

Commonwealth Bank Group

Commonwealth Bank of Australia
ABN: 48 123 123 124

Commonwealth Bank
Tower 1
Darling Park
201 Sussex Street
SYDNEY NSW 2000

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Reply
GPO Box 2719
SYDNEY NSW 2001

Ms Toni Matulick
Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra
ACT 2600

Dear Ms Matulick,

Re: Questions on Notice received from Committee on 1 December 2015

On 24 December 2015 we provided responses to a number of the Committee's Questions on Notice received by Commonwealth Bank on 1 December 2015.

We now provide answers to questions 1, 2, 3, 4 and 6. The answers to Questions 5, 7, 8 and 9 have not changed since our 24 December 2015 response.

If you or members of the Committee would like to discuss our response do not hesitate to contact me on [redacted] or Euan Robertson on [redacted].

Yours sincerely,

David Cohen
Group Executive Group Corporate Affairs
Commonwealth Bank of Australia

1. For the matters raised in submissions and evidence by Mr Boman, Mr Cavasinni, Mr Eriksson, Mr Evanian, Mr Lavis, Mr O'Brien, Mr Power, and Mr & Ms Schaumberg please provide:

- a. the dates on which properties were valued by the bank;**
- b. copies of the instructions given to the valuers for each valuation;**
- c. what the valuations were;**
- d. copies of the valuation reports;**
- e. information on whether the valuers were registered certified property valuers;**

As agreed with the Committee secretariat, for questions 1a to 1e we have provided original hardcopies of the most recent valuation reports commissioned by either the bank or the receiver for the eight customer matters identified above.

We request that these documents remain confidential. Some documents are original versions and we request that they be returned to Commonwealth Bank in due course.

We note that in seven of the eight cases the customer was in monetary default and in none of the eight cases was a loan to value ratio breach the critical default.

- f. copies of instructions to receivers;**
- g. final statements of account from the receivers;**

For questions 1f and 1g we have provided to the Committee copies of instructions given to receivers and their final statements of accounts for seven of the eight cases named above. In the case of Mr and Mrs Schaumberg, no receiver was appointed.

We request that these documents remain confidential.

h. any information where the bank challenged or sought to control the fees charged by receivers.

It is in a financial institution's interest to monitor and minimise all costs of receiverships, including the fees charged by receivers and managers, in part because it is common for the bank to suffer a shortfall on loans where a receiver is appointed. In such instances, some if not all of the cost is borne by the bank itself. As a result, the costs of the receivership, including fees, are reported to the bank and discussed regularly with the receiver.

Of the seven customer matters named above where a receiver was appointed, Commonwealth Bank or Bankwest wrote off amounts owed in all cases. At least some, if not all, of the receiver's costs were borne by the bank and its shareholders, not the customer.

We have also reviewed 36 submissions to the Parliamentary Joint Committee which relate to customers of Bankwest. Of those 36 customers, a receiver was appointed to 28. Of those 28, Commonwealth Bank wrote off amounts owed in 25 instances. Therefore in more than 80 per cent of cases, some if not all of the cost of the receivership was ultimately borne by the bank and its shareholders rather than the customer.

In addition, to assist in mitigating the loss to Commonwealth Bank shareholders by limiting receiver fees, we have negotiated reduced fee rates with receivers and managers that we may appoint.

Finally, our use of a range of receivers and managers is believed to be an effective means of managing receivers' fees due to competitive pressure between firms.

i. where investigative accountants were appointed:

- 1. The instructions to the investigative accountants,**
- 2. Information on whether the investigative accountant and the receivers were both from the same firm or company;**
- 3. The findings of the investigative accountant.**

Investigative accountants were appointed in three of the above eight matters (Mr Power, Mr Cavasinni and Mr Lavis).

For questions 1i(1) and 1i(3) we have provided to the Committee copies of the investigative accountant's final report. We request that these remain confidential.

For question 1i(2), in the three cases where investigative accountants were appointed, the same firm acted as the receiver.

j. Information on whether there any had been any secondments of staff to or from the firms or companies of the lawyers, investigative accountants and receivers involved with those cases.

From a review of our records, we have identified less than 40 secondees from investigative accountants and receivers who worked in Group Credit Structuring in the period between February 2010 and November 2015.

Of those secondees, only one worked on a customer case when they were seconded to the bank where the relevant firm also worked on that case. However, in that instance, the secondee worked on the file 10 months after the relevant firm concluded their engagement and that firm had no further involvement with the file.

2. Please provide complete documentation/files on Mr Lavis' loans and Mr Eriksson's loans.

Further to our previous response and as discussed with the Committee Chair, in the interests of providing information to the Committee which is relevant and useful we provide key documents and emails relating to:

- the initial period of the banking relationship; and
- the period from shortly before financial difficulties arose onwards

We have done this for both the CEC Group and Mr Eriksson.

We request that these documents remain confidential as they involve the financial affairs of CEC and Mr Eriksson.

3. What are the incentive structures that apply:

Performance based remuneration arrangements are designed to ensure that employees provide products and services to customers that are in that customer's interests.

Performance based remuneration (including the measures used to assess outcomes) is systematically reviewed and adjusted for risk. The Commonwealth Bank Group offers various types of performance awards, depending on role and seniority.

All staff members eligible for performance based remuneration must meet risk and compliance standards to ensure that behaviour is consistent with our regulatory obligations and our internal risk appetite. Furthermore, customer satisfaction and customer experience are important measures in determining performance and incentive outcomes.

The below describes the current arrangements for staff who set up loans and in Group Credit Structuring.

a. for staff who set up loans

Commonwealth Bank and Bankwest offer annual incentive programs to employees who write commercial loans. The characteristics of these two programs are similar.

The total of these discretionary incentives is primarily determined by the Group's financial performance for the year to June 30, with each business unit's performance being a key factor in determining its portion of the overall total. As such, individual employee incentive payments will reflect a combination of Group performance, business unit/team performance, individual performance and behaviour over the financial year.

The incentives awarded to an individual will reflect both the results achieved and how those results were achieved. For example, Bankwest employees who set up commercial loans are measured on a balanced scorecard consisting of four key measures which are weighted:

- sustainable business growth
- customer experience
- simplicity
- people and culture.

No incentive payments are made where the level of performance or behaviour is unsatisfactory, or where conduct is not in line with our risk and compliance frameworks.

All employees also have standalone risk and compliance requirements included in their individual performance assessments. These are the behaviours our employees must each meet before they can be considered for an incentive payment and are not negotiable.

If performance does not meet required risk and compliance standards, an individual's overall performance assessment and subsequent incentive payment may be moderated or reduced to nil.

Specific remuneration arrangements differ between teams, between levels of seniority and even within teams. For the roles that write commercial loans within Bankwest, potential incentives range from 0 to 60 percent of an employee's base salary, depending on experience and the nature of the role. The final incentive payment made each year is determined by an assessment of the individual's performance against the balanced scorecard measures and compliance with the risk gate opener/ modifier. In the 2014-15

financial year, the average final incentive payment for these employees was around 40 per cent of their potential incentive.

No staff member is rewarded on a pure commission basis.

b. for staff who are in credit management departments who are involved with loans in financial distress, default or impairment.

Members of the Group Credit Structuring team are eligible to participate in the Group-wide discretionary Short Term Incentive Plan. This operates in a similar manner to that described above.

For Group Credit Structuring, incentive gate openers must be met before any employee is eligible for an incentive. Some examples of risk gate opener requirements include:

- meet all compliance requirements, both internal and external
- maintain accurate, complete and consistent data
- prompt and thorough follow-up and resolution of audit and other agreed control issues

After demonstrating compliance with the gate opener, Group Credit Structuring employees will be assessed against how they have achieved their results against their balanced scorecard. The balanced scorecard consists of four key measures which are weighted:

- customer focus
- people skills
- business performance
- productivity initiatives.

The extent to which individuals show contribution to the above four areas will impact the final amount they are each individually entitled to.

Employees of Group Credit Structuring do not receive incentives for appointing a receiver or an investigating accountant to individual customer accounts. No staff member is incentivised to sell a business or its assets for less than its value – this is in neither the interests of the customer nor the bank.

Specific remuneration arrangements differ between teams, between levels of seniority and even within teams. In Group Credit Structuring, potential incentives range from 0 to 50 percent of an employee's base salary, depending on experience and the nature of the role. The final incentive payment made each year is determined by an assessment of the individual's performance against the balanced scorecard measures listed above and compliance with the risk gate opener. In the 2014-15 financial year, the average final incentive payment for Group Credit Structuring employees was around 60 per cent of their potential incentive.

4. What incentive structures applied since 30 June 2008, including any special arrangements that may have occurred at particular times, such as during the GFC or following acquisitions of other banks?

We have assumed that this question refers to incentives structures particularly within Bankwest.

On 1 July 2009 (approximately six months after Commonwealth Bank acquired Bankwest), we introduced the Bankwest Incentive Plan described in our response to question 3(a) which was consistent with the Group-wide discretionary incentive plan. This superseded a number of previous plans which varied by role. For the first few years of the operation of the Bankwest Incentive Plan, a number of divisional or team incentive plans continued to exist, however the number of these in operation reduced over the years.

In addition to the Bankwest Incentive Plan, a small number of additional incentive plans are from time to time implemented in some parts of the business, including for those writing commercial loans. For the most part, these additional incentive plans are put in place for specific times and can take the form of financial incentives or in kind rewards, such as prizes and products.

5. Please provide information on the extent to which receivers are seconded into banks to work with distressed, defaulted or impaired loans.

a. Please also set out the arrangements for managing conflicts of interest in the appointment of investigating accountants and receivers.

During times of peak workflow, experienced employees of accounting firms (though not partners) may be seconded to Commonwealth Bank and/ or Bankwest.

From a review of our records, we have identified approximately 40 secondees from firms who may undertake investigative accountant and receivership engagements who worked in Commonwealth Bank or Bankwest in the period between February 2010 and November 2015.

These secondees are not engaged as receivers or independent accountants, nor do they have the authority to make the decision to appoint either receivers or investigative accountants. These arrangements mean that:

- Any conflict of interest between the secondee and the bank is managed, because there is no opportunity for the secondee to favour their employing firm; and
- Any conflict of interest between the secondee and a customer is managed because the secondee does not have the ability to decide that a receiver or independent accountant is necessary, or in the event that a receivership or independent accountant is required, to determine which firm would undertake that work.

6. Are there any occasions where appropriate conflict of interest arrangements were not put in place? Please provide information on the number of occasions where appropriate conflict of interest arrangements have been breached and advise what consequences were applied to those responsible.

In Question 5 we outlined two potential conflicts of interest:

- between the interests of the secondee and the interests of the bank (because they might favour their own employing firm); and
- between the interests of the secondee and the interests of the customer (because they might have a bias towards appointing a receiver, and where a receiver is appointed, to favour their own employing firm).

As outlined in Question 5, these potential conflicts are managed through secondees not having the authority to make the decision to appoint either receivers or investigative accountants. We are unaware of any circumstances where these arrangements have not applied.

7. When valuations and revaluations are sought, does the bank use registered certified property valuers?

Yes.

In our original submission to the Parliamentary Joint Committee on page 10 we said valuers used by Commonwealth Bank must:

- be registered or licensed (in states where required);
- comply with the regulatory requirements governing licensing or registration;
- be a member of the Australian Property Institute (API), as a Certified Practising Valuer (CPV);
- comply with annual compulsory training requirements;
- comply with the Code of Ethics and Rules of Conduct of the API;
- be suitably experienced to undertake required valuations (generally a minimum of 5 years' experience in their field of expertise); and
- have suitable and current professional indemnity insurance cover.

We also said:

In a small proportion of cases, especially in remote areas where expert valuers are unavailable Commonwealth Bank has relied on internal bank valuations completed by accredited staff. In these cases, the valuation officer must comply with Commonwealth Bank policy and measures are in place to manage risk. Where a loan is determined to be troublesome or impaired, Commonwealth Bank policy does not permit the use of internal valuations.

8. Where the committee has received submissions relating to Commonwealth Bank matters could you advise the committee if the valuers used by the bank in those cases were registered certified valuers?

Yes.

9. Please respond to comments made by Mr Wijeyeratne on pages 15 and 16 of the transcript of 13 November 2015:

Mr Wijeyeratne’s comments are highly inaccurate.

- After the acquisition of Bankwest by Commonwealth Bank, the Commonwealth Bank Group, including Bankwest, was able to raise both capital and debt as needed.
- Rather than terminating customers, as Mr Wijeyeratne suggests, Bankwest grew loan balances and the number of commercial loan customers:

	At Acquisition	30 June 09	30 June 10
Loan balances (\$m)	58,783	61,500	67,573
Total commercial customers	25,719 (31 Jan 2009)	26,056	26,573

- The *Bank of Western Australia Act* contains no provision which refers to prudential regulation, regulatory capital nor Basel framework accreditation – certainly nothing to stop Bankwest from applying to become Basel II advanced accredited or raising capital.
- The differing Basel regulatory capital treatments had no impact on the management of individual customer accounts. There is no economic incentive for the Group to recognise losses on Bankwest loans under either the Basel I or Basel II capital regulations. Actually recognising losses means a permanent loss of capital for the bank.
- As we have said on a number of occasions, the best outcome for customers, the bank and the economy occurs when customers repay their debt according to the loan agreement. It is hard to imagine a circumstance where a bank would benefit more from complex manipulation of capital requirements rather than from allowing a customer who was able to service and repay a loan to do so.
- Mr Turner made the quoted statement at the Commonwealth Bank AGM in 2014 (not 2013). It is not obvious what point the quote is intended to illustrate. The quote was in response to a question about Commonwealth Financial Planning, not about Bankwest. Mr Turner did not suggest that the Group was in financial difficulty or had difficulty raising capital.