

Mr Hartzer : It potentially could. I agree that the water is muddied, but I think it mostly works pretty well. I would say we have issues here at the edge, which doesn't mean we shouldn't deal with them, but I wouldn't say that the whole model has a problem. But you could go with the FOFA style thing, and I think that's worth considering. I would just highlight that, if you did that, you would dramatically change the economics of the brokerage model, because the amount of compliance, training and cost impost that that would bring to many of those companies would be significant, and it may therefore change the competitive dynamics in the brokerage industry, which may not necessarily be to the benefit of customers. So that's why I would say that certainly transparency is a really important part and you could consider that, but I would think it through pretty carefully.

Mr THISTLETHWAITE: If the notion of an up-front commission and a trail commission continues—and, from what I understand, a lot of the loans that brokers will apply for could be interest-only loans—it's not in the broker's best interest for that loan to be paid off quickly, is it, because then that trail commission disappears and they're actually financially worse off in those circumstances. So isn't there a built-in incentive for them, firstly, to write higher value loans and interest-only loans with higher interest rates and have those loans continue for as long as possible so that they make an earn out of it?

Mr Hartzer : I suppose that's a risk. In practice, I'm not sure it's as simple as that, although I think it's a good point.

Mr THISTLETHWAITE: Based on the statistics, I'm arguing.

Mr Hartzer : Statistically, for most people with an interest-only loan, the loan amortises at the same rate as a P&I loan. That might sound counterintuitive, but it's because, as I said in an earlier response, most of the people who are taking out an interest-only loan are taking an offset account, and they're often affluent people or investors who have lumpy cash flows, so they're putting the cash into an interest-only account and then paying it down over time. So the evidence doesn't suggest that those loans amortise at a different rate.

Mr THISTLETHWAITE: Okay. I want to move on to financial advice. In January 2018, ASIC published a report, Financial advice: vertically integrated institutions and conflicts of interest. In it they concluded that, in 75 per cent of the files that ASIC reviewed, the adviser did not demonstrate compliance with the requirements of section 961G to give appropriate advice. In 75 per cent of files reviewed, ASIC found that advisers appeared to have prioritised their own interests over the interests of the client and, alarmingly, in 10 per cent of those cases there were significant concerns about the impact of non-compliant advice on the customer's financial situation. I asked ASIC when they appeared before us if they'd provide us with the details of which institutions fell into that 10 per cent, because, based on the advice that was given, people have been left worse off. They wouldn't supply it to me. Was your organisation one of those that were included in the 10 per cent?

Mr Hartzer : Again, I'm not sure exactly what the question is or what the details of those statistics are. What I would say is that there have clearly been cases we've had of advisers who have given poor advice that we have found ourselves and that we've reported to ASIC. We've had advisers banned. We have a major remediation exercise underway. So we certainly have had issues along those lines.

Mr THISTLETHWAITE: The problem with all of this appears to be that we've got laws in place in the Corporations Act that are meant to stop all of this, but it's still occurring. The royal commissioner goes to that point later on in further comments within that section when he says:

… the evidence to the Commission showed that there had been some significant systemic failures after the FoFA reforms.

These reforms were put in place to try and stop that, but it's still occurring, and people are losing homes, they're losing businesses and they're losing money. Are you aware of anyone that's been prosecuted under FOFA?

As far as I'm aware, it's a criminal offence. But I'm not sure that anyone has been prosecuted under these regulations—are you?

Mr Hartzer : We've certainly seen advisers who've been banned for life from the industry. I can think of one case where there was financial loss—I can't remember whether the person was an adviser or not—where they ended up in jail. So there certainly have been actions.

Mr THISTLETHWAITE: That case was before FoFA, I understand—

Mr Hartzer : Potentially. I don't want to interrupt your thought, but, as a general observation, I think FoFA did make a big improvement, but I completely agree that—and I said in my opening statement—we didn't manage the transition as well as we have. To me, it has gotten better but it's not perfect.

Historically, financial planning—and, to me, this is not a banking issue, although some might take issue with my characterisation—grew out of the insurance broking industry in the nineties. That was a commission based revenue model. Progressively, through the 2000s, and formalised through FoFA, it has been moving from a commission model to a fee-for-service model. That move has meant new requirements for compliance and tracking and the like. The nature of advice is also extra complicated because you're talking about an individual customer's situation and you're talking about the conversation that goes on between an adviser and the customer and how you document all of that. That is an inherently complex process to nail down. And some of what we're seeing here is the consequence of that. That's not an excuse, by any means, and what's happened in these cases is unacceptable and we need to do better at this—and by 'we', I mean the whole industry. I think it's really important that we figure out a way that we can provide advice in a sustainable, compliant, economic way for the Australian population, and the issues we've seen have just showed how complex this is.

CHAIR: Sorry—in the last eight minutes I'm going to have to seize the questioning back to myself, but thank you, Deputy Chair.

I want to go back to your opening statement and particularly some of the, shall we say, concluding remarks around the environment in which we operate as policymakers. You specifically talked about—and it was one of the clear outcomes of the Hayne interim report—the fact that the problems aren't just explicitly around regulation, whether it's there or whether it's enforced; there's also a case for simplification, potentially, of regulation. Do you see that as a case to make it easier to hold banks to account from the perspective of the bank and of the regulator?

Mr Hartzer : Yes. I think that would be an extra benefit, definitely.

CHAIR: When you talk about 'simplification', what do you mean? I'm sure there are a lot of Australians out there who would hear 'simplification' and think it's code for deregulation or removing regulation, which I suspect most people wouldn't be sympathetic to, and hence I think the case needs to be very clearly made that simplification means, presumably, stopping duplication and—

Mr Hartzer : Yes. I should acknowledge the point in your question. Believe it or not, we think a strong regulatory framework is really important because it helps establish trust. It demonstrates that people can rely on banks being overseen and the like. So we're not arguing that we shouldn't have strong, vigorous regulators and that there shouldn't be sanctions when people get things wrong.

You've given me a great set-up, actually, with the point about duplication. There can be overlaps in the responsibility of regulators. Responsible lending is a good example. On the one hand, in mortgage lending, APRA's very concerned about the quality of our credit book and making sure that we don't make loans that can't be paid back, because it's important for our depositors that our balance sheet is safe and secure. On the other hand, we have the responsible lending rules that are administered by ASIC, which are looking at the customer's interest in that. As to those two things, I would argue that actually it's the role of a prudent banker to not give someone a loan they can't afford; it's not in our interest to do that. But the technical rules around that—particularly around responsible lending, for example—are very explicit about the steps one needs to go through, and complement, but slightly overlap with, the rules from an APRA point of view. It's a matter of working through all that and deciding how explicit the law needs to be about how you do some of these things, versus, for example, some of the principles that Commissioner Hayne has articulated about what you should be trying to do. I would also say perhaps more focus on outcomes rather than input. The issue we spent a lot of time this afternoon about vulnerable customers and how complaints are handled is something that hasn't had as much attention but, in some ways, might lead to better outcomes at the beginning if we dealt with that more.

CHAIR: How would you say you get better outcomes from simplification of regulation for people who are in vulnerable situations? I think most Australians would say that it's actually about taking their complaints seriously rather than trying to find pathways to extend, delay or use the power-information imbalance against their interests.

Mr Hartzer : I guess I should probably reflect a bit more on that and give you a better answer later. Quickly, though, what I would say is that often the regulations tend to be very explicit about the steps that one needs to go through. That can create a false level of confidence among operating-level people about what they should do—'If I do these things I'm okay.'

CHAIR: So essentially a bureaucratic approach of 'I ticked the box and passed that test.'

Mr Hartzer : That is probably a better way of saying it. 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.'

CHAIR: You raised your concern around the broader environment we have at the moment where there have been issues around wages growth, and you say house prices are falling and consumer spending is tightening in that current environment. How do you see any simplification or change to regulation impacting that environment?

Mr Hartzer : The observation that I would make—which we haven't touched on but is something to highlight—is around small business. I'll use that one example. With small businesses, because the size of the loan that people often need is relatively low in the scheme of things, banks often need to rely on housing security in order to make the loan. Therefore, changes which affect the ability of people to get a consumer housing loan also have an impact on the availability of credit for business customers.

CHAIR: So you are essentially saying that anything that will affect house prices could have a direct impact on the capacity for small businesses to be established or grow to be able to contribute to the economy and create jobs?

Mr Hartzer : Not just house prices but the availability of credit for housing is also relevant and is very significant for smaller businesses. The other aspect here is we have an economy that has a lot of self employed people. We have first homebuyers, we have people who have immigrated to Australia and we have people who are working casually and aspire to own a home. If we make it really prescriptive about the level of history and documentation and the like that someone needs to have before they can get a home loan, then we, in some ways, end up restricting the access to credit for people at lower wages or lower levels of society and we tilt the playing field towards people who have a lot of money or assets already. I just observe from a policy point of view that that's something worth bearing in mind as well.

CHAIR: One of the great concerns—which I think has come out of Mr Falinski's comments as well as the comments of others—is around competition in the marketplace. I think it would be fair to say that there are a lot of Australians who are saying that having four major banks concentrates too much market power, particularly when they might have retail shopfronts, which creates at least the perception of competition but, in practice, there's a lot of commonality between the products that are being provided in the marketplace—and I say this as a Bank of Melbourne customer, not in a critical way but just as an observation. I think a lot of Australians are probably saying, 'Why shouldn't the banks be broken up?' I was wondering what your response to that is?

Mr Hartzer : I think that, actually, what's been happening through regulation and technology is making it more the case that for people to get the quality of service and security around cybersecurity, for example, and compliance with all these different rules, we're actually lifting the cost of delivering banking services. It's not surprising that larger organisations are able to cope with all those changes more than smaller organisations are.

CHAIR: So part of the task ultimately around regulatory responses and legislative responses is that we can potentially decrease competition by concentrating the power of existing banks who can contribute. I don't want to put words in your mouth, but that sort of the conclusion I'm drawing from it.

Mr King : I'd also just say that one of the benefits to the economy is the banks—in Westpac's case we import about $150 billion of wholesale funding. The ability we have to do that is because where a diversified large organisation and investors offshore are prepared to give us their money. That helps growth in the economy. So I think there are the points that Brian makes and there are also the points about our importing wholesale funding capital for the country.

CHAIR: With a high dependence on importing capital, ultimately, it would be very difficult if we didn't have at least a small number of larger banks, and that would have a broader impact on the economy.

Mr Hartzer : Yes. The way I would break this down—and this might be in the category of 'I would say this, wouldn't I?'—if you look at the quality of service, the technology that's available, the digital services, the risk management and the balance sheet strength of the Australian banks, they are very good by world standards. We have clearly seen through the issues we've been discussing this afternoon and through the royal commission that there are a whole bunch of places where we've dropped the ball and need to do better. Let's fix that and let's recognise that more technology is going to make it easier for people to shop around, and that will ultimately bring competition, and we are seeing that happen. Returns of banks have fallen; the margins have fallen. Customers are benefiting from that.

CHAIR: It sounds to me more like I wouldn't really want to be a bank customer overseas, but that's a separate point. I'll be putting on notice some questions relating to investment lending, particularly around property, just so you're aware. That concludes today's hearing. Thank you for your attendance here. The committee secretariat will be in touch with you in relation to any matters arising out of today's hearing. You'll be sent a copy of the transcript of your evidence, to which you can make corrections of grammar and fact. I note that other members have put questions on notice or may put further questions on notice. Your speedy response to those would be appreciated. I'm also mindful that you have spent a long time here—three hours is a long time—as well as probably extensive preparation time, so I want to express our thanks for that as well.

Resolved that these proceedings be published.

Committee adjourned at 16:18

Source URL (modified on 15 Oct 2018 - 11:18pm): https://www.bankreformnow.com.au/node/509