Parliamentary Joint Committee on Corporations and Financial Services

Impairment of Customer Loans

May 2016

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Executive summary

1.1 The terms of reference for this inquiry into the impairment of customer loans required the committee to consider the practices of banks towards borrowers who they judge may be in financial difficulty and may have breached the terms of their loan contracts.

1.2 The majority of the evidence received by the committee addressed small business and commercial loans, so the committee has focussed its attention on those areas, rather than residential loans which were considered in the post-GFC banking inquiry by the Senate Economics References Committee in 2013. The Committee notes that business lending spans a large range of disparate parties. Some borrowers are publically listed entities with considerable resources to conduct due diligence prior to entering into a contract with a lender. Many, however, are small family businesses—who may still have to borrow millions of dollars to achieve their commercial objectives—yet be run by an individual, family or partnership that has significant personal exposure due to the use of personal assets such as the family home as security.

1.3 The bulk of the evidence received in relation to lenders also related to banks and therefore so does much of the committee's report. However, to ensure consistency across all relevant lenders, the committee's recommendations should be interpreted as applying to all lenders listed as authorised deposit taking institutions by the Australian Prudential Regulation Authority.

1.4 The terms of reference drew particular attention to:

- constructive or non-monetary defaults which include breaches of loan contract terms other than borrowers not meeting repayment requirements; and
- the role of other service providers including valuers and receivers.

1.5 From the evidence it has received, the committee has been able to determine that there has been—albeit in a minority of cases—a persistent pattern of abuse of the almost complete asymmetry of power in the relationship between lender and borrower.

1.6 Many submitters and witnesses alleged that banks had engaged in a range of illegal actions, or actions that breached the Banking Code of Practice. The committee has not been able to discover evidence that demonstrates that there was widespread or systematic illegal behaviour by banks or that there were deliberate impairments of loans motivated solely by clawbacks or warranties associated with acquisitions of banks. However, the committee does consider that there are four factors that create an environment in which small business borrowers are very vulnerable and that banks are able to exploit this vulnerability.

1.7 These factors are:

- that there is a wide variation of conduct that is deemed acceptable by lenders due to the significant level of discretion and commercial judgement available

to the banks for both initial lending and the management of loans in financial difficulty;

- complex, non-negotiable loan contracts, coupled with gaps in existing legislation and regulations, give banks the power to behave in ways that—in relation to loans—are unethical, unreasonable and lack transparency;
- in many cases, borrowers in financial difficulty are unable to pursue their rights though the courts because the process in either unaffordable, or they have lost control of their financial assets due to the appointment of receivers; and
- there are significant gaps in the coverage of mediation and external dispute resolution schemes leaving borrowers without the means to have their disputes with banks tested.

1.8 This inquiry has been conducted at a time when there has been substantial activity in relation to financial services generally, including the Financial Systems Inquiry, reforms arising from a major parliamentary inquiry into the performance of Australian Securities and Investments Commission (ASIC), the ASIC capability review and law reforms relating to insolvency and unfair contract terms. The Australian Small Business and Family Enterprise Ombudsman (ASBFE Ombudsman) was established in March 2016.

1.9 In addition, in April 2016 the government made a range of announcements relating to regulation of banks and lending practices. Commendable as each of these initiatives or reforms are individually, there is a very real risk that significant resources will be committed to processes that may operate in isolation, or worse, at odds with each other. This could leave small business consumers still having to engage in relationships with lenders that are neither transparent nor fair and still facing gaps in their access to effective and affordable dispute resolution.

1.10 The committee considers that to address the vulnerability of small business and commercial borrowers it is essential that a single body be empowered to:

- lead and/or coordinate the implementation of the outcomes of this inquiry and the aspects of the above reforms (government and financial services sector) that relate to small business in order to avoid the significant risk that major gaps and flaws in the protections for small business would remain;
- bring together a team with expertise in financial services, ethics and education to establish standards for the conduct of bank management and their employees in relation to small business loans and to work with the banking industry to implement those standards and appropriate mediation and dispute resolution schemes;
- to work with the banking industry to develop nationally consistent standardised loan contracts; and
- where gaps in the implementation of those standards and appropriate dispute resolution schemes remain, to act as a small business loans dispute resolution tribunal.

1.11 The committee considers that the most appropriate body to undertake this role is the ASBFE Ombudsman. The committee therefore recommends that the government bring forward legislation and other measures to give the ASBFE Ombudsman the relevant powers to carry out this role, and to do so retrospectively where appropriate

1.12 The provisions of the ABSFE Ombudsman Act prevent the ABSFE Ombudsman from recommending the use of commercial arbitration. Commercial arbitration could provide a viable alternative to courts for those businesses and commercial borrowers that do not qualify for external dispute resolution schemes. The committee considers that commercial arbitration may be appropriate in some circumstances and is therefore recommending that the ASBFE Ombudsman be able to direct parties to participate in commercial arbitration for larger commercial loans outside of its jurisdiction.

1.13 The committee also noted suggestions for the development of a nationally consistent farm debit mediation scheme. The committee recommends that a national farm debt mediation scheme should be established. The committee further recommends that a similar nationally consistent mediation scheme be put in place for small business.

Conduct of the inquiry

1.14 The committee has examined the evidence it received in the context of a number of existing legislative, regulatory and other requirements relating to loans including:

- the role of the Australian Prudential Regulatory Authority in protecting financial stability and the interests of depositors;
- the role of ASIC including:
    - licensing and consumer protection for financial services;
    - authorisation and oversight of external dispute resolution schemes;
- the role of the Australian Small Business and Family Enterprise Ombudsman in relation to disputes between small business borrowers and banks;
- industry peak bodies, self-regulatory functions, codes of practice and other roles that these bodies perform relating to banks, other lenders, valuers and receivers;
- the role of the Australian Competition and Consumer Commission in making public competition assessments of acquisitions of banks by other banks; and
- the role of the Commonwealth government in approving acquisitions.

1.15 The committee is aware that the matters raised in this inquiry have been examined previously and despite previous examination, allegations continue to be raised. In order to ensure that the issues raised during the inquiry were thoroughly examined, the committee has:

- conducted this inquiry over a period of approximately 11 months;
- received and published 195 submissions, including submissions received after the closing date and considered more than 11 000 thousand pages of evidence;
- held eight public hearings leading to more than 450 pages of transcribed evidence;
- asked and received answers to over 300 written questions on notice from banks, industry bodies, government bodies and others;
- requested that the Commonwealth Bank provide documents and then used these documents to:
    - consider the behaviour of the Commonwealth Bank in relation to 95 borrowers, including 36 submitters to the inquiry and 59 cases associated with the acquisition of Bankwest by the Commonwealth Bank;
    - consider in detail eight disputes between borrowers and banks and considered responses and counter responses to information provided by both parties to the disputes; and
    - formally referred four disputes to ASIC for consideration and response to the committee.

1.16 At the start of the inquiry, the committee resolved and stated publicly that while it welcomed submitters' experiences with banks to inform the committee's report to the Parliament, the committee would not investigate or seek to resolve disputes between individual borrowers and banks. As the committee has concluded this inquiry, it notes that for some submitters, their grievance remains unresolved and that a number of them have called for a Royal Commission.

Recent announcements

1.17 The committee acknowledges the Commonwealth government's release of the ASIC Capability Review, the government response and a new policy announcement on 20 April 2016. The government announced that five of the Capability Review recommendations would be implemented, and that it expected ASIC to provide an implementation plan for the other 29 recommendations. The announcement identified a user pays industry funding model to deliver $127 million in additional funding for:

- deepening the surveillance and enforcement capability of ASIC with a specific focus on investigating financial advice, responsible lending and life insurance;
- enhancing data analytics and surveillance capabilities as well as modernising data management systems; and

- strengthening ASIC's powers.[1]

1.18 The committee acknowledges the government's policy announcements on 20 April 2016 including an additional ASIC commissioner, bringing forward law reforms recommended by the Financial System Inquiry, a review of the jurisdiction of the Financial Ombudsman Service and possible consolidation of disputes and complaints functions in the financial system.[2] However, the committee does note that it is disappointed with the pace of the implementation of other related reforms, including recommendations made by this committee during earlier inquiries.

1.19 The committee also notes the announcements made on 21 April 2016 by the Australian Bankers' Association including a review of commissions and product based payments, improving protections for whistleblowers, improving complaints handling, and better access to external dispute resolution.[3] The committee will monitor the progress of the above announcements and the coordination of their implementation.

Practices of banks

1.20 With the benefit of hindsight (post GFC) and based on the evidence it has received, the committee observes that for many failed loans, including those with Bankwest, it is likely that irresponsible lending was the primary or significant cause of loan failure in a number of cases. However, the committee considers that the manner in which the banks facilitated the defaulting of loans, and the subsequent treatment of customers, was in many cases unconscionable. In making its recommendations, the committee is seeking to prevent this type of conduct by banks in the future.

1.21 While mechanisms have been put in place to require banks to meet improved standards of responsible lending for residential and related loans, this inquiry has identified that these standards are only implemented on a voluntary basis in relation to small business and commercial loans. The committee is therefore recommending that responsible lending provisions, including ASIC's monitoring under the *National Consumer Credit Protection Act 2009*, become mandatory and be extended to small business loans. The committee is disappointed that banks have not chosen to implement these standards voluntarily.

1.22 The committee considers that the banks' compulsion to deliver ever-increasing returns to shareholders has become the overriding driver of behaviour and culture in the banks. As the margins on business loans reduce, this culture is evidenced by some customers being offered high risk credit facilities such as credit cards, instead of secured loans.

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1 Australian Government Factsheet, *Improving Consumer Outcomes in Financial Services*, 20 April 2016, p. 1.

2 The Hon Scott Morrison MP, Treasurer, joint media release with the Hon Kelly O'Dwyer MP, Minister for Small Business, Assistant Treasurer, *Turnbull Government bolsters ASIC to protect Australian Consumers*, 20 April 2016.

3 Australian Bankers' Association, Media Release, *Banks act to strengthen community trust*, 21 April 2016.

1.23 The committee is deeply concerned that more than three years have elapsed since the conclusion of the post-GFC banking inquiry by the Senate Economics References Committee in which a number of recommendations were made to improve banking practices. Since this time, the banking industry has not addressed matters as simple as providing borrowers with copies of valuation reports.

1.24 The current inquiry into impairment of customer loans has amply demonstrated that the provision of valuation reports to borrowers has not been written into the Banking Code of Practice, or become universal practice by banks.

1.25 The committee has also received evidence that borrowers perceive that banks provide inconsistent information and advice between the bank's lending departments and their credit management departments. Evidence considered by the committee indicates that there is the potential for lending departments in banks to be more optimistic about valuations than credit management departments. The committee is concerned that this may be influenced by inappropriate or conflicted remuneration incentives and cultures in those departments. The rules that exist in the financial advice space, which restrict conflicted remuneration and require financial advisers to act in the customer's best interest, do not extend to small business loans. The committee is very concerned about the lack of any obligation on lenders to provide consistent information in the best interests of borrowers.

1.26 The committee also heard a large number of concerns about the appointments of and instructions to valuers, investigative accountants and receivers. These concerns related to inconsistent information, as already discussed, but also included concerns about transparency and accountability.

1.27 To address these issues, the committee is therefore recommending that appropriate legislation and regulations be put in place to:

- prohibit conflicted remuneration for all bank staff;
- require bank officers to act in the customer's best interests for small business loans;
- require officers from lending and credit management departments to provide consistent information to borrowers, including:
    - copies of valuation reports and instructions to valuers; and
    - copies of investigative accountants' reports and instructions to investigative accountants and receivers;
- require banks to ensure that the valuation instructions do not change during the term of the loan agreed in the loan contract, and that businesses are valued as the market value of a going concern, not just a collection of business assets, and that the market value of all security supporting the loan are taken into account, not just real property.

1.28 This will require internal processes that ensure coordination between lending officers and credit management officers prior to making the initial offer to the borrower.

1.29 While inconsistent valuation instructions from banks are a significant concern, they are not the only concern. From the evidence presented to this inquiry, there is fragmentation of relevant professional standards, registration processes and dispute resolution arrangements that apply to valuers, and which are spread across three peak bodies and several state bodies. The committee notes recent media reports[4] which allege that banks are bullying valuers into accepting below cost fees, strengthening the need for greater oversight of the relationships between banks and valuers.

1.30 Prudential Standard 220 sets out substantial requirements for how banks must value property held as security for loans, including: regular assessment, bank procedures, marketing periods, determining fair value and the role of the bank's credit administration function. Evidence put to this inquiry suggests that cases may exist where the above requirements are not met. APRA's position is that it only considers systemic issues, it is not mandated to consider the relationship between banks and borrowers, and it may have a conflict of interest if it did consider the relationship between banks and borrowers. There is what seems to be an appropriate standard in place, but no way of ensuring that the standard is applied, or that borrowers are able to raise concerns about its implementation.

1.31 The committee is therefore recommending that a nationally consistent approach be developed for the professional standards and conduct of valuations in relation to small business loans, and which includes valuation of all assets, not just real property.

Bankwest and Landmark

1.32 The committee considered allegations that there was a deliberate strategy by the Commonwealth Bank to over-impair loans in order to seek financial gain through a range of mechanisms after the acquisition of Bankwest in 2007. After considering the evidence and responses it has received, the committee has not been able to determine that deliberate impairment of loans, solely motivated by clawbacks or warranties, occurred. While the contractual arrangements associated with the acquisition of Bankwest may have played a role, the evidence before the committee points strongly to a culture of placing profit and return to shareholders ahead of the interests of borrowers.

1.33 Loans associated with the price adjustment mechanism in the Bankwest acquisition by the Commonwealth Bank were separately assessed by three major accounting and audit firms. The fact that the three assessments differed by hundreds of millions of dollars would suggest that despite the same accounting and prudential standards being used, identifying which loans were impaired and the extent of the impairment was an uncertain process requiring commercial judgements in a significant number of cases. Such a broad discretion must be subject to appropriate monitoring and accountability. There are many loans for which the accountability is limited due to the lack of an applicable dispute resolution scheme. As discussed

4 Duncan Hughes, 'Bullying banks to force valuers out of business', *Australian Financial Review*, 27 April 2016.

earlier, the committee is therefore recommending substantial improvements to dispute resolution schemes, codes of practice and regulation and monitoring of lending.

1.34 The committee considered allegations regarding deliberate impairments or defaults of performing loans associated with ANZ's acquisition of Landmark. After considering the evidence and responses it has received, the committee has not been able to conclusively determine that this occurred. The committee welcomes ANZ's acknowledgement that its treatment of customers could be improved and that it is now implementing better practices. The committee will follow with interest developments in ANZ's approach to resolving issues with customers and encourages all lenders to take an open and constructive approach to helping borrowers to resolve their difficulties, especially in light of the significant power imbalance that may exist between lenders and borrowers.

1.35 In conclusion, the committee is struck by the different approaches employed by the ANZ and the Commonwealth Bank. The ANZ, after internal review, appears to have realised that their conduct was questionable, and have voluntarily sought to make recompense to their customers. The Commonwealth Bank, on the other hand, have consistently denied that there have been issues with their conduct and the way in which they have engaged with their customers. The evidence of witnesses and submitters to this inquiry has strongly called into question the Commonwealth Bank's denial of unreasonable or unethical conduct.

Recommendations

Recommendation 1

The committee recommends that appropriate regulation and legislation be put in place to prevent banks profiting from defaulted or impaired loans by requiring banks to:

a. **levy additional costs that the bank incurs when a loan is in default or is impaired in accordance with a schedule or process approved by the Australian Small Business and Family Enterprise Ombudsman.**
b. **provide transparent and accountable information to borrowers on the additional costs that the bank incurs when a loan is in default or is impaired; and**
c. **where a bank charges additional fees or interest of any kind associated with a defaulted or impaired loan;**
    - **the increased costs incurred by the bank must be disclosed in the loan contract, where possible, as a flat dollar figure; and**
    - **any amount charged that exceeds the increased costs incurred by the bank is to be paid off the loan principal.**

Recommendation 2

The committee recommends that the banking codes of practice administered by the Australian Bankers' Association or the Customer Owned Banking Association and other regulatory arrangements be revised to require that:

a. **authorised deposit taking institutions must commence dialogue with a borrower at least six months prior to the expiry of a term loan. Further, where a monetary default has not occurred, they must provide a minimum of three months notice if a decision is made to not roll over the loan, even if this means extending the expiration date to allow for the three months following the date of decision;**
b. **if a customer is meeting all terms and conditions of the loan and an authorised deposit taking institution seeks to vary the terms of the loan, the authorised deposit taking institution should bear the cost associated with the change and provide six months notice before the variation comes into effect;**
c. **customer protections relating to revaluation, non-monetary defaults and impairment should be explicitly included in the code; and**
d. **subscription to a relevant code becomes mandatory for all authorised deposit taking institutions.**

Recommendation 3

The committee recommends that responsible lending provisions, including ASIC's monitoring under the *National Consumer Credit Protection Act 2009*, be extended to small business loans.

Recommendation 4

The committee recommends that the government bring forward legislation and other measures to enable the Australian Small Business and Family Enterprise Ombudsman to:

a. **lead and/or coordinate the implementation of the outcomes of this inquiry and all other reforms that relate to small business lending in order to avoid the significant risk that major gaps and flaws in the protections for small business would remain;**
b. **bring together a team with expertise in financial services, ethics and education to establish standards for the conduct of bank management and their employees in relation to small business loans and to work with the banking industry to implement those standards and appropriate mediation and dispute resolution schemes;**
c. **work with the banking industry to develop mandatory nationally consistent standardised loan contracts that include a cover sheet summarising the obligations of the customer and the consequences of any breach;**
d. **have the power to direct the parties to a dispute to participate in mediation or dispute resolution;**
e. **where gaps in the implementation of those standards and appropriate dispute resolution schemes remain, to act as a small business loans dispute resolution tribunal; and**
f. **direct the parties to a dispute to participate in commercial arbitration for larger commercial loans.**

Recommendation 5

The committee recommends that appropriate legislation and regulations be put in place to:

a. **prohibit conflicted remuneration for all bank staff;**
b. **extend the clawback period on any bonus or like incentives provided to management and senior executives involved in the line approvals or systematic oversight of lending;**
c. **require bank officers to act in the best interests of a small business customer;**

d. require officers from lending and credit management departments to provide consistent information to borrowers, including:

i. copies of valuation reports and instructions to valuers; and

ii. copies of investigative accountants' reports and instructions to investigative accountants and receivers;

e. require lending officers and credit management officers to ensure that:

i. the valuation instructions do not change during the term of the loan agreed in the loan contract; and

ii. businesses are valued as the market value of a going concern, not just a collection of business assets and that the market value of all security supporting the loan are taken into account, not just real property.

Recommendation 6

The committee recommends that nationally consistent arrangements be put in place for:

a. farm debt mediation;

b. small business debt mediation; and

c. the professional standards and conduct of valuations in relation to small business loans.

Recommendation 7

The committee recommends that the link between lenders and key creditors, such as builders who may be building on a developer's land, needs to be formalised so that lenders have an obligation to advise creditors once a loan is placed in default.

Recommendation 8

The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services conducts an inquiry to examine the regulatory environment for valuers with a view to:

a. reforming the industry to improve ethical and professional standards for valuers;

b. improving transparency and independence within the industry; and

c. preventing them from being captured by banks.

Recommendation 9

The committee recommends that if an authorised deposit taking institution is intending to appoint a receiver:

a. **that is from the same company that was engaged as an investigative accountant, the borrower should be given an opportunity to request an alternate company if the borrower is concerned about a conflict of interest;**

b. **in addition to the requirement to sell assets for fair market value under section 420A of the *Corporations Act 2001*, receivers should be required to sell a business as a going concern where possible—if this will result in a higher return—rather than separately selling the assets within the business; and**

c. **that receivers or similar entity selling assets under section 420A be required to take every reasonable step to ensure those assets are sold at or as close to listed market value as possible under the following conditions:**

    i. **proof of marketing through but not limited to mainstream media, catalogues and online;**

    ii. **in cases with no monetary default, marketing periods consistent with Prudential Standard APS 220;**

    iii. **in the case where monetary defaults have occurred, the marketing period can be reduced below the APS 220 standard where a shorter marketing period can be demonstrated to be in the borrower's best interest; and**

    iv. **that a strong penalty regime for breach of section 420A be administered by the Australian Securities and Investments Commission.**

Recommendation 10

The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services conduct an inquiry to examine the remuneration of insolvency practitioners.

Recommendation 11

The committee recommends that:

a. **lenders should engage independent experts nominated by the Australian Small Business and Family Enterprise Ombudsman to critically examine contentious cases to determine what, if any, restitution may be appropriate in the light of the standards developed by the Australian Small Business and Family Enterprise Ombudsman, with particular regard to unconscionable conduct; and**

b. that funding through a user pays industry funding model be provided to Australian Small Business and Family Enterprise Ombudsman —acting as a tribunal—to consider cases retrospectively in the event that lenders do not choose to voluntarily examine contentious cases as recommended above.

Abbreviations

AAT	Administrative Appeals Tribunal
ABA	Australian Bankers' Association
ACCC	Australian Competition and Consumer Commission
ADIs	Authorised Deposit-taking Institutions
ANZ	Australia and New Zealand Banking Group Limited
API	Australian Property Institute
APRA	Australian Prudential Regulation Authority
ARITA	Australian Restructuring Insolvency & Turnaround Association
ASBFE	Australian Small Business and Family Enterprise
ASIC	Australian Securities and Investments Commission
ASIC Act	ASIC Act 2001
AVI	Australian Valuers Institute
AWB	Australian Wheat Board
CAFBA	Commercial Asset Finance Brokers Association of Australia
CBA	Commonwealth Bank of Australia
CBD	Central Business District
CCLSWA	Consumer Credit Legal Service Western Australia
CCMC	Code Compliance Monitoring Committee
CIO	Credit and Investments Ombudsman
COBA	Customer Owned Banking Association
COBCOP	Customer Owned Banking Code of Practice
COSBOA	Council of Small Business Organisations of Australia
CPV	Certified Practising Valuer
The Code	Code of Banking Practice
DCBS	Draft Completion Balance Sheet
EDR	External Dispute Resolution
FDM	Farm debt mediation
FOS `	Financial Ombudsman Service
FOSCode	FOS Code Compliance and Monitoring Team
FSI	Financial System Inquiry
FSSA	Financial Sector (Shareholdings) Act 1998

GFC	Global Financial Crisis
HBOS	Halifax Bank of Scotland
IDR	Internal Dispute Resolution
IVSC	International Valuation Standards Council
LAQ	Legal Aid Queensland
LFS	Landmark Financial Services
LVR	Loan Value Ratio
Model Bill	Model Commercial Arbitration Bill
NAB	National Australia Bank
NCCP Act	National Consumer Credit Protection Act 2009
PCBS	Parliamentary Commission on Banking Standards
PCL	Permanent Custodians Limited
PwC	Price Waterhouse Coopers
RBS	Royal Bank of Scotland
RICS	Royal Institution of Chartered Surveyors
s420A	Section 420A of the Corporations Act
s761G	Section 761G of the Corporations Act
TSBC	Tasmanian Small Business Council
UK	United Kingdom

Chapter 1
Introduction and background

Introduction

Duties of the committee

1.1 The Parliamentary Joint Committee on Corporations and Financial Services (the committee) is established by Part 14 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). Section 243 of the ASIC Act sets out the committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Takeovers Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions); or

(iii) the operation of any other law of the Commonwealth, or any law of a State or Territory, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); or

(iv) the operation of any foreign business law, or of any other law of a foreign country, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.[1]

Referral of the inquiry

1.2 On 4 June 2015 the House of Representatives referred an inquiry into the impairment of customer loans to the committee for inquiry and report by 31 March 2016.[2] On 4 June 2015 the committee resolved that:

- in conducting the inquiry the committee would not investigate or seek to resolve disputes between customers and banks; and

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1 *ASIC Act 2001,* s. 243.

2 House of Representatives, Votes and Proceedings, No. 122, 4 June 2015, pp 1362–1363.

- where the experiences of customers may inform the committee about the practices of banks, the committee welcomed submissions that explicitly addressed the terms of reference.

1.3 On 2 March 2016, the House of Representatives extended the reporting date until 20 May 2016**.** On 15 April 2016, the inquiry lapsed due to the prorogation of the House of Representatives.[3] On 19 April 2016, the committee resolved to re-adopt the inquiry using the same terms of reference as the original inquiry referred by the House of Representatives on 4 June 2015 but with a reporting date to be determined by the committee.

Terms of reference

1.4 The terms of reference are as follows:

(a) practices of banks and other financial institutions using a *constructive default* (security revaluation) process to impair loans, where constructive default/security revaluation means the engineering or the creation of an event of default whereby a financial institution deliberately reduces, through valuation, the value of securities held by that institution, thereby raising the loan-to-value ratio resulting in the loan being impaired;

(b) role of property valuers in any constructive default (security revaluation) process;

(c) practices of banks and other financial institutions in Australia using non-monetary conditions of default to impair the loans of their customers, and the use of punitive clauses such as suspension clauses and offset clauses by these institutions;

(d) role of insolvency practitioners as part of this process;

(e) implications of relevant recommendations of the Financial System Inquiry, particularly recommendations 34 and 36 relating to non-monetary conditions of default and the external administration regime respectively;

(f) extent to which borrowers are given an opportunity to rectify any genuine default event and the time period typically provided for them to do so;

(g) provision of reasonable written notice to a borrower when a loan is required to be repaid;

(h) appropriateness of the loan to value ratio as a mechanism to default a loan during the period of the loan; and

(i) conditions and requirements to be met prior to the appointment of an external administrator; and

(1) in undertaking this inquiry, the Committee take evidence on:

(a) the incidence and history of:

3 His Excellency General the Honourable Sir Peter Cosgrove AK MC (Retd), Governor-General of the Commonwealth of Australia, *Proclamation*, 21 March 2016.

(i) loan impairments; and

(ii) the forced sale of property;

(b) the effect of the forced sale of property in depressed market conditions and drought;

(c) comparisons between valuations and sale price;

(d) the adequacy of the legal obligations on lenders and external administrators (including s420A of the *Corporations Act 2001*) to obtain fair market value for the forced sale of property; and

(e) any related matters.[4]

Conduct of the inquiry

1.5 The committee advertised the inquiry on its webpage and in relevant national and regional newspapers and invited submissions from a range of relevant stakeholders. The committee set a closing date for submissions of 24 July 2015 and subsequently extended the due date for submissions to 21 August 2015. The committee received 195 submissions, with the public submissions being published on the committee's website. The committee held public hearings in Melbourne on 16 October 2015, Sydney on 13 and 18 November 2015, Brisbane on 19 November 2015, Canberra on 23 November 2015 and 2 December 2015, and in Sydney on 16 February 2016 and 4 April 2016.

Structure of this report

This report is structured as follows:

- The remainder of Chapter 1 provides background to the inquiry;
- Chapter 2 discusses the practices of banks relevant to the terms of reference;
- Chapters 3 and 4 discuss dispute resolution schemes;
- Chapter 5 discusses the role of valuers in relation to loans;
- Chapter 6 discusses the role of receivers and investigative accountants; and
- Chapter 7 discusses allegations put to the committee regarding the acquisition of Bankwest by the Commonwealth Bank and Landmark by ANZ.

Background and previous inquiries

1.6 In conducting this inquiry, the committee was acutely aware that many of the issues raised were not new, and that many of the issues and fact scenarios have been considered by earlier parliamentary and other inquiries. A number of submitters to this inquiry have also had their matters considered in other forums, including earlier parliamentary inquiries. Despite this, as part of assessing systemic issues within the small business lending environment, the committee devoted time to examine submissions from Bankwest customers who alleged that the acquisition of

4 House of Representatives, Votes and Proceedings, No. 122, 4 June 2015, pp 1362–1363.

Bankwest by the Commonwealth Bank in 2007 had adversely affected them. The Committee also took evidence from customers of a number of lenders including ANZ, NAB, Westpac, Macquarie Bank, Rabobank, Landmark, Elders, Suncorp, Bank of Queensland, AMP, Rural Bank, Adelaide Bank, AMP Bank, Members Equity Bank, St George Bank and the Uniting Church.

1.7 The committee notes that this inquiry has been conducted at the same time as a number of relevant and significant reforms were being considered by government. Therefore previous inquiries relevant to this inquiry, as well as recent policy announcements made in relation to the powers and reach of the Australian Securities and Investments Commission (ASIC), are set out below.

Inquiry into the post-GFC banking sector

1.8 In 2012 the Senate Economics References Committee conducted an inquiry into the post-GFC [global financial crisis] banking sector, which devoted three chapters to issues related to Bankwest customers. That committee considered the appropriateness of regulatory settings governing the financial sector and whether the government agencies charged with administering and enforcing these regulations were effectively performing their role. That committee noted that while there were many sad and distressing stories, the borrowers may have been able to operate successfully when the business environment was relatively strong, however, the GFC placed stress on less robust and speculative projects. In many cases, loans were sought for ventures that posed a considerable risk even during a stable economic environment. That was evidenced by the cases where banks other than Bankwest had refused to finance the initial loans. The Senate Economics References Committee stated that:

> This of course does not apply to every case, nor does it excuse Bankwest—under its previous owners Bankwest was willing to enter into these loans that other financial institutions, acting more prudently, chose not to. When its small business borrowers are experiencing difficulties, Bankwest has a duty to make genuine attempts to work with the borrower, to clearly explain what is happening and why, and to treat them with courtesy.[5]

1.9 During that inquiry, that committee was advised by ASIC that it had not received evidence to suggest that Bankwest had engaged in systemic misconduct, and nor had they received a significant number of complaints from Bankwest customers.[6]

Relevant inquiries in the United Kingdom

1.10 In the United Kingdom (UK), the Independent Commission on Banking was established in 2010 and reported in 2011. This Commission considered structural and related non-structural reforms to the UK banking sector to promote financial stability and competition. It made a number of recommendations that led to the release of a white paper in June 2012. A key recommendation from the inquiry was the ring-

5 Senate Economics Reference Committee, *The post-GFC banking sector,* November 2012, pp 163–164.

6 Mr Peter Kell, Commissioner, ASIC, *Senate Economics Committee Hansard,* Inquiry into the post-GFC banking sector, 8 August 2012, p. 59.

fencing of banks so that retail activities such as deposit-taking are made separate from international wholesale and investment banking operations.[7]

1.11 Another relevant UK inquiry, conducted by the Parliamentary Commission on Banking Standards (PCBS) was published in June 2013 on failures of accountability of senior bankers in the wake of the global financial crisis. The PCBS found that there was a loss of trust caused by profound lapses in banking standards. The PCBS argued that no single change, however dramatic, could address the problems of banking standards and that reform across several fronts was required. The PCBS therefore made the following proposals to restore public confidence in the banking sector:

- requiring individual responsibility in banking at the most senior levels;
- reforming governance within banks to reinforce each bank's responsibility for its own safety and soundness and for the maintenance of standards;
- creating better and more diverse banking markets in order to empower consumers and provide greater discipline on banks to raise standards;
- reinforcing the responsibilities of regulators in the exercise of judgement in deploying their current and proposed new powers; and
- specifying the responsibilities of the government and Parliaments.[8]

1.12 The UK government's response to the PCBS was released in July 2013 and noted that banks in the UK have not done enough to carry out their core role of financing economic growth. The UK government response was also critical of banks for failing taxpayers, customers and shareholders. The UK government announced plans to implement the major recommendations including:

- a new banking standards regime governing the conduct of bank staff;
- a criminal offence for reckless misconduct by senior bank staff; and
- further steps to improve competition in the banking sector.[9]

1.13 On 17 November 2014, the former members of the PCBS released a statement noting their concerns about continued examples of misconduct in the sector, and expressing their disappointment about the slow progress in implementing reforms.[10]

Relationship to the inquiry into the impairment of customer loans

1.14 The committee's current inquiry into impairment of customer loans was triggered to some extent by allegations of issues arising between Bankwest and its

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7 The Independent Commission on Banking, *The Vickers Report*, December 2013, pp 9–10; Senate Economics Reference Committee, *The post-GFC banking sector,* November 2012, p. 176.

8 Parliamentary Commission on Banking Standards, *Changing banking for good,* June 2013, p. 9.

9 The government's response to the Parliamentary Commission on Banking Standards, 8 July 2013, p. 3.

10 *Statement by former members of the Parliamentary Commission on Banking Standards,* 17 November 2014, http://www.parliament.uk/bankingstandards, (accessed 9 July 2015).

customers. Prior to the acquisition of Bankwest by the Commonwealth Bank, Bankwest was owned by HBOS Australia. On 5 April 2013 the PCBS published a report on the failure of HBOS, titled *An accident waiting to happen.* The report drew a number of conclusions about HBOS, including that:

> Whatever may explain the problems of other banks, the downfall of HBOS was not the result of cultural contamination by investment banking. This was a traditional bank failure pure and simple. It was a case of a bank pursuing traditional banking activities and pursuing them badly.
>
> Another lesson is that prudential supervisors cannot rely on financial markets to do their work for them. In the case of HBOS, neither shareholders nor ratings agencies exerted the effective pressure that might have acted as a constraint upon the flawed strategy of the bank. By the time financial markets were sufficiently concerned to act as a discipline, financial stability was already threatened.[11]

1.15 The report also noted that for HBOS's operations in Australia, the impairments totalled £3.6 billion, equivalent to 28 per cent of the value of the loan book there at the end of 2008, an even higher loss as a proportion of loans than incurred by the Corporate Division in the UK. The report argued that such a loss is all the more striking in view of the comparative resilience of the Australian economy in the global downturn. The PCBS report on HBOS also stated that:

> In two markets alone—Australia and Ireland—it incurred impairments of £14.5 billion in the period from 2008 to 2011. These losses were the result of a wildly ambitious growth strategy, which led in turn to significantly worse asset quality than many of its competitors in the same markets. The losses incurred by HBOS in Ireland and Australia are striking, not only in absolute terms, but also in comparison with other banks. The HBOS portfolio in Ireland and in Australia suffered out of proportion to the performance of other banks. The repeated reference in evidence to us by former senior executives to the problems of the Irish economy suggests almost wilful blindness to the weaknesses of the portfolio flowing from their own strategy.[12]

Productivity Commission inquiry into business set-up, transfer and closure

1.16 The Productivity Commission inquiry into business set-up, transfer and closure published its final report in December 2015. The committee has noted that several of the findings of this report are relevant to this inquiry, and include the following:

- access to finance is not a significant barrier for most new businesses—most, with good reason, do not seek finance from external sources;
- most businesses are closed or transferred without financial failure;

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11 Parliamentary Commission on Banking Standards, *An accident waiting to happen: the failure of HBOS,* 5 April 2013, p. 53.

12 Parliamentary Commission on Banking Standards, *An accident waiting to happen: the failure of HBOS,* 5 April 2013, pp 14–15.

- specific reforms to Australia's corporate insolvency regime are warranted, but a wholesale change to the system, such as the adoption of the United States' 'chapter 11' framework, is not justified nor likely to be beneficial; and
- formal company restructuring through voluntary administration should only be available when a company is capable of being a viable business in the future.[13]

The Financial System Inquiry

1.17 In December 2014 the final report of the Financial System Inquiry (FSI) was released. This report aimed to provide a blueprint for the Australian financial system over the coming decade. Previous financial system inquiries, including the Campbell Report in 1981 and Wallis Report in 1997, provided the catalyst for major economic reforms. The Campbell Report led to the floating of the Australian dollar and the deregulation of the financial sector, while the Wallis Inquiry led to streamlined financial services regulation, the creation of the Australian Prudential Regulation Authority (APRA), and the current form of ASIC.[14]

1.18 The FSI made the following two recommendations which were specifically included in the terms of reference for this inquiry:

- Recommendation 34: Unfair contract term provisions
  - Support Government's process to extend unfair contract term protections to small businesses.
  - Encourage industry to develop standards on the use of non-monetary default covenants.
- Recommendation 36: Corporate administration and bankruptcy.
  - Consult on possible amendments to the external administration regime to provide additional flexibility for businesses in financial difficulty.[15]

1.19 Subsequent changes relating to the above recommendations are discussed further in chapters 4 and 6.

The ASIC Capability Review and other recent announcements

1.20 On 24 July 2015, the ASIC Capability Review commenced as part of the government's response to the FSI which recommended periodic reviews of the capabilities of financial and prudential regulators, commencing with a review of ASIC in 2015 to ensure it has the skills and culture to carry out its role effectively.[16]

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13 Productivity Commission, *Business Set-up, Transfer and Closure*, December 2014, p. 2.

14 *Financial System Inquiry*, http://fsi.gov.au/, (accessed 21 April 2016).

15 *Financial System Inquiry*, December 2014, p. xxvii.

16 *Fit for the Future, A capability review of the Australian Securities and Investments Commission*, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2016/ASIC-capability-review, (accessed 22 April 2016).

1.21 The Capability Review found that many of ASIC's regulatory capabilities are in line with global best practice. However, the review recommended additional measures to support ASIC in delivering its mandate and ensuring it is fit for the future. The Capability Review found there were aspects of strategy, governance, IT, data infrastructure, management information systems and ASIC's approach to stakeholder engagement that required improvement.[17]

1.22 On 20 April 2016 the Commonwealth government released the ASIC Capability Review and its response to the review. The government announced that five of the Capability Review recommendations would be implemented, and that it expected ASIC to provide an implementation plan for the other 29 recommendations.[18] The announcement identified a user pays industry funding model to deliver $127m in additional funding for:

- deepening the surveillance and enforcement capability of ASIC with a specific focus on investigating financial advice, responsible lending and life insurance;
- enhancing data analytics and surveillance capabilities as well as modernising data management systems; and
- strengthening ASIC's powers.[19]

1.23 The government also made the following policy announcements on 20 April 2016:

- appointment of an additional ASIC commissioner with experience in the prosecution of crimes in the financial services industry;
- bringing forward of law reforms recommended by the FSI, including product intervention powers, product distribution obligations, strengthening consumer protection for electronic payments and a review of ASIC penalties and the enforcement regime;
- a review of the Financial Ombudsman Service's (FOS's) small business jurisdiction, monetary limits and compensation caps;
- additional funding for the superannuation tribunal to deal with legacy complaints; and
- establishment of a panel to advise on consolidation of disputes and complaints functions in the financial system.[20]

17 Australian Government Factsheet, *Improving Consumer Outcomes in Financial Services*, 20 April 2016, p. 1.

18 Australian Government Factsheet, *Improving Consumer Outcomes in Financial Services*, 20 April 2016, p. 1.

19 Australian Government Factsheet, *Improving Consumer Outcomes in Financial Services*, 20 April 2016, p. 1.

1.24 On 21 April 2016, the Australian Bankers' Association announced a range of new measures which they claim will protect consumer interests, increase transparency and accountability and build trust and confidence in banks. The new measures include:

- an independent review of product sales commissions and product based payments, with a view to removing or changing them where they could result in poor customer outcomes;
- improving protections for whistleblowers to ensure there is more support for employees who speak out against poor conduct;
- improved complaints handling and better access to external dispute resolution, as well as providing compensation to customers when needed; and
- supporting the Federal Government's review of the FOS.[21]

1.25 This inquiry has been conducted at a time when there has been substantial activity in addition to the announcements above, including the Financial Systems Inquiry, reforms arising from a major parliamentary inquiry into the performance of ASIC, and law reforms relating to insolvency and unfair contract terms that may interact with the above announcements. In addition the Australian Small Business and Family Enterprise Ombudsman (ASBFE Ombudsman) was established in March 2016.

1.26 The announcements above identify the establishment of a panel to advise on consolidation of disputes and complaints functions in the financial system. The committee considers that to address the vulnerability of small business and commercial borrowers it is essential that a single body be empowered to lead and coordinate the implementation of the outcomes of this inquiry and the aspects of the above reforms and announcements that relate to small business in order to avoid the significant risk that major gaps and flaws in the protections for small business would remain. The committee considers that the most appropriate body to undertake this role is the ASBFE Ombudsman.

1.27 The committee further considers that additional funding should also be available for the ASBFE Ombudsman to deal with legacy complaints along similar lines to the recently announced funding for the superannuation tribunal to deal with legacy complaints.

1.28 The committee is therefore recommending in chapter 2 that the government bring forward legislation and other measures to give the ASBFE Ombudsman the relevant powers and resources to carry out the functions discussed above, along with other functions to address gaps identified by this inquiry.

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20 The Hon Scott Morrison MP, Treasurer, joint media release with the Hon Kelly O'Dwyer MP, Minister for Small Business, Assistant Treasurer, *Turnbull Government bolsters ASIC to protect Australian Consumers,* 20 April 2016.

21 Australian Bankers Association, Media Release, *Banks act to strengthen community trust,* 21 April 2016.

Chapter 2
Practices of banks

Introduction

2.1 This chapter discusses allegations and issues regarding lending practices of banks that were raised with the committee during the inquiry. The first section lists the issues identified by submitters and witnesses. Following that, examples of lending practices put forward by submitters and views from industry bodies and banks are summarised. Where available, observations from the Financial Ombudsman Service (FOS) and ASIC are also discussed.

2.2 In summary, the main allegations raised by submitters and witnesses to the inquiry related to the practices of banks and include:

- the use of non-monetary defaults[1] including loan to value ratios;
- charging excessive fees, default interest and penalty interest;
- insufficient notice periods for decisions not to roll over term loans leading to difficulty in refinancing loans;
- insufficient time to address financial difficulties or consider alternative solutions to foreclosure;
- irresponsible lending; and
- using the bank's power advantage to the detriment of borrowers.

2.3 This chapter focuses on evidence received and considered by the committee in relation to the practices of banks. Submitters also raised issues relating to dispute resolution (chapters 3 and 4), the role of valuers and valuations (chapter 5), and investigative accountants and receivers (chapter 6). Another smaller group of submitters made allegations of deliberate impairment and defaults to pursue financial advantage from contract clauses associated with bank acquisitions. Those allegations are discussed in chapter 7.

2.4 During the inquiry, the banks disputed many of the allegations discussed in the following sections. In summary, the banking industry indicated that a number of the cases considered by the committee during the inquiry were caused by customers being unable to meet the terms of their loan agreement, rather than as a result of the deliberate impairment of the loan by the bank. The Australian Bankers' Association (ABA) informed the committee that:

> The proportion of business customers with loans in difficulty is very low. For the year ending March 2015, less than one per cent of business and agribusiness customers had impaired loans, and a tenth of one per cent were in recovery action. Banks have well-established practices for helping

1 Non-monetary defaults include defaults other than borrowers meeting repayment requirements set out in loan contracts. Further details are provided later in this chapter.

> consumers and small businesses in financial hardship with their credit facilities. There is no financial incentive for a bank to deliberately undervalue an asset or lose a customer. Banks are bound by strict legal and prudential requirements, as well as being subject to legislative disclosure and conduct obligations towards their customers.[2]

2.5 In turn, this position of the ABA and banks was disputed by many witnesses and submitters.

2.6 Around 40 Bankwest customers provided submissions to this inquiry. The committee notes that at the time of acquisition by the Commonwealth Bank, there were approximately 26 000 commercial customers who had loans with Bankwest.[3] The Commonwealth Bank responded in general terms to relevant submissions and provided detailed responses to the allegations in eight cases selected by the committee. The Commonwealth Bank's responses to the allegations are discussed later in this chapter and in chapter 4.

2.7 ANZ informed the committee that it had reviewed the 11 submissions related to ANZ customers, of which five are related to Landmark. ANZ acknowledged there were some cases where it could have done a better job of working with customers; in particular to ensure that lawyers, receivers or others behaved in a way that is acceptable to the bank and to customers. In December 2014, ANZ announced a 12-month moratorium on farm repossessions in drought-declared regions of Queensland and north-west New South Wales. The moratorium, an interest rate freeze and other measures, have now been extended to December 2016, and apply nationally.[4]

2.8 NAB informed the committee that it has an early engagement approach whereby each customer is assessed and managed in response to their specific circumstances. NAB advised the committee that:

- NAB's aim is to raise concerns with customers at the earliest opportunity with a view to resolving these issues as part of a mutually agreeable strategy;
- NAB's objective is always to retain its customers if at all possible; and
- more than 85 per cent of customers who are referred to a workout[5] area avoid some form of external administration or mortgagee sale.[6]

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2 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Committee Hansard*, 18 November 2015, p. 29.

3 Mr David Craig, Group Executive for Financial Services, and Chief Financial Officer, Commonwealth Bank of Australia, *Committee Hansard*, 2 December 2015, p. 2.

4 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 64.

5 Workout activities are discussed later in paragraph 2.26.

6 Mr Timothy Williams, General Manager, Group Strategic Business Services, National Australia Bank, *Committee Hansard*, 18 November 2015, p. 8.

2.9 The committee heard from witnesses and submitters that while this process, described above by NAB, but also similarly described by other banks, may sound appropriate, in practice it may not work as intended:

> It was annoying but if the banks tell you to do something, you do it so I just went ahead and provided those as required. It was in our loan documentation that I had to provide it so I kept doing it. We did get a phone call one day saying that they felt they needed a specialist—a.k.a. an investigative accountant—to come and have a look at our books. I said, 'Why, when you get all that information you need straight from my MYOB files and also from our accountant?' They said it was a specialist in the area and that they wanted to do that. They said, 'By the way, it will cost you.' I asked how much would it cost and they said about $25,000. I said 'No, you are not doing it.' And then I got threatened that I had no choice and I had to let them in and let them do that.[7]

2.10 The committee also heard from several other submitters who had disputes with NAB.[8]

2.11 Submitters raised concerns in relation to a range of lenders including ANZ, NAB, Westpac, Macquarie Bank, Rabobank, Landmark, Elders, Suncorp, Bank of Queensland, AMP, Rural Bank, Adelaide Bank, AMP Bank, Members Equity Bank, St George Bank, and the Uniting Church.

2.12 As the versions of events and matters in dispute between some borrowers and banks differed significantly in the evidence provided to the committee, in many cases the committee was unable to form a view as to which version was accurate. The committee considered it important to try to establish if there were some disputes in which the allegations were accurate and therefore selected four cases and referred those to ASIC for consideration. ASIC's response to the committee is discussed later in this chapter. The committee notes that consideration of these cases is not intended to influence any court or dispute resolution process that may formally consider these cases.

Non-monetary defaults

2.13 This section summarises some information brought to the committee's attention on non-monetary defaults. Many submitters allege that their loans were placed into default and foreclosed on the basis of non-monetary defaults.[9]

2.14 The ABA provided information on monetary and non-monetary defaults:

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7 Mrs Danielle Schaumburg, *Committee Hansard,* 19 November 2015, p. 26.

8 Mr Dario Pappalardo, *Submission 13,* p. 1; Mr & Mrs Mytton-Watson, *Submission 29,* p. 1; Ms Deborah Perrin, *Submission 30*, p. 2; Mr & Mrs Kruetzer, *Submission 39,* p. 1; Bank Reform Now, *Submission 116,* p. 1.

9 Mr & Mrs Lock, *Submission 14,* p. 2; Department Agriculture, *Submission 44,* p. 1; Tasmanian Small Business Council, *Submission 61,* p. 21; Ms Robyn Toohey, *Submission 62,* p. 2; Mr Peter Ward, *Submission 98,* p. 2; Mr Trevor Eriksson, *Submission 101,* pp 2–4; Mr Trevor Hall, *Submission 109,* p. 43; Mr Jim Martinek, *Submission 153,* p. 2.

- monetary defaults may include non-payment of interest or principal and interest, debt amortisation schedules, expiry of facilities, non-clearance of excesses or frequent requests for temporary assistance.
- non-monetary defaults may include:
    - changes in the legal structure of the entity;
    - breakdown or dispute within the borrowing group;
    - legal action by an external party or arrears action by the Australian Taxation Office;
    - substantial decline in business performance;
    - changes in the value of the security and the Loan to Value ratio (LVR);
    - client fraud breaches of legal obligations; and
    - customer initiated insolvency appointments.[10]

2.15 An accountant informed the committee about the experience of some of his clients for whom banks reviewed their portfolios and for those clients who were on tighter LVRs, valuers were engaged:

> As an example of this occurring, our practice acts for clients who had not defaulted on any payments…their properties were valued at approximately $5m. Their lender insisted that a revaluation be undertaken of these properties. The same valuer was engaged who had valued the properties less than 12 months previously and returned with a reduction of over $1.2m in value. The bank then advised that the client was outside the terms of their agreement and they should seek an alternate financier.[11]

2.16 Legal Aid Queensland informed the committee of a case that they became aware of:

> the agribusiness banker engaged a particular valuation firm to conduct valuations in both 2011 and 2012 when it approved increases in loan facilities. These valuations resulted in a value of around $7.5 million which included improvements valued at $1.9 million dollars. After the farmer experienced cash flow difficulties, the asset management team within the bank engaged a different firm of valuers in 2013. This valuer valued the assets at $3.4 million including improvements at $340,000.00. Although there were other matters also affecting decision making between the farmer and bank, the reduced valuation provided the bank with justification to encourage the farmer to sell the property at the greatly reduced price to "meet the market".[12]

2.17 The Department of Agriculture informed the committee that while adverse climate or market conditions can impact the ability of farmers to service their debts,

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10 Australian Bankers' Association, *Submission 47,* pp 7–8.

11 Mr Bill Ringrose, *Submission 31,* p. 2.

12 Legal Aid Queensland, *Submission 55,* p. 5.

there have also been allegations that banks are using non-monetary conditions in loan contracts to foreclose on farms, despite those farmers not having missed any principal and/or interest payments.[13]

2.18 The Department of Agriculture also noted that it had been informed of allegations relating to declining land values and impacts on loan to value ratios, allegedly unsound property evaluation processes, use of higher interest rates on riskier loans, and potentially unreasonable use of other loan covenants and provisions to foreclose on farm properties.[14]

2.19 The committee notes however, that while nominal broadacre land values in northern Australia have declined by 20 per cent on average since 2008 and by greater amounts in some parts of Queensland, this followed an increase in nominal broadacre land values of over 400 per cent over the previous decade.[15] The committee considers that these dramatic changes to land values shows that borrowers and banks should take care to set realistic LVRs when real estate prices are rising rapidly.

2.20 FOS informed the committee that it considers it unusual for a financial services provider to rely on a non-monetary default alone when calling in a loan. FOS noted that non-monetary defaults occur from time to time, but it is more likely that a bank will rely on a payment default to call in a loan. FOS also noted that there is usually only a short period of time given to comply with the notice, however, in most cases this follows a longer period of negotiation.[16]

2.21 Some witnesses, however, argued that monetary default was triggered by actions or inaction by the banks such as excessive fees associated with investigative accountants, delays in notification of a decision to not roll over a facility or directions to take certain actions such as reducing the LVR through disposal of income producing assets or incurring fees through forced rate-swaps or hedging.[17]

ABA information on banks practice regarding non-monetary defaults

2.22 The ABA argued that data collected from a selection of ABA members shows that the proportion of customers with loans which are in difficulty is very low:

> For the year ending March 2015 less than 1 per cent of business and agribusiness customers had impaired loans and a tenth of 1 per cent were in recovery action. In only a handful of cases were substantial changes to LVRs the major factor that created impairment of the loan. The overwhelming majority of defaults were a result of monetary breaches of

13 Department Agriculture, *Submission 44,* p. 2.

14 Department Agriculture, *Submission 44,* p. 3.

15 Department Agriculture, *Submission 44,* p. 5.

16 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard,* 16 October 2015, p. 8.

17 Mr Rory, O'Brien, *Committee Hansard,* 13 November 2015, p. 4; Mr Roy Lavis, *Committee Hansard,* 19 November 2015, pp 2–6; Mr Trevor Eriksson, *Committee Hansard,* pp 54–55.

the loan covenant or a combination of both monetary and non-monetary breaches.[18]

2.23 The ABA submitted that banks are required to make prudentially responsible lending decisions and that the occurrence of problems is low given the substantial number of business loans in Australia. The ABA argued that:

- it is not industry practice for banks to use non-monetary processes or triggers such as LVRs to impair customer loans or to construct a default;
- it is not financially beneficial for banks to adopt the practices described in paragraphs (a) and (c) of the terms of reference;
- banks make substantial efforts to work with business and agribusiness customers when they experience financial difficulties; and
- the ABA's Code of Banking Practice (the Code) sets standards for fairness, transparency, behaviour and accountability beyond legislative requirements that individuals and small businesses can expect from their banks.[19]

2.24 The ABA also informed the committee about monetary and non-monetary factors that are considered when loans are reviewed, noting that business loans are assessed and graded according to credit risk in line with the Australian Prudential Regulation Authority's (APRA) prudential requirements. The ABA argued that it is standard practice for banks to review loans either periodically, if there has been a change in customer circumstances, or if there are significant changes in account behaviour. The ABA submitted that if the risk profile has deteriorated below an acceptable credit standard, the loan may be placed on a 'watch list'[20].

2.25 The ABA explained the actions of banks when a customer is placed on a 'watch list':

- the bank works with the customer to try and overcome the financial difficulties with their credit facility, including developing a repayment plan to rectify the default;
- the aim is to support the customer in difficult times and help them to restructure the business;
- management of the account generally stays with the customer relationship manager, however, the account is reviewed more frequently;
- a business remediation plan is developed and agreed with the customer, the objective is to return the loan to a satisfactory credit position;
- there is close communication and sourcing of additional information from the customer; and

18 Australian Bankers' Association, *Submission 47,* p. 5.

19 Australian Bankers' Association, *Submission 47,* p. 1.

20 Australian Bankers' Association, *Submission 47,* pp 7–8.

- if the customer's remediation plan does not achieve the expected outcome and there is a further deterioration of business fundamentals or the customer decides not to communicate with the bank, most banks will transfer the account to a 'workout' area.[21]

2.26 According to the ABA, a workout area is a specialised unit within the bank made up of staff with skills in accounting, business restructuring, commercial management, insolvency and legal expertise. The ABA summarised the role of the workout area as follows:

- the workout area will assess the customer's financial and business situation with a view to restoring the credit facility to a satisfactory position or minimising the potential loss;
- options identified by the bank are discussed with the customer and the strategy adopted is dependent on the individual circumstances;
- it may be appropriate to allow the customer more time to address certain key actions within a mutually agreed strategy;
- if the account is successfully remediated it is transferred back to the customer relationship manager; and
- if there is no improvement over time, further options will be explored with the customer, including further asset sales, winding up a company or recovery action on a property, with the enforcement of security being very much a last resort.[22]

2.27 The Customer Owned Banking Association (COBA) argued that its members had a good record in relation to non-monetary defaults and that the need to adjust its code of practice is not urgent.[23]

Information from banks on non-monetary defaults

2.28 This section summarises the responses by banks to allegations relating to non-monetary defaults.

2.29 The Commonwealth Bank indicated that, in its view, it is exceedingly rare for a bank to instigate recovery proceedings on the basis of LVRs or 'non-monetary' covenants alone, and in the absence of missed payments, more commonly, both types of contractual breach occur before a bank takes legal steps to recover money it is owed.[24] The Commonwealth Bank provided detailed information on 36 cases submitted to the inquiry indicating which cases were in monetary default:

> Of the 36 customers reviewed, 33 were in monetary default. Of the remaining three customers in one case, no enforcement action was taken, in

21 Australian Bankers' Association, *Submission 47,* p. 8.

22 Australian Bankers' Association, *Submission 47,* p. 9.

23 COBA, *Submission 51,* p. 2.

24 Commonwealth Bank of Australia, *Submission 48,* p. 2.

the second case, the customer appointed a voluntary administrator and as a result of this significant default a receiver was appointed and in the third case, Bankwest appointed a receiver after the customer invited Bankwest to do so.

We provide the table below to assist the Committee to understand the variety of defaults that were evident in these cases. Categories are not mutually exclusive (i.e. if a customer was in interest arrears they might also have breached other financial covenants and their loan to value ratio obligations).

Reason for Default	Customers
Interest arrears	27
Failure to repay expired facilities	22
Loan to value ratio breach	14
Financial covenant breach	12
Failure to supply financial information	5
Other (e.g. administrator appointed)	21

The average number of defaults for these customers was greater than three.[25]

2.30 The Commonwealth Bank also provided further information for 59 borrowers associated with the price adjustment mechanism for the Bankwest acquisition[26] which indicated that 53 borrowers were in monetary default. Of the remaining six borrowers, no receiver was appointed in three cases, a voluntary administrator was appointed in two cases and another creditor commenced liquidation proceedings in court against the borrower in the other case.[27]

2.31 The committee questioned the bank in relation to the causes of monetary defaults in the cases discussed above. In response, the Commonwealth Bank indicated that:

- for the 36 cases submitted to the inquiry, only two had interest rate increases prior to a monetary default;
- of the 59 cases examined in relation to the Bankwest acquisition only 5 had interest rate increases prior to a monetary default;
- in seven cases where default interest was charged, the full rate was only charged in one case, which involved a voluntary administrator and in the other 6 cases the reasons for interest rate increases included:

25 Commonwealth Bank of Australia, *Answers to questions on notice*, taken on 12 November 2015, received 16 December 2016.

26 The Bankwest acquisition and price adjustment mechanism are discussed in Chapter 7.

27 Commonwealth Bank of Australia, *Answers to questions on notice*, taken on 12 November 2015, received 16 December 2016.

- the business performing below expectations;
- material breaches, such as non-remittance of bond proceeds; and
- increases in funding and/or restructure/extension of facilities.[28]

2.32 ANZ stated that it does not engage in the practice of constructing a default as suggested in the terms reference. ANZ indicated that it only takes possession of property held as security for a loan where there has been a monetary default and after working with the customer. It is only in extraordinary circumstances where action is taken outside of monetary default such as where directors appoint a voluntary administrator.[29] ANZ submitted that, in its view, non-monetary covenants in lending contracts serve as an 'early warning sign' that a customer may be experiencing difficulty meeting their obligations, or that they may do so in the near future.[30]

2.33 ANZ argued that its examination of all borrowers in ANZ-enforced insolvency administration as at 31 March 2015 provides evidence that ANZ does not use non-monetary conditions of default to move to impairment or enforcement action:

> Of the 116 commercial customers identified, 113 were in monetary default at the time of ANZ enforcement and the monetary default was relied upon to take possession of property held as security by ANZ. Of the remaining three customers, there were specific and compelling reasons for ANZ to take action following the occurrence of other significant defaults (for example, the appointment of a receiver by another financier).[31]
>
> The data did not identify any instances of ANZ relying on the breach of a LVR covenant as the primary default. Of the 116 customers, only two had been in default of their LVR covenant and in both of cases, the default relied upon for the enforcement was a monetary default and not the LVR breach.[32]

2.34 ANZ also informed the committee that it supported the development of an enforceable industry standard on the use of non-monetary default covenants, to ensure that contracts with small business are fair and appropriately balance the contractual rights and obligations of the parties.[33] ANZ suggested that customers would benefit from clearer information upfront regarding what events constitute a default and that an industry standard might be appropriate.[34]

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28 Commonwealth Bank of Australia, *Answers to questions on notice,* taken on 9 March 2016, received 31 March 2016.

29 Mr Graham Hodges, Deputy Group Executive Officer, ANZ, *Committee Hansard,* 13 November 2016, p. 64.

30 ANZ, *Submission 49,* p. 2.

31 ANZ, *Submission 49,* p. 2.

32 ANZ, *Submission 49,* p. 2.

33 ANZ, Submission 49, p. 14.

34 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, 13 November 2016, p. 64.

2.35 NAB submitted that it would not object to changes to the Code of Banking Practice to provide greater transparency around the use of non-monetary defaults. NAB indicated that it only uses non-monetary events of default in limited circumstances to commence enforcement action where the customer, its directors or a third party has placed the customer in external administration. NAB also argued that if enforcement of non-monetary defaults was somehow restricted, it may impact the provision of funding and have unintended commercial consequences. NAB also submitted that banks are required by APRA Prudential Standard APS 220 Credit Quality policy and accounting standards to recognise impairment as and when it occurs.[35]

2.36 NAB submitted that non-monetary defaults provide an early warning of deteriorating risk profiles, and that this provides opportunities for financiers to have discussions with their customers and work with customers so as to avoid monetary defaults arising. NAB also argued that non-monetary defaults are essential to identifying risk relating to a certain range of loans which require customers to make only limited scheduled repayments (sometimes with lengthy time periods between repayments). These loans include commercial property construction loans, certain forms of asset based finance, margin lending and products which support export focussed industries and some agriculture.[36]

2.37 Westpac informed the committee that in the majority of cases a non-monetary default, including LVR, is not the sole reason for enforcement action, even where that option is available under the terms of the contract. Westpac indicated that it does not have any current matters under recovery subject solely to an LVR default in either the farm or non-farm sectors. Westpac also noted:

> …enforcement of security due to a non-monetary default may occur in certain circumstances, such as the appointment of an administrator by a third party or where there is evidence of fraud. Absent these circumstances the Westpac Group's preference is to work with the customer to reach a mutually agreed work out position taking into consideration the customer's business plan, forecasts and cash flow.[37]

Committee view

2.38 The committee acknowledges suggestions from banks in the course of the inquiry regarding the development of an enforceable industry standard on the use of non-monetary default covenants to ensure that contracts with small business are fair and appropriately balance the contractual rights and obligations of the parties. The committee considers that the best way to achieve this is for the industry to work with an independent body as soon as possible to develop nationally consistent standard loan contracts. At the end of this chapter the committee makes recommendations to address this.

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35 NAB, *Submission 50*, pp 4–7.

36 NAB, *Submission 50*, pp 4, 6.

37 Westpac, *Submission 126*, p. 11.

Penalty interest, default interest and fees

2.39 This section summarises evidence presented to the committee in relation to penalty interest, default interest and fees. A large number of submitters alleged that they were subject to excessive penalty interest, default interest or fees.[38]

2.40 Some submitters indicated that in their view, the banks do work with business clients, however, they charge exorbitant penalty interest rates of up to 15 per cent. It was also alleged that when the banks are working with a client, they are still charging unjustified penalty interest rates.[39]

2.41 Another submitter described the interest rate changes that they experienced:

> The rate of interest went from 7.9% to 8.9% within a few months. Their explanation for this interest rate hike was that we were now a high risk client and they were applying a risk penalty, effectively meaning our interest rate had risen 3% in around 12 months to 10.95%. This was during a period when the Reserve Bank was continually lowering the cash rate. Overdraft interest rates increased from 11.55% in early 2010 to as high as 17.62% later that year, with a 21.62% rate on overdraft "excess" created by disadvantageous distribution of funds by the lender. They would also require a full document application every 6 months if the loan was to be renewed.[40]

2.42 The committee also heard that, in relation to a Bankwest customer, a penalty rate prevented them from being able to refinance their loan facility, and that Bankwest managers acknowledged that the interest rate of 17.51 per cent was not helping their situation.[41]

2.43 Another submitter claimed that his interest rate was increased from 6.98 per cent to 18.26 per cent as a penalty for default. The penalty interest was increased to 18.56 per cent in September 2010, increased again to 18.81 per cent in November 2010 and continued until December 2011 when the appointed receivers sold the properties.[42]

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38 Name withheld, *Submission 5,* p. 7; Name withheld, *Submission 10,* p. 4; Mr Anthony Rigg, *Submission 15,* pp 6–7; Mr & Mrs Courte, *Submission 17,* p. 2; Name withheld, *Submission 26,* p. 3; Mr Michael Sanderson, *Submission 28,* p. 4; Mr & Mrs Kreutzer, *Submission 39,* p. 9; Department of Agriculture, *Submission 44,* p. 2; Dr Evan Jones, *Submission 83,* p. 2; Mr & Mrs Bennette, *Submission 85,* p. 5; Danielle & Peter Schaumburg, *Submission 95,* p. 5; Mr Peter Ward, *Submission 98,* p. 6; Mr Trevor Eriksson, *Submission 101,* p. 2; Ms Faye Andrews, *Submission 102,* pp 2–6; Mr Peter McNamee, *Submission 107,* p. 13; Mr Sean Butler, *Submission 113,* p. 8; Ms Rita Troiani and Ms Janine Barrett, *Submission 114,* p. 6; Bank Reform Now, *Submission 116,* pp 6, 9, 13; Name withheld, *Submission 152,* p. 1; Mr Jim Martinek, Submission 153, *p. 12.*

39 Mr Peter McNamee, *Submission 107,* p. 13.

40 Mr & Mrs Courte, *Submission 17,* p. 2.

41 Name withheld, *Submission 184,* p. 4.

42 Mr Trevor Eriksson, *Submission 101,* p. 14.

Views of industry bodies and banks

2.44 This section summarises responses from industry bodies and banks to allegations regarding penalty interest, default interest and fees.

2.45 The ABA submitted that excessive interest is cited as a cause of loan failure in less than 5 per cent of business insolvencies.[43]

2.46 The Commonwealth Bank advised the committee that APRA requires banks to hold much more capital against loans in default, therefore requiring the bank to dedicate resources to working with a customer in default. The Commonwealth Bank informed the committee that:

> There are many cases where we do not apply the default rates, as we recognise that higher interest rates can impinge on the cash flow of our customers. However, there have clearly been some very high rates charged, so we would be happy to see a standard industry practice for default interest rates.[44]

2.47 Westpac submitted that while it is entitled to charge default interest following a non-monetary default, it is usual for a review to be undertaken and where possible, other arrangements agreed with the customer before an adjustment to the interest rate is made. Westpac argued that default interest generally only applies where the borrower is late with repayments or has failed to meet their account limit obligations. Westpac indicated that it would be unusual for it to charge default interest in situations where it is working cooperatively with the customer.[45]

2.48 NAB informed the committee that it often waives default interest rates in order to maximise the chances of the customer being able to trade through their difficulties.[46]

2.49 As noted at the beginning of this chapter ANZ has announced some measures to assist borrowers.

Committee view

2.50 The committee notes that some banks appear willing to support standardising practices in relation to default interest. The committee acknowledges that when loans are impaired or in default, there are additional costs to banks associated with increased engagement with the customer and meeting prudential requirements. However, the committee is concerned that evidence indicates that banks may make significant profit by charging fees, default interest and penalty interest greatly in excess of the costs to the bank. The committee considers such profit taking or price gouging, to the

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43 Australian Bankers' Association, *Submission 47*, p. 3.

44 Mr David Craig, Group Executive for Financial Services, and Chief Financial Officer, Commonwealth Bank of Australia, *Committee Hansard*, 2 December 2015, pp 2–3.

45 Westpac, *Submission 126*, p. 13.

46 Mr Timothy Williams, General Manager, Group Strategic Business Services, NAB, *Committee Hansard*, 18 November 2015, p. 10.

extent alleged or indicated by evidence, to be unethical and is making the following recommendation to restrict such practices.

Recommendation 1

2.51 The committee recommends that appropriate regulation and legislation be put in place to prevent banks profiting from defaulted or impaired loans by requiring banks to:

- **a. levy additional costs that the bank incurs when a loan is in default or is impaired in accordance with a schedule or process approved by the Australian Small Business and Family Enterprise Ombudsman.**
- **b. provide transparent and accountable information to borrowers on the additional costs that the bank incurs when a loan is in default or is impaired; and**
- **c. where a bank charges additional fees or interest of any kind associated with a defaulted or impaired loan;**
    - **a. the increased costs incurred by the bank must be disclosed in the loan contract, where possible, as a flat dollar figure; and**
    - **b. any amount charged that exceeds the increased costs incurred by the bank is to be paid off the loan principal.**

Timeframes for customers including notice to roll over loans

2.52 This section summarises some cases brought to the committee's attention in which submitters identify concerns about the amount of time they were provided to attempt to resolve financial difficulties or seek refinance if the bank decided not to roll over a term loan. A significant number of submitters alleged that banks did not meet their expectations and provided:

- insufficient notice periods for decisions not to roll over term loans leading to difficulty in refinancing loans;[47] and
- insufficient time to address financial difficulties or consider alternative solutions to foreclosure; [48]

47 Mr Anthony Rigg, *Submission 15,* p. 4; Mr Michael Sanderson, *Submission 28,* p. 2; Mr & Mrs Kreutzer, *Submission 39,* pp 1, 5; Legal Aid Queensland, *Submission 55,* p. 6; Mr & Mrs Bennette, *Submission 85,* p. 10; Mr Peter Hall, *Submission 109,* pp 7, 41.

48 Name withheld, *Submission 5,* p. 5; Mr & Mrs Randles, *Submission 8,* p. 5. Mr Anthony Rigg, *Submission 15,* p. 5; Name withheld, *Submission 21,* p. 5; Ms Deborah Perrin, *Submission 30,* p. 2; Name withheld, *Submission 32,* p. 8; Mr Greg Bloomfield, *Submission 34,* p. 4; Mr & Mrs Kreutzer, *Submission 39,* pp 1, 9; Ms Robyn Toohey, *Submission 62,* p. 3; Mr Robert Barr, *Submission 78,* p. 10; Mr Robert Johnson, *Submission 84,* p. 7; Mr Roy Lavis, *Submission 82,* p. 2; Ms Charalambia Evripidou, *Submission 93,* p. 1; Danielle & Peter Schaumburg, *Submission 95,* p. 7; Mr Peter Ward, *Submission 98,* pp 6, 8; Mr Trevor Eriksson, *Submission 101,* p. 13; Mr Vittorio Cavasinni, *Submission 103,* p. 2; Mr Bruce White, *Submission 104,* p. 2; Bank Reform, *Submission 116,* pp 10–14.

2.53 Legal Aid Queensland informed the committee that, in its experience, banks generally provide realistic timelines to satisfy defaults such as extending time to enable crops to be harvested or livestock sold, however, timelines considered for the sale of land or other assets such as machinery are more challenging. Legal Aid Queensland noted that despite farmers in financial difficulty being given time to sell properties, many farmers have been unable to sell their farms.[49] Legal Aid Queensland also drew the committee's attention to the impact that term loans can have on long term businesses, such as farms:

> Banks sometimes offer…short term loans which expire in one to five years. These types of facilities are inappropriate in most circumstances where the loan is to finance the full purchase price of a farm. At the expiry of these short term facilities, the banks have no legal obligation to extend them. Unfortunately some farmers have been disadvantaged by loans of this nature when the bank decides not to extend the facility.
>
> In one matter, a loan in excess of $10 million was approved to finance the full purchase price of a grazing property where the facility expired in 5 years. The bank did not renew the loan on expiry despite the bank manager having assured the borrowers that it would simply be rolled over. The farmers would not have accepted the loan had they not been assured that the facility would be rolled over.[50]

2.54 A submitter alleged that many former Bankwest customers state that their relationship managers had assured them that the bank was favourably considering rolling over their facilities, and then provided them with as little as 48 hours to fully repay their facilities.[51]

2.55 Another submitter indicated that during discussions with its bank, his company was told to bring its borrowings down from approximately $160m to $120m by the end of May 2008, then down to $80m by the end of October 2008.[52]

2.56 A witness argued that a six month notice period should be required, suggesting that six months prior to the expiration of a loan the bank should be required to tell a borrower whether they will roll over the term loan to provide the borrower with an opportunity to seek alternative finance.[53]

2.57 Another witness argued for a period of 6 to 12 months:

> There should be a minimum period, if the bank does not want you, of 12 months. You need that to refinance and regroup. You cannot do it on three days notice.

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49 Legal Aid Queensland, *Submission 55,* pp 4, 9.

50 Legal Aid Queensland, *Submission 55,* p. 6.

51 Mr Trevor Hall, *Submission 109,* p. 7.

52 Mr Roy Lavis, *Submission 82,* p. 2.

53 Mr Peter McNamee, *Committee Hansard,* 13 November 2016, p. 47.

> I think, by the time they instruct a valuer and he gets around, and then you get your accounts up to date and you go in—you might be able to do it in three months, but you are leading yourself short on any contingency that might happen. I think six months is fair.[54]

Views of industry bodies and banks

2.58 This section summarises the responses from industry bodies and banks to allegations regarding timeframes and notice periods for borrowers.

2.59 The ABA informed the committee that the timeframe over which banks work with borrowers in financial difficulty varies depending on the circumstances of the loan. The ABA indicated that, in its view, the average length of time that a borrower's loan remains in financial difficulty is over 12–18 months for non-farm gate loans and around 12–24 months for farm gate loans. Larger commercial loans typically have more complex business operations and may take several years.[55]

2.60 ANZ informed the committee that the difference between the time of default and when there is a demand of payment can be quite a long time, but the time between a demand for payment and recovery action can be relatively short. ANZ argued that once a demand for payment is made, there is a high risk that the business is trading while insolvent, necessitating quick action.[56]

2.61 ANZ also informed the committee that on average, the time between first issuing a default notice and recovery action is about one and a half years for non-agribusiness commercial borrowers and over two and a half years for an agribusiness borrower.[57]

2.62 The Commonwealth Bank informed the committee that receivers were appointed in 28 of the 36 cases it examined in response to questions on notice from the committee. For those 28 cases the average number of days between the first default and the appointment of receivers was 539 days. The Commonwealth Bank noted that for the 36 receivership appointments examined in relation to the Bankwest acquisition, the average number of days between the first default and the appointment of receivers was 395 days.[58]

2.63 The Commonwealth Bank informed the committee that it considers options such as repayment holidays or interest free periods to relieve distress to customers, and in the case of natural disasters has a range of special assistance initiatives. The Commonwealth Bank also advised that:

> In the year to 31 March 2015 more than 40 per cent of commercial customers rated as troublesome or impaired returned to a satisfactory

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54 Mr Trevor Eriksson, *Committee Hansard,* 13 November 2016, p. 62.

55 Australian Bankers' Association, *Submission 47,* p. 9.

56 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, 13 November 2016, p. 73.

57 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, 13 November 2016, p. 64.

58 Commonwealth Bank of Australia, *Answers to questions on notice*, taken 12 November 2015, receiver 16 December 2015.

> position. These data demonstrate our willingness to give customers time to address arrears and return to sustainable payment arrangements.[59]

2.64 The Commonwealth Bank suggested that in future, they would consider allowing a minimum of one month between when a customer defaults on loan and when a bank requires full repayment of the loan as result of default.[60]

2.65 NAB informed the committee that it considers exercising its rights in response to any event of default on a case by case basis, considering the customer's financial position and particular circumstances. The time period provided by NAB to rectify an event of default depends on these factors as well as an assessment of:

- whether the default is capable of being rectified;
- the likelihood of rectification;
- other actions agreed with the customer as part of an overall plan to address the event of default; and
- whether the assets of the business and the security are deteriorating or have a limited life or there are other factors such as animal welfare.[61]

2.66 NAB argued that it does not consider that there is any need to impose further compulsory notice periods in addition to the currently applicable statutory notice periods.[62]

2.67 Westpac advised that it employs a variety of mechanisms to assist customers resolve financial difficulties. Westpac informed the committee that terms renegotiated with the customer in the loan facility agreement include the loan term, loan pricing, repayment arrangements, financial covenants, forecasts for cash flow and any undertaking to sell assets, and the ability to raise additional equity or security or provide security. Westpac also noted that in practice, there is no set time period for refinancing or the sale of assets and that the time period for refinance or the sale of assets would usually be 90 to 120 days.[63]

2.68 Evidence received from customers of these banks disputed many of the claims made by the banks. This only further highlights the need for:

- a mandatory code of practice which includes ethics, conduct and related protocols; and
- an independent body to mediate contested disputes.

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59 Commonwealth Bank of Australia, *Submission 48,* p. 8.

60 Mr David Craig, Group Executive for Financial Services, and Chief Financial Officer, Commonwealth Bank of Australia, *Committee Hansard*, 2 December 2015, p. 2.

61 NAB, *Submission 50*, p. 10.

62 NAB, *Submission 50*, p. 10.

63 Westpac, *Submission 126*, pp 12–14.

ASIC & FOS

2.69 ASIC informed the committee that one of the difficulties faced by a lender is determining how much time must be allowed after delivering a demand on the borrower before appointing a receiver. Often the speed of appointment is crucial to allow the lender to safeguard the assets in question. ASIC advised that although the appointment of a receiver may occur quickly after a formal demand is made, it is likely this action would follow a relatively lengthy period during which there have been ongoing discussions between the borrower and the bank about the status of the loan facility. ASIC also noted that borrowers must be given reasonable time for payment after the notice of demand. What constitutes reasonable notice will depend on a range of factors including:

- the nature of the security and the amount owed;
- the risk to the secured party (i.e. whether the secured assets are in jeopardy);
- the period of the relationship between the secured party and the debtor;
- the circumstances leading up to the demand; and
- the debtor's ability to satisfy the demand.[64]

2.70 The FOS informed the committee that banks generally work with the borrower for some time before default notices are served, trying to work with the borrower to solve the problem, whether it is through the sale of assets, refinancing, restructuring or other options to overcome financial difficulties.[65]

Committee view

2.71 The committee accepts that the majority of business loans proceed without dispute between the parties. It further accepts that statistically, the average time between initial dialogue commencing and default is generally in excess of three months. The committee remains concerned however by evidence it has received regarding the lack of notice being given to a number of borrowers about the impending expiry of loan terms and decisions by banks not to roll over term loans. The fact that this practice is possible, albeit limited, indicates a systemic and unreasonable imbalance of power in the business lending relationship. Banks should be well aware of the timeframe required to refinance loans in general, but especially small business and commercial loans. The committee is therefore making the following recommendation to provide appropriate protections to borrowers.

64 ASIC, *Submission 45*, p. 28.

65 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 9.

Recommendation 2

2.72 The committee recommends that the banking codes of practice administered by the Australian Bankers' Association or the Customer Owned Banking Association and other regulatory arrangements be revised to require that:

a. authorised deposit taking institutions must commence dialogue with a borrower at least six months prior to the expiry of a term loan. Further, where a monetary default has not occurred, they must provide a minimum of three months notice if a decision is made to not roll over the loan, even if this means extending the expiration date to allow for the three months following the date of decision;

b. if a customer is meeting all terms and conditions of the loan and an authorised deposit taking institution seeks to vary the terms of the loan, the authorised deposit taking institution should bear the cost associated with the change and provide six months notice before the variation comes into effect;

c. customer protections relating to revaluation, non-monetary defaults and impairment should be explicitly included in the code; and

d. subscription to a relevant code becomes mandatory for all authorised deposit taking institutions.

Irresponsible lending

2.73 This section discusses some further information brought to the committee's attention on irresponsible lending. Responsible lending obligations require credit licensees to make inquiries into a consumer's objectives and financial situation and verify their financial situation. Credit licensees must assess this information and not provide or suggest credit to a consumer if that credit will not meet the consumer's objectives or the consumer will not be able to meet their financial obligations without substantial hardship.[66]

2.74 The committee received evidence from some submitters that banks had acted in a way that was inconsistent with their responsible lending obligations.[67]

2.75 The Consumer Credit Legal Service WA Inc (CCLSWA) advised the committee that some consumers will readily accept loans with unnecessarily high LVRs, while being unaware of the inordinate level of risk associated with loans of that nature. CCLSWA submitted that:

> Our experience is that [financial service providers] do not actively inform consumers of the risks associated with loans with LVRs above 80%. A high LVR effectively means that the consumer is purchasing a home or

66 ASIC, *Submission 45*, pp 6–7.

67 Name withheld, *Submission 18*, pp 5–6; Consumer Credit Legal Service (WA) Inc, *Submission 56*, pp 5–6; Ms Suzi Burge, *Submission 63*, p. 7; Ms Jean Andersen, *Submission 99*, p. 1.

> investment property without paying a deposit, and retaining little to no equity. A lack of equity presents both short-term and long-term problems. In the short term, a lack of equity will often result in higher initial interest rates on the home loan, making it far more difficult for the consumer to make repayments. The long-term risks are far more pronounced. If a consumer is not in a very strong position to service a high-risk loan, they are far more susceptible to fall into a pattern of default if they encounter temporary financial difficulty.[68]

Views of industry bodies and banks

2.76 This section summarises the responses from industry bodies and banks to allegations regarding irresponsible lending. Information provided by ASIC and FOS is discussed in chapter 4.

2.77 The ABA argued that banks are required to make prudentially responsible lending decisions and that the occurrence of problems is low given the substantial number of business loans in Australia.[69]

2.78 The Code Compliance Monitoring Committee (CMCC) indicated that it intended to conduct an own motion inquiry into banks' compliance with the provision of credit obligations. The CCMC noted that clause 27 of the code requires banks to be prudent and diligent in assessing a customer's ability to replay a credit facility. The CCMC also asserted that many of the submissions to the inquiry relate to loans that should not have been provided:

> We have reviewed the submissions made to this inquiry by individuals and small businesses. In many of the submissions, the issues raised appear to relate to the provision of credit and whether or not it should have been granted in the first place. We have been able to identify only two instances where a person making an allegation to the CCMC has also made a submission to this inquiry. In one case an investigation is currently ongoing, and in the other case it was identified that the bank had breached its obligations relating to the provision of copies of documents.[70]

2.79 The Commonwealth Bank informed the committee that it applies loan serviceability tests when assessing an application for a loan and that staff are trained in serviceability calculations. The Commonwealth Bank argued that it makes no commercial sense from a bank's point of view, or the customer's point of view, to enter into a loan where the customer is unlikely to be able to service a loan.[71]

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68 Consumer Credit Legal Service (WA) Inc, *Submission 56*, pp 5–6.

69 Australian Bankers' Association, *Submission 47*, p. 1.

70 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 12–13.

71 Mr David Cohen, Group Executive for Corporate Affairs, and Group General Counsel, Commonwealth Bank of Australia, *Committee Hansard*, 4 April 2016, p. 39.

2.80 Westpac outlined its approach to responsible lending, submitting that it acknowledges its obligation to design and market products responsibly in line with the expectations of customers and the community:

> The extension of both consumer and business credit is also underpinned by the Westpac Group''s own "Principles of Responsible Lending", including the principle that we seek to lend only what our customers can afford to repay. It is not in the Westpac Group's interests to extend credit that cannot be repaid. The Westpac Group's interests and the interests of our customers and the broader national economy are ultimately aligned; our success relies on the success and prosperity of our business customers.[72]

2.81 ANZ informed the committee about its approach to responsible lending:

> We would want to assess a loan on its serviceability in the first instance. Is that customer able to comfortably service that loan?…There will be some examples where the cash flows are not there but there is a prospective cash flow or there is an asset being created which will then be sold to repay the loan, so you could see some circumstances where serviceability is not immediately apparent but a means of paying back the loan is quite evident in front of you. There are obviously going to be exceptions around that, but we would always want to ensure that there is a sufficient cash flow and a sufficient buffer for issues that a customer would deal with.[73]

Committee view

2.82 The committee considers that the current situation in which responsible lending provisions are only voluntary is not satisfactory. The committee is therefore recommending that responsible lending protections be extended to small business borrowers. However, the committee wishes to ensure that the protections do not impede business that are well informed, have a strong business case and are prepared to back themselves in taking on a venture. The committee therefore suggests that the responsible lending provisions for small business should include a threshold test for a level of responsible lending whereby the bank will not allow a borrower to exceed this level unless:

- the borrower is able to demonstrate that they have sought independent advice as to their capacity to manage the extra debt; and
- is willing to sign a clearly documented front page to the loan contract that informs them of the conditions to which they will be subject if they do not meet the terms of the contract.

Recommendation 3

2.83 The committee recommends that responsible lending provisions, including ASIC's monitoring under the *National Consumer Credit Protection Act 2009,* be extended to small business loans.

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72 Westpac, *Submission 126,* p. 4.

73 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard,* 4 April 2016, p. 33.

Power imbalance between customers and banks

2.84 This section summarises evidence raised by a number of submitters in relation to the power imbalance between borrowers and banks.[74] Many submitters throughout the inquiry told the committee harrowing stories about the devastating financial situations that they found themselves in. This was compounded by the frustration that they did not have the means left to pursue their disputes through the courts. Some submitters suggested that because of the significant resources of banks, borrowers may be entering into risky loans or conditions on these loans because they perceive they have limited options. Some further examples are discussed in Chapter 3 under the section on alternatives to dispute resolution.

2.85 A submitter argued that the problem for small businesses is that when it comes time to borrow money the bank writes the loan contract, the loan contract is not negotiable and the contract documents are large and difficult to understand. These factors combine to place the bank in a much more powerful position than the borrower. The submitter indicated that that his loan document was 53 pages long, and contained obligations on the borrower that included positive undertakings, negative undertakings, default conditions and standard terms. In the submitter's view, the banks have perfected loan contract documents so that is virtually impossible for a small to medium enterprise to challenge a bank in a court:[75]

> And it is all because of the initial contract between the bank and the borrower, and we have to change that. If we do not change that, the voluntary codes of conduct are not worth anything, and oversights are not worth anything. We have to change that contract. If we cannot change the balance of power at the contractual level, between the bank and the borrower, then this will repeat itself forever.[76]

Committee view

2.86 The power imbalance between banks and borrowers as a result of the loan contract appears to the committee to leave borrowers in an extremely vulnerable position. Even in those circumstances where a customer may have a legal case to take to court, the capacity of the banks to 'deep-pocket' or out-spend and out-wait the borrower means that court action is often not a viable mechanism for addressing disputes. The committee notes that the above arguments add further weight to the

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74 Mr & Mrs Lock, *Submission 14,* p. 6; Name withheld, *Submission 18,* p. 5; Mr Brent Renouf, *Submission 42,* p. 4; Legal Aid Queensland, *Submission 55,* pp 4, 8; Tasmanian Small Business Council, *Submission 61,* p. 8; Ms Robyn Toohey, *Submission 62,* p. 1; Mr Lynton Freeman, *Submission 64,* p. 14; Dr Evan Jones, *Submission 83,* p. 11; Mr John Dahlsen, *Submission 87,* pp13–14; Mr Peter McNamee, *Submission 107,* p. 11; Name withheld, *Submission 11,* p. 5; Mr Sean Butler, *Submission 113,* p. 11; Bank Reform, *Submission 116,* pp 9, 27. JMA Parties, *Submission 120,* p. 3.

75 Mr Peter McNamee, *Committee Hansard,* 13 November 2016, p. 46; Mr Peter McNamee, *Submission 107,* p. 21.

76 Mr Peter McNamee, *Committee Hansard,* 13 November 2015, p. 54.

earlier recommendation made by the committee for nationally consistent standard loan contracts that have been developed by an oversight body consisting of representatives from industry, consumers and ethicists.

ASIC's examination of misconduct reports

2.87 ASIC informed the committee that in the five years from 1 July 2010, it considered 66 reports of misconduct in relation to loans and determined not to pursue further regulatory action because there was insufficient evidence of misconduct on which to base an enforcement action against the relevant lender. ASIC noted that for the 66 cases, questions of fact in relation to the lender's conduct were in dispute. ASIC noted common features across these 66 cases:

- relevant loans were not covered by consumer protections in the *National Consumer Credit Protection Act 2009*;
- half of the matters occurred in 2009–10 or 2010–11;
- the borrowers were likely to have received advice about the loan terms or were expected to have sought advice and elected not to;
- the borrowers' financial circumstances changed significantly;
- changes to the value of security resulted in breaches of LVR covenants;
- banks determined not to rollover commercial facilities at their discretion;
- concerns that the banks had imposed unfair terms or used their strong bargaining position to disadvantage debtors could not be made out on the evidence presented;
- lenders had been willing to renegotiate loans, but borrowers sought more generous arrangements; and
- banks or borrowers had initiated legal action in relation to the dispute.[77]

ASIC's examination of four cases

2.88 As noted earlier in this chapter, information provided to the committee indicates that dissatisfied borrowers disagree with the banks on the facts of their cases. The committee is not able to discern which version of events is accurate however the committee has made its best efforts to establish whether genuine disputes exist. The committee selected four cases and formally referred those cases to ASIC for review in relation to relevant legislation, regulation and codes of practice.

2.89 The committee notes that this is an unusual approach for parliamentary committees and in doing so, notes that it does not intend to publicly identify the four cases or any of the details associated with them. Furthermore, the examination of these cases is not intended to influence any court or dispute resolution mechanism that may formally consider those cases.

77 ASIC, *Submission 45*, pp 11–13.

2.90 ASIC informed the committee that overall, its consideration of the material provided did not indicate breaches of the existing regulatory obligations on lenders administered by ASIC.[78] ASIC noted that:

> …the case studies provided relate to business borrowers who obtained large commercial lending facilities from banks. It is difficult for ASIC to offer a comment on whether or not the conduct of the lenders in these case studies was unethical. This is because our regulatory role for commercial lending is limited, and relates to considering allegations of misconduct as opposed to judging questions of ethics.[79]

Committee view: practices of banks

2.91 The committee notes ASIC's advice that its role does not include judging questions of ethics. However, the committee also notes that it is not acceptable for the situation to continue to exist where banks are not required to meet minimum professional and ethical standards, and to be held accountable to those standards. The committee is therefore recommending that the ASBFE Ombudsman should draw together relevant expertise across small business, financial services, ethics and education to drive the development of appropriate professional standards for the conduct of banks in relation to loans.

2.92 The committee has no powers to investigate or resolve individual disputes, however the committee has used the cases presented to it to understand the practices of banks and makes the following observations:

- for many failed loans under the 2008 Bankwest commercial loan book, it appears likely that problems arose from irresponsible lending prior to the acquisition of Bankwest by the Commonwealth Bank;
- for many failed loans with other banks it is also likely that irresponsible lending was the primary or significant cause of loan failure; and
- there may be some individual cases for which there are legitimate disputes with banks.

2.93 While mechanisms have been put in place to require banks to meet improved standards of responsible lending for residential and related loans, this inquiry has identified that these standards are not required of banks in relation to small business and commercial loans.

2.94 The committee has received evidence to suggest that borrowers perceive that banks provide inconsistent information and advice between the bank's lending departments and their credit management departments. The committee is concerned that this may be influenced by inappropriate incentives and cultures in those departments.

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78 ASIC, *Supplementary submission 45*, p. 3.

79 ASIC, *Supplementary submission 45*, p. 11. ASIC also noted that commercial and competitive drivers exist for lenders and their employees and representatives to serve the needs of customers.

2.95 ASIC informed the committee that:

- a lender providing conflicting advice to a borrower may not be in breach of its regulatory obligations;
- from a legal perspective, a lender's employees or representatives would have contractual, general law, and employment law obligations to act in the interests of the lender, as their employer or engager; and
- there is no overriding regulatory obligation on commercial lender employees or representatives to act in the best interests of the borrower.[80]

2.96 The committee is very concerned about the lack of any obligation on lenders to provide consistent information in the best interests of borrowers. The committee therefore makes recommendations to:

- prohibit conflicted remuneration for banks officers, especially those involved with lending and credit management;
- allow longer remuneration clawback periods for poor performance, such as those used in the US and UK; and
- require bank officers in lending and credit management departments to act in the best interests of the borrower.

2.97 The committee considers that the need to refinance loans may arise for reasons including that the existing banking arrangement is not constructive for either party, or the loan is a term loan that either party may not wish to roll over. Effective refinancing of loans, particularly for commercial loans, requires sufficient time. This is particularly important where the underlying business, such as a primary production business, runs for timescales much longer than loan terms. Once default or demand notices are issued, other banks are understandably reluctant to refinance.

2.98 The committee acknowledges the Commonwealth government's announcement on 20 April 2016 that it will enhance the surveillance and enforcement capability of ASIC for investigating financial advice and responsible lending.[81] The committee also acknowledges the announcement on 21 April 2016 by the ABA in relation to new measures to protect consumer interests, including:

- an independent review of product sales commissions and product based payments, with a view to removing or changing them where they could result in poor customer outcomes;
- improving protections for whistle blowers to ensure there is more support for employees who speak out against poor conduct;
- improved complaints handling and better access to external dispute resolution, as well as providing compensation to customers when needed; and

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80 ASIC, *Supplementary submission 45*, p. 12.

81 Australian Government Factsheet, *Improving Consumer Outcomes in Financial Services*, 20 April 2016, p. 1.

- bringing forward a review of the Banking Code of Practice.[82]

2.99 This inquiry has been conducted at a time when there has been substantial activity in relation to financial services generally, including the Financial Systems Inquiry, reforms arising from a major parliamentary inquiry into the performance of ASIC, the ASIC capability review and law reforms relating to insolvency and unfair contract terms. The Australian Small Business and Family Enterprise Ombudsman (ASBFE Ombudsman) was established in March 2016. In addition, in April 2016 the government made a range of other announcements relating to regulation of banks and lending practices.

2.100 The committee considers that to address the vulnerability of small business and commercial borrowers it is essential that a single body be empowered to:

- lead and/or coordinate the implementation of the outcomes of this inquiry and the aspects of the above reforms that relate to small business in order to avoid the significant risk that major gaps and flaws in the protections for small business would remain;
- bring together a team with expertise in financial services, ethics and education to establish standards for the conduct of bank management and staff in relation to small business loans and to work with the banking industry to implement those standards and appropriate mediation and dispute resolution schemes;
- to work with the banking industry to develop nationally consistent standardised loan contracts that include a cover sheet summarising the obligations of the customer and the consequences of any breach; and
- where gaps in the implementation of those standards and appropriate dispute resolution schemes remain, to act as a small business loans dispute resolution tribunal.

2.101 The committee considers that the most appropriate body to undertake this role is the ASBFE Ombudsman. The committee therefore recommends that the government bring forward legislation and other measures to give the ASBFE Ombudsman the relevant powers to carry out this role.

Recommendation 4

2.102 The committee recommends that the government bring forward legislation and other measures to enable the Australian Small Business and Family Enterprise Ombudsman to:

a. lead and/or coordinate the implementation of the outcomes of this inquiry and all other reforms that relate to small business lending in order to avoid the significant risk that major gaps and flaws in the protections for small business would remain;

82 Australian Bankers Association, Media Release, *Banks act to strengthen community trust*, 21 April 2016.

b. bring together a team with expertise in financial services, ethics and education to establish standards for the conduct of bank management and their employees in relation to small business loans and to work with the banking industry to implement those standards and appropriate mediation and dispute resolution schemes;

c. work with the banking industry to develop mandatory nationally consistent standardised loan contracts that include a cover sheet summarising the obligations of the customer and the consequences of any breach;

d. have the power to direct the parties to a dispute to participate in mediation or dispute resolution;

e. where gaps in the implementation of those standards and appropriate dispute resolution schemes remain, to act as a small business loans dispute resolution tribunal; and

f. direct the parties to a dispute to participate in commercial arbitration for larger commercial loans.

Recommendation 5

2.103 The committee recommends that appropriate legislation and regulations be put in place to:

a. prohibit conflicted remuneration for all bank staff;

b. extend the clawback period on any bonus or like incentives provided to management and senior executives involved in the line approvals or systematic oversight of lending;

c. require bank officers to act in the best interests of a small business customer;

d. require officers from lending and credit management departments to provide consistent information to borrowers, including:

i. copies of valuation reports and instructions to valuers; and

ii. copies of investigative accountants' reports and instructions to investigative accountants and receivers;

e. require lending officers and credit management officers to ensure that:

a. the valuation instructions do not change during the term of the loan agreed in the loan contract; and

b. businesses are valued as the market value of a going concern, not just a collection of business assets and that the market value of all security supporting the loan are taken into account, not just real property.

Recommendation 6

2.104 The committee recommends that nationally consistent arrangements be put in place for:

- **a. farm debt mediation;**
- **b. small business debt mediation; and**
- **c. the professional standards and conduct of valuations in relation to small business loans.**

2.105 The committee also heard that there is a problem caused by the failure of banks to notify creditors, such as builders who are building on a developer's land, when a loan is placed into default. The committee considered the case of Integrity New Homes, who were constructing housing on behalf of a client whose loan was subsequently placed into default. Integrity New Homes continued to build and add value to the secured asset which was then liquidated by the bank with no compensation for Integrity New Homes.

Recommendation 7

2.106 The committee recommends that the link between lenders and key creditors, such as builders who may be building on a developer's land, needs to be formalised so that lenders have an obligation to advise creditors once a loan is placed in default.

Chapter 3
FOS and internal dispute resolution

Introduction

3.1 This chapter examines Internal Dispute Resolution (IDR) procedures and one External Dispute Resolution (EDR) scheme known as the Financial Ombudsman Service (FOS).

3.2 Australian credit providers are required to put in place a dispute resolution system consisting of internal review procedures, known as internal dispute resolution or IDR, as well as membership of an external dispute resolution scheme. Consumers can submit a complaint to their bank through the bank's IDR procedures. If the consumer is not satisfied with the response received from their bank, they may then submit a complaint to the EDR scheme to which the bank belongs.[1] There are two main EDR schemes that have been approved by ASIC under the *National Consumer Credit Protection Act 2009*, the Financial Services Ombudsman (FOS) and the Credit and Investments Ombudsman (CIO).[2] These two schemes are discussed in further detail along with other dispute resolution arrangements in Chapter 4.

3.3 The chapter includes the following sections:

- internal dispute resolution;
- self-reporting of breaches of the Banking Code of Conduct by banks;
- issues raised by submitters, include the inaccessibility of the courts;
- similar experiences in the United Kingdom (UK); and
- the jurisdiction of the FOS;

3.4 In this report the committee has largely considered issues related to banks as the committee only received limited evidence in relation to the customer owned banking sector. The committee notes however, that where it makes recommendations to improve the dispute resolution system, its intention is for those recommendations to apply to all authorised deposit taking institutions (ADIs).

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1 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

2 ASIC, *Submission 45,* p. 22.

Internal dispute resolution

3.5 The committee received limited evidence during the inquiry from submitters regarding IDR procedures in banks. However, because the majority of the evidence received by the committee concerned disputes with banks, the committee examined the IDR procedures that banks have in place.

3.6 ASIC Regulatory Guide 165 requires banks to have IDR procedures that meet the standards or requirements approved by ASIC. When approving standards or requirements for IDR procedures, ASIC is required to take into account Australian Standard AS ISO 10002–2006 Customer satisfaction—Guidelines for complaints handling in organisations.[3]

3.7 ASIC considers IDR to be an important and necessary first step in the complaints/disputes handling process because it gives lenders the opportunity to hear borrower concerns and address them genuinely, efficiently and effectively. ASIC considers that addressing complaints or disputes through IDR can also assist in improving business systems and products/services, which is integral to growing a successful business.[4]

3.8 ASIC advises banks that wherever possible, they should seek to resolve complaints or disputes directly with borrowers through IDR procedures. It is better for all parties if a complaint or dispute is dealt with at the earliest possible stage because it prevents complaints or disputes from becoming entrenched, preserves customer relationships, is efficient and cost-effective and may improve customer satisfaction.[5]

3.9 ASIC Regulatory Guide 165 requires that both retail and small business customers are covered by IDR procedures. As a minimum, any IDR procedure for financial service providers must be able to deal with complaints made by 'retail clients', as defined in section 761G of the Corporations Act and its related regulations, and this includes small businesses. A small business is defined in s761G as a business employing fewer than: (a) 100 people (if the business manufactures goods or includes the manufacture of goods); or (b) 20 people (otherwise).[6]

3.10 FOS indicated that, in its view, IDR arrangements provide the cornerstone for effective consumer redress mechanisms in the financial sector. The vast majority of consumer issues are resolved by financial services providers directly with their

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3 ASIC, *Regulatory Guide 165, Licensing: Internal and external dispute resolution,* July 2015, pp 4, 10, 12.

4 ASIC, *Regulatory Guide 165, Licensing: Internal and external dispute resolution,* July 2015, p. 12.

5 ASIC, *Regulatory Guide 165, Licensing: Internal and external dispute resolution,* July 2015, pp 18–19.

6 ASIC, *Regulatory Guide 165, Licensing: Internal and external dispute resolution,* July 2015, p. 19.

customers. The FOS argued that research shows the way in which financial services providers deal with problems when they occur is crucial to gaining consumer trust and confidence.[7]

3.11 The Australian Banker's Association (ABA) noted that small business customers have access to IDR procedures with their bank. The ABA argued that in many cases, the complaint will be resolved internally by the bank with no further action required. If the dispute cannot be resolved expeditiously, the small business customer is able to lodge the dispute with FOS.[8]

Banks' operation of IDR procedures

3.12 ANZ informed the committee that it reported three breaches of the internal dispute resolution requirements under the Code of Banking Practice to the Code Compliance Monitoring Committee (CCMC) in 2014–15 and six in 2013–14. Two of these breaches in 2014–15 were self-identified and one was raised with ANZ by the CCMC. None of those breaches related to matters before this inquiry.[9]

3.13 NAB informed the committee that it operates an independent service called NAB Resolve, to work with customers who are in dispute with the bank. NAB explained that:

> We also have an area called NAB Assist which works with customers who have impaired files. So customers that are facing hardship can absolutely avail themselves of the services within NAB Assist. Should they have an issue with the way in which a file is being managed, they can also work with NAB Resolve to have that worked through in a different scenario if they are not happy with the way in which that file has been resolved.[10]
>
> NAB Resolve is a separate function so it is a separate team from my frontline team where the bankers work. It is a separate independent function and has the ability and capacity to make decisions on any agreement that might be reached with those customers that are in dispute.[11]

7 FOS, *Submission 46*, p. 7.

8 ABA, *Submission 47*, p. 11.

9 Mr Gerard Brown, Group General Manager, Corporate Affairs, ANZ, *Committee Hansard,* 4 April 2016, p. 24.

10 Mr Tim Armstrong, Head, Micro and Small Business, South, NAB, *Committee Hansard,* 4 April 2016, p. 59.

11 Mr Tim Armstrong, Head, Micro and Small Business, South, NAB, *Committee Hansard,* 4 April 2016, p. 59.

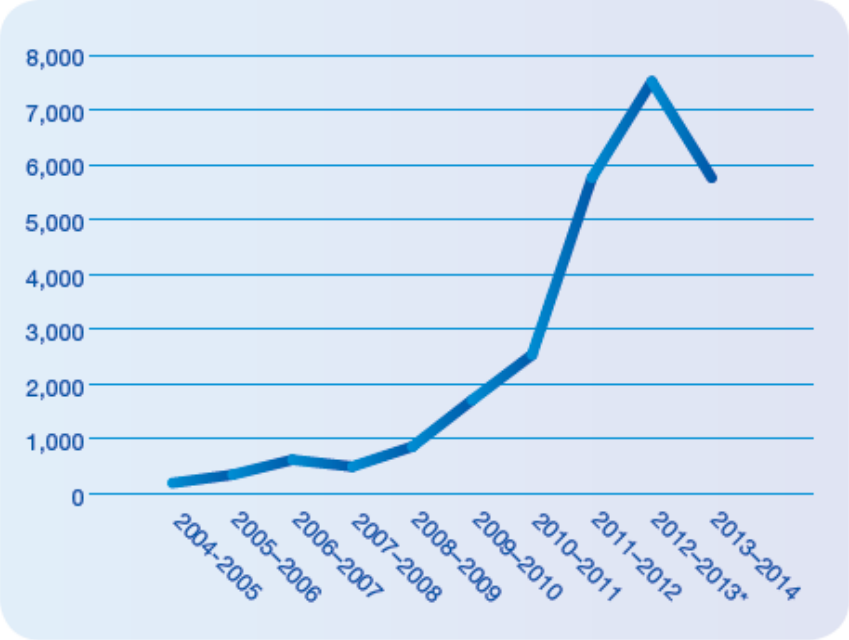
3.14 The Commonwealth Bank's IDR procedures state that the bank will provide a final response to the complaint within 45 days and that most complaints are resolved within a few days.[12]

3.15 In addition to its complaints handling procedures, Westpac has a customer advocate service for complaints that are not properly resolved or handled.[13]

Self-reported breaches related to IDR and other matters

3.16 The committee noted with some concern results that the CCMC has published based on self-reporting of breaches of the Banking Code of Practice by banks. Under the CCMC Annual Compliance Statement program, banks are required to self-report areas of non-compliance with the Banking Code of Practice and share information with the CCMC about how they intend to improve compliance.[14] The figure below shows the number of self-reported breaches between 2004 and 2014. The CCMC also reported that for the 2014–15 financial year, there were 6558 self-reported breaches, an increase of 14 percent on the previous year.[15]

Figure 3.1: Banks' self-reported breaches of the Banking Code of Practice



Source: Code Compliance Monitoring Committee: *2013–14 Annual Report*, p. 7.

12 Commonwealth Bank of Australia, *What happens when I make a complaint?* https://www.commbank.com.au/support/faqs/1255.html, (accessed 7 Aril 2016).

13 Westpac, *Dispute resolution procedures*, http://www.westpac.com.au/docs/pdf/pb/Dispute.pdf, (accessed 7 Aril 2016).

14 CCMC, *2013–14 Annual Report*, p. 7.

15 CCMC, *2014–15 Annual Report*, p. 11.

3.17 Prior to the GFC, banks self-reported several hundred breaches of the Banking Code of Practice per year. The number of breach reports has now grown to 6000 to 7000 per year.[16]

3.18 The CCMC reported that for internal dispute resolution in 2013–14, banks self-reported 91 breaches of the relevant clauses of the Code.[17] In 2014–15 annual report the CCMC indicated that self-reported breaches of internal dispute resolution obligations rose to 536, a 523 percent increase relative to 2013–14. The CCMC reported that one bank accounted for 65 percent of the 536 breaches.[18]

3.19 In relation to complaints lodged by customers in 2013–14, banks recorded 1.1 million disputes in total, a year–on–year increase of 53 per cent. One bank accounted for 73.8 per cent of all disputes recorded. The CCMC reported that in total, banks recorded 1 226 093 complaints in 2014–15, an 11.5 per cent increase on the previous period.[19]

Committee comment

3.20 The committee has not examined the breach reporting in further detail and has not sought to identify the banks responsible for significant issues relating to the total number of disputes and IDR. However, the figure and discussion above indicate to the committee that problems exist with banks' IDR procedures. These problems add weight to the committee's view that EDR schemes need to be strengthened, as discussed later in this and the following chapter.

Issues raised by submitters about EDR schemes

3.21 This section summarises evidence provided by submitters in relation to EDR schemes, including FOS. The issues raised relate to the jurisdiction of FOS, the independence of FOS from the banks, the fragmentation of EDR schemes and the inability of borrowers to use the court system.

3.22 The committee heard concerns about some matters falling outside the jurisdiction of FOS for a variety of reasons including:

- FOS making a determination that a matter is more appropriately dealt with by the courts;[20]
- FOS upper limits on claim size and compensation amounts;[21]

16 CCMC, *2013–14 Annual Report,* p. 7; CCMC, *2014–15 Annual Report,* p. 11.

17 CCMC, *2013–14 Annual Report,* p. 20.

18 CCMC, *2014–15 Annual Report,* pp 11, 15.

19 CCMC, *2013–14 Annual Report,* p. 20; CCMC, *2014 –15 Annual Report,* p. 15.

20 Name withheld, *Submission 8,* p. 11; Mr Paul Topping, *Submission 25,* p. 1; Mr Michael Sanderson, *Submission 28,* p. 8.

- settlements with banks that preclude a customer from raising disputes with FOS;[22]
- whether FOS has the necessary powers;[23] and
- where other processes such as mediation had been used, FOS may then be excluded from considering the matter.[24]

3.23 A submitter alleged that the FOS is so severely restricted by its terms of reference and the CCMC by its constitution that the two organisations fail to investigate all but a very small percentage of customer complaints.[25] The Tasmanian Small Business Council agreed with this assessment, and further argued that a decision of the FOS cannot be challenged.[26]

3.24 The committee considers issues related to the limits of FOS' jurisdiction later in this chapter.

Suggestions for different approaches

3.25 Several submitters and witnesses made suggestions to the committee on how dispute resolution schemes could be improved. Legal Aid Queensland (LAQ) argued that there is no way to enforce the bank to act fairly or reasonably, although the mediation process does provide that the bank must act in good faith, which is a different concept to fair and reasonable. LAQ suggested that for an issue arising from any of those sorts of matters, it would be far more powerful if there was an independent review:

> Because of the financial limitations with people who are in financial difficulties, clearly it is the role for FOS powers to be expanded to investigate those particular issues. FOS has the knowledge and experience to manage those types of matters and to make reasoned decisions binding on both parties. If there was even that option available, I am sure it would

21 Mr Dario Pappalardo, *Submission 13,* p. 2; Mr Paul Topping, *Submission 25,* p. 1; Mr Michael Sanderson, *Submission 28,* p. 8; Mr Eric Fraunfelter, *Submission 68,* p. 2; Mr Trevor Eriksson, *Submission 101,* p. 7; JMA Parties, *Submission 120,* pp 6–7; Mr & Mrs Smith, *Submission 141,* p. 19; Mr Denis McMahon, Senior Lawyer, Farm and Rural Legal Service, Civil Justice Services, Legal Aid Queensland, *Committee Hansard,* 19 November 2015, p. 36.

22 Mr & Mrs Randles, *Submission 8,* pp 8, 10.

23 Bank Reform Now, *Submission 116,* p. 27.

24 Mr Denis McMahon, Senior Lawyer, Farm and Rural Legal Service, Civil Justice Services, Legal Aid Queensland, *Committee Hansard,* 19 November 2015, p. 36.

25 JMA Parties, *Submission 120,* p. 9.

26 Tasmanian Small Business Council, *Submission 61,* p. 12.

> be a catalyst for the banks to act more fairly and reasonably in certain circumstances.[27]

3.26 A submitter suggested that external dispute resolution schemes are fragmented and the legal system is not conducive to the borrower because of the process and high cost:

> The terms of reference of some industry bodies (such as FOS) do not focus or allow for access by some category of borrowers. It is recommended that an authority with power to resolve matters between the lender and borrower be established with the fall back to the legal system. This authority should be staffed by generalists, some with knowledge of law but importantly persons that understand both sides of the lender/customer relationship. The authority should be empowered to make the final decision on disputes. Consolidation of current relative institutions should be considered.[28]

3.27 A witness argued that all defaulted loans should go to an independent tribunal, much like a tenant who cannot pay their rent:

> …you go to a residential tenancy tribunal. They talk about it and give the guy a bit more time and give you a few more months and they work it through and hopefully resolve it. But with a small business guy, a bank can move in and can not only kick him out of the house but will also take the house and sell it, take his holiday house and sell it, take his cars and his jewellery and all of his assets—all of that stuff. The bank will do all of that and they will not even have sold the property that the loan is secured upon. I am saying we need something like a residential tenancy tribunal so that when a genuine event of default occurs, it gets referred to a third party who then review it.[29]

3.28 The Tasmanian Small Business Council suggested that the IDR procedure and EDR scheme of the Australian banks should be reformed so that small businesses, farmers, and individual customers can have complaints arbitrated quickly, cheaply, and fairly.[30]

Financial Ombudsman Service

3.29 The section discusses the FOS, its history, jurisdiction and functions in relation to consumer protections.

3.30 The ABA explained to the committee that FOS was initiated in 1989, following major inquiries into the banking system. The ABA indicated that the

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27 Mr Denis McMahon, Senior Lawyer, Farm and Rural Legal Service, Civil Justice Services, Legal Aid Queensland, *Committee Hansard,* 19 November 2015, p. 33.

28 Mr Trevor Eriksson, *Submission 101,* p. 2.

29 Mr Peter McNamee, *Committee Hansard,* 13 November 2015, pp 47–48.

30 Tasmanian Small Business Council, *Submission 61,* p. 26.

objective was to provide customers with a free, easily accessible and simple means of dealing with disputes with their banks. The ABA noted that:

> That was the original banking ombudsman scheme—the Australian banking industry ombudsman. It was later renamed the banking and financial services ombudsman during 2000 or so, and it is now an aggregation of three separate external dispute resolution schemes formed into one dispute resolution scheme. It now covers general insurance and financial services matters like financial advice and so forth.[31]

3.31 As a condition of their licence, credit licensees must join an ASIC-approved EDR scheme such as FOS and the CIO.[32]

3.32 Treasury informed the committee that while determinations made by FOS are binding on credit providers, FOS' decisions are not binding on the complainant. As such, customers are free to seek recourse through the court system should they be unhappy with the EDR process. Treasury indicated that there are no reforms to the consumer credit laws currently being considered.[33]

Disputes that FOS can consider

3.33 This section sets out some of the disputes that FOS can consider.

Mortgagee sales

3.34 A financial services provider in possession of a borrower's property must take reasonable care to sell the property for either its market value or the best possible price. If FOS believes the financial services provider in a dispute did not take reasonable care, FOS may award the borrower compensation for any difference between the sale price and the market value of the property.[34]

Financial difficulty

3.35 FOS considers that financial difficulty occurs when a consumer is unexpectedly unable to meet their repayment obligations. This can be the result of a variety of causes including accident, separation, death of a family member, unexpected medical or funeral expense, reduction of work hours, redundancy or a downturn in business.[35]

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31 Mr Ian Gilbert, Director Banking Services Regulation, Australian Banker's Association, *Committee Hansard,* 18 November 2015, p. 30.

32 ASIC, *Submission 45,* p. 22.

33 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

34 Financial Ombudsman Service, *Submission 46,* p. 4.

35 Financial Ombudsman Service, *Submission 46,* p. 5.

Responsible lending

3.36 When a consumer cannot make their loan repayments, they may claim their financial services provider should not have given them the loan because they never had the capacity to repay it. The consumer may lodge a dispute with FOS seeking compensation for a loss resulting from provision of the loan. FOS refers to this as a "responsible lending" dispute. When FOS considers responsible lending disputes, FOS decides whether it was appropriate for the financial services provider to enter into the loan.[36]

3.37 The committee was informed that responsible lending issues also arose in relation to how farm loans were originally negotiated, including the findings of a study on regional farm debt that found that more than 20 per cent of respondents reported that bank managers completed their budgets and offered loans larger than expected.[37]

Disputes that FOS cannot consider

3.38 This section sets out the disputes that FOS cannot consider:

- A receiver may have been appointed to a company before it lodged a dispute with FOS. At law, a receiver acts as an agent of the company, not the creditor who appointed the receiver. As the receiver is in control of the company at the time of lodgement, the receiver must consent to the dispute being lodged. Similarly, if a liquidator has been appointed, then the liquidator's consent is required.[38]
- FOS can consider disputes where legal proceedings have been issued by the financial services provider against the borrower, provided those proceedings have not gone beyond lodging a defence and counterclaim. If they have gone beyond that stage, FOS cannot consider the dispute.[39]
- If a borrower is a small business and one loan exceeds $2 million FOS cannot consider the dispute as it is considered that a court could more appropriately deal with the matter. The $2 million limit was introduced on 1 January 2015. Thirteen disputes lodged with FOS since that date, have exceeded the limit and FOS has therefore not considered those disputes.[40]

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36 Financial Ombudsman Service, *Submission 46*, p. 5.

37 Australian Bureau of Agricultural and Resource Economics and Sciences, the Australian Bankers' Association and the National Farmers' Federation, *Regional farm debt*, December 2014, p. 27.

38 Financial Ombudsman Service, *Submission 46*, p. 6.

39 Financial Ombudsman Service, *Submission 46*, p. 6.

40 Financial Ombudsman Service, *Submission 46*, p. 6.

- If legal proceedings have been issued and judgment obtained before a dispute was lodged, FOS cannot consider the dispute. Any claim the borrower had merges into the judgment. The borrower must apply to the court to set aside the judgment. [41]
- FOS can only consider a dispute where the amount of the claim (the amount of loss) does not exceed $500 000. The maximum compensation FOS can award is $309 000. The amount of loss is not necessarily the amount of the loan, as often the borrower repays the principal and at least some interest.[42]
- Where a guarantor owes more than $309 000 and seeks to have the guarantee set aside, a court is a more appropriate place to consider the dispute. This is because a guarantee cannot be set aside in part. It is either valid for the amount or it is not valid at all.[43]
- FOS cannot consider a dispute where FOS has already dealt with the subject matter. For example if FOS issued a determination which the customer did not accept, FOS will not look at a new dispute about the same matters.[44]

FOS jurisdiction relation to small business and commercial loans

3.39 This section summarises the jurisdiction of the FOS in relation to small business and commercial loans.

3.40 ASIC informed the committee about limits on the application of EDR schemes in relation to small business lending:

> Because the National Credit Act does not apply to loans for business purposes, lenders that do not provide consumer credit are not required to hold an Australian credit license and are therefore not required to belong to an EDR scheme. Where a lender is a member of an EDR scheme, whether on a voluntary basis or because they provide regulated consumer credit, the EDR scheme may consider small business disputes.[45]
>
> An EDR scheme's ability to consider small business disputes relating to lending is not based on any legislative requirement but is limited to the general consumer law, existing voluntary codes of industry practice and by the monetary value of the claim.[46]

41 Financial Ombudsman Service, *Submission 46,* p. 6.

42 Financial Ombudsman Service, *Submission 46,* p. 6.

43 Financial Ombudsman Service, *Submission 46,* p. 6.

44 Financial Ombudsman Service, *Submission 46,* p. 6.

45 ASIC, *Submission 45,* pp 22–23.

46 ASIC, *Submission 45,* p. 23.

3.41 The Senate Economics References Committee inquiry into the post-GFC banking sector recommended that the terms of reference of FOS be amended so that FOS may consider disputes from small business applicants where the value of the claim is up to $2 million, and that the cap on the maximum compensation that FOS can award be increased to $2 million when the dispute relates to small business.

3.42 The FOS informed the committee that when the Banking Code of Practice was first introduced in 2003, the jurisdiction of the ombudsman's office was increased to cover small business cases. When the *National Consumer Credit Protection Act 2009* commenced in 2010–11, FOS still had that broader jurisdiction, even though the regulation does not cover it. If an organisation joins FOS, their small business products are covered as well.[47]

3.43 FOS is required to commission regular independent reviews of its operations and procedures. The most recent review was conducted in 2013. The 2013 review of FOS noted that 5 per cent of disputes accepted by FOS were small business disputes, primarily relating to credit and payment system disputes. The review also noted that:

- the disputes often relate to property development, with some disputes about loans in excess of $5 million;
- where it is clear that the claim (not the loan) is in excess of $500 000 FOS will rule the matter outside its jurisdiction;
- it is rare for FOS to exclude small business disputes using its discretion to decide that the courts are more appropriate for the dispute; and
- FOS has accepted disputes where farmers have rejected or withdrawn from mediation process, except where mediation is legislatively mandated.[48]

3.44 The 2013 review recommended that FOS should be more active in using its jurisdiction to reject large complex commercial disputes and publish guidelines about how it will use its discretion.[49]

3.45 The review also led to recommendations focussed on the need for FOS to increase the pace of its current efforts to eliminate dispute backlogs and reshape its dispute processes to reduce the time taken to resolve new disputes.[50]

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47 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 10.

48 CameronRalph Navigator, *2013 Independent Review Report to the Board of the Financial Ombudsman Service,* pp 63–65.

49 CameronRalph Navigator, *2013 Independent Review Report to the Board of the Financial Ombudsman Service,* pp 63–65.

50 CameronRalph Navigator, *2013 Independent Review Report to the Board of the Financial Ombudsman Service,* pp 8–10.

3.46 Regulatory Guide 139 (RG 139) on approval and oversight of EDR schemes sets the jurisdictional limit of approved EDR schemes at $500 000. ASIC informed the committee that:

> This limit is aligned to the retail client definition as set out in the Corporations Act: s761G(7)(a) and regs 7.1.18–19. Approved schemes also operate a compensation cap which is the maximum amount a scheme is able to award in compensation to a retail client. Until 2012, the compensation cap for most complaints about credit and financial services was $280,000. RG 139 requires that the compensation cap be increased every 3 years. Therefore, on 1 January 2015, the cap increased from $280,000 to $309,000.[51]
>
> RG 139 requires that EDR scheme coverage under the Corporations Act and National Credit Act must be sufficient to deal with the vast majority of consumer complaints or disputes in the relevant industry, up to the jurisdictional limit of $500,000.[52]

3.47 FOS informed the committee that it considers the 2013 Code of Banking Practice to represent good industry practice and generally reflects the common law obligations of financial services providers. Financial services providers can subscribe to the code and, once they subscribe, they are required to comply with the code.[53]

3.48 ASIC informed the committee that it is intended that high value and complex disputes of a more commercial character are excluded from the jurisdiction of the schemes. The level at which jurisdictional limits and compensation caps are set affects all industry participants providing financial services to retail clients and will have particular implications for EDR scheme members who require professional indemnity insurance to meet any claims.[54]

3.49 The current FOS terms of reference now include an extensive list of over 20 exclusions from FOS's jurisdiction. As noted earlier, financial exclusions include that FOS may not consider a dispute where the applicant's claim in the dispute exceeds $500 000 or about debt recovery against a small business for loans over $2 million. There are also limits for small business of 20 employees (or 100 for manufacturers).[55]

3.50 FOS commented on how well banks contribute to resolving disputes, noting that there had been improvements for retail and but not for small business borrowers:

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51 ASIC, *Submission 45,* p. 23.

52 ASIC, *Submission 45,* p. 23.

53 Financial Ombudsman Service, *Submission 46,* p. 5.

54 ASIC, *Submission 45,* p. 23.

55 Financial Ombudsman Service, *Terms of Reference,* 1 January 2010, pp 11–12.

> It depends on the institution. They all sort of go through peaks and troughs—they get better at things and then they drop the ball. In consumer cases involving financial hardship, banks and other financial services providers have vastly improved the way they deal with their customers. That has been driven by the code in the first instance and by the National Consumer Credit Protection Act more recently. What we are not seeing is the same level of improvement in relation to small business customers, yet the code obligation still exists. Even though there is no regulation about assisting small business customers in hardship, if you are a subscribing bank you do have that obligation and it does form part of the contract.[56]

3.51 FOS informed the committee that of the small business disputes relating to credit (excluding credit card disputes) closed in the 2014–2015 financial year, 11 were excluded because they exceeded the monetary limits noted above. In eight of those disputes, the value of the claim exceeded $500 000 and the remaining three disputes involved debt recovery and a credit facility of over $2 million.[57]

Industry views on the FOS jurisdiction

3.52 This section briefly summarises views put to the committee by banks and the ABA about the jurisdiction of FOS.

3.53 Changes to the Banking Code of Practice in 2013 (the Code) included a number of new provisions for small business lending. For example, banks are now required to give small business borrowers a reasonable period of notice (not less than 10 business days) in writing of a variation to terms and conditions of a credit facility, including a revaluation of the credit facility. The Code was revised to include more details on how banks must help clients, both individual and business, overcome financial difficulties through discussions and possible rearrangements.[58]

3.54 In the former version of the Code, banks could vary terms and conditions without providing written advice in advance of the new terms and conditions taking effect. The Code previously did not include detail on how to help clients experiencing financial difficulties.[59]

3.55 ANZ indicated that it supported FOS as an independent dispute resolution system for commercial loans, but not for large corporate clients. ANZ informed the

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56 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 10.

57 Financial Ombudsman Service, *Submission 46*, p. 11.

58 CCMC, *Submission 4*, p. 2.

59 Treasury, *Answers to questions on notice*, taken on 1 December 2015, received on 14 December 2015.

committee of its view on the distinction between small and medium businesses and large corporate clients:[60]

> The definition of that would be: anyone borrowing up to $10 million to $20 million would be what I would call the small and medium businesses. Anything beyond that, they are lawyered up. They have people who are very capable professionals; they have their accountants…I would say above that level you definitely have very capable people on the other side negotiating.[61]

3.56 Westpac argued for the current FOS terms of reference to remain in place:

> We think that the current level is sufficient and has the right balance. We think that small businesses need more protection under this, and we think that the levels that they are afforded—the Financial Ombudsman Service, for example—at their level deal with the right size of customer to deal with that fairly and efficiently. If we start including that for broader, more well-resourced companies then I think that could get clogged and decrease the efficiency of that organisation. We will from time to time agree to hear matters outside of their limits where we think it is warranted. We have gone to FOS for matters that are above their limit where that has been appropriate, or where we have thought that is appropriate and the customer has agreed.[62]

3.57 When questioned about expanding the jurisdiction of FOS, the ABA responded by stating that:

> We certainly do not have a formal position taken with our members on consultation on that. The fundamental principle underpinning the scheme was that it existed to deal with simple cases, disputes, that could be dealt with fairly readily on a no-cost-to-the-customer basis for the dispute. Where a review of the financial cap on the scheme goes, I guess it will need to be measured against the principle that it is for relatively uncomplicated matters. That is what the scheme was designed to do, and not necessarily to replace other tribunals or the court system for the more complex matters which perhaps are better dealt with by courts. We accept that there is an access to justice issue in all of this.[63]

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60 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, pp 65–66.

61 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 73.

62 Mr William Malcom, General Manager, Credit Risk, Westpac Banking Corporation, *Committee Hansard*, 18 November 2015, p. 65.

63 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Committee Hansard*, 18 November 2015, p. 30.

Committee view

3.58 The committee has formed the view that small business borrowers are often just as vulnerable as residential borrowers as they may have been required to provide their homes or personal guarantees as security for their loans. The committee considers that the evidence in this inquiry demonstrates that it is no longer sufficient for lenders to small business to be voluntary members of EDR schemes. The committee therefore recommends that relevant regulatory changes be introduced to require lenders to small business to participate in an EDR scheme.

3.59 The committee acknowledges the Commonwealth government's announcement of 20 April 2016 of a review of FOS's small business jurisdiction, monetary limits and compensation caps.[64] The committee also notes the ABA's announcement on 21 April 2016 that they would introduce:

- improved complaints handling and better access to external dispute resolution, as well as providing compensation to customers when needed; and
- that the ABA support the Commonwealth government's review of FOS.[65]

3.60 The committee has recommended in chapter 2 the extension of responsible lending provisions to cover small business loans, closing of other gaps in coverage and a role for the ASBFE Ombudsman in leading and coordinating reforms including the review of the jurisdictions of external dispute resolution schemes including FOS.

Time limits

3.61 This section discusses the time limits established by FOS' terms of reference that apply to disputes being considered by FOS. Some submitters raised concerns regarding FOS time limits.[66]

3.62 Where a dispute relates to a variation of a credit contract as a result of financial hardship, an unjust transaction or unconscionable interest and other charges under the National Credit Code, FOS will not consider the dispute unless it is lodged with FOS before the later of the following time limits:

> (i) within two years of the date when the credit contract is rescinded, discharged or otherwise comes to an end; or

64 The Hon Scott Morrison MP, Treasurer, joint media release with the Hon Kelly O'Dwyer MP, Minister for Small Business, Assistant Treasurer, *Turnbull Government bolsters ASIC to protect Australian Consumers*, 20 April 2016.

65 Australian Bankers Association, Media Release, *Banks act to strengthen community trust*, 21 April 2016.

66 Mr Ken Winton, *Submission 67*, p. 31.

(ii) where, prior to lodging the dispute with FOS, the Applicant received an IDR Response in relation to the dispute from the Financial Services Provider—within 2 years of the date of that IDR Response.[67]

3.63 In all other situations, FOS will not consider a dispute unless the dispute is lodged with FOS before the earlier of the following time limits:

(i) within six years of the date when the Applicant first became aware (or should reasonably have become aware) that they suffered the loss; and

(ii) where, prior to lodging the dispute with FOS, the Applicant received an IDR Response in relation to the dispute from the Financial Services Provider—within 2 years of the date of that IDR Response.[68]

3.64 However, FOS may still consider a dispute lodged after either of these time limits if FOS considers that exceptional circumstances apply.[69]

3.65 The 2013 FOS independent review found that in 2012–13 there were 133 disputes rejected on the basis that they were outside the time limits. The review did not consider how many disputes were not raised because potential applicants became aware that their circumstances were outside the time limits. The review found that the timeframes should normally be sufficient, but that FOS should report on how it exercises its discretion to allow 'out of time' disputes to use a FOS service.[70]

3.66 The committee notes however that the 2013 review did receive a joint consumer submission raising concerns that the two year timeframe from the end of the contract was quite limiting.[71]

3.67 The committee discusses other EDR schemes and its recommendations for EDR schemes in the next chapter.

Other issues raised by submitters

Level of independence from the banks

3.68 Many submitters suggested that FOS was not sufficiently independent from banks,[72] raising allegations including:

67 Financial Ombudsman Service, *Terms of Reference,* 1 January 2010, p. 14.

68 Financial Ombudsman Service, *Terms of Reference,* 1 January 2010, p. 14.

69 Financial Ombudsman Service, *Terms of Reference,* 1 January 2010, p. 14.

70 Cameron Ralph Navigator, *2013 Independent Review report to the Board of the Financial Ombudsman Service,* p. 63.

71 Cameron Ralph Navigator, *2013 Independent Review report to the Board of the Financial Ombudsman Service,* p. 65.

- current or former bank officers being seconded to FOS or having other relationships with FOS which may lead to perceived conflicts of interest;[73] and
- FOS ruling in favour of the banks because it is funded by the banks.[74]

3.69 The Tasmanian Small Business Council submitted that, in its view, in many cases the FOS does its job acceptably, however, there are continuing issues surrounding the independence of the FOS and its effectiveness in resolving customer disputes.[75]

3.70 FOS informed the committee that the requirements in ASIC Regulatory Guide 139 ensure that FOS:

- operates independent of industry;
- acts impartially and fairly in its decision-making;
- is governed by a board of directors, comprised of equal numbers of consumer and industry directors and an independent chair;
- reports regularly to its stakeholders and publicly on its performance;
- reports systemic issues and serious misconduct to ASIC; and
- undertakes periodic independent reviews.[76]

3.71 The FOS also informed the committee that:

> …the Code of Banking Practice is not an approved code by the ACCC or ASIC, under relevant legislation. It is a code that was introduced by the banks themselves, and it sits above the legal requirements that are imposed on financial services providers.
>
> The code itself has a provision that, where there is a requirement in the code that a bank needs to comply with that is greater than the legal standard, they

72 Name withheld, *Submission 2,* p. 1; Ms Katie Shafar, *Submission 11,* p. 2; Name withheld, *Submission 18,* pp 3–5; Mr Paul Topping, *Submission 25,* p. 1; Mr & Mrs Mytton-Watson, *Submission 29,* p. 9; Mr Brent Renouf, *Submission 42,* p. 4; Mr Gerard O'Grady, *Submission 65,* p. 2; Mr Ken Winton, *Submission 67,* p. 29; Mr & Mrs Sterndale, *Submission 82,* p. 1; Dr Evans Jones, *Submission 83,* p. 12.

73 Ms Katie Shafar, *Submission 11,* p. 2; Name withheld, *Submission 18,* p. 3; Tasmanian Small Business Council, *Submission 61,* pp 12–13; Mr & Mrs Smith, *Submission 141,* p. 19.

74 Mr Brent Renouf, *Submission 42,* p. 4; JMA Parties, *Submission 120,* pp 6–7; Mr & Mrs Smith, *Submission 141,* p. 19; Name withheld, *Submission 152,* p. 2.

75 Tasmanian Small Business Council, *Submission 61,* pp 12–13.

76 Financial Ombudsman Service, *Submission 46,* pp 8–9.

> will comply with the code rather than the legal standard, provided they do not get into a breach of the law if they do that.[77]

3.72 The ANZ acknowledged that 'a common feature of the submissions is that customers are looking for an independent review of their situation and avenues for address.'[78]

FOS, CIO and CCMC funding arrangements

3.73 This section summarises the funding arrangements that are currently in place for FOS, CIO and the CCMC.

3.74 FOS is funded by participating financial service providers through fees including an application fee, an annual user levy based on the size of the business and case fees for disputes handled by FOS.[79] CIO is also funded by participating financial service providers through fees including application fees, an annual user levy based on the size of the business[80] and service fees for complaints received by CIO.[81] The CCMC is funded by annual bank subscriptions.[82]

3.75 The FOS informed the committee about the governance and funding arrangements for FOS:

> The funding of the service is by charging fees and levies to the various financial services providers: banks, insurance companies, superannuation funds, advisers—fees for services.
>
> They are charged a levy based firstly on their size and then a separate levy based on the number of cases they have had in the previous year. Then, for each dispute that comes into the office they are charged a fee, depending on where the case closes in our system. The longer it takes to resolve and the further it goes, the greater the charge.[83]

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77 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 8.

78 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 65.

79 Financial Ombudsman Service, *Apply for membership*, *https://www.fos.org.au/members/apply-for-membership/#id=AFSL*, (accessed 31 March 2016).

80 Credit and Investments Ombudsman, *Applying for CIO Membership*, http://www.cio.org.au/members/apply-for-membership/, (accessed 31 March 2016).

81 Credit and Investments Ombudsman, http://www.cio.org.au/members/member-faqs/are-there-any-fees-for-cio-hearing-a-complaint/, (accessed 27 March 2016).

82 CCMC, *2014–15 Annual Report*, p. 33.

83 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 9.

Committee view

3.76 The committee notes that the funding arrangements that involve a levy that is dependent on the number of cases being raised with FOS for each bank provides an incentive for banks to follow good banking practices and where disputes arise, to resolve them effectively through their IDR arrangements.

3.77 However from the evidence received from submitters and witnesses in this inquiry, FOS, CIO and the CCMC are not generally perceived as being sufficiently effective or independent from banks. Therefore the committee suggests that the EDR bodies, the ABA and ASIC should:

- develop greater cooperation and coordination of their activities in relation to small business under the guidance of the ASBFE Ombudsman which the committee is recommending elsewhere in the report to be the lead agency to coordinate reforms for small business loans;
- provide better communication to borrowers about the nature of the existing funding models and how the system creates incentives for banks to resolve customer disputes in a timely and effective manner; and
- Explore the potential for the ASBFE Ombudsman as an independent body to also take over the role of compliance reporting and enforcement once the new ethical and professional standards are in place. This would allow the de-funding of the CCMC and funds to be allocated to the ASBFEO.

Alternatives through the courts are unaffordable and ineffective

3.78 This section summarises views put forward by submitters about the difficulties associated with pursuing disputes with banks through the courts.

3.79 For disputes that are outside the jurisdiction of EDR schemes, such as FOS, the committee heard that many customers were prevented from taking legal action because they have lost control of their financial resources, or the cost of legal action excludes all but the wealthiest borrowers.[84] In some cases the commercial nature of their business also rules out access to low cost legal services or Legal Aid.[85] A number of submitters argued that the legal process is too costly for the average borrower.[86]

3.80 A witness informed the committee that he was unable to pursue legal action because he had lost control of his financial assets:

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84 Mr Trevor Eriksson, *Submission 101,* p. 2; Tasmanian Small Business Council, *Submission 61,* Attachment 1, pp 7, 9, 18; Mr Erik Fraunfelter, *Submission 68,* p. 2.

85 Mr Michael Sanderson, *Submission 28,* p. 8.

86 Mr Trevor Eriksson, *Submission 101,* p. 2; Mr and Mrs Smith, *Submission 141,* p. 4; Mr Nashaat Sedhom, *Submission 91,* p. 6; Mr Jim Martinek, *Submission 153,* p. 2.

> First of all they send in the receivers who clean out all of your assets and your cash resources so you do not have any money to fight. If you survive that, then they go for bankruptcy.[87]

3.81 A submitter argued that banks and their solicitors have perfected the banks' commercial loan documentation to ensure that the bank's interests are thoroughly protected. Mr McNamee suggested that:

> The result of this is that an SME is unable to resist the will of a bank even in a court of law.
>
> The contractual balance of power between the bank and the customer has moved so far in favour of the bank in recent years that it is impossible for an SME to challenge a bank in court.[88]

3.82 Another submitter suggested that any hope of legal redress or remedy has been extinguished by settlement deeds and prohibitively expensive court processes.[89]

3.83 A submission argued that even if matters make it to court, often the borrower has a significant disadvantage when they are against powerful institutions such as banks.[90] Another submitter had a similar view:

> The court system in Australia is closed to small businesses and individuals attempting to compel banks to abide by their own Code and regulations. The costs are prohibitive and the banks have vast resources at their disposal.[91]

3.84 Submitters also argued that the unaffordability of the court system for addressing loan disputes was recognised by earlier inquiries into Australia's financial system, including the Campbell and Martin inquiries.[92] The Tasmanian Small Business Council also argued that:

> The concerns outlined by the Martin Committee that the judicial system is unfairly weighted towards leading banks—whose resources far outweigh small businesses, farmers, and individuals—is as true today as in 1991.[93]

3.85 A receiver disputed these views arguing that courts are handling disputes regarding loans well:

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87 Mr Trevor Eriksson, *Committee Hansard*, 13 Nov 2015, p. 60.

88 Mr Peter McNamee, *Submission 107*, pp 4, 21.

89 Mr Trevor Hall, *Submission 109*, p. 48.

90 Bank Reform Now, *Submission 116*, p. 27.

91 JMA Parties, *Submission 120*, p. 6.

92 JMA Parties, *Submission 120*, Attachment A, p. 4.

93 Tasmanian Small Business Council, *Submission 61*, p. 26.

> …the Court is already dealing with disputes that arise out of LVR covenant breaches and should a bank or financial institution be accused of using a constructive default (security revaluation) process to impair loans the Court is the best place for such a determination to be made.
>
> …the Court is a more than adequate forum for redress and mediation and that further legislation in this matter may potentially hamstring the ability of the Court to consider cases on their individual merits.[94]

3.86 NAB noted that in some cases resources are available to challenge relevant decisions of the banks. The liquidator of a company has access to the Assetless Administration Fund and to litigation funding, so there is the possibility for liquidators to pursue action against banks if they form the view that the action is necessary, and NAB noted that there are examples of liquidators who have done so.[95]

3.87 The committee wishes to acknowledge the evidence put forward by submitters in which there are many accounts of extreme financial hardship arising from loan contracts that require the borrower to bear all the risk. The power in the contracts is so skewed in favour of banks that the capacity of a borrower to protect their rights is very limited. In addition, even if a borrower can begin a legal case, their prospects of success are limited because of the capacity of banks to 'deep-pocket', out-spend and out-wait the borrower.

Experiences in the UK

3.88 This section summarises allegations that have been made in the UK regarding EDR schemes and the accessibility of courts for borrowers in disputes with banks.

3.89 The Tomlinson report alleged that in the UK there are many businesses that have no effective avenue to raise disputes regarding practices of banks in relation to loans. Tomlinson suggested that the internal dispute resolution systems for some banks in the UK have been absent or ineffective:

> The banks do have internal procedures for settling disputes. Some of the evidence received for this report does suggest these are not working effectively and the decisions made are not impartial within the bank...There is no 'stoppage time' within the banks once a complaint has been made so the activity which the bank is complaining about continues throughout.
>
> Evidence was even submitted of instances where the individual banker that the business has complained about has in fact run the internal complaints procedure against themselves.
>
> Rarely do these processes lead to an adequate resolution for the business and it is apparent that they need an external, impartial body to take a fair

94 Ferrier Hodgson, *Submission 147*, pp 5–6.

95 Mr Geoff Greene, Head, Strategic Business Service, NAB, *Committee Hansard*, 4 April 2016, p. 61.

> decision. However, the delays of going through this process mean that the business is in an even weaker position once they seek external support.[96]

3.90 The Tomlinson report suggested that the UK Financial Ombudsman Service has claim, compensation and business size limits that rule out many businesses. Mr Tomlinson argued that in the UK for businesses unable to access dispute resolution services, there are significant impediments to using the courts to raise their disputes with banks:

> Once a business has been put into administration, the business owner is no longer a director of the business and therefore unable to pursue legal remedies – only the administrator can do this.
>
> …there is much concern that the administrators often have conflicts of interest and are in fact appointed by the bank, or at least on the advice of the bank, meaning there is little incentive for them to initiate legal proceedings. The business owner can then not take any action against what has happened to them unless the bank brings a case against them, for example calling in a personal guarantee, in which case the business can instigate a counter claim. At this point, it is worth bearing in mind that the business owner may be under serious financial strain as a result of the banks actions, possibly having invested personal money into the business prior to its collapse, meaning the cost of taking legal action is unaffordable for them.[97]

3.91 Even if a small business or it owner(s) have resources to pursue a matter through the courts, access to effective legal representation may still be limited. The Tomlinson report noted that law firms that do business with banks may have clauses in their contracts preventing them from taking action against banks.[98] As a result, the pool of lawyers available to advise and conduct cases for small business is limited.

3.92 The UK Financial Conduct Authority has indicated that it is examining the matters raised in the Tomlinson report and that it intends to report on its findings later in 2016.

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96 Lawrence Tomlinson, Entrepreneur in Residence at the Department for Business Innovation and Skills, *Bank's Lending Practices: Treatment of Businesses in distress,* November 2013, pp 14–15.

97 Lawrence Tomlinson, Entrepreneur in Residence at the Department for Business Innovation and Skills, *Bank's Lending Practices: Treatment of Businesses in distress,* November 2013, pp 14–16.

98 Lawrence Tomlinson, Entrepreneur in Residence at the Department for Business Innovation and Skills, *Bank's Lending Practices: Treatment of Businesses in distress,* November 2013, p. 16.

Chapter 4

Other EDR schemes and borrower protections

Introduction

4.1 This chapter examines EDR schemes for ADIs and other legislated borrower protections. Each of the EDR schemes is briefly summarised followed by an analysis of the coverage of the scheme, as well as any gaps identified in the scheme's coverage.

Self-regulation through codes of conduct

4.2 The Code of Banking Practice and the Customer Owned Banking Code of Practice are the two primary sources of self-regulation in the Australian banking industry.

4.3 The Australian Bankers' Association (ABA) manages the Code of Banking Practice (the Code) that applies to their members. The ABA describes the Code as the banking industry's customer charter on best banking practice standards. It sets out the banking industry's key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their banking services. The Code applies to personal and small business bank customers.[1] Operation of the FOS and the role that it plays in relation to EDR and borrow complaints was discussed in detail in the previous chapter, so it is not covered again here.

4.4 ASIC informed the committee that courts have considered that the Code may operate as a contract between banker and customer; however, a breach of the Code does not constitute unconscionable conduct and does not require a bank to subordinate its own interests to that of the borrower. ASIC noted that a breach of the Code is a factor that may be considered by the Court in determining unconscionability.[2]

4.5 The Customer Owned Banking Association (COBA) manages the Customer Owned Banking Code of Practice (COBCOP). COBCOP is described as the code of practice for Australia's credit unions, mutual banks and mutual building societies.[3] COBCOP is discussed further below.

FOSCode

4.6 The FOS has a Code Compliance and Monitoring Team (FOSCode) which is a separately operated and funded business unit of FOS, reporting to the Chief Ombudsman. The Team supports independent committees that monitor compliance with codes of practice in the banking, customer-owned banking, general insurance and

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1 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

2 ASIC, *Supplementary submission 45,* p. 9.

3 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

insurance broking industries. These committees are comprised of an independent Chair, an industry representative and a representative of consumers and small business. The aim is to achieve service standards that people can trust within the respective industries.[4]

4.7 The role of the independent FOSCode committees is to work with both industry and consumers to ensure that key promises made about service delivery are met and that financial service providers have effective systems in place to ensure compliance with those obligations and to resolve disputes with their customers, if and when they arise. This is done by actively monitoring compliance through annual compliance statement returns, shadow shopping, own motion inquiries and investigating concerns lodged by consumers that the codes may have been breached.

4.8 The FOScode committees have undertaken inquiries into a range of matters including whether banks are meeting their obligations to borrowers in financial difficulty, the visibility and accessibility of information for consumers about the Codes and internal and external dispute resolution, chargebacks, direct debits and guarantees.[5]

CCMC

4.9 The CCMC is an independent compliance monitoring body established by the Australian Bankers' Association under clause 36 of the 2013 Code of Banking Practice (the Code). It is comprised of an independent chair, a person representing the interests of the banking industry and a person representing the interests of consumers and small business. This is consistent with the model for self-regulatory governance under ASIC's Regulatory Guide 183.[6]

4.10 The CCMC states that it adopts a collaborative approach to working with code-subscribing banks and aims to be a trusted and valued partner, assisting banks to comply with their Code obligations. The CCMC's Mandate (which is an attachment to the Code) sets out its powers and functions, which include:

- monitoring banks' compliance with the Code's obligations;
- investigating an allegation that a bank has breached the Code, and
- monitoring aspects of the Code that are referred to the CCMC by the ABA.[7]

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4 Financial Ombudsman Service, *The Code Compliance and Monitoring Team*, https://www.fos.org.au/the-circular-22-home/fos-news/the-code-compliance-and-monitoring-team/, (accessed 2 April 2016).

5 Financial Ombudsman Service, *The Code Compliance and Monitoring Team*, https://www.fos.org.au/the-circular-22-home/fos-news/the-code-compliance-and-monitoring-team/, (accessed 2 April 2016).

6 CCMC, *Submission 4*, p. 1.

7 CCMC, *Submission 4*, p. 1.

4.11 The CCMC informed the committee that the Code is a voluntary code of conduct which sets standards of good banking practice for subscribing banks to follow when dealing with individual or small business customers of a code-subscribing bank, or a guarantor. The CCMC indicated that:

> Eighteen banks, representing 13 banking groups, currently subscribe to the Code meaning that it covers approximately 95% of the Australian retail banking industry.[8]
>
> Once a bank has subscribed to the Code, it becomes part of the enforceable contract between the customer and the bank. A breach of the Code by a bank is a breach of that contract.[9]

CCMC jurisdiction limits

4.12 Routine CCMC investigations are limited to matters that occurred within the previous 12 months, however the CCMC can request a bank's permission to go beyond 12 months or the CCMC can initiate an own motion inquiry:

> The 12-month rule…arises quite frequently when complaints are received. When it does arise, our experience to date is that, mostly, the banks will agree to allow us to go behind the 12-month period…Once a bank declines to allow us to go beyond the 12-month period in the code, that is the end of the matter from our perspective…[except] if we were to form a view that, indeed, the bank was being unreasonable in refusing its permission to go beyond the 12-month rule, we could, under another provision in the code, initiate an own motion inquiry.[10]

4.13 The CCMC acknowledged that there are no specific provisions in the Code that relate to the revaluation of security or impairment of loans. The CCMC is therefore not able to investigate issues relating to impairment or valuations. The CCMC informed the committee that it has no record of investigating any matters where impairment or valuations were raised as part of a complaint, nor any record of any individual or small business bank customer approaching the CCMC with a complaint solely about revaluation of loan security or loan impairment.[11]

4.14 The CCMC also informed the committee that the code does impose a number of obligations that are relevant to this inquiry. The obligations are:

- clause 27, to act as a prudent and diligent banker in assessing a customer's ability to repay a credit facility;

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8 CCMC, *Submission 4,* p. 1.

9 CCMC, *Submission 4,* p. 2.

10 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, pp 13, 14.

11 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

- clause 28, an obligation to try to assist customers with their agreement and cooperation to overcome financial difficulties with any credit facility held with the bank; and
- clause 20, to provide at least 10 days' notice to a small business customer of any change to terms and conditions where the change will be materially adverse to the customer and will only affect that customer.[12]

4.15 The Tasmanian Small Business Council argued that the CCMC rules mean that many matters are not heard:

> In fact, any of the 16 banks against which a complaint has been lodged can refer the complaint to 'any forum', meaning they can commence an action in the court, refer customers to the Financial Ombudsman or, as has recently been the case in drought-affected farming areas, force customers into mediation. In each of these cases, customers' rights to have the monitors investigate the code breaches are dishonestly taken away.[13]

4.16 The CCMC has a limited capacity to assist borrowers. The only action the CCMC can take is to determine whether a breach of the Code has occurred. The CCMC informed the committee that:

> The sole remedy we can provide for an individual is to say, 'Yes, you are quite right. Bank X did breach the Code Of Banking Practice.' The reason people come to us rather than going elsewhere is usually because they want to, for example, have a technical finding of a breach of the code which might assist them in litigation or other dealings.[14]
>
> The Code does not give the CCMC the power to make orders for compensation, declarations on the rights and entitlements of parties or issue fines and penalties. Where an allegation to the CCMC is concurrently also in another forum (such as FOS or a Court) the CCMC puts its process on hold until that other forum has finished its review.[15]

4.17 The ABA informed the committee that the limitations on the CCMC apply to avoid duplication of process, possible inconsistent findings and to ensure that an allegation a bank has breached the code is made in a timely way.[16]

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12 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 12.

13 Mr Geoffrey Fader, Chair, Tasmanian Small Business Council, *Committee Hansard*, 16 October 2015, p. 1.

14 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 17.

15 CCMC, https://forms.fos.org.au/CCMC/(S(nvvafgnb02z3ow1ceufs5qj2))/Complaint/New, (accessed 23 March 2016).

16 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Committee Hansard*, 18 November 2015, p. 29.

4.18 The CCMC informed the committee that under the terms of its mandate, any decision made by the FOS to the effect that a code-subscribing bank has breached the Code will be adopted by the CCMC.

4.19 The Code applies to retail banking customers of banking services provided by banks to individual and small business customers or potential customers as defined in the Code. The CMCC advised the committee that:

> It also applies to any individual from whom a bank has obtained or proposes to obtain a bank guarantee. Thirteen banking groups currently subscribe to the code, meaning that it covers approximately 95 per cent of the Australian retail banking industry. The code forms an important part of the broader national consumer protection framework. It is a means by which code-subscribing banks complement statutory law and regulation in areas relating to service issues for consumers, standards of professional conduct, banking practices and, importantly, ethical behaviour.[17]

4.20 In its 2013–14 Annual Report, the CCMC noted that in 2013–14, 26 of 48 and that in 2012–13, 12 of 84 alleged breaches of the Code were confirmed by the CCMC.[18] As noted above the CCMC is only able to determine that a breach has occurred.

Borrower awareness of the code

4.21 The Tasmanian Small Business Council argued that the existence and contents of the Code of Banking Practice are not well known by customers:

> The Australian Bankers' Association say publicly that the Code of Banking Practice is part of the lending agreement which customers enter into. Few, if any, banks actually provide a copy of that code to the customer when the time comes to sign the documentation, although it is referred to consistently through the lending agreement.[19]

4.22 The ABA argued that information on EDR and the Code is readily available and that information about these arrangements must be prominently published by the bank, including in branches, on internet sites and in telephone banking services.[20]

4.23 The CCMC provided information about how it sought to inform bank customers about the banking code of practice:

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17 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 12.

18 CCMC, *2013 –14 Annual Report*, p. 24.

19 Tasmanian Small Business Council, *Committee Hansard*, 16 October 2015, pp 3, 7.

20 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Committee Hansard*, 18 November 2015, p. 29.

> …there is a listing of the number of locations to which the code is actually provided, one of which is 'every branch of every bank in the country'. In order to ensure that these are readily available to members of the public, the CCMC has its staff undertake mystery shopping expeditions: in different locations they simply walk into a branch to see whether the code is readily available—and not only in branches but on a range of websites. There are also several hundred subscribers, in various ways electronically, to information about the code. That represents consumer groups and others.[21]

4.24 The CCMC also noted that it maintains contact with financial counsellors and other bodies that are dealing with people in financial trouble. The CCMC informed the committee that:

> For example, the most prominent one is Financial Counselling Australia. There are approximately a thousand financial counsellors across Australia. We address and attend their conferences, we send staff out talking to consumer groups, we talk to local legal groups—legal aid groups and other community legal centres.[22]

Credit and Investments Ombudsman

4.25 The Credit and Investments Ombudsman (CIO) provides a free, independent and partial dispute resolution service to facilitate the resolution of complaints between consumers and participants of the EDR scheme. In doing so, the CIO provides both consumers and financial services providers with an alternative to legal proceedings for resolving financial services disputes. The CIO is required to meet benchmarks prescribed and approved by ASIC to operate as an EDR scheme in the financial services industry. Participants of the CIO scheme include non-bank lenders, finance brokers, credit unions, building societies, debt collection firms, financial planners, trustees, servicers, aggregators, mortgage managers, and many more.[23]

4.26 The CIO is also funded by participating financial service providers through fees including application fees, an annual user levy based on the size of the business[24] and service fees for complaints received by the CIO.[25]

4.27 The CIO scheme has the following limits in relation to small business:

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21 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 15.

22 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 16.

23 Credit and Investments Ombudsman, Our Role, http://www.cio.org.au/about/our-role/, (accessed 27 March 2016).

24 Credit and Investments Ombudsman, *Applying for CIO Membership*, http://www.cio.org.au/members/apply-for-membership/, (accessed 31 March 2016).

25 Credit and Investments Ombudsman, http://www.cio.org.au/members/member-faqs/are-there-any-fees-for-cio-hearing-a-complaint/, (accessed 27 March 2016).

- the borrower did not have net assets of $2.5 million or more for each of the two financial years prior to the date of making the complaint;
- the borrower did not have a gross income of $250,000 or more for each of the two financial years prior to the date of making the complaint; and
- excluding claims where the financial services provider had, before the complaint was received by the scheme, commenced legal proceedings against the small business complainant in relation to a credit facility having a credit limit of more than $2 million.[26]

Customer Owned Banking Code Compliance Committee

4.28 The Customer Owned Banking Code Compliance Committee (Code Compliance Committee) supports credit unions, mutual banks and mutual building societies to achieve their service standards. The Code Compliance Committee monitors compliance with the Customer Owned Banking Code of Practice (COBCOP) which is a set of promises outlining how Australia's customer owned banks should behave in their dealings with customers.[27]

4.29 The role of the Code Compliance Committee is to investigate allegations that a customer owned bank has breached its obligations under the COBCOP and to work with the customer owned bank to ensure the breach does not happen again.[28]

ASIC

ASIC's role in regulating credit

4.30 In relation to issues raised by the terms of reference, ASIC identified that its role as the national regulator for consumer credit is based on:

- administering the broader regulatory framework for insolvency practitioners, including receivers, under the Corporations Act; and
- to the extent that it applies, the regulatory framework for lenders under the ASIC Act and the *National Consumer Credit Protection Act 2009* (National Credit Act)—noting that the National Credit Act does not apply to loans for business purposes.[29]

4.31 ASIC also administers the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which contains provisions relating to prohibitions on

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26 Credit and Investments Ombudsman, *Credit and Investments Ombudsman Rules*, 5 May 2014, pp 12, 40.

27 Customer Owned Banking Code Compliance Committee, *About us*, http://www.cobccc.org.au/about-us/, (accessed 2 April 2016).

28 Customer Owned Banking Code Compliance Committee, *About us*, http://www.cobccc.org.au/about-us/, (accessed 2 April 2016).

29 ASIC, *Submission 45*, pp 3, 6.

unconscionable conduct and false or misleading representations in relation to financial services, including credit. These ASIC Act provisions are not limited to consumer credit, and extend to credit for business and commercial purposes.[30]

4.32 ASIC's role in relation to commercial lending and borrowing is more limited as consumer protection laws under the Australian Consumer Law do not apply.[31] For commercial lending activity, ASIC's role is limited to administering the consumer protection provisions in the ASIC Act, including the prohibition on false or misleading representations and unconscionable conduct.[32]

4.33 ASIC regulates the conduct of lenders and receivers (and other insolvency practitioners) under the provisions of the Corporations Act, the ASIC Act and the *National Consumer Credit Protection Act 2009* including the National Credit Code.

4.34 ASIC noted that disputes between lenders and borrowers, including the actions of receivers, do not necessarily suggest that the lender or receiver has breached a regulatory obligation enforced by ASIC. This is more so the case in relation to commercial lending and borrowing, where ASIC has a limited jurisdiction compared with consumer credit. In addition, the focus of ASIC's regulatory action must be the public interest. Given limitations of ASIC's resources, ASIC's role does not extend to taking actions against lenders or receivers on behalf of individuals or businesses in relation to their private disputes.[33]

4.35 ASIC informed the committee that:

> ASIC does not intervene in individual disputes in financial services and corporate regulation, and is not resourced to undertake such a role. ASIC's role is not to provide an ombudsman or mediation service for individual disputes. This includes disputes between lenders and debtors. The exception is where such action would serve a broader public interest. The regulatory obligations for commercial lending activity are far more limited than for retail (consumer) lending. In general, the number of reports we have received relating to commercial lending and the issues relating to the inquiry's terms of reference is small.[34]

30 ASIC, *Submission 45*, p. 7.

31 ASIC, *Submission 45*, p. 7; see also Mr Peter Kell, Commissioner, ASIC, *Senate Economics Committee Hansard*, Inquiry into the post-GFC banking sector, 8 August 2012, p. 59.

32 ASIC, *Submission 45*, p. 9.

33 ASIC, *Submission 45*, p. 8.

34 Footnote: ASIC, *Submission 45*, p. 6.

National Consumer Credit Protection Act

4.36 ASIC is the national regulator for consumer credit under the *National Consumer Credit Protection Act 2009* (NCCP Act). Central elements of the NCCP Act include:

- a licensing regime that imposes minimum standards of conduct for credit industry participants, including requirements for competence, mandatory membership of an ASIC-approved external dispute resolution (EDR) scheme, compensation arrangements, and adequate compliance and risk management systems. The licensing regime provides mechanisms to cancel an Australian credit licence (credit licence) and ban persons from engaging in credit activities;
- responsible lending obligations (discussed below); and
- lender disclosure and conduct obligations under the National Credit Code which includes specific requirements for pre-contractual disclosures, interest charges, mortgages, and enforcement action.[35]

Previous consideration of reforms

4.37 ASIC informed the committee about previous reforms that considered extending protection of the National Consumer Credit Protection Act to small business. In December 2012, the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 was released for public consultation. Among other items, the bill proposed amendments to the National Credit Act to extend regulation to small business lending, with a focus on disclosure of fees by finance brokers and responsible lending provisions focused on equity stripping (i.e. the practice of lending to small business borrowers seeking to refinance another loan on which they had defaulted on repayments and where the new loan is to be secured by a mortgage over residential property).[36]

4.38 In February 2013, the Commonwealth government announced that it had decided that any reforms to small business finance would be deferred as consultation had indicated a need to further examine a number of key issues, including whether the benefits could be delivered in a more targeted and effective way. Further reforms have not been proposed. ASIC indicated that its understanding is that some small business representatives were concerned that the proposed amendments may restrict lending in the sector.[37]

4.39 While some submitters and witnesses to this inquiry have sought reforms to small business finance, some small business peak bodies do not share that view. For

35 ASIC, *Submission 45*, p. 6.

36 ASIC, *Submission 45*, p. 18.

37 ASIC, *Submission 45*, p. 18.

example, the Commercial Asset Finance Brokers Association of Australia (the national peak professional body of the equipment finance industry) made the following statement in its 2013–14 annual review:

> It is well known that CAFBA, through its association with the Council of Small Business Organisations of Australia (COSBOA), was the primary force behind the previous government's deferral of NCCP Phase 2, which would have pushed consumer type legislation into small business lending. The effect of this would be to make lending to small business more difficult and more expensive.[38]

4.40 The committee notes the above concerns about access to finance. However, during its inquiry into business set-up transfer and closure, the Productivity Commission found that access to finance is not a significant barrier for most new businesses and that businesses with a credible business plan are successful in seeking debt or equity finance.[39]

Responsible lending

4.41 The NCCP Act requires all providers of consumer credit, including brokers and intermediaries to meet reasonable lending conduct requirements so that they do not provide credit products and services that are unsuitable, either because they do not meet the consumers' requirements or because the consumer does not have the capacity to meet the repayments.[40] ASIC informed the committee that:

> Responsible lending obligations, which mandate that credit licensees must make inquiries into a consumer's objectives and financial situation and verify their financial situation. Credit licensees must assess this information and not provide or suggest credit to a consumer if that credit will not meet the consumer's objectives or the consumer will not be able to meet their financial obligations without substantial hardship.[41]

4.42 Data collected by APRA shows that the responsible lending obligations have had a positive impact on the credit industry. The amount of new approved low documentation loans issued by ADIs declined 89.52% from approximately $4.8 billion on 30 June 2009 to $0.5 billion on 30 September 2013. As a percentage of all new household loans approved per quarter, the proportion of low doc loans fell from 6.95% to 0.66% over the same period.[42]

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38 Commercial Asset Finance Brokers Association of Australia, *2013–14 Annual Review,* p. 2.

39 Productivity Commission, *Business Set-up, Transfer and Closure,* September 2015, p. 15.

40 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

41 ASIC, *Submission 45,* pp 6–7.

42 ASIC, *Submission 45,* p. 11.

4.43 ASIC undertakes regular monitoring of responsible lending, covering 79 per cent of owner-occupied mortgages in the big four banks every year and the remaining 160 ADIs every 13 years.

4.44 FOS informed the committee that when a consumer cannot make their loan repayments, they may claim their financial services provider should not have given them the loan because they never had the capacity to repay it. The consumer may lodge a dispute with FOS seeking compensation for a loss resulting from provision of the loan. FOS refers to this as a "responsible lending" dispute. When FOS considers responsible lending disputes, FOS decides whether it was appropriate for the financial services provider to enter into the loan.[43]

Unconscionable conduct

4.45 The ASIC Act contains prohibitions on unconscionable conduct and false or misleading representations in relation to financial services, including credit. These provisions are not limited to consumer credit, and extend to credit for business and commercial purposes.[44]

4.46 In seeking to enforce loans, lenders are subject to a prohibition on engaging in unconscionable conduct. Section 12CB of the ASIC Act prohibits unconscionable conduct in relation to credit facilities, including commercial loans. The protections can apply to conduct in relation to the initial provision of credit and the collection of a debt owing under a contract, including enforcement action. Through its submission, ASIC informed the committee that:

> Whether particular conduct is unconscionable turns on the specific facts of the case. Establishing unconscionable conduct across a number of loan transactions can be more difficult than establishing unconscionable conduct in an individual transaction. In addition, the courts impose a high bar when a party is seeking to establish unconscionable conduct in relation to a commercial loan, as performance of contracted promises freely and fairly made is central to commerce.[45]

4.47 Where lenders are regulated under National Credit Code they are generally required to provide debtors with a written default notice containing prescribed particulars. Lenders seeking to enforce loans must also meet certain other requirements, including that:

- at least 30 days be given to the debtor to rectify a default; and

43 Financial Ombudsman Service, *Submission 46*, p. 5.

44 Treasury, *Answers to questions on notice*, taken on 1 December 2015, received on 14 December 2015.

45 ASIC, *Submission 45*, p. 16.

- a lender cannot commence enforcement action until it has dealt with any hardship application made by the debtor.[46]

4.48 ASIC informed the committee that it is very difficult to establish conduct that is unconscionable under the law. There have been some court cases, but borrowers have had a very difficult time in establishing their case. ASIC indicated that:

> …we have not seen a case where we would say we get involved and will explore or better something or widen the class or the definition of 'unconscionable conduct'. [47]
>
> In making a finding of unconscionability, Courts have generally concluded that some moral fault or responsibility or lack of ethics was involved. This requires a consideration of legal, commercial and social norms. The courts therefore impose a high bar when a party is seeking to establish unconscionable conduct in relation to a commercial loan, as performance of freely made contractual promises is central to commerce.
>
> In addition, the statutory unconscionable conduct prohibition as it applies to the provision of credit does not extend to borrowers who are publicly listed companies.[48]

Unfair contract terms

4.49 Consumers are also protected from unfair terms in standard form consumer contracts. The ASIC Act allows a court to declare void a term in a standard form consumer contract for certain financial products or financial services that it finds to be unfair. A term is unfair if it:

- would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

4.50 The Financial System Inquiry (FSI) considered unfair contract term provisions and supported the government's proposal to extend unfair contract term protections to small businesses and encouraged industry to develop standards on the use of non-monetary default covenants.[49] From 12 November 2016, unfair contract term protections will also be available to small businesses (businesses employing

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46 ASIC, *Submission 45*, p. 16.

47 Mr Warren Day, Senior Executive Leader, ASIC, *Committee Hansard*, 23 November 2015, p. 11.

48 ASIC, *Supplementary submission 45*, p. 4.

49 Financial System Inquiry, *Final Report*, December 2014, p. xxvii.

fewer than 20 people) when they engage in standard form contracts worth no more than $300,000, or $1 million if the contract duration is longer than 12 months.

4.51 The FOS supported the introduction of unfair contract terms for small business. However, in doing so, the FOS noted that the introduction of the legislation may not address all of the concerns being considered by the committee. For example, if there has been a significant fall in the loan-to-valuation ratio, it may be fair and reasonable for a lender to require that the level of borrowing be reduced rather than repaid, in order to meet the lending-to-value ratio requirements. That may not necessarily be an unfair contract term in itself.[50]

Financial hardship

4.52 The National Credit Code also provides borrowers with mechanisms to seek changes to credit contracts on the grounds of hardship and for the courts, on application, to reopen unjust transactions or to annul or reduce unconscionable interest or other charges.[51] ASIC informed the committee that:

> A lender may agree to change the terms of the credit contract in response to the hardship notice by reducing the repayments, extending the period of the contract or postponing the due date, or any combination of changes.
>
> The lender need not agree to change the credit contract as a result of a hardship notice. This is especially true if the lender does not believe there is a reasonable cause (such as illness or unemployment) for the debtor's inability to meet their obligations or the lender reasonably believes the debtor would not be able to meet their obligations under the contract even if it were changed.
>
> If the lender decides not to change the credit contract, the debtor may take the matter to an EDR scheme. This has become a significant source of disputes for EDR schemes.[52]

4.53 The eligibility provisions for financial hardship have varied in recent years in the following way:

- for loans established from March 2013, there are no caps on the loan value. Prior to March 2013, there were upper limits that varied over time and between states and territories;[53] and

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50 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 8.

51 ASIC, *Submission 45*, p. 18.

52 ASIC, *Submission 45*, p. 20.

53 ASIC, *Trouble with debt*, https://www.moneysmart.gov.au/managing-your-money/managing-debts/trouble-with-debt#hardship, (accessed 23 March 2016).

- since January 2014, FOS has been able to consider financial difficulty application and has the power to vary the terms of some personal or residential credit contacts.[54]

4.54 The CCMC informed the committee that during the 2014-15 financial year, the CCMC conducted an own motion inquiry into how well banks comply with the Code's financial difficulty obligations. The CCMC inquiry confirmed that banks had improved the way they deal with customers, including small businesses, when they were experiencing difficulty repaying a credit facility.[55]

> This inquiry found that banks had in place adequate systems and procedures to meet these obligations. The inquiry did, however, make some recommendations to promote better informed decisions by prospective guarantors.[56]
>
> During the last financial year, 44 allegations were received alleging that banks had breached their obligations under the code. Of this number, we determined that 19 were actual breaches of the code and that only five of the breaches related to the provision of credit obligations.[57]

4.55 In its inquiry into financial difficulty, the CCMC made the following recommendations for ways in which banks could increase their level of compliance with the Code:

- ensure that their processes and procedures are applied consistently for all customers, including those who are not represented by a consumer advocate;
- ensure processes are appropriate for customers with particular issues, for example those related to poor mental health or family violence;
- consider whether their procedures are adequate to avoid making unnecessary or inappropriate requests for information that may be difficult or time consuming for customers to fulfil; and
- continue to identify areas where further improvements can be made by analysing data regarding customers who request assistance more than once and complaints related to financial difficulty assistance.[58]

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54 Cameron Ralph Navigator, *2013 Independent Review report to the Board of the Financial Ombudsman Service,* p. 54.

55 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

56 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

57 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

58 Code Compliance Monitoring Committee, *Financial Difficulty Own Motion Inquiry,* November 2015, p. 7.

Australian Small Business and Family Enterprise Ombudsman

4.56 The Australian Small Business and Family Enterprise (ASBFE) Ombudsman was established on 15 March 2016.[59] Under the assistance function, the Ombudsman responds to requests for assistance by an operator of a small business or family enterprise.[60]

4.57 The assistance requested may relate to a dispute with another entity. In that case, the ASBFE Ombudsman may recommend that an alternative dispute resolution process be undertaken. The ASBFE Ombudsman may keep a list of alternative dispute resolution providers, to assist small businesses and family enterprises in accessing alternative dispute resolution.[61] Treasury described this function of the ASBFE Ombudsman as providing a concierge service for small business dispute resolution.[62]

4.58 The ASBFE Ombudsman has information-gathering powers and where directed by the Minister, the ASBFE Ombudsman would inquire into matters including by taking evidence in hearings.[63] As discussed in chapter 2, the committee is recommending a significantly enhanced role for the ASBFE Ombudsman.

Farm debt mediation

4.59 Farm debt mediation (FDM) is a mechanism to facilitate a discussion between a farmer and their bank or other lender so they can better negotiate their financial position. The process uses an independent mediator to help identify workable solutions.[64] The ABA informed the committee that:

> The ABA believes that farm debt mediation can deliver positive outcomes for all parties. The process varies across jurisdictions. Currently NSW and Victoria are the only states with mandatory farm debt mediation schemes. The ABA has advocated for some time for the implementation of a consistent farm debt mediation model across Australia.[65]

4.60 The ANZ encouraged the committee to 'consider recommending a national approach to farm debt mediation', and noted that:

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59 Announcement by Minister for Small Business and Assistant Treasurer, the Hon Kelly O'Dwyer MP, http://www.asbfeo.gov.au/news-article/asbfeo-commences, (accessed 22 March 2016).

60 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, p. 3.

61 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, pp 3–4.

62 Treasury, *Australian Small Business and Family Enterprise Ombudsman*, http://www.treasury.gov.au/Policy-Topics/Business/Small-Business/Family-Enterprise-Ombudsman, (accessed 2 April 2016).

63 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, p. 4.

64 Australian Bankers Association, *Submission 47*, p. 12.

65 Australian Bankers Association, *Submission 47*, p. 12.

> While formal schemes are not currently available in all states and territories, ANZ's approach is to offer farm debt mediation in all cases, even if it is not mandatory. All Australian farmers should have access to high-quality, independent mediation processes operating under nationally consistent principles.[66]

4.61 NAB supported the development of a national farm debt mediation scheme:

> …a single national farm debt mediation scheme should be implemented as a matter of priority. Our experience of the existing state based farm debt mediation schemes is positive. That is particularly so where there is additional legal, financial, health and community support provided to our farmers. However, there are areas of ambiguity and inconsistency across the various state schemes which would benefit from a national approach.[67]

4.62 The Department of Agriculture informed the committee that a national approach will ensure that all farmers, regardless of where they do business, have access to a consistent and fair method of addressing debt serviceability issues:

> The FDM working group was re-established and has developed an options paper which identifies key aspects and processes within a national FDM approach and how these could be implemented consistently Australia-wide. Further work is planned with the states and territories, as well as other key stakeholders, to settle the finer details and establish the best processes for implementing a nationally consistent scheme in due course.[68]

Commercial arbitration

4.63 The committee has noted the existence of commercial arbitration providers and sought the banks' views of the use of commercial arbitration for small business and commercial loan disputes that fall outside the jurisdiction on EDR schemes.

4.64 ANZ acknowledged that in some cases borrowers cannot afford to participate in court proceedings against banks, but indicated that ANZ was not in favour of commercial arbitration, stating that:

> Ultimately, the arbitration process is going to require exactly the same as the court process. It is going to be just as costly. Mediation is clearly a better outcome if the parties can get to a point where they can agree. I am aware of several cases where there is no way there is going to be an agreement and, for the most part, they will go through a court process. It is unfortunate, but that is just where it is. We get to a point where you cannot agree to something that you absolutely do not agree with. It is not about the

66 Mr Graham Hodges, Deputy Group Executive Officer, ANZ, *Committee Hansard*, 13 November 2016, p. 65.

67 Mr Timothy Williams, General Manager, Group Strategic Business Services, National Australia Bank, *Committee Hansard*, 18 November 2015, pp 8–9.

68 Department of Agriculture, *Submission 44*, pp 2–3.

> dollars here or there; it is about fundamental disagreement. That is where you have those problems.
>
> I know that we have got to a point with some of our customers where we have paid them to get legal advice to help them through an issue because they have a completely different view. We have paid for them to get independent legal advice to help them better understand their situation because we believe that they are wrong. They are better to get the advice there and come back and mediate, rather than to go through a whole court process. But there are some customers—and we are talking about at the very margins—who will never agree with you. They will fight to the last. I would say one or two of the customers who are in dispute in this inquiry fit into that camp.[69]

4.65 The Commonwealth Bank indicated that, in its view, commercial arbitration had provided an expedient alternative in the past, however the costs of the process were now more substantial:

> …whilst in the past it had quite an attractive element to it, these days commercial arbitration itself is quite a lengthy, time consuming and legalistic process. Perhaps to just take your question away from commercial arbitration per se and to look at some alternative dispute mechanisms, my response to that would be: in the case of small business, that might be an appropriate position to take. However, I imagine that, in the case of medium to large businesses, we tend to operate on the basis that those businesses are able to pursue their legal rights if the parties are unable to come to an agreement.[70]

4.66 In 2010, the *International Arbitration Act 1974* (Cth) was amended to increase the effectiveness, efficiency and affordability of international commercial arbitration.[71] In May 2010, the Standing Committee of Attorneys-General agreed to implement a Model Commercial Arbitration Bill (Model Bill) to apply to domestic arbitration in Australia. These reforms were aimed at harmonising domestic arbitration law with the law applying to international arbitration. The first State to implement the Model Bill was NSW which passed the *Commercial Arbitration Act* 2010 in June 2010. The majority of other states and territories in Australia have now followed suit. These reforms provide the framework for internationally experienced

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69 Mr Graham Hodges, Group Chief Executive Officer, ANZ, *Committee Hansard,* 4 April 2016, p. 31.

70 Mr David Cohen, Group Executive for Corporate Affairs and Group General Counsel, Commonwealth Bank of Australia, *Committee Hansard*, 4 April 2016, p. 40.

71 Australian Centre for International Commercial Arbitration, http://acica.org.au/about, (accessed 8 April 2016).

arbitrators to resolve local, cross-border and international disputes on Australian territory.[72]

4.67 The committee noted that in general the fees for commercial arbitration are still likely to be lower than court costs based on the example fees set out in the Australian Centre for International Commercial Arbitration rules. The example fees include a $2 500 registration fee, plus an administration fee ranging from 1 per cent of the dispute for dispute up to $500 000 to a maximum fee of $60 000.[73] The costs are generally borne by the unsuccessful party, however, the arbitration process can apportion costs between the parties.[74]

Summary of dispute resolution schemes and consumer protections

4.68 Table 3.1 provides a summary of the existing dispute resolution schemes and consumer protections that a borrower may consider if they have a dispute with their lender.

72 Australian Centre for International Commercial Arbitration, http://acica.org.au/about, (accessed 8 April 2016).

73 Australian Centre for International Commercial Arbitration, http://acica.org.au/assets/media/Rules/2016-Rules-and-Schedule/ACICA-Fee-Schedule-2016.pdf, (accessed 8 April 2016).

74 Australian Centre for International Commercial Arbitration, *Arbitration Rules*, 1 January 2016, p. 36.

Table 4.1: Existing dispute resolution schemes and consumer protections

Protections and dispute mechanisms available to borrowers	Retail / Residential	Small Business	Larger Commercial
Internal dispute resolution with lenders	Y	Y	Y
Financial Ombudsman Service	Y	Some	N
FOSCode – FOS Code Compliance monitoring team	Y	Some	N
Code Compliance Monitoring Committee^^	Y	Some	N
Credit and Investments Ombudsman***	Y	Some	N
Customer Owned Banking Code Compliance Committee#	Y	Some	N
Responsible lending NCCP Act	Y	N	N
Financial hardship NCCP Act	Y	N	N
Prohibitions on unconscionable conduct###	Y	Y	Y
Protection from unfair contract terms##	Y	Some	N
Australian Small Business and Family Enterprise Ombudsman*	N	Concierge only	N
National Farm Debt Mediation**	N	N	N
Commercial arbitration	N	N	Some
Taking action through the courts	Y	Y	Y

Source: Treasury, *Answers to questions on notice*, taken on 1 December 2015, received on 14 December 2015. # Customer Owned Banking Association, *Customer Owned Banking Code of Conduct*, January 2014, p. 6. # The COBCOP notes that the code may be voluntarily applied to other customers. ## ASIC information sheet, *Unfair contract term protections for small businesses.* *Announcement by Minister for Small Business and Assistant Treasurer, the Hon Kelly O'Dwyer MP, http://www.asbfeo.gov.au/news-article/asbfeo-commences, *Australian Small Business and Family Enterprise Ombudsman Act 2015*, pp 6–7, Treasury, *Australian Small Business and Family Enterprise Ombudsman*, *http://www.treasury.gov.au/Policy-Topics/Business/Small-Business/Family-Enterprise-Ombudsman*, (accessed 22 March 2016). *** Credit and Investments Ombudsman, *Credit and investment ombudsman rules,* 5 May 2014, p. 14. ** Department of Agriculture, *Submission 44*, p. 2. ### ASIC *Supplementary submission 45*, p. 4.

Committee view

4.69 As discussed in chapters 2 and 7, both borrowers and lenders have discretion to make commercial judgments under loan contracts that enable them to take actions that, theoretically, significantly affect the financial position of the other party. In practice only the small business borrower is likely to be significantly affected. While the committee appreciates that these are private contracts that parties are able to freely enter into, the committee is concerned that the transparency and accountability associated with the discretion to make commercial judgements by banks is insufficient for customers to be assured that they are being treated fairly at all times.

4.70 Where disputes arise that affect the interests of banks, the loan contracts, prudential standards and accounting standards allow the banks to adequately protect their interests. Borrowers, on the other hand, have limited power or capacity to negotiate contract terms with banks when loans are established. Where disputes affect borrowers' interests:

- borrowers subject to circumstances including receivership are often unable to use the court system to protect their interests during disputes because the borrowers have lost legal control of their financial resources;
- there is a group of borrowers for whom no dispute resolution mechanism exists because their circumstances fall outside the jurisdiction of existing dispute resolution mechanisms; and
- existing dispute resolution mechanisms can be complex, lack transparency and are fragmented across multiple organisations, some of which are not perceived by borrowers to be sufficiently independent from banks.

4.71 The FOS informed the committee that it considers that there are some banks' small business recovery areas where refresher training in relation to provisions of the Code of Banking Practice 'would not go astray'. The FOS also argued that there are provisions of the code that are of great benefit to individuals and small businesses, particularly those relating to lending standards, the taking of guarantees, and hardship.[75]

4.72 The committee considers that refresher training is not sufficient. As recommended in chapter 2, the ASBFE Ombudsman should lead the development and implementation of an appropriate professional standard framework by working with relevant experts in financial services, ethics and education.

ASBFE Ombudsman and EDR schemes

4.73 The committee welcomes the creation of the ASBFE Ombudsman and the assistance function it has in providing a concierge service for dispute resolution, and

75 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 8.

notes that this service has the potential to assist small business to navigate dispute resolution schemes and protections available to them. The committee also welcomes the provisions that enable the ASBFE Ombudsman to recommend that parties to a dispute participate in alternative dispute resolution.

4.74 The ASBFE Ombudsman has the power to:

- gather information and conduct investigations, including through gathering evidence at hearings; and
- publicise the fact that a party withdraws from or refuses to participate in dispute resolution.[76]

4.75 However, the ASBFE Ombudsman is not able to conduct dispute resolution and is not able to provide assistance if the person requesting assistance became aware of the action more than 12 months before the request was made.[77] The committee is concerned about this timeframe. The nature of matters that arise in long term contracts such as consumer and small business loans means that the impact of banks' actions may not be apparent within 12 months. For actions such as irresponsible lending, unfair contract terms or unconscionable conduct associated with troubled loans the impacts on the borrower are likely to occur more than 12 months after the action as many submissions to this inquiry have alleged.

4.76 As noted above, the ASBFE Ombudsman may publicise the fact that a party withdraws from or refuses to participate in dispute resolution. The committee welcomes that as an important aspect of accountability for both parties. However, the committee is concerned that such a penalty is unlikely to compel a bank to participate in dispute resolution and many borrowers will remain unable to seek an independent consideration of their dispute.

4.77 The provisions of the ABSFE Ombudsman Act prevent the ombudsman from recommending commercial arbitration.[78] As discussed earlier in this chapter, commercial arbitration could provide a viable alternative to courts for those businesses and commercial borrowers that do not qualify for EDR schemes. The committee therefore recommends in chapter 2 that the ABSFE Ombudsman be empowered to recommend commercial arbitration for larger commercial loans above its current jurisdiction.

4.78 The committee acknowledges the Australian Government's announcement on 20 April 2016 that ASIC would work with FOS to review FOS's small business jurisdiction with a view to extending FOS's current jurisdiction to include a wider

76 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, sections 3, 71.

77 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, sections 68, 71.

78 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, section 4.

range of small businesses loans, as well as conducting a review of monetary limits and compensation caps.[79]

4.79 In chapter 2, the committee has recommended that the ASBFE Ombudsman coordinates such reforms to ensure that gaps do not remain in the dispute resolution arrangements for small business.

Farm Debt Mediation

4.80 The committee supports the development of a nationally consistent approach to farm debt mediation. The committee notes that some work has been progressed by the Department of Agriculture to develop a nationally consistent farm debt mediation scheme.

4.81 In chapter 2, the committee is recommending the development of a nationally consistent mediation scheme for both farm debt and small business loans. The committee suggests that the development of the small business loan mediation scheme could be informed by existing farm debt mediations schemes and the work undertaken to date to develop a national farm debt mediation scheme.

79 ASIC, *Supplementary submission 45*, pp 9–10.

Chapter 5

The role of property valuers

Introduction

5.1 This chapter discusses the evidence received by the committee about valuers and their role in relation to loans including issues raised by submitters, views of banks, the roles and actions of peak bodies for valuers, prudential requirements for valuation of securities by banks and access to valuation and instructions for borrowers.

5.2 The valuation process is generally used at three different points in time in relation to bank loans:

- the initial funding approval process;
- during the course of a review of existing facilities as required under loan contracts; and
- during the course of the sale of assets.

Market value

5.3 The International Valuation Standards Council (IVSC) provides the following definition of market value that is used by valuers of real property in Australia:

> ...the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing, wherein the parties had each acted knowledgeably, prudently and without compulsion.[1]

5.4 Business valuers in Australia use a slightly different definition of market value:

> …the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length.[2]

5.5 In 1907 the High Court of Australia in *Spencer v. The Commonwealth*, recognised the following four principles for market value:

- the willing but not anxious vendor and purchaser;
- a hypothetical market;

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1 Australian Taxation Office, *What 'market value' means,* 1 July 2015, https://www.ato.gov.au/General/Employee-share-schemes/In-detail/Market-value/Market-valuation-for-tax-purposes/?page=3, (accessed on 16 December 2015).

2 Australian Taxation Office, *What 'market value' means,* 1 July 2015, https://www.ato.gov.au/General/Employee-share-schemes/In-detail/Market-value/Market-valuation-for-tax-purposes/?page=3, (accessed on 16 December 2015).

- the parties being fully informed of the advantages and disadvantages associated with the asset being valued (in the specific case, land); and
- both parties being aware of current market conditions.[3]

5.6 In discussing the concept of market value in *Spencer v. The Commonwealth*,[4] Isaacs J indicated that:

> … to arrive at the value of the land at that date, we have … to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land and cognisant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then present demand for land, and the likelihood as then appearing to persons best capable of forming an opinion, of a rise or fall for what reasons so ever in the amount which one would otherwise be willing to fix as to the value of the property.[5]

Issues raised by submitters

5.7 Submitters and witnesses to the inquiry raised a number of issues and allegations relating to valuers and the accuracy of valuations including:

- significant reductions in valuations between loan establishment and foreclosure or the appointment of receivers;[6]
- whether valuers are sufficiently independent from banks and free from inappropriate influences, such as reduced work, if valuers do not agree with bank requirements;[7]
- the instructions given by banks to valuers and whether those instructions appropriately request market value and are made available to borrowers;[8]

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3 1907 5 CLR 418.

4 1907 5 CLR 418.

5 Australian Taxation Office, *What 'market value' means*, 1 July 2015, https://www.ato.gov.au/General/Employee-share-schemes/In-detail/Market-value/Market-valuation-for-tax-purposes/?page=3, (accessed on 16 December 2015).

6 Name withheld, *Submission 5*, p. 10; Mr & Mrs Randles, *Submission 8*, pp 9, 14; Mr Colin Power, *Submission 12*, p. 5; Mr Barry Alcock, *Submission 19*, p. 3; Mr Frank Galea, *Submission 20*, pp 1, 2; Name withheld, *Submission 21*, p. 2, Aurora Lifestyle Holdings Pty Ltd; *Submission 22*, p. 2; Kelgon Development Corporation Pty Ltd, *Submission 24*, p. 4; Mr Michael Sanderson, *Submission 28*, p. 2; Name withheld, *Submission 31*, p. 2; Mr Lynton Freeman, *Submission 64*, pp 30–31; Mr Yves El Khoury, *Submission 71*, p. 3; The Provincial Financial Group (Provic), *Submission 88*, p. 3; Danielle & Peter Schaumburg, *Submission 95*, p. 3; Consumer Credit Legal Service (WA) Inc., *Submission 56*, pp 9–10;

7 Ms Catherine Kearney, *Submission 33*, p. 2; Mr Lynton Freeman, *Submission 64*, pp 17, 30.

- the methods used by valuers, including:
    - changes in the valuation method (such as multi-purpose or all-in-one line);[9] or
    - the level of rigour involved with drive-by and desk-top valuations,[10]
- the practice of requiring borrowers to pay for valuations requested by banks;[11]
- borrowers not being given access to valuation reports;[12]
- whether valuations appropriately reflected the value of business as a going concern, rather than just the assets;[13] and
- the inadequacy of accountability and dispute resolution in relation to valuers.[14]

Some examples of the concerns raised by submitters

5.8 An accountant from Queensland, indicated that many of his clients had encountered similar issues to those listed above:

> The issues that this raises does show that banks reviewed their exposure to a particular area or client type, engaged valuers to look at this exposure and

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8 Mr Bill Ringrose, *Submission 31,* p. 2; Legal Aid Queensland, *Submission 55,* p. 5; Mr John Dahlsen, *Submission 87,* p. 21; The Provincial Financial Group (Provic), *Submission 88,* p. 1; Danielle & Peter Schaumburg, *Submission 95,* p. 3; Mr Trevor Eriksson, *Submission 101,* p. 1.

9 Mr Eric Fraunfelter, *Submission 68,* p. 1; Mr John Dahlsen, *Submission 87,* p. 21; Mr Romesh Wijeyeratne, *Committee Hansard,* 13 November 2015, p. 20; Mr Trevor Eriksson, *Submission 101,* p. 4.

10 Name withheld, *Submission 5,* p. 10; Mr & Mrs Lock, *Submission 14,* p. 3; Name withheld, *Submission 59,* p. 1; Ms Robyn Toohey, *Submission 62,* p. 2; Mrs Kathryn Johnson, *Submission 90,* p. 1; Legal Aid Queensland, *Submission 55,* p. 5; Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard,* 16 February 2016, p. 11.

11 Kelgon Development Corporation Pty Ltd, *Submission 24,* p. 1; Mr & Mrs Kreutzer, *Submission 39,* p. 9; Tasmanian Small Business Council, *Submission 61,* p. 19; Mr Lynton Freeman, *Submission 64,* p. 22; Mr Robert Barr, *Submission 78,* p. 1; Danielle & Peter Schaumburg, *Submission 95,* p. 7.

12 Mr Barry Alcock, *Submission 19,* p. 3; Mr Bill Ringrose, *Submission 31,* p. 2; Name withheld, *Submission 31,* p. 2; Ms Catherine Kearney, *Submission 33,* p. 2; Legal Aid Queensland, *Submission 55,* p. 5; Tasmanian Small Business Council, *Submission 61,* p. 3; Mr & Mrs Christian, *Submission 74,* p. 1; Mr Robert Barr, *Submission 78,* p. 1; Mr & Mrs Bennette, *Submission 85,* p. 2. Mr Trevor Eriksson, *Submission 101,* p. 1.

13 Mr Barry Alcock, *Submission 19,* p. 3; Mr Bill Ringrose, *Submission 31,* p. 2; Mr Lynton Freeman, *Submission 64,* pp 22, 30; Mr Roy Lavis, *Committee Hansard,* 19 November 2015, pp 7–8.

14 Tasmanian Small Business Council, *Submission 61,* p. 3; Mr Ken Winton, *Submission 67,* p. 3; Mr & Mrs Sterndale, *Submission 82,* p. 1; Mr John Dahlsen, *Submission 87,* p. 21; The Provincial Financial Group (Provic), *Submission 88,* p. 1; Ms Charalambia Evripidou, *Submission 93,* p. 1.

then used those valuers opinions to orchestrate reasons to cease lending. The concerns this raises are:

- Banks are relying on valuers to justify their actions;
- The clients have to pay for these valuations;
- Banks often advise valuers as to how they want a property valued – eg. Fire sale, normal market conditions etc.
- There is significant resistance to valuers providing these valuations to the clients as banks insist it is their valuation – despite the client paying for them;
- The valuer then has all the power, and therefore the risk, as it is their opinion that is making and breaking deals.
- These valuers are only using the property value for sale, and no valuations are being undertaken on the "value of the enterprise". The entire focus is the recoverability by banks and as such, the valuations being used to make these decisions are understated.[15]

5.9 The Tasmanian Small Business Council (TSBC) drew attention to clauses in standard form loan contracts which seek to deny access to valuation reports and seek to prevent borrowers from raising disputes against the banks or valuer.[16]

5.10 A submitter questioned the independence of property valuations, informing the committee that in his view:

> Financiers access valuations either internally or externally. However any valuation has to be acceptable to the institution and secondly external valuers are subject to legal process. In this situation professional indemnity insurance premiums are prohibitive to valuation competition, so by financial pressure and the threat of legal process, financiers' can control all valuation functions.[17]

5.11 The committee was advised that different valuation methods may produce different results. A witness put his views to the committee on the different valuation methods that valuers may use in some cases, as an 'as is' development property, as a direct land comparison, as strata title, or as an in-line property.[18] Another witness provide an example of strata versus in-one-line valuations:

> There was another case…It was a strata development of storage units. On an individual sale it was worth about $3.9 million…But the bank instructed the valuer to value it on one-line and to ignore the strata. So that valuation came in at $1.7 million.[19]

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15 Mr Bill Ringrose, *Submission 31,* p. 2.

16 Tasmanian Small Business Council *Submission 61,* p. 3.

17 Mr Lynton Freeman, *Submission 64,* p. 17.

18 Mr Romesh Wijeyeratne, *Committee Hansard,* 13 November 2015, p. 20.

19 Mr Trevor Eriksson, *Committee Hansard,* 13 November 2015, p. 61.

5.12 A witness informed the committee that:

> …my suggestion is that, given that we have lots of recent valuations by banks—generally every six months they will revalue your projects—they are not stale valuations. Copies of valuations are never given to the borrower even though the borrower pays for them. I think that, if we had the copy of the valuation, we would know the instructions that were given to the valuer in the case of all these Bankwest constructive defaults.[20]

5.13 A submitter made the following suggestions in relation to valuation processes, based on its experience:

- there should be more recognition of the intrinsic uncertainty of valuations when they are used to make decisions with significant consequences for borrowers;
- an independent dispute resolution process should be available;
- instructions to valuers should reflect market value with reasonable sale periods; and
- standards for the qualification and independence of valuers should be applied.[21]

5.14 ASIC informed the committee that in the five years from 1 July 2010 ASIC received 61 reports of alleged misconduct from people raising concerns about banks' treatment of commercial loans that relate to the issues raised in the inquiry's terms of reference. ASIC indicated that some of those matters related to changes in valuation of assets held as security. ASIC ultimately determined not to pursue further regulatory action or enforcement proceedings against a lender in relation to these matters. Generally, this was because ASIC's inquiries did not reveal sufficient evidence of misconduct on which to base an enforcement action. Some matters included allegations that property valuers were conflicted, though further inquiry by ASIC did not indicate any corresponding misconduct by the receiver with respect to this allegation.[22]

How valuations are used by banks

5.15 TSBC argued that the clauses in loan contracts mean that Australian banks are legally allowed to re-value a secured property at the customer's expense. The TSBC alleged that if the valuation shows that the secured property has fallen in value since the loan was agreed, then the bank has the right to default the customer and demand full payment of all amounts owing.[23]

5.16 The committee was informed about a case where a bank was alleged to have made inappropriate use of multiple valuations:

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20 Mr Trevor Eriksson, *Committee Hansard*, 13 November 2015, p. 61.

21 The Provincial Financial Group (Provic), *Submission 88*, pp 4–5.

22 ASIC, *Submission 45*, pp 10–15.

23 Tasmanian Small Business Council *Submission 61*, p. 20.

> After obtaining a home loan for $80,000 seven years prior, Mr and Mrs X began experiencing financial difficulty which led to Bank Y taking possession of their property. As mortgagee in possession, Bank Y sold the property for $50,000. This resulted in Mr and Mrs X owing a shortfall debt of $50,000. During the mortgagee sale process, Bank Y obtained two separate property valuation reports from independent property valuers. The earlier report stated the market value of the property was $60,000, while the later report valued the property at $150,000. Bank Y disregarded the second valuation report, and proceeded to sell the property at auction. Bank Y set a reserve price of $60,000, and sold the property at the fall back price of $50,000. One week later, a third party offered Mr and Mrs X's real estate agent $160,000 for the property. The real estate agent was unaware that the property had been sold at auction one week prior.
>
> Note: A FOS determination concluded that the FSP did not meet its obligations to take reasonable steps to determine the value of the property before selling it.[24]

5.17 One submitter informed the committee that their properties were valued at approximately $5 million, and valued again by the same valuer 12 months later for $1.2 million less. The bank then advised that the client was outside the terms of their agreement and they should seek an alternate financier.[25]

5.18 The Consumer Credit Legal Service (WA) Inc suggested that financial service providers should be required to obtain two separate and independent property valuations and if a significant difference exists between the valuations, financial service providers should be required to undertake further inquiries to ascertain the current market value of the property.[26]

5.19 Legal Aid Queensland provided an example where an agribusiness banker engaged a particular valuation firm to conduct valuations in both 2011 and 2012 when it approved increases in loan facilities. These valuations resulted in a value of around $7.5 million which included improvements valued at $1.9 million. After the borrower experienced cash flow difficulties, the asset management team within the bank engaged a different firm of valuers in 2013. This valuer valued the assets at $3.4 million including improvements at $340, 000.00. Although there were other matters affecting decision making between the borrower and bank, the reduced valuation provided the bank with justification to encourage the borrower to sell the property at the greatly reduced price to 'meet the market'.[27]

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24 Consumer Credit Legal Service (WA) Inc., *Submission 56*, pp 9–10.

25 Mr Bill Ringrose, *Submission 31*, p. 2.

26 Consumer Credit Legal Service (WA) Inc., *Submission 56*, p. 10.

27 Legal Aid Queenland, *Submission 55*, p. 5.

Rural land prices

5.20 The Department of Agriculture indicated that a notable portion of the correspondence received by the Minister for Agriculture regarding debt matters raised issues including:

- banks refusing to provide property valuation documents to farmers;
- use of unreasonable charges or fees for compulsory property valuations;
- re-evaluating properties to 'engineer' defaults, despite farmers not missing required principal and/or interest payments; and
- use of single organisations for valuation and receivership processes, including allegations of using organisations that are known to undervalue property.[28]

5.21 An accountant noted that in some parts of Australia significant price reductions of real property followed extraordinary price increases in the decade prior to the GFC:

> During the 2000s, property prices in Western Queensland increased by over 300%. By way of example, an average price for open downs country in the Longreach region was around $35 per acre around the year 2000. Towards the start of the GFC in 2007/08, prices were being paid around $140 per acre.[29]

5.22 The Department of Agriculture informed the committee that the largest land value declines occurred in northern Australia (Queensland, the Northern Territory, and the Kimberley and Pilbara regions in Western Australia). Land values reported in 2013–14 for some regions in Queensland were as much as 30 per cent below those in 2007–08, in nominal terms. Much smaller reductions in land values occurred in the high rainfall and crop growing regions of northern Australia, and in southern Australia more generally.[30]

Valuing the whole business

5.23 Some submitters raised concerns about whether valuers appropriately considered the value of the whole business as a going concern, rather than the value of the individual assets. A witness shared his view on how valuations had affected him:

> These valuers are only using the property value for sale, and no valuations are being undertaken on the 'value of the enterprise'. The entire focus is the recoverability by banks and as such, the valuations being used to make these decisions are understated.[31]

> The company was made up, as I said, of 50 different companies. We were spread across the whole of the North: we were in Cooktown, Cairns, Mount Isa, Townsville and Mackay, and we had different entities running in

28 Department of Agriculture, *Submission 44*, p. 7.

29 Mr Bill Ringrose, *Submission 31*, p. 2.

30 Department of Agriculture, *Submission 44*, p. 5.

31 Mr Bill Ringrose, *Submission 31*, p. 2.

> different places. What they would do was sell the equipment. For instance, we had a bitumen business out at Mount Isa that was spraying something like 10 million litres of bitumen a year, which is very sizeable. The refinery in Townsville only produces 40 million litres, so we were doing a quarter of the North's bitumen. What they did was sell all the assets.[32]

Prudential requirements in relation to property valuations

5.24 Prudential Standard APS 220 on Credit Quality sets out requirements for how property to be held as security against loans should be valued. An authorised deposit taking institution (ADI) must ensure that assets to be taken as security are accurately and completely identified and documented in facility documentation. The ADI's credit administration function must ensure that the relevant legal requirements are met to maintain the ADI's security position and to provide for its enforcement. Valuation of security must be undertaken prior to drawdown on any facilities.[33]

5.25 An ADI's policies and procedures must provide for regular assessment of security values so as to ensure that the fair value of security underpinning provisioning, and any security coverage measures applied to facilities, is timely and reliably reflects values which an ADI might realise if needed. This is especially important where facilities are secured by assets that are susceptible to significant changes in value (for example, commercial property) or where the margin for diminution of value of security is small (for example, high loan-to-valuation loans).[34]

5.26 In determining the fair value of security, an ADI may utilise the valuations of suitably qualified internal appraisers or external valuers. Policies and procedures covering the fair value of security must address the circumstances in which such valuations would be sought.[35]

5.27 In many instances, property is a prime source of security held by an ADI against facilities it has provided to an entity. As a result, the processes used to value property in determining the fair value of security are significant for the measure of an ADI's impaired assets, provisions and, ultimately, its capital.[36]

5.28 For security held in the form of property, the timing as to when property will be accessed, and ultimately disposed of, is a crucial issue. Of particular importance in valuations is the time allocated to market a property. For purposes of determining the fair value of security involving property, an ADI must assume:

(a) a property would be accessed in the near future;

(b) the period for marketing a property would be up to 12 months, although a longer period (up to a maximum of 24 months) may be adopted for specialised

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32 Mr Roy Lavis, *Committee Hansard*, 19 November 2015, pp 7–8.

33 APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, p. 27.

34 APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, p. 28.

35 APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, p. 27.

36 APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, p. 28.

> or unusual properties when professional valuers advise that this is appropriate; and
>
> (c) for the purposes of valuation, market conditions and thus asset values are assumed to remain static over the marketing period. To reinforce this point, marketing periods are to be assumed to have lapsed at the date of valuation (that is, they should be retrospective), thereby eliminating any possibility for improved market conditions to be factored into the valuations.[37]

5.29 In determining fair values of security, property assets must, unless otherwise agreed with APRA, be valued on the basis of existing use. Any higher value related to an alternative use or 'element-of-hope' value arising from prospects of redevelopment, and any possible increase in value consequent upon special investment or finance transactions, must be disregarded. In determining values based on 'existing use', care must be exercised in imputing future income streams (for example, lease payments) which are not already contracted.[38]

5.30 A submitter also noted that, in his view, the prudential standards in relation to valuations would not prevent a financial institution from accepting a top of the range valuation when selling the facility (money) and reducing the value to a lower level by instruction at a further time.[39]

5.31 It was argued by a submitter that APRA did not investigate borrower complaints in relation to valuations.[40] The committee questioned APRA on whether APRA has a role in protecting borrower's interests. APRA informed the committee that its primary statutory obligation is to depositors and to financial stability and that it focussed on systemic issues, rather than individual facilities.[41] APRA also noted that:

> …it is not in our statute right now to look at the bank's relationship with borrowers. APRA is, right now, not statutorily mandated to protect borrowers. We are a prudential regulator and, as Neil said, we are interested mainly in protecting depositors and financial stability. If parliament were of the mind to have APRA have the responsibility of also protecting borrowers, that would present us with somewhat of a dilemma in that we would have a conflict in whose interests are paramount. As you said, there are other regulatory bodies who have that mandate. If you deposited that responsibility to a prudential regulator, we would be in a position of conflict which would be very difficult to maintain.[42]

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37 APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, pp 28–29.

38 APRA, *Prudential Standard APS 220 Credit Quality*, January 2015, p. 29.

39 Mr Lynton Freeman, *Submission 64*, p. 19.

40 Mr Lynton Freeman, *Submission 64*, p. 19.

41 Mr Neil Grummitt, Credit and Operational Risk Services, *APRA*, *Committee Hansard*, 16 February 2016, pp 39, 41.

42 Mr Warren Scott, General Counsel, APRA, *Committee Hansard*, 16 February 2016, p. 39.

Views of banks and other bodies

5.32 Australian Restructuring Insolvency and Turnaround Association (ARITA) informed the committee that in its view, valuations are based on point-in-time assessments, and noted that any revaluation may be based on prevailing depressed market conditions that may be temporary or later improve.[43] ARITA also informed the committee that:

> …we're not aware of any improper role of property valuers in "constructive default" as the terms of reference describe. Of course, there is often legitimate dispute as to valuation evidence. Valuations are often the subject of rigorous assessment in court proceedings.[44]
>
> ARITA notes that disputes sometimes arise when borrowers have an inflated opinion of the value of their asset compared to a realistic current market valuation. It is important to note that a current market valuation is based on what an independent, informed purchaser would pay; it is not based on past value or what amount may have been invested in the asset. Also, the value of an asset may have been reduced by the activity that led to the asset becoming distressed.[45]

5.33 FOS informed the committee that a financial services provider in possession of a borrower's property must take reasonable care to sell the property for either its market value or the best possible price. If FOS believes the financial services provider in a dispute did not take reasonable care, FOS may award the borrower compensation for any difference between the sale price and the market value of the property.[46]

5.34 The Australian Bankers' Association (ABA) advised the committee that it is standard industry practice for banks to use preferred lists or expert panels of independent external valuers to undertake mortgage valuations under strict industry standards. The ABA added that:

> Valuations are based on a point-in-time assessment of property values and will change with prevailing market conditions.
>
> This process ensures that valuations are provided by skilled and independent valuers with no coercive influence by the bank. In rare circumstances, for instance a property located in an isolated area where there are very few suitably qualified valuers available, a bank may rely on an internal valuation. The valuer's role is to provide a valuation based on what is happening in the marketplace and not look to devalue properties. In many cases, valuers will not know the customer's debt or reason for the valuation.[47]

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43 ARITA, *Submission 38,* p. 5.

44 ARITA, *Submission 38,* p. 5.

45 ARITA, *Submission 38,* p. 6.

46 FOS, *Submission 46,* p. 4.

47 Australian Bankers Association, *Submission 47,* p. 10.

5.35 The Commonwealth Bank informed the committee that they usually obtain valuations in the initial funding approval process, review of existing facilities/term extensions and realisation of assets via sale. In addition, revaluations during the course of a review of existing facilities arise from time to time under the terms and conditions of contractual arrangements. The Commonwealth Bank indicated that valuers used by the 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 five years experience in their field of expertise); and
- have suitable and current professional indemnity insurance cover.[48]

5.36 The Commonwealth Bank further advised that processes and standards for valuations include:

- detailed formal written instructions are issued to preferred valuers to undertake valuation reports;
- valuations are to be based on current unencumbered market value (International Valuation Standards);
- valuations must be completed in accordance with API Mortgage Security Professional Practice Standards and reporting requirements;
- valuers must not undertake any valuations where a conflict of interest may occur;
- a director or head of valuations of the valuation firm must complete (or countersign) valuations; and
- valuers must maintain strict confidentiality in respect of customer details.[49]

5.37 The Commonwealth Bank also noted that in a small proportion of cases, especially in remote areas where expert valuers are unavailable, the 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.[50]

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48 Commonwealth Bank of Australia, *Submission 48,* pp 9–10.

49 Commonwealth Bank of Australia, *Submission 48,* pp 9–10.

50 Commonwealth Bank of Australia, *Submission 48,* pp 9–10.

5.38 ANZ informed the committee that it engages property valuers to assess value of the security underpinning the loan. This can occur at the initial approval of the loan, when reviewing existing facilities and when the security is to be sold. The ANZ framework for the use of valuations in determining fair market value is underpinned by the prudential requirements for the use of valuations and international standards and practices on property valuations. The ANZ stated that its valuation process is independent of sales and lending decisions, and they use a panel of approved commercial property valuers to provide independent expert advice to determine the acceptability and value of property held as security.[51]

5.39 ANZ indicated that when it instructs a valuer to determine the current market value of a property for a security, the valuer must apply the following definition of market value from the IVSC:

> The estimated amount for which an asset or liability should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.[52]

5.40 ANZ noted that the above definition places the equivalent emphasis on the interests of the purchaser and the vendor to obtain a fair market value. The valuer's role is to make a prediction of the most likely price a property would receive if offered to the market on the day of inspection, taking into account all material factors which may impact on the determination of that price.[53]

5.41 ANZ responded to claims that banks are in a position to engineer defaults by 'deliberately reducing, through valuation, the value of securities held by the bank':

> ANZ is required under its prudential obligations to ensure the value of the security of a loan is accurate and the risk associated with the facility is adequately capitalised. One way to achieve this is through conducting regular reviews of facilities and valuations of underlying security. ANZ's policies ensure that approval of valuations are held at arm's length from lending decisions and managed by Risk functions so that the valuation received is a true estimate of market value on a given day. Of course, once a valuation is established, other criteria contribute to an overall assessment of achieving a customer turnaround plan.[54]

5.42 NAB also responded to similar concerns, informing the committee that:

> To the extent this is suggesting financiers inappropriately participate in the valuation process, misuse valuations, or otherwise that such valuations are

51 ANZ, *Submission 49,* pp 10–11.

52 ANZ, *Submission 49,* pp 10–11.

53 ANZ, *Submission 49,* pp 10–11.

54 ANZ, *Submission 49,* pp 10–11.

> contrived, this is not a practice that NAB engages in. In our view, there is no commercial or economic justification for this practice.[55]

5.43 Westpac explained that it only uses valuers from a panel of external valuers that provide an independent view of the value of properties, in accordance with the bank's valuation instructions and valuation standards. This includes compliance with the API Valuation Practice Standard and the API Mortgage Security Valuation Practice Standard. In appointing a valuer for a particular property Westpac would take into consideration location, type and value and seek to match with a valuer who has experience in that type of property and is accredited for that location and value. Westpac also noted that it requires valuers to provide a sensitivity analysis on the major variable affecting the valuation.[56]

5.44 Westpac also informed the committee that:

> The Westpac Group does not engage in practices to artificially engineer a business default, including revaluation of security. It would be rare for the Westpac Group to use a decreased loan to value ratio (LVR) as a sole default trigger to commence enforcement action i.e. when the Westpac Group accelerates the loan and enforces security, which could include the appointment of a Receiver and Manager. Enforcement on the sole basis of an LVR default has not taken place since our merger with St. George in December 2008.[57]

Peak bodies for valuers

5.45 There are three peak bodies representing valuers in Australia: the Australian Valuers Institute; the API, which is the largest, and the Royal Institute of Chartered Surveyors. Most of the valuations done for banks in Australia are performed by the Australian Property Institute.[58] This section summarises evidence from the three peak bodies in relation to their role in supervising the valuation industry.

The Australian Property Institute

5.46 The API informed the committee that arrangements for valuers vary across state and territories. The actual revaluation of a property asset by registered valuers only occurs in New South Wales, Queensland and Western Australia. In the other

55 NAB, *Submission 50*, p. 4.

56 Westpac, *Answers to questions on notice, taken on 18 November 2015, received on 29 February 2016.*

57 Westpac, *Submission 126*, p. 3.

58 Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard*, 16 February 2016, p. 11.

states and territories, it is done by certified practising valuers (CPVs),[59] and members from the API.[60]

5.47 The API, responding to questions on the methods used to conduct valuations, suggested that the way valuation of real estate occurs is a matter for the banks and financial institutions.[61] The API advised the committee that legislation in three states compels valuers to act independently, and in the remaining states and territories, the duty on valuers to act independently comes from the API's rules and guidance notes.[62]

5.48 The committee questioned the API at length about its role in the event that a valuer is inappropriately influenced or provided with inappropriate instructions. The API did not appear to place any obligations on valuers to report situations in which they are asked to breach the API code of conduct.[63] When asked if there was any recourse available to an individual valuer if they are inappropriately influenced in relation to their valuation the API replied that:

> In the general guidance notes and what we call the technical notes in the institute, if a valuer receives instructions which he does not agree with or believes are in contravention of the ethics of the institute, he is instructed to refuse the instructions. It is as simple as that.[64]

The Australian Valuers Institute

5.49 The Australian Valuers Institute (AVI) informed the committee that they discourage their members from taking work from banks on the basis that it puts valuers at considerable risk :

> Valuers get sued all the time. It is not unusual for the insurance companies to step to one side and leave it to the valuer to sort it out. They lose their homes at times. One particular valuer…has basically lost everything. Any valuer who is doing work for banks and cutting corners is crazy.
>
> We instruct all our members not to work for banks or financial institutions, because in this day and age you are almost underwriting the loan.[65]

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59 The API offers a range of membership types and certifications, one of which is a CPV who by education, training and experience is qualified to perform a valuation of real property. API¸ *Certifications*, https://www.api.org.au/certifications-0, (accessed 26 Apr 2016).

60 Professor John Sheehan, Chair, Government Liaison, and past President, Australian Property Institute, New South Wales Division, *Committee Hansard*, 18 November 2015, p. 39.

61 Professor John Sheehan, Chair, Government Liaison, and past President, Australian Property Institute, New South Wales Division, *Committee Hansard*, 18 November 2015, p. 39.

62 Professor John Sheehan, Chair, Government Liaison, and past President, Australian Property Institute, New South Wales Division, *Committee Hansard*, 18 November 2015, p. 39.

63 *Committee Hansard*, 18 November 2015, pp 45–47.

64 Professor John Sheehan, Chair, Government Liaison, and past President, Australian Property Institute, New South Wales Division, *Committee Hansard*, 18 November 2015, p. 40.

65 Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard*, 16 February2016, p. 12.

5.50 The AVI indicated that as a result of the above circumstances it is common for valuers to put a conservative value on properties in order to avoid being sued. The AVI informed the committee that:

> …there is a sort of a general feeling amongst valuers that there is a 10 per cent leeway that you are allowed before you get sued. Some lawyers have told me it is 10 to 15 per cent, but 10 per cent is the general figure. So if a house is worth $1 million and you want to put a conservative value on it, you might value it at $910,000.[66]

5.51 While individual valuers are required to resist pressure, the AVI informed the committee that it is very common for valuers to be under pressure from parties involved with valuations to make the valuation favourable to one or other of the parties:

> In the valuation industry 80 per cent of the time you have people trying to sway you one way or the other. In a divorce situation where the husband is buying out the wife, he wants it at a certain price and the wife wants it at another price. As a valuer you are constantly under pressure from one side or another to lean it one way or the other. If you are doing a stamp duty job you are under pressure to make that value conservative to reduce the stamp duty for the person. On a capital gains job the instructing parties want it the other way. It is up to the valuer to resist those pressures and simply value the property as it is valued.[67]

5.52 The committee notes that unlike the API, the AVI has a process for valuers to raise concerns about inappropriate pressure from parties to valuations however in order to resolve the matter the only remedy available to the valuer is to take the matter to court.[68]

5.53 The AVI also acknowledged that it had not attempted to address situations in which a valuation company or valuer was under pressure to comply with banks' instructions, because a large proportion of their work came from banks. The only option available to the AVI would be terminate the membership of a valuer who succumbed to such pressure.[69]

The Royal Institution of Chartered Surveyors

5.54 The Royal Institution of Chartered Surveyors (RICS) has published a professional standards guide (consistent with international standards for valuations) that is commonly known as the red book. RICS-registered valuers will be required to

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66 Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard,* 16 February 2016, pp 13, 15.

67 Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard,* 16 February 2016, p. 11.

68 Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard,* 16 February 2016, pp 11, 14.

69 Mr Paul Waterhouse, Chairman, Australian Valuers Institute, *Committee Hansard,* 16 February 2016, pp 16, 17.

adhere to provisions of the red book. RICS noted that the red book guidelines associated with the international standards would have much in common with the API guidelines, however country specific requirements, such as native title, may vary.[70]

5.55 RICS informed the committee that it has an independent complaints handling system:

> RICS will consider any complaint received from a member of the profession, a concerned stakeholder or an individual. Complaints are handled at arm's length by an independent conduct and appeals committee. To demonstrate the independence of the committee, it is chaired by a nonmember of the RICS, and other members are drawn from within and without the organisation and profession. Disciplinary action can involve the suspension or termination of RICS membership. It could also involve the levying of a fine or the temporary suspension of a member or firm from conducting particular activities. This disciplinary action applies to all members of the RICS, regardless of the nature of the qualification, be they a valuer, land surveyor or a building manager.[71]

5.56 RICS stated that it had consulted its members and found no evidence of authorised deposit-taking institutions acting improperly in the drafting of instructions given to valuers so as to deliberately alter the value of property to the benefit of either party.[72]

5.57 In relation to variations in valuations, RICS noted that the level of variation depends on property type. For example, CBD office buildings have tended to show less variation than development land or residential subdivisions.[73]

5.58 When questioned by the committee on how to address the issue of valuers being constrained to work within the instructions and assumptions provided by the bank, RICS indicated that the only way to protect borrowers was to strengthen foreclosure laws:

> Only in strengthening the law around foreclosure and the regulation around foreclosure. Generally, following most property collapses we have had over the last 30 years we have strengthened the regulation around unlisted trusts, listed trusts, property syndicates. As government strengthens the legislation and strengthens the regulation, some operators will find further ways around it.[74]

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70 Professor David Parker, Fellow, Royal Institution of Chartered Surveyors, *Committee Hansard*, 4 April 2016, p. 10.

71 Mr Robert Hardie, Manager, Corporate Affairs, Oceania, Royal Institute of Chartered Surveyors, *Committee Hansard,* 4 April 2016, pp 8.

72 Mr Robert Hardie, Manager, Corporate Affairs, Oceania, Royal Institute of Chartered Surveyors, *Committee Hansard,* 4 April 2016, p. 8.

73 Professor David Parker, Fellow, Royal Institution of Chartered Surveyors, *Committee Hansard*, 4 April 2016, p. 10.

74 Professor David Parker, Fellow, Royal Institution of Chartered Surveyors, *Committee Hansard*, 4 April 2016, p. 12.

5.59 RICS stated that whether or not copies of valuations were provided to borrowers was a matter for banks to decide.[75]

Access to valuations and instructions

5.60 The committee actively sought responses from banks and industry bodies on their views in relation to imposing a requirement for banks to provide copies of valuations and instructions to customers.

5.61 In December 2015, the Commonwealth Bank suggested that across the industry, the practice could change to one whereby, if a valuation is obtained by a financial institution, then a copy of the valuation is provided to the customer because the customer is paying for that valuation.[76]

5.62 The ANZ suggested that there is a case to be made for development of an industry-wide guideline on the role and use of valuations to make sure that the valuation process is transparent and easily understood by customers.[77] ANZ indicated that it uses external valuers on most occasions, and where the customer pays for that valuation, the bank provides a copy of that valuation to the customer:[78]

> It is our practice rather than a requirement. We do that and the valuer typically…write what the bank was asking for at the start of the valuation so it is clear under the circumstances of doing the valuation. So it is quite clear to the customer.[79]
>
> We would be very happy if it were put in the Code of Banking Practice and, as you sign up to the code, you are obliged to do that and if you do not do that, then customers should complain. I think that is quite right.[80]

5.63 NAB indicated that it would not have an objection to providing borrowers with a copy of the valuation and the instructions to the valuer.[81] NAB also informed

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75 Professor David Parker, Fellow, Royal Institution of Chartered Surveyors, *Committee Hansard*, 4 April 2016, p. 14.

76 Mr David Cohen, Group Executive for Corporate Affairs and Group General Counsel, Commonwealth Bank of Australia, *Committee Hansard*, 4 April 2016, p. 44.

77 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 65.

78 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 67.

79 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 67.

80 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 68.

81 Mr Geoff Greene, Head, Strategic Business Services, NAB, *Committee Hansard*, 4 April 2016, p. 62.

the committee that it gives customers the option to obtain further valuations if they are concerned about the initial valuation by the bank.[82]

5.64 Westpac informed the committee that its current policy is not to provide the valuation to borrowers. However, Westpac indicated that:

- on occasions it will provide the valuation upon request for specific purposes, if there is agreement that the valuation has been provided for the Bank's purposes;
- it is common that there is a reasonable level of information exchange between the Bank and the customer in regards to valuations, and in some instances the customer gets full access to the valuation;
- if there is a dispute about the valuation an additional valuation could be sought from another panel valuer and in some cases, the bank has paid for this alternate valuation; and
- if a company is in receivership, the receiver is the agent of the company and the directors do not have any standing to require copies of the valuations of company owned property assets. For third party security e.g. provided by directors to support guarantees, the bank could provide a copy but it would need to have the agreement of the valuer and be qualified given that it has been prepared under bank instructions and for bank purposes.[83]

5.65 ASIC informed the committee that it is unlikely that a requirement to provide instructions and a copy of the valuation report to borrowers would have a significant impact on the cost and availability of credit to business, and is worthy of further consideration.[84]

Recommendations of the post-GFC banking inquiry

5.66 In November 2012 the Senate Economics References Committee concluded its inquiry in to the post-GFC banking sector. In its report, the committee called on the ABA to develop a code of practice specifically related to the practice of lending to small business, recommending that in relation to valuations the code should require:

- any initial valuation reports associated with the purchase of a small business be relied on by the bank for a reasonable amount of time, such as for the first two years of the loan, unless a major defined shock or event occurs; and
- borrowers to be automatically provided with copies of valuation reports that they have paid for or which the bank intends to rely on to demonstrate that the

82 Mr Timothy Williams, General Manager, Group Strategic Business Services, National Australia Bank, *Committee Hansard,* 18 November 2015, p. 9.

83 Westpac, *Answers to questions on notice,* taken on 18 November 2015, received on 29 February 2016.

84 ASIC, *Submission 45,* p. 22.

borrower is in default, and that all instructions given by banks to valuers be provided to the borrower on request.[85]

5.67 The Senate Economics References Committee added that:

> Failure by the ABA and the banks to develop an appropriate code of conduct for small business lending may strengthen the case for more prescriptive government regulation in this area. Given the arguments from the sector about the cost and burden of added regulation in general, the committee is of the view that if banks genuinely have these concerns they have both the obligation and opportunity to demonstrate that the sector takes concerns about small business finance issues seriously and is willing to proactively develop a stronger self-regulated solution.[86]

Committee view on the role of valuers

5.68 In this section the committee puts forward its view of the following matters:

- provision of valuation reports and instructions to borrowers by banks;
- how instructions for valuers are developed within banks; and
- dispute resolution for valuations associated with loans.

Provision of valuation reports to borrowers

5.69 The committee is deeply concerned that over three years have elapsed since the conclusion of the post-GFC banking inquiry by the Senate Economics References Committee in which a number of relevant recommendations were made to improve banking practices. Since this time, the banking industry has not addressed matters as simple as providing borrowers with copies of valuation reports.

5.70 The current inquiry into impairment of customer loans has amply demonstrated that the provision of valuation reports to borrowers has not been written into the Banking Code of Practice, or become universal practice by banks.

5.71 This is a disappointing outcome given that the Economics committee foreshadowed that if the ABA and banks failed to progress such recommendations, this lack of action would strengthen the case for more prescriptive government regulation. The committee is therefore of the view that if banks and the ABA do not address this matter in their common practice and in the Banking Code of Practice by the end of 2016, the government should bring forward appropriate legislation or regulation to require banks to provide copies of valuation reports and valuation instructions to all borrowers (not just retail and small business borrowers) as soon as the reports are received by the bank from the valuer.

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85 Senate Economics References Committee, *The post-GFC banking sector,* November 2012, p. xxiii.

86 Senate Economics References Committee, *The post-GFC banking sector,* November 2012, p. xxiv.

Instructions to valuers

5.72 A common theme in evidence presented to the inquiry was that valuations at the time of loan establishment were high or optimistic and that valuations at the time of review or dealing with financial difficulties were low or pessimistic. The committee acknowledges that market conditions contribute to such perceptions as there is often more enthusiastic buying in a rising market that a falling market.

5.73 However, the committee considers that evidence presented to it identifies that there is also the potential for lending departments in banks to be more optimistic about valuations than credit management departments. While the committee is not necessarily alleging deliberate behaviour on the part of banks, it notes that an optimistic outlook on prices —whether driven by a relationship manager just wanting to see a local family business succeed or due to remuneration schemes that provide incentive for employees to write new business—could lead to insufficient critical assessment of valuation instructions and valuations. Similarly, a pessimistic outlook could lead to an overly critical assessment of valuation instructions and valuations.

5.74 The committee questioned banks on whether incentive arrangements could contribute to lending more than necessary and foreclosing more than necessary. The Commonwealth Bank and ANZ argued that they did not.[87] However, ASIC informed the committee that:

> The kinds of rules that exist in the financial advice space, however, which restrict commissions and other forms of conflicted remuneration do not extend to consumer credit. So the restrictions on commissions do not apply if someone is getting a mortgage, a credit card or a personal loan; institutions are able to remunerate their staff and their distribution channels in the way they want to. Those arrangements do need to be disclosed to consumers, generally speaking, but the institutions themselves have the ability to structure those arrangements in whatever way they wish to.[88]

5.75 The committee therefore considers that it is vitally important for banks to ensure alignment between their lending and credit management departments, particularly in relation to the preparation to instructions to valuers and the use of valuations in decision making about the viability of loans.

5.76 The committee is therefore recommending in chapter 2 that appropriate legislation and regulations be put in place to:

- require officers from lending and credit management departments to provide consistent information to borrowers, including:
    - copies of valuation reports and instructions to valuers; and

87 Commonwealth Bank of Australia, *Answers to questions on notice*, taken on 1 December 2015, received on 18 February 2016; ANZ, *Answers to questions on notice*, taken on 1 December 2015, received on 22 December 2015.

88 Mr Michael Saadat, Senior Executive Leader, Deposit Takers & Insurers &credit Services, AISC, *Committee Hansard*, 16 March 2016, p. 4.

- copies of investigative accountants' reports and instructions to investigative accountants and receivers;

- ensure that there are industry standards for nationally consistent valuation instructions and valuation reports; and
- require lending officers and credit management officers to negotiate a single set of instructions to be provided to a valuer both at initial lending and in the case that the loan is presenting risk to the bank.

Dispute resolution for valuations associated with loans

5.77 From the evidence presented to this inquiry, the committee is concerned about dispute resolution arrangements for valuations in relation to loans from two perspectives:

- the availability of appropriate dispute resolution for valuations produced by valuers; and
- the availability of appropriate dispute resolution for valuation instructions issued by banks and the compliance of banks with prudential requirements for valuations.

Dispute resolution for valuations produced by valuers

5.78 The committee questioned the three peak bodies for valuers about their arrangements for ensuring compliance and hearing complaints or disputes in relation to valuations. RICS described what appeared to be a well-defined compliance and complaints handling system, however, RICS presently only covers a small part of the market for valuations related to loans. The committee noted that AVI has a more informal complaints system, and that AVI indicated it was actively discouraging its members from working with banks. API, which has the greatest market share, indicated that it used the dispute handling system under the relevant state based registration schemes. The committee notes however, that state based registration schemes only in exist in three states and one of those states is considering removing the registration scheme.[89] The committee is concerned that there are gaps in the availability of dispute resolution processes in relation to valuers, and in fact, some of the peak bodies acknowledged that they did not have processes to require valuers to report instructions from banks that breach the relevant codes of conduct for their valuers.

5.79 In addition, there appears to be little prospect that the existing limited dispute resolution arrangements are publicised well enough for borrowers to be aware that their disputes can be heard in some cases. Combined with the lack of access to valuation reports and instructions, as discussed above, this leaves borrowers in a very difficult situation.

89 Professor John Sheehan, Chair, Government Liaison and Past President, Australia Property Institute, *Committee Hansard*, 18 November 2015, p. 48.

5.80 As a result the committee can only conclude that the valuation industry does not have appropriate compliance and dispute resolution arrangements in place for valuations associated with loans. In chapter 2 the committee makes recommendations to provide for dispute resolution to apply to valuers where appropriate.

Dispute resolution for prudential requirements relating to valuations

5.81 As noted earlier in this chapter, Prudential Standard 220 sets out substantial requirements for how ADIs must value property held as security for loans including:

- the role of the ADI credit administration function;
- regular assessment to ensure fair value, especially for commercial property or loans with high loan-to-value ratios;
- a requirement for policy and procedures relating to circumstances in which valuations are sought; and
- in determining fair value the ADIs must take account of:
    - timing of property disposal if required; and
    - marketing periods up to 12 months or longer periods for specialised properties or based on advice from valuers.

5.82 Evidence put to this inquiry suggests that cases may exist where the above requirements are not met. However, many borrowers would not be aware that such requirements exist. APRA's position is that it only considers systemic issues; it is not mandated to consider the relationship between banks and borrowers; and it may have a conflict of interest if it did consider the relationship between banks and borrowers.

5.83 The committee has therefore formed the view that effective arrangements for oversight or dispute resolution of prudential requirements in relation to valuations for loans are not in place. There is what seems to be an appropriate standard in place, but there is no way of ensuring that the standard is applied, or that borrowers are able to raise concerns about its implementation. While APRA argues that other agencies have responsibility for protecting borrowers[90] it would be unusual for another agency to be responsible for providing oversight and dispute resolution for prudential standards under APRA's jurisdiction. The committee does not wish to make specific recommendations on which agency should provide oversight and dispute resolution for borrowers in relation to Prudential Standard 220. However the committee does suggest that the government should ensure that appropriate oversight and dispute resolution is in place.

5.84 The committee notes recent media reports which allege that banks are bullying valuers into accepting below cost fees, strengthening the need for greater oversight of the relationships between banks and valuers. The report indicates that the Australian Property Institute has raised their concerns with ASIC and the ACCC.[91]

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90 Mr Warren Scott, General Counsel, APRA, *Committee Hansard*, 16 February 2016, p. 39.

91 Duncan Hughes, 'Bullying banks to force valuers out of business', *Australian Financial Review*, 27 April 2016.

Recommendation 8

5.85 The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services conducts an inquiry to examine the regulatory environment for valuers with a view to:

- **a. reforming the industry to improve ethical and professional standards for valuers;**
- **b. improving transparency and independence within the industry; and**
- **c. preventing them from being captured by banks.**

Chapter 6

Receivers and investigative accountants

6.1 This chapter discusses the evidence received by the committee about receivers and investigative accountants and their role in relation to loans. After summarising the issues raised by submitters, the current arrangements for receivers and investigative accountants are then discussed.

Issues raised by submitters

6.2 Submitters to the inquiry raised a number issues and allegations relating to receivers and investigative accountants including:

- use of single organisations for investigative accountant and receivership processes;[1]
- receivers selling properties and assets under value;[2]
- receivers not considering or taking up sale options put forward by borrowers;[3]
- the level of receiver's fees;[4]
- harm to businesses caused by receivers lacking relevant experience or poorly administering businesses;[5]
- lack of information provided to borrowers by receivers;[6] and
- lack of effective dispute resolution for the above issues.

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1 Department of Agriculture, *Submission 43,* p. 7; Directors of Gippsland Secured Investments Ltd, *Submission 53,* p. 4; Mr Ross Waraker, *Committee Hansard,* 13 November 2015, p. 33.

2 Name withheld, *Submission 5,* p. 12; Mr & Mrs Randles, *Submission 8,* p. 14; Mr Colin Power, *Submission 12,* p. 6; Mr Tony Rigg, *Submission 15,* p. 8; Name withheld, *Submission 21,* p. 2; Kelgon Development Corporation Pty Ltd, *Submission 24,* p. 4; Mr Michael Sanderson, *Submission 28,* p. 11; Mr Yves El Khoury, *Submission 71,* p. 3; Dr Evan Jones, *Submission 83,* p. 5; The Provincial Finance Group, *Submission 88,* p. 3; Allied Hospitality Ltd, *Submission 89,* p. 2; Mr Milton Wilde, *Submission 97,* p. 1; Mr Trevor Eriksson, *Submission 101,* p. 4; Mr Vittorio Cavasini, *Submission 103,* p. 4.

3 Name withheld, *Submission 21,* p. 2; Name withheld, *Submission 26,* p. 4; Dr Evan Jones, *Submission 83,* p. 5.

4 Ms Deborah Perrin *Submission 30,* p. 2; Mr Bill Ringrose, *Submission 31,* p. 4; Directors of Gippsland Secured Investments Ltd, *Submission 53,* p. 4; Mr John Dahlsen, *Submission 87,* p. 2; The Provincial Finance Group, *Submission 88,* p. 4; Mr Milton Wilde, *Submission 97,* p. 1; Mr Trevor Eriksson, *Submission 101,* p. 1.

5 Mr Joshua Hunt, *Submission 27,* p. 4; Mr Colin Power, *Submission 12,* p. 6; Mr Robert Barr, *Submission 78,* pp 4–6; Mr Don Turner, *Submission 71,* p. 1; Mr Vittorio Cavasinni, *Committee Hansard,* 18 November 2011, p. 1.

6 Legal Aid Queensland, *Submission 55,* p. 7; Mr Peter McNamee, *Submission 107,* p. 10.

6.3 The committee wishes to acknowledge the many accounts it has received from people who have been subject to receivership and suffered dire financial consequences as a result. The circumstances being faced by people in those situations goes beyond pure financial hardship and creates many other stressors. Those impacts occur even if a receiver does their job in a highly professional and empathetic way. However the committee has heard accounts in which receivers have not behaved in a professional manner, which compounds the impacts on individuals and their families. Multiple allegations were raised with the committee about potentially illegal or unethical practices, with no dispute resolution mechanism available for borrowers' disputes to be heard.

Examples of some of the concerns raised by submitters

6.4 This section provides examples of some of the issues raised by submitters. During the inquiry, the committee heard about some of the difficulties faced by clients of an accountancy practice in Queensland:

- Repossessed properties have caretakers appointed when clients are evicted. The fees for these caretakers often run between $200 and $300 per day which is paid by the receivers, and ultimately comes from any residual proceeds should the property be sold.
- Calculations done by this office with negotiation with some insolvency practitioners generally has shown that a standard receiver's fee from a property sale will run at approximately $500,000 for a 6 month period.
- There is no provision for the landholder to remain on their properties, have the caretaking fee be applied against their debts, or pay them for that work.
- We have had a number of receiver's sales in the Central West. These sales generally have seen prices between 40 and 50% below normal market sales. There are a number of reasons for this with a major one being a lack of understanding of local markets by the receivers or their agents and a resistance to engage suitably qualified locals.
- …the potential for multiple forced sales when the current drought breaks is a very real threat. Changes must be made to how this process is carried out or there will be a very real risk of a general property market collapse. This would therefore have a potential for significant other properties to be deemed in default from a LVR position.[7]

6.5 One witness expressed concerns about the lack of information from his bank on the role and cost of an investigative accountant:

> …we had no understanding of what it was that the bank wanted us to do or who this person was. There were difficulties in his engagement, with costs

7 Mr Bill Ringrose, *Submission 31*, p. 4.

> to the tune of $15,000 a month and no outline whatsoever of what he was going to do that would bring any solid results or milestones to work towards.[8]

6.6 Submitters also raised concerns about properties being sold for much less than they were valued. In some case the properties were soon sold again for prices substantially higher than the price achieved by receivers. The committee also heard of cases in which existing contracts for the sale of units may not have been pursued appropriately.[9]

6.7 Section 420A of the Corporations Act requires a receiver to take reasonable care to sell a property for market value or the best price reasonably obtainable under the circumstances.[10] The committee heard that there are concerns that this provision of the Corporations Act is not being met in some circumstances. A submitter informed the committee of his view on section 420A based his experience:

> It needs to be strengthened, with greater accountability placed on the receiver to ensure that the market value in compliance with section 420A is not justified by an auction process alone. Put a few ads in the paper and put it up for auction. At an auction on a receiver's sale, generally, people expect to get it cheap.
>
> By this time, we had had a valuation for the St George Bank and we had one for the ANZ bank earlier. The NAB used another valuer, so we had three valuations, plus two previously from Bankwest. Both came up to about $11 million; they sold the properties for $4½ million.
>
> What I am saying here is that you could not justify a 45 per cent sale when the valuation is only four months old.[11]

Complaints received by ASIC regarding receivers

6.8 ASIC informed the committee that it receives and assesses reports of misconduct about receivers. ASIC can consider the conduct of receivers appointed under a security instrument by a secured lender, including a receiver's conduct in relation to the sale of any secured asset. However, ASIC (and the courts) generally do not intervene in a receiver's commercial decision making under their appointment.[12]

6.9 ASIC indicated that in the five years from 1 July 2010 it had received 45 reports of alleged misconduct from borrowers about receivers appointed by banks or non-bank financial institutions.[13] ASIC's inquiries into these matters identified common concerns in the reports of misconduct:

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8 Mr Vittorio Cavasinni, *Committee Hansard,* 18 November 2011, p. 1.

9 Mr Vittorio Cavasinni, *Committee Hansard,* 18 November 2011, pp 6–7; Mr Chris Evanian, *Committee Hansard,* 18 November 2011, pp 26–27.

10 *Corporations Act 2001,* section 420A.

11 Mr Trevor Eriksson, *Committee Hansard,* 13 November 2015, pp 59–61.

12 ASIC, *Submission 45,* p. 13.

13 ASIC, *Submission 45,* p. 13.

- the validity and timing of the default and the receiver's appointment;
- the level of receiver's fees and their accountability for fees;
- receivers not providing updates to borrowers;
- secured properties being sold through open processes, such as by invitation, tender, or auction;
- receivers taking advice from independent, third party, real estate agents and property valuers regarding the sale process and sale price of the property;
- allegations that property valuers were conflicted, though further inquiry by ASIC did not indicate any corresponding misconduct by the receiver with respect to this allegation;
- decisions on the sale process being taken by the receivers in consultation with the secured creditors;
- concerns that the receivers sold the secured property for less than market value, or sold the property to a third party who then on-sold the property for a higher value; and
- allegations that receivers would not accept offers for the secured property from parties connected with the debtor, which they believe resulted in the receiver accepting lower offers from unrelated third parties.[14]

6.10 ASIC conducted further inquiries into five of the above matters and subsequently determined not to pursue regulatory action against the receiver. ASIC informed the committee that its inquiries did not reveal sufficient grounds to pursue the receiver for a breach of their statutory duties or to consider further disciplinary action. ASIC did not identify systemic concerns about any particular receiver in these matters, and ASIC's assessment and inquiries could not substantiate breaches of section 420A of the Corporations Act which warranted further regulatory action.[15]

Views of industry bodies and banks

6.11 This section discusses the views put forward by industry bodies and banks regarding issues about receivers.

6.12 The Australian Restructuring Insolvency and Turnaround Association (ARITA) submitted that it considers that the law imposes high standards in relation to the sale of property by receivers under section 420A of the Corporations Act. ARITA also informed the committee about the history of this provision:

> By way of background, the history of the section is that the duty of receivers under Australian case law was based in negligence only. The 1988 Harmer Report considered that this was not adequate and that there should be a specific obligation imposed to secure the best price in the circumstances of the sale. Thus section 420A was introduced. The purpose

14 ASIC, *Submission 45*, pp 14–15.

15 ASIC, *Submission 45*, p. 15.

> behind the introduction of section 420A was stated in the Explanatory Memorandum to the relevant Bill: "It is sometimes said of receivers that they are prepared to sell property at a price less than the best obtainable, so long as it is sufficient to cover the debt of the charge holder who appointed them. Proposed s420A makes it clear, that in selling company property, a controller must take all reasonable care to sell the property for the best price that is reasonably obtainable having regard to the circumstances existing when the property is sold."[16]

6.13 ARITA indicated that it was not aware of concerns about the operation of that section, but noted concerns had been raised by the Productivity Commission in its inquiry into business set-up, transfer and closure. ARITA also informed the committee that in court challenges by borrowers under section 420A, the courts have generally upheld the conduct of the receiver. Complaints to ARITA about receiver sales are generally dismissed on the basis that the established process to ensure market value is obtained was followed.[17]

6.14 ARITA indicated that section 420A has been in operation for over 20 years and that it was not aware of any issues about the standard that section 420A imposes. ARITA argued that section 420A been the subject of a number of decisions from the courts in relation to the process of obtaining market value:

> Many of these cases raise complex and difficult issues. However as a general statement, the history of court decisions has supported the receiver in relation to their compliance with the section. In other words, challenges to section 420A sale are generally unsuccessful. A receiver is also subject to other controls and responsibilities under Part 5.2 and elsewhere in the Act. They are officers of the company and are therefore subject to the significant duties of care and diligence, good faith, and other duties under s 180-184 of the Act.[18]

6.15 The ABA informed the committee that it considers that receivers are appointed by a bank to take control of the assets under the bank's security after all other options for workout, or a voluntary recovery have been exhausted. The ABA suggested that:

- The appointment of receivers may be necessary where early action is needed to protect the bank's position, if a voluntary administrator has been appointed, or liquidator has been appointed by court order;
- receivership is the least preferred option as it tends to incur additional costs and may result in a lower net return; and
- receiverships often arise where both the customer and the bank may incur a loss, so it is clearly in the bank's interests to ensure that property is sold at

16 ARITA, *Submission 38,* p. 6.

17 ARITA, *Submission 38,* p. 1.

18 ARITA, *Submission 38,* p. 6.

market value and that the receiver's and other costs are as reasonable as possible.[19]

6.16 ANZ submitted its view, noting that the right of a lender/mortgagee to exercise a power of sale or appoint a receiver is usually provided by the loan and security (e.g. mortgage or charge) document. ANZ indicated that lenders' rights are also conferred by property legislation (e.g. *s77* of the *Transfer of Land Act (Vic)*, *s109* of the *Conveyancing Act (NSW)*) and in respect of receivers, the *Corporations Act 2001*.[20]

6.17 NAB cited similar provisions in its submission:

> Where NAB, or a Receiver/Controller appointed by NAB, exercises a power of sale there are strict legal obligations which they each are required to comply with. Where property is owned by a company, NAB, or a Receiver/Controller appointed by NAB, (under section 420A of the Corporations Act) is required to take all reasonable care to sell that property for not less than its market value, or otherwise (where there is no market value), to sell the property at the best price reasonably obtainable, having regard to the circumstances existing when the property is sold.[21]

6.18 The ANZ informed the committee that:

> To be clear, receivers have no role in the valuation of security. We do not needlessly appoint receivers. Such action is costly and distressing for all parties. As at March 2015, 116 commercial customers, or less than one 10th of one per cent of our 140,000 commercial customer base were in some form of ANZ enforced administration. However, it is important to note that the appointment of a receiver can be essential in arresting losses and erosion of equity, protecting suppliers—in other words, unsecured creditors—and protecting directors from trading while insolvent.[22]

Post-GFC banking inquiry

6.19 The Senate Economics References Committee inquiry into the post-GFC banking sector made a number of recommendations for improving banking practices relating to the enforcement of security interests and the conduct of receivers. These recommendations included that:

- a secured party be prevented from appointing a receiver unless the 14 day period specified in the notice of demand has expired and, if the secured party is a member of Financial Ombudsman Service (FOS), advising the borrower that they may apply to FOS to determine a dispute, if any, between the borrower and the secured lender;

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19 Australian Bankers Association, *Submission 46*, p. 10.

20 ANZ, *Submission 49*, p. 10.

21 NAB, *Submission 50*, p. 11.

22 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 64.

- receivers be required to cooperate with all requests from the Financial Ombudsman Service (FOS) that relate to a dispute between the bank and the borrower that FOS is considering;
- receivers be required to cooperate with any reasonable requests for information made by the borrower that would assist the borrower secure refinance;
- the secured party regularly inform the borrower about the costs and fees associated with the receivership and take reasonable care to ensure that those costs and expenses are reasonable; and
- the receiver demonstrate to the borrower that they have considered all unconditional offers when exercising the power of sale.[23]

Receiver appointments

6.20 This section summarises requirements relating to the appointment of receivers, including the requirement for receivers to satisfy themselves that the appointment is appropriate.

6.21 There are a number of formalities imposed on the appointer and the receiver.

- a person cannot be appointed as a receiver unless they are a registered liquidator;
- a person may be restricted from accepting an appointment if the appointment might create a lack of independence;
- the appointer must file notice of the appointment of the receiver with ASIC within 7 days and the receiver must do so within 14 days;
- the receiver must also serve notice of the appointment on the company as soon as practicable; and
- the receiver is not obliged to inform creditors of the appointment.[24]

6.22 ASIC informed the committee that before accepting appointment as receiver and entering into possession or taking control of a company's property, the receiver should satisfy themselves that:

- the security interest under which they are being appointed is valid and properly registered;
- an event of default within the terms of the security document has occurred;
- the requirements of the security document as conditions precedent to the appointment (including the making of a demand for the secured money and providing reasonable notice to the company of the intention to terminate the loan facility) have been strictly complied with; and

23 Senate Economics Reference Committee, *Inquiry into the post-GFC banking sector*, November 2012, pp xxvii - xxviii.

24 ASIC, *Submission 45*, p. 26.

- other relevant statutory requirements have been complied with.[25]

6.23 ASIC suggested that a prudent receiver would not accept appointment as a receiver on the basis of a monetary or other default except with clear evidence that the default has occurred. If an appointment is based solely on a non-monetary default (e.g. a loan-to-value ratio default), a prudent receiver would generally make further inquiries into the client's loan history before accepting the appointment.[26]

Receiver remuneration

6.24 ASIC informed the committee that remuneration of a receiver is supervised by the courts. ASIC argued that when courts assess the reasonableness of a receiver's remuneration they should have regard to proportionality—that is, the reasonableness of remuneration compared to the benefits realised. Recent court decisions have considered the issue of proportionality. ASIC informed the committee that:

> In Australian Securities and Investments Commission v Letten (No 23) [2014] FCA 985, Justice Gordon was required to determine among other things, the reasonableness of receivers' remuneration claimed in relation to work undertaken in the adjudication of investors' claims. One factor her Honour relied on in applying a 20% discount (on top of a voluntary 10% reduction) to the remuneration to be allowed, was that the claimed remuneration 'appeared large' ($4 million) when compared to the amount anticipated to be made available for distribution to the investors ($10 million). On appeal, ASIC made submissions concerning the issue of proportionality. This matter has been appealed, and we await the decision of the Full Court of the Federal Court.[27]

6.25 ASIC submitted that the concept of 'proportionality' is not expressly dealt with under the Corporations Act. However, the list of matters for a court to consider in assessing the reasonableness of a receiver's remuneration include the time properly taken in completing work, the necessity of the work, the complexity of the work performed by the receiver and the value and nature of the property dealt with by the receiver.[28]

6.26 ASIC informed the committee that subject to the terms of the agreement, the company will usually bear the cost of the receiver's remuneration and the receiver will draw their remuneration during the course of the receivership by submitting an account for their remuneration to the secured party (generally, those costs will then be added to the company's outstanding debt). The secured creditor will normally scrutinise the account and approve it for payment. Commonly, the receiver will secure an indemnity for remuneration and expenses from the secured party. The secured party has a significant degree of influence over the level of remuneration of the

25 ASIC, *Submission 45*, p. 26.

26 ASIC, *Submission 45*, p. 26–27.

27 ASIC, *Submission 45*, p. 29.

28 ASIC, *Submission 45*, p. 29.

receiver, due to the direct nature of the appointment. In some situations, this position can result in the receiver charging less than their standard hourly rates.[29]

6.27 ASIC also informed the committee that the Corporations Act provides for a review process regarding the remuneration payable to receivers. The court retains wide powers to set and vary the remuneration of receivers. Applications to fix or vary a receiver's remuneration may be made in certain circumstances by ASIC, a liquidator, voluntary administrator or deed administrator of the company. The 2007 reforms to the Corporations Act introduced amendments that require the court, when reviewing or setting a receiver's remuneration, to have regard to whether the remuneration is reasonable, taking into account various matters, including whether the work performed was reasonably necessary.[30]

6.28 ASIC also noted that often in receiverships, the secured party may suffer a significant deficit on the recovery of the debt owed by the company. If there are insufficient assets, the secured party pays the receiver's remuneration out of their own funds.[31]

6.29 The Commonwealth Bank noted that in many cases the costs of the receiver's remuneration is borne by the bank because the borrower does not have sufficient financial resources or assets:

> 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.[32]

29 ASIC, *Submission 45*, p. 43.

30 ASIC, *Submission 45*, p. 44.

31 ASIC, *Submission 45*, p. 44.

32 Commonwealth Bank of Australia, *Answers to questions on notice, taken on 1 December 2015, received on 18 February 2016.*

Recent reforms

6.30 This section summarises the reforms recently introduced by the Insolvency Law Reform Bill 2015[33] which amended the Corporations Act, the ASIC Act and the *Bankruptcy Act 1966* (Bankruptcy Act) to create common rules that:

- remove some costs and are designed to increase efficiency in insolvency administrations;
- align the registration and disciplinary frameworks that apply to registered liquidators and registered trustees;
- align a range of specific rules relating to the handling of personal bankruptcies and corporate external administrations;
- enhance communication and transparency between stakeholders;
- promote market competition on price and quality;
- improve the powers available to the corporate regulator to regulate the corporate insolvency market and the ability for both regulators to communicate in relation to insolvency practitioners operating in both the personal and corporate insolvency markets; and
- improve overall confidence in the professionalism and competence of insolvency practitioners.[34]

6.31 The Insolvency Law Reform Bill implemented new rules regarding the remuneration of receivers, so that creditors may set a receiver's remuneration through a remuneration determination. Where there is no determination the receiver will be able to receive a reasonable amount for the work conducted up to $5000 (exclusive of GST and indexed). In addition the new rules ensure that receivers must not:

- employ a related entity, unless certain requirements are met; or
- purchase any assets of the estate; or
- get any other benefits or profits from the administration of the estate.[35]

6.32 As discussed at the beginning of this chapter, a common concern raised during the inquiry is poor access to information from receivers in some cases. The Insolvency Law Reform Bill 2015 has enabled the following rules to be implemented, so that receivers must:

- give annual reports of the administration of the estate (called annual administrative returns) to the Inspector-General; and
- keep books of meetings and other affairs of the estate; and
- allow those books to be audited if required to do so; and

33 The bill was passed and received assent on 29 February 2016.

34 Insolvency Law Reform Bill 2015, *Explanatory Memorandum*, p. 3.

35 Insolvency Law Reform Bill 2015, division 60, p. 48.

- allow access to those books by creditors; and
- give creditors and others requested information, documents and reports relating to the administration;[36]

6.33 In the case of a receiver of a regulated debtor's estate, she or he must have regard to directions given to the receiver by the creditors of the estate but is not obliged to comply with those directions.[37]

6.34 The Insolvency Law Reform Bill 2015 put in place new requirements for disputes relating to the conduct of receivers including provisions for reviews by the courts, the Inspector-General and creditors:

> The Court may inquire into the administration of a regulated debtor's estate either on its own initiative or on the application of the Inspector-General or a person with a financial interest in the administration of the regulated debtor's estate.
>
> The Court has wide powers to make orders, including orders replacing the trustee or dealing with losses resulting from a breach of duty by the trustee.
>
> The Inspector-General may review a decision of the trustee of a regulated debtor's estate to withdraw funds from the estate for payment for the trustee's remuneration.
>
> The Insolvency Practice Rules may set the powers and duties of the Inspector-General in conducting such a review and may deal with issues relating to the review process.
>
> The creditors of a regulated debtor's estate may remove the trustee of the estate and appoint another. However, the trustee may apply to the Court to be reappointed.[38]

6.35 The Inspector-General may review the remuneration of receivers on their own initiative or following application by the regulated debtor or a creditor.[39]

Section 420A

6.36 The ineffectiveness of section 420A of the Corporations Act was a significant issue for many submitters and witnesses who had concerns about properties being sold below value.

6.37 Borrowers are often unable to make use of section 420A to pursue complaints against a receiver, because the borrower has lost control of their financial assets and therefore cannot fund a legal case.

6.38 ASIC informed the committee that the Corporations Act imposes certain requirements on receivers when exercising the power of sale, including that they take

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36 Insolvency Law Reform Bill 2015, division 70, p. 63.

37 Insolvency Law Reform Bill 2015, division 85, p. 91.

38 Insolvency Law Reform Bill 2015, division 90, pp 91–92.

39 Insolvency Law Reform Bill 2015, division 90, p. 96.

reasonable care to sell the property for not less than market value. This obligation is not breached simply because market value (where it exists) or the best price reasonably obtainable is not achieved, but where the receiver has not taken all reasonable care.[40]

> The dominant view is that s420A does not confer a right to damages or any other remedy. Section 420A is not an offence or civil penalty provision. ASIC can take action against the receiver for a breach of s420A, under s423 for failing to observe a requirement under the Corporations Act or for a breach of the receivers duties as an 'officer' under the Corporations Act. ASIC will assess the circumstances of each case in light of the statutory requirements and relevant case law.[41]

6.39 The Consumer Credit Legal Service (WA) noted that while there is no consumer equivalent to section 420A of the Corporations Act good industry practice requires that a financial services provider must exercise reasonable care to sell a property for its market value or best possible price. The accepted industry practice for the sale of a property at auction requires:

- A minimum marketing period of four weeks, including suitable advertising in local and national newspapers, and reputable online real estate websites;
- An independent sworn valuation and a market appraisal prior to the setting of an adequate reserve;
- General maintenance of the property; and
- The property to be sold in a timely manner. However, a mortgagee is not required to delay the sale of a property if there are concerns about market fluctuations.[42]

6.40 ANZ suggested that the committee might consider whether a formal ASIC approved EDR process should be established in relation to insolvency practitioners.[43] However, ANZ also made the following observations:

> …there are examples of where 420A cases have been taken to court and liquidators have been accused of not selling at the right price…there have been one or two occasions when…the customer has been compensated. But there are very few that really go through…That could be just because of an imbalance to get those things before the courts, but overall our view would be that it generally works quite well and it is in the interests of both the

40 ASIC, *Submission 45*, p. 31.

41 ASIC, *Submission 45*, p. 32.

42 CCLSWA Inc., *Submission 56*, pp 8–9; See also FOS approach to mortgagee sales, http://www.fos.org.au/custom/files/docs/fos-approach-mortgagee-sales.pdf, (accessed 29 March 2016).

43 Mr Graham Hodges, Deputy Group Executive Officer, ANZ, *Committee Hansard*, 13 November 2016, p. 65.

> bank and the customer to get the most for any value when you are being sold up.[44]

6.41 The FOS informed the committee that in relation to the appointment of receivers there is a small but growing trend amongst some financial services providers to appoint receivers over residential properties mortgaged by individuals who guarantee business loans. FOS noted that as a receiver acts as an agent for the borrower, even though appointed by the lender, this has the potential to reduce avenues for address when there is a concern about, for example, the under-sale of a property.[45]

6.42 FOS expanded further on this issue, suggesting the receivers in such circumstances may need to be subject to an external dispute resolution scheme:

> Say, for example, that the receiver undersold the property and you wanted to complain about that—and we do deal with those sorts of complaints—we could not consider it because the receiver is not part of the Financial Ombudsman Service scheme. That is my concern.[46]

> As I said, this could be a state matter, so maybe this is not the right place to raise it. But it seems to me that what receivers in those circumstances are doing is acting as an agent for the bank or acting as an agent for the mortgagee, and that should be recognised as such so that if a person wishes to lodge a complaint about whatever it is they are or are not doing they can still have redress through our service by lodging a complaint against the bank, because the bank is responsible for its agents.[47]

Committee view

6.43 The committee welcomes the new provisions relating to remuneration of receivers, including maximum default remuneration, capacity for creditors to set remuneration and powers for the Inspector-General to review the remuneration of receivers. The committee also welcomes the new rules relating to the independence of receivers and the sharing of information with creditors and borrowers.

6.44 However, the committee remains concerned that there is no clearly established requirement for receivers to be part of an industry-wide independent external dispute resolution scheme supported by internal dispute resolution procedures. While disputes can be heard by a court, this inquiry concluded in chapter 4 that court processes are often inaccessible to borrowers who have lost control of their financial resources due the appointment of a receiver. While ASIC is able to

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44 Mr Graham Hodges, Deputy Group Chief Executive Officer, ANZ, *Committee Hansard*, 13 November 2015, p. 72.

45 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 8.

46 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 10.

47 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 10.

review practices of receivers under the new insolvency laws, ASIC has clearly stated on many occasions that it only has resources to pursue selected matters that are in the wider public interest.

Investigative accountants subsequently appointed as receivers

6.45 A number of submitters raised concerns about the practice of single companies being appointed as the investigative accountant and then subsequently as the receiver. This was perceived by some submitters as creating a conflict of interest.

6.46 ASIC informed the committee that prior to exercising its contractual rights to appoint a receiver, a secured party would ordinarily assess its security position. In the first instance, a secured party might engage the prospective receiver as an 'investigating accountant' prior to a formal appointment as external administrator. The investigating accountant would then assess the debtor's financial circumstances and the options available to the secured party. However, a person does not necessarily need to be a registered liquidator to act as an investigating accountant. The investigating accountant's report will not usually recommend a specific course of action but provide information to enable the secured party to decide future steps. An insolvency practitioner conducting such an investigation on behalf of the secured party owes a duty to the secured party to protect the interests of that party, even if the company pays for the cost of the investigation.[48]

6.47 The committee was advised that the Corporations Act[49] does not prohibit an insolvency practitioner who has acted as investigating accountant from subsequently accepting an appointment as a receiver or liquidator of the company. However, the insolvency practitioner must have regard to how their investigating accountant's report may affect their independence or the perception of their independence. If appointed, the court may remove them if there is an actual or distinct possibility of a conflict of interest.[50]

6.48 NAB informed the committee of its view, suggesting that it would be common practice in Australia that the person who does the initial investigation becomes the receiver. NAB argued that the person who has done the investigation has a fair degree of familiarity with the business; they understand its operations, its people and what it is doing. It therefore makes it easier for the receiver to step into a strange business and take it on, as well as avoiding additional costs.[51]

> We have investigating accountants do reviews on somewhere between two-thirds and three-quarters of the files that we look after. As we said, only about 15 per cent of them end up in formal insolvency. We see that the

48 ASIC, *Submission 45*, pp 25–26.

49 Sections 418, 448C and 532.

50 ASIC, *Submission 45*, p. 25.

51 Mr Geoff Green, Head of Strategic Business Services, National Australia Bank, *Committee Hansard*, 18 November 2015, p. 13.

> majority are helped to stay out of insolvency, but, yes, some go the other way.[52]

6.49 ASIC suggested that to address concerns that receivers may act without regard to the debtor's or guarantor's interests, consideration could be given to law reform to require a receiver to prepare and serve on the company a declaration of relevant relationships or a declaration of indemnities that discloses:

- the nature and extent of their relationship with the secured party;
- the services provided concerning the company prior to the appointment; and
- details of any indemnity provided.[53]

6.50 ASIC noted that insolvency practitioners are not required to complete a declaration of relevant relationships or indemnities when they are appointed. Although an investigating accountant's report may not specifically recommend a formal insolvency appointment, it is possible that other private representations may be made in favour of such an appointment. ASIC made the following suggestion to the committee:

> To address concerns that the insolvency practitioner may act without regard to the debtor's or guarantor's interests, consideration could be given to law reform to require a receiver to prepare and serve on the company a Declaration of Relevant Relationships or a Declaration of Indemnities that discloses:
>
> (a) the nature and extent of their relationship with the secured party;
>
> (b) the services provided concerning the company prior to the appointment; and
>
> (c) details of any indemnity provided.[54]

6.51 The committee questioned the Commonwealth Bank on its use of investigative accountants to examine whether the appointment of an investigative accountant automatically leads to a receivership. In response the Commonwealth Bank noted that:

> We have performed this task for the 95 cases referred to in our letter to the Committee of 16 December 2015. These 95 cases consist of: 36 Bankwest customers who have provided a submission or appeared before the Parliamentary Joint Committee in relation to this inquiry and 59 additional customers specified in the Ernst & Young Expert Determination Report dated 7 July 2009.
>
> Of these cases, investigative accountants were appointed in 37 of the 95 matters (12 out of 36 submitters to the inquiry, 25 out of 59 Ernst & Young cases).[55]

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52 Mr Geoff Green, Head of Strategic Business Services, National Australia Bank, *Committee Hansard*, 18 November 2015, p. 13.

53 ASIC, *Submission 45*, p. 29.

54 ASIC, *Submission 45*, p. 29.

> We asked four of the largest investigative accountants and receivers (Ferrier Hodgson, Korda Mentha, Grant Thornton and McGrath Nicol) to provide data for the last two to three years. For each case where they were engaged as an investigative account, we asked them to identify how often they were subsequently engaged as a receiver for that business. [56]
>
> Of the 67 cases where the investigating accountant did not become the receiver (87 per cent of cases), we advise that:
>
> - 40 remain existing customers, 25 are managed by Group Credit Structuring;
> - 13 repaid their facilities through asset sales;
> - 9 refinanced their facilities with another lender;
> - 2 were placed into liquidation;
> - 2 entered into voluntary administration; and
> - 1 went into bankruptcy.[57]

Committee view

6.52 The committee notes the information from the Commonwealth Bank that the appointment of an investigative accountant does not inevitably lead to the appointment of a receiver from the same company. The committee also notes requirements that now exist under the new insolvency laws regarding the independence of receivers.

6.53 However, the committee remains concerned that use of the same company for both the investigative accountant role and the receiver role does create the potential for perceived or actual conflicts of interest. The committee suggests that it may be possible for banks intending to appoint a receiver to inform the borrower of the proposed receiver, and to provide the borrower with the opportunity to request an alternative receiver if the borrower is concerned that a conflict of interest may arise.

6.54 The committee heard arguments by banks that using the same company saves the borrower money. However the committee notes that if the investigative accountant's report and files on the case are appropriately thorough, a different company should be able to quickly understand the state of the business with minimal additional costs.

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55 Commonwealth Bank of Australia, *Answers to questions on notice*, taken on 2 December 2015, received on 5 February 2016.

56 Commonwealth Bank of Australia, *Answers to questions on notice*, taken on 2 December 2015, received on 5 February 2016.

57 Commonwealth Bank of Australia, *Answers to questions on notice*, taken on 9 March 2016, received on 31 March 2016.

Recommendation 9

6.55 The committee recommends that if an authorised deposit taking institution is intending to appoint a receiver:

- **a. that is from the same company that was engaged as an investigative accountant, the borrower should be given an opportunity to request an alternate company if the borrower is concerned about a conflict of interest;**
- **b. in addition to the requirement to sell assets for fair market value under section 420A of the *Corporations Act 2001*, receivers should be required to sell a business as a going concern where possible—if this will result in a higher return—rather than separately selling the assets within the business; and**
- **c. that receivers or similar entity selling assets under section 420A be required to take every reasonable step to ensure those assets are sold at or as close to listed market value as possible under the following conditions:**
    - **a. proof of marketing through but not limited to mainstream media, catalogues and online;**
    - **b. in cases with no monetary default, marketing periods consistent with Prudential Standard APS 220;**
    - **c. in the case where monetary defaults have occurred, the marketing period can be reduced below the APS 220 standard where a shorter marketing period can be demonstrated to be in the borrower's best interest; and**
    - **d. that a strong penalty regime for breach of section 420A be administered by the Australian Securities and Investments Commission.**

6.56 Another common concern put to the committee was that borrowers were not always provided with access to the reports of investigative accountants. The committee considers that providing the investigative accountant's report to borrowers is unlikely to cause significant additional costs to banks. The committee has therefore recommended in chapter 2 that banks be required to provide copies to borrowers of both the instructions to investigative accountants and the reports by investigative accountants.

Recommendation 10

6.57 The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services conduct an inquiry to examine the remuneration of insolvency practitioners.

Chapter 7

Bankwest and Landmark

7.1 The committee has received a range of allegations about the 2008 Bankwest commercial loan book and what caused a rate of loan failures that stood out from the rest of the banking industry. In this chapter the committee has collated those allegations and the responses from the Commonwealth Bank. This chapter also covers allegations in relation to the acquisition of Landmark by ANZ.

7.2 The Senate Economics References Committee inquiry into the post-GFC banking sector devoted four chapters to issues related to the Bankwest loan book.[1] The Senate Economics Reference Committee inquiry into the post-GFC banking sector noted that businesses and their loans can fail due to both external events and internal events. The Senate Economics Reference Committee found that internal events may include poor management, the business not being commercially viable, and inappropriate debt levels. The debt levels described in some submissions to that inquiry involved a level of risk that left businesses unable to be resilient even in times of relative economic stability, and which led the committee to conclude:

> While there are many sad and distressing stories now on the public record, the committee cannot help but observe that, in some cases, although the aggrieved borrower may have been able to operate successfully during periods when the business environment was relatively good, the more challenging times presented by the global financial crisis placed extra stress on less robust and more speculative projects. In many cases, loans were sought for ventures that were a considerable risk even during the more stable economic environment that existed prior to the global financial crisis; this is evidenced by the cases where banks other than Bankwest had refused to finance the initial loans.[2]

Bankwest

7.3 This section summarises information that has come to the committee's attention during the present inquiry regarding Bankwest including:

- the collapse of Bankwest's parent company, HBOS;
- the role of the government in the acquisition of Bankwest by the Commonwealth Bank;
- a timeline for the acquisition of Bankwest by the Commonwealth Bank; and
- allegations regarding a deliberate strategy by the Commonwealth Bank to impair loans in order to seek financial benefit.

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1 Senate Economics Reference Committee, *The post-GFC banking sector*, November 2012, pp 163–164.

2 Senate Economics Reference Committee, *The post-GFC banking sector*, November 2012, pp 163–164.

The collapse of HBOS

7.4 This section summarises the collapse of Bankwest's parent company HBOS and the banking strategies employed prior to the collapse of HBOS. The post-GFC Banking inquiry noted that Bankwest was dependent on its UK-based parent company HBOS for 35 per cent of its funding. HBOS, which was highly exposed during the GFC, experienced a run on its shares and was subsequently acquired by Lloyds.[3]

7.5 On 5 April 2013, the UK Parliamentary Commission on Banking Standards published a report on the failure of HBOS, titled *An accident waiting to happen.* The report drew a number of conclusions about HBOS, including that:

> …the downfall of HBOS was not the result of cultural contamination by investment banking. This was a traditional bank failure pure and simple. It was a case of a bank pursuing traditional banking activities and pursuing them badly…prudential supervisors cannot rely on financial markets to do their work for them. In the case of HBOS, neither shareholders nor ratings agencies exerted the effective pressure that might have acted as a constraint upon the flawed strategy of the bank. By the time financial markets were sufficiently concerned to act…financial stability was already threatened.[4]

7.6 The UK Parliamentary Commission on Banking Standards, in its report on the failure of HBOS, suggested that 28 percent of the Bankwest loan book was impaired at the end of 2008 and that such a loss was striking in view of the comparative resilience of the Australian economy.[5] The report also noted that for HBOS:

> In two markets alone—Australia and Ireland—it incurred impairments of £14.5 billion in the period from 2008 to 2011. These losses were the result of a wildly ambitious growth strategy, which led in turn to significantly worse asset quality than many of its competitors in the same markets. The losses incurred by HBOS in Ireland and Australia are striking, not only in absolute terms, but also in comparison with other banks…The repeated reference in evidence to us by former senior executives to the problems of the Irish economy suggests almost wilful blindness to the weaknesses of the portfolio flowing from their own strategy.[6]

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3 Senate Economics Reference Committee, *The post-GFC banking sector,* November 2012, p. 110.

4 Parliamentary Commission on Banking Standards, *An accident waiting to happen: the failure of HBOS,* 5 April 2013, http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/144/144.pdf, (Accessed 9 July 2015), p. 53.

5 Parliamentary Commission on Banking Standards, *An accident waiting to happen: the failure of HBOS,* 5 April 2013, http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/144/144.pdf, (Accessed 9 July 2015), p. 14.

6 Parliamentary Commission on Banking Standards, *An accident waiting to happen: the failure of HBOS,* 5 April 2013, http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/144/144.pdf, (Accessed 9 July 2015), p. 14.

7.7 In 2003 Bankwest embarked on an aggressive growth strategy focused on the east coast states with the aim of opening 160 branches over four years.[7] The ACCC described this expansion as 'unprecedented in Australian banking'.[8] It was also reported that in 2007 Bankwest's lending increased by 36 percent.[9] Some submitters advised the committee that Bankwest was the only bank that would consider their loan applications.[10]

Role of the Commonwealth government in the Bankwest acquisition

7.8 This section briefly summarises the role of the Commonwealth government in the acquisition of Bankwest by the Commonwealth Bank.

7.9 The proposed acquisition of Bankwest by the Commonwealth Bank was subject to a Public Competition Assessment by the Australian Competition and Consumer Commission (ACCC) because the acquisition was considered to raise issues of interest to the public. The ACCC described the impact of the GFC on banking in Australia as follows:

> Since July 2007, the global financial crisis has had an impact on the competitive dynamic in banking markets…the increased cost of wholesale funds since late 2007, many non-bank lenders who were reliant on wholesale markets for their funding have had to exit the Australian market.
>
> Other market players, including smaller authorised deposit-taking institutions (ADIs) with low deposit bases, have had to withdraw from lending in some areas or to some customers.[11]

7.10 In considering the Commonwealth Bank's proposal to acquire Bankwest, the ACCC considered the viability of Bankwest if it was not acquired and reported that:

> The financial situation and risk appetite of HBOS (or a merged Lloyds/HBOS with 40% UK Government ownership) is such that these companies would no longer continue to grow the BankWest business. Not only would this likely see a cessation of the bank's east coast expansion plan, but also the aggressive pricing targeted at growing market share.[12]

7.11 On 5 December 2008 the Treasury received the Commonwealth Bank's application to acquire Bankwest under the *Banking Act 1959,* for approval under the

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7 Senate Economics Reference Committee, *The post-GFC banking sector,* November 2012, p. 109.

8 ACCC, 'Commonwealth Bank of Australia—proposed acquisition of BankWest and St Andrew's Australia', *Public Competition Assessment,* 10 December 2008, p. 10.

9 Eric Johnston, 'BankWest cool as HBOS falters', *Australian Financial Review,* 23 June 2008, p. 64.

10 See for example, Name withheld, *Submission 5,* p. 4.

11 ACCC, Public Competition Assessment, *Commonwealth Bank of Australia – proposed acquisition of Bankwest and St Andrew's Australia,* 10 December 2008, pp 1–3.

12 ACCC, Public Competition Assessment, *Commonwealth Bank of Australia – proposed acquisition of Bankwest and St Andrew's Australia,* 10 December 2008, p. 10.

Financial Sector (Shareholdings) Act 1998 (FSSA). When assessing the application, in addition to the above mentioned Public Competition Assessment by the ACCC, the Treasurer also considered the national interest under the FSSA.[13] On 18 December 2008 the then Treasurer announced the approval of the Commonwealth Bank acquisition of Bankwest, making it subject to several conditions including the maintenance and growth of the Bankwest brand and branches.[14]

7.12 As part of its response to the GFC, the Commonwealth government introduced a guarantee on retail deposits and a wholesale funding guarantee for ADIs. The retail deposit guarantee came into effect in October 2008 and applied to all ADIs, including foreign banks with operations in Australia. The wholesale funding guarantee came into effect on 28 November 2008 for eligible ADIs that registered for the scheme. However, for foreign bank branches, such as Bankwest, the guarantee only applied in respect of their short term wholesale funding raised from Australian residents with maturities up to the end of 2009.[15] The average daily value of Bankwest securities covered by Commonwealth guarantee was first reported at $276 million in December 2008, peaking at $644 million in April 2009 and gradually reducing to zero by early 2011.[16]

Timeline for the Bankwest acquisition by the Commonwealth Bank

Mid September 2008[#]	Lloyds announced a proposal to acquire HBOS, with UK Government to take a 40 percent stake in the merged firm.
September 2008*	Bankwest's intragroup funding estimated to be as high as $18b.
8 October 2008[#]	Commonwealth Bank announces proposal to acquire Bankwest and St Andrew's for 0.8 times the book value, which is low compared to the nine precedents for which the average is 1.9 times book value.
8 October 2008*	Commonwealth Bank entered into a **Share Sale Deed** with HBOS Australia and HBOS plc, which set an initial purchase price of $2.1b, with any amount owing by a Bankwest group company to the HBOS group to be paid in full by that Bankwest group company up to $14.5 billion on 19 December 2008, with any amounts in excess of this to be repaid on 19 June 2009.

13 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

14 The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Media release, *Proposed acquisition of Bank of Western Australia and St Andrew's by the Commonwealth Bank of Australia,* 18 December 2008; Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

15 ACCC, Public Competition Assessment, *Commonwealth Bank of Australia – proposed acquisition of Bankwest and St Andrew's Australia,* 10 December 2008, p. 4.

16 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

20 October 2008[#]	**ACCC Public Competition Assessment** commenced
28 November 2008[#]	Australian government wholesale funding guarantee comes into effect, but Bankwest was not eligible.
10 December 2008[#]	**ACCC Public Competition Assessment decision** formed the view that the proposed acquisition would be unlikely to result in a substantial lessening of competition in any of the relevant markets.
19 December 2008*	**Completion date,** initial purchase price of $2.1b paid to HBOS, along with $14.5b for intragroup debt.
19 December 2008*	By this date Bankwest had borrowed $3.751b from the Reserve Bank of Australia (excluding interest) and used these funds to repay a portion of its intragroup funding with HBOS prior to completion.
31 December 2008*[%]	Bankwest year end. Commonwealth Bank half-year end results indicate $328m for an initial estimate of the outcome of the price adjustment mechanism contained in the Share Sale Deed.
January 2009*	Bankwest repaid the RBA funding amount of $3.77b (including interest) in January 2009 and increased its funding from Commonwealth Bank.
11 February 2009*	Commonwealth Bank half-year and financial statements released, including disclosure of provisional acquisition accounting of Bankwest.
19 February 2009*	**Draft Completion Balance Sheet (DCBS)** prepared for HBOS by KPMG for accounts as at 19 December 2008. This resulted in a proposed increase to the purchase price of $197m.
17 April 2009*	PwC issues report to Commonwealth Bank based on DCBS on a range of disputed items, including the potential understatement of loan impairment provisions.
20 April 2009*[@]	Commonwealth Bank **dispute notice** sent to HBOS with 22 items disputed. Two of the items related to impairment of loans, with a combined value of $418m.
6 June 2009*	Ernst & Young appointed as the **independent expert** to review the disputed items and determine the final purchase price.
19 June 2009*	The excess funding amount between HBOS and Bankwest was determined to be $744m. In accordance with the Share Sale Deed, $744m was settled with HBOS, bringing the total funding repaid to $19.027b.

30 June 2009*	Commonwealth Bank financial year end.
7 July 2009*@	**Independent expert determination,** final purchase price of $2.126b agreed being a net price increase of $26m after taking into account price increases and decreases arising from the 22 disputed items. Two of the 22 disputed items related to impairment of loans, together these two items accounted for a $156.6m price decrease.
9 July 2009*	**Final acquisition payment**, $26m paid to HBOS.
12 August 2009*	Commonwealth Bank year-end financial statements released, including details of the Bankwest acquisition.
April 2010*	**Project Magellan** commenced by the Commonwealth Bank to evaluate the adequacy of loan impairments for 1100 higher risk non-retail Bankwest customer files including targeting property finance, aged care and hotel sectors, covering security valuations greater than $5m or greater than two years old.
Sources for the information in the timeline include the #ACCC Public Competition Assessment,[17] the * Commonwealth Bank answers to questions on notice,[18] @the dispute notice,[19] % Commonwealth Bank response to submission 109 by Mr Trevor Hall.[20]	

Allegations of a deliberate strategy to impair loans

7.13 This section sets out allegations put to the committee regarding a deliberate strategy by the Commonwealth Bank to impair loans in order to seek financial benefit from Bankwest acquisition contract clauses, including:

- changes to the initial purchase price;
- a price adjustment mechanism;
- payment of an excess loan amount;
- the use of warranty clauses;
- that the Commonwealth Bank sought to close the commercial loan book;
- that the Commonwealth Bank's review of the Bankwest commercial loan book called project Magellan was a deliberate strategy to impair loans; and
- allegations about capital holding requirements under prudential standards.

17 ACCC, Public Competition Assessment, *Commonwealth Bank of Australia – proposed acquisition of Bankwest and St Andrew's Australia,* 10 December 2008, p. 3.

18 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, pp 2–8, 18.

19 Commonwealth Bank of Australia, *Sale deed – draft completion balance sheet dispute notice*, 20 April 2009, pp 1–8.

20 Commonwealth Bank of Australia, *Response to Submission 109*, p. 2.

7.14 The Commonwealth Bank's response to each allegation is also discussed.

7.15 A number of these allegations were considered by the Senate Economics References Committee inquiry into the post-GFC banking sector. That committee concluded that:

> In examining the Bankwest issue, some individuals put forward the terms of the purchase agreement entered into by the CBA to acquire Bankwest as an explanation for what occurred. The committee notes these concerns but believes other factors such as the deterioration of the property market and general anxiety about the business and economic environment seem more significant based on the evidence available.[21]

7.16 Several submitters and witnesses have suggested to the committee that new evidence has become available to shed further light on the allegations regarding the initial purchase price for Bankwest, the price adjustment mechanism and the warranty and excess loan amounts.[22] These allegations and the responses received from the Commonwealth Bank are set out in the following sections.

Allegations regarding the initial purchase price for Bankwest

7.17 The committee heard the allegation that the Commonwealth Bank may have incorrectly reported the initial purchase price for Bankwest:

> The actual purchase price agreed with HBOS can also be verified from the 8 October Investor pack, where…the CBA states that the purchase price is 0.8 times the 2007A book value. The 2007A book value is verified in the Investor Pack as being for $3,050 million. Thus, 0.8 purchase price multiplied by $3,050 book value equals $2,440 million. This amount bears close similarity to the theoretical estimate of the agreed purchase price for Bank[w]est, as at 8 October 2008.[23]

7.18 A similar allegation was made, with the claim that the difference in purchase price represented a clawback based on impaired loans:

> …the agreed purchase consideration was… actually $2.428 billion.
>
> The bank handed over $2.1 billion and they withheld $328 million. They then conducted this review and…increased the losses and backdated the provisions. They increased the losses so much that the price of the bank reduced, so they did not have to pay $328 million; they only had to pay a final additional payment of $26 million—a clawback saving of $302 million.[24]

21 Senate Economics Legislation Committee, *The post-GFC banking sector,* November 2012, p. 164.

22 Mr Rory O'Brien, *Committee Hansard,* 13 November 2015, p. 6.

23 Mr Trevor Hall, *Submission 109,* p. 11.

24 Mr Romesh Wijeyeratne, *Committee Hansard,* 13 November 2016, p. 18.

Commonwealth Bank response to the Bankwest purchase price allegations

7.19 The Commonwealth Bank provided the following response to these allegations:

> [The allegations fail] to note that Commonwealth Bank's Investor Presentation dated 8 October 2008 stated that book value is defined as ordinary shareholders' equity, which excludes redeemable preference shares issued by Bankwest. As shown below the initial purchase price is $2,100 million as Commonwealth Bank has consistently stated, not $2,440 million.

Item	$ million
Bankwest total equity	3,050
Less: preference shares[1]	(530)
Ordinary shareholders' equity	**2,520**
Purchase price multiple	0.8084
Recalculated Bankwest purchase price	**2,037**
Purchase price for other entities[2]	63
Total initial purchase price per Share Sale Deed	**2,100**

> The sum of $328 million in the Profit Announcement for the half year ended 31 December 2008 represented an initial estimate of the outcome of the price adjustment mechanism contained in the Share Sale Deed for the acquisition of Bankwest. An estimate was included as the Profit Announcement was finalised before the release of the draft completion balance sheet from HBOS.[25]

Allegations regarding the price adjustment mechanism

7.20 The committee heard allegations regarding the price adjustment mechanism in the Bankwest acquisition:

> From 8 October 2008, the CBA began with the construction of a process to impair and provision the Bankwest Commercial Loan Book, utilising the BankWest purchase price and outstanding wholesale funding amounts in an attempt to effect (but not openly), its plan to reduce the Final Purchase Price paid for BankWest.[26]
>
> In this fashion, the Share Sale Deed provisions enabled CBA to:
>
> - avoid payment of the balance of the Final Purchase Price of $328 million; and
> - claw back, and / or offset from the loan outstanding to HBOS, all amounts of provisioned and impaired debts up-to the entire amount of the Initial Purchase Price.[27]

7.21 The committee heard the allegation that:

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25 Commonwealth Bank response to *Submission 109*, by Trevor Hall, pp 1–2.

26 Mr Trevor Hall, *Submission 109*, pp 10–11.

27 Mr Trevor Hall, *Submission 109*, p. 13.

> The central allegation of the CBA/Bankwest unconscionable conduct is that CBA had a financial motive to force Bankwest commercial loan customers into insolvency in order to obtain a discount on the purchase price from HBOS by way of an impairment indemnity - referred to as "clawback".[28]
>
> These losses could be incurred firstly, prior to the purchase on 19th Dec 2008 or secondly, retrospectively after the purchase as long as the impairment date was successful backdated to 19th Dec 2008.[29]

7.22 Another submitter raised similar concerns:

> Having read the contract of sale between the CBA and HBOS Australia it would appear that there were two (2) opportunities for the CBA to reduce the purchase price. The first opportunity was referred to as the Adjustment to the Purchase Price, in clause 10 of the Share Sale Deed. The Second opportunity was the warranty provisions of the Share Sale Deed under clause 15 Warranties and clause 16 Limitations of Liability.[30]
>
> However, [the] 20 April 2009…"Sale Deed---Draft Completion Balance Sheet Dispute Notice"…references Clause 10 of the Share Sale Deed. Page six…refers to the adjusted purchase price calculated by HBOS Australia reflecting the trading results up to 18 December 2008. Based upon these results HBOS Australia had requested an increase in the purchase price from $2,100 million to $2,296.8 million being an increase of $196.8m.[31]
>
> The CBA claimed a reduction to this increased price in the amount of $490.8m. The majority of this claim for a reduction in price was based upon provisions made against customer loans for anticipated losses that were identified by the CBA within the first 40 working days following settlement.[32]

Commonwealth Bank response to the price adjustment allegations

7.23 The Commonwealth Bank provided the following response to the allegations that the Commonwealth Bank deliberately impaired loans in order to use the price adjustment mechanism in the Share sale deed to reduce the purchase price of Bankwest:

> Upon release of the draft completion balance sheet, the estimate of $328 million was revised downwards to $196.8 million. This was further revised to $26.1 million upon the Independent Expert's determination under the price adjustment mechanism, resulting in a final purchase price of $2,126.1 million.
>
> Contrary to [the] submission, the estimated balance of the purchase price ($328 million) was not reduced through Commonwealth Bank manipulating

28 Name withheld, *Submission 10,* p. 1.

29 Name withheld, *Submission 10,* p. 2.

30 Mr Peter McNamee, *Submission 107,* p. 3.

31 Mr Peter McNamee, *Submission 107,* p. 3.

32 Mr Peter McNamee, *Submission 107,* p. 3.

> the level of impaired loans. The estimate was firstly reduced through HBOS' Draft Completion Balance Sheet delivered on 19 February 2009 and then through the price adjustment mechanism determination of the Independent Expert. Both these processes occurred in accordance with the provisions of the Share Sale Deed.[33]

7.24 The sale deed for the acquisition of Bankwest by the Commonwealth Bank included a price adjustment mechanism to take account the fact that it was not possible to calculate the final accounts until sometime after time of sale date. In the event that there was a dispute relating to the price adjustment mechanism, the sale deed provided for an expert determination to be conducted by Ernst & Young. The price adjustment mechanism was triggered by the 20 April 2009 sale deed draft completion balance sheet dispute notice, in which 22 items were disputed. Two of the 22 items related to loan impairments in which the Commonwealth Bank sought to increase impairment provisions by $418m consisting of:

- $232m for individual provisions and impairment losses on loans and advances; and
- $186m for group collective provisions and impairment losses on loans and advances.[34]

7.25 Through answers to questions on notice, the Commonwealth Bank informed the Committee that:

> The Independent Expert determined that Bankwest's individually assessed provision on specific disputed loans should be increased by $106.5 million and Bankwest's collective provision should be increased by $50.0 million, equating to $156.5 million before tax and capital impacts to reflect the need for higher loan impairment provisions as at 19 December 2008.
>
> No further adjustments could be made to the final purchase price, once it was determined by the Independent Expert. PwC in its role as external auditor performed procedures in relation to the final purchase price and identified no errors. In addition, PwC states it was not aware of any other agreement relevant to determining the purchase price of the acquisition.[35]

7.26 The Commonwealth Bank informed the committee that there were no other periods for review or reassessment of loans or price adjustments that occurred in addition to the loans considered in the July 2009 expert determination. The Commonwealth Bank also confirmed that there were no other agreements entered into between the Commonwealth Bank and HBOS that varied the purchase price subsequent to the Independent Expert's determination. The Commonwealth Bank also informed the committee that its lawyers Herbert Smith Freehills and auditors PwC

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33 Commonwealth Bank of Australia, Response to *Submission 109*, by Trevor Hall, p. 2.

34 Commonwealth Bank of Australia, *Sale deed – draft completion balance sheet dispute notice*, 20 April 2009, p. 3.

35 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, p. 8.

have also confirmed that they are not aware of any other agreement relevant to determining the purchase price of the acquisition.[36]

Allegations regarding excess loan amounts

7.27 The committee heard the following allegation regarding an excess loan amount associated with the acquisition of Bankwest by the Commonwealth Bank:

> …the CBA did not pay the entire [$17 billion] amount of wholesale funding to HBOS on acquisition.
>
> The $4.6 billion loan amount that the CBA has not paid back to HBOS for the purchase, meant that they were not required to fund the entire purchase price in the market because they had obtained $4.6 billion of it by way of vendor finance.
>
> Clause 12. (c) of the Share Sale Deed limited the CBA's obligations for payments of Bank[w]est's indebtedness to the HBOS companies to $14.5 billion with the remainder, the "Excess Amount", payable in 6 months from that date.[37]

7.28 A similar allegation was made by another submitter:

> …it would seem that the CBA was required to pay $2.1 billion for the BW business and to pay a further $17 billion for funding. On the day of settlement the CBA did paid the $2.1 for the BW business but only $14.5 billion for the funding. The CBA was required to pay a further $2.5 billion within 6 months from the date of the settlement…Did the CBA ever pay the remaining $2.5 billion to HBOS? [38]

Commonwealth Bank response to the excess loan amount allegations

7.29 In answers to questions on notice the Commonwealth Bank provided the following additional information regarding the excess loan amount and the funding for the Bankwest acquisition:

> In the Share Sale Deed, the parties agreed any amount owing by a Bankwest group company to the HBOS group would be paid in full by that Bankwest group company up to $14.5 billion on 19 December 2008, with any amounts in excess of this to be repaid on 19 June 2009. The cash flows that occurred on 19 December 2008 are as follows:[39]

36 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, p. 11.

37 Mr Trevor Hall, *Submission 109*, pp 11–12.

38 Mr Peter McNamee, *Submission 107*, p. 4.

39 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, pp 6–7.

	19 Dec 2008 $ million
Initial purchase price for acquisition of Bankwest share capital	2,100
Repayment of HBOS funding to Bankwest	
Bankwest subordinated liabilities	1,025
Bankwest intragroup funding	12,958
Redemption of redeemable preference shares	530
Payment for intragroup debt	14,513

7.30 The Commonwealth Bank provided the following response to allegations regarding the excess loan amount:

> A central proposition in the submission…is that HBOS subsidised Commonwealth Bank's acquisition of Bankwest to the amount of $4,587 million through the "Excess Amount".
>
> The Excess Amount due to HBOS as at 31 December 2008 was $744 million. "Payables due to financial institutions" included this Excess Amount ($744m), a loan from the Reserve Bank of Australia ($3,751 million) and other miscellaneous payables ($92 million).[40]
>
> By 19 December 2008, Bankwest had borrowed $3,751 million from the Reserve Bank of Australia (RBA) (excluding interest) and used these funds to repay a portion of its intragroup funding with HBOS prior to completion. Bankwest repaid the RBA funding amount in January 2009 and increased its funding from Commonwealth Bank. The excess funding amount between HBOS and Bankwest was determined to be $744 million. In accordance with the Share Sale Deed, $744 million was settled with HBOS on 19 June 2009. No further payments were made to HBOS in relation to funding commitments.[41]

Allegations that loans were impaired to access a warranty

7.31 The committee also received allegations that the Commonwealth Bank impaired loans in order to access a warranty under the acquisition of Bankwest:

> The net effect of these clauses are that under the Warranty provisions of the Share Sale Deed…the CBA was able to claim from HBOS for impaired assets not provided for by HBOS in the Draft Audited Finalisation Accounts…By this I mean provided that the CBA made a claim for an impaired asset within 20 days of its knowledge of an impairment and 12 months of the completion of the purchase of the Bankwest Shares the CBA had an unlimited amount of time in which spread out the foreclosures over the following years. It is possible that after a certain amount of individual claims CBA would effectively buy Bankwest for nothing.[42]

40 Commonwealth Bank response to *Submission 109*, by Trevor Hall, pp 2–3.

41 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, pp 6–7.

42 Name withheld, *Submission 10*, p. 13.

> It is contended that it was for this motivation that the CBA continued with its aggressive foreclosures on the Bank[w]est Commercial loan book well beyond the conclusion of the price adjustment mechanism adjudicated by Ernst & Young in July 2009.[43]

7.32 Allegations were also made in relation to warranty claims:

> Subsequent to the impairment and provisioning of loans that were stated on the dispute notice, you identify them on the basis that in the 12 months that followed from 19 December 08 to 19 December 09, a great number of loans were provisioned and impaired, and a warranty claim was clearly made on the seller's guarantor. The seller's guarantor was HBOS plc, which was the parent company.[44]

7.33 Similar concerns regarding warranty clauses in the share sale deed were also raised:

> …it would appear that:
>
> 1. The parent company of HBOS Australia being HBOS plc. (UK) provided a warranty to the CBA.
> 2. This warranty was limited in value to the initial purchase price, as defined in the Share Sale Deed as $2.1 billion.
> 3. The warranty was limited to matters that became known to the CBA after the sale.
> 4. The warranty was limited to a period of one (1) year after the sale.[45]
>
> Alternatively did the CBA rely on the warranty provisions in Share Sale Deed to create a second "claw back" event based upon the impairment of commercial loans during the warranty period?[46]

7.34 Another submitter alleged:

> They had 18 months which, we assume, was their negotiated warranty period during which they could make HBOS pay for it. It is a strange thing that, if you do the maths, it hits the wall at 18 months—which is the end of the warranty period, or the amended warranty period—and then they turn into a good bank.[47]

Commonwealth Bank response to the warranty allegations

7.35 The Commonwealth Bank informed the committee that it did not make any formal warranty claim under the Bankwest share sale deed, however there were three matters capable of a warranty claim that did not relate to customer loans:

- basis swaps between Bankwest and Bank of Scotland entities;

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43 Name withheld, *Submission 10,* p. 14.

44 Mr Trevor Hall, *Committee Hansard,* 13 November 2015, p. 26.

45 Mr Peter McNamee, *Submission 107,* p. 4.

46 Mr Peter McNamee, *Submission 107,* p. 4.

47 Mr Iyad Rafidi, *Committee Hansard,* 13 November 2015, p. 25.

- eBusiness information technology platform invoices; and
- HBOS exposures such as letters of credit and bank guarantees.[48]

7.36 The Commonwealth Bank informed the committee that:

> In respect of these three matters, Commonwealth Bank, HBOS plc and Lloyds International Pty Ltd (formerly HBOS Australia Pty Ltd) entered a commercial settlement on 11 December 2009.
>
> Commonwealth Bank received a payment of A$5,360,193 on 15 December 2009 under the settlement. The parties also released each other from claims under the Share Sale Deed, including any warranty claims other than warranties relating to ownership and structure of the Bankwest Group and warranties relating to tax matters. Commonwealth Bank has not made any claims under these warranties.[49]

7.37 The committee questioned the Commonwealth Bank on whether there were any other agreements between the Commonwealth Bank, HBOS and other parties relating to the Bankwest acquisition. The Commonwealth Bank informed the committee about ancillary agreements which do not appear to relate to customer loans:

- a deed to terminate agreements between Bankwest and HBOS;
- three transitional services agreements to enable continued banking operations;
- three software licence agreements; and
- a records deed to transfer records.[50]

Allegations that the Commonwealth Bank did not want the commercial loan book

7.38 The committee heard from a submitter that in his view, the Commonwealth Bank did not want the Bankwest commercial loan book and that the Commonwealth Bank proceeded to actively take steps to remove those loans from its portfolio:

> At the time that the CBA entered into the Bank[w]est Share Sale Deed, it had formed the view that it would not be proceeding with a large part of the Bank[w]est Commercial Loan Book, and that it would exact the cost of its exit from that loan book at the cost of HBOS. It would do so by making provisions against the loan book, and by impairing and provisioning the Bank[w]est Commercial Loan Book Customers facilities.[51]
>
> This process of intentional reclassification meant that, in aggregate, there were at least 1,100 performing loans provisioned and impaired from the

48 Commonwealth Banks, *Answers to questions on notice,* taken on 16 November 2015, received on 23 November 2015.

49 Commonwealth Banks, *Answers to questions on notice,* taken on 16 November 2015, received on 23 November 2015.

50 Commonwealth Banks, *Answers to questions on notice,* taken on 16 November 2015, received on 23 November 2015.

51 Mr Trevor Hall, *Submission 109,* p. 2.

> commercial loan book and placed into receivership. These loans included loans otherwise appearing on the Bank[w]est good loan book.[52]

7.39 Another submission stated that:

> Hundreds of Bankwest commercial loan customers were foreclosed upon by the CBA in the period from late 2009 through to (as late as) 2013, well after the sale settlement in July 2009. CBA would have the Senate believe that this was merely as a result of a 'book review' (known as Project Magellan) and that CBA had no clawback-type motive to wrongly force these customers into default.[53]

Commonwealth Bank's response to allegations about the commercial loan book

7.40 The Commonwealth Bank provided information on the Bankwest commercial loan book, which indicates that following its acquisition of Bankwest, the number and value of commercial loans grew:

Table 7.1: Number of Bankwest commercial loans

	At acquisition	30 Jun 2009	30 Jun 2010
Loan Balances ($m)	58783	61500	67573
Number of Commercial customer	25719 (31 Jan 2009)	26056	26573

Source: Commonwealth Bank, *Answers to questions on notice,* taken on 1 December 2015, received on 24 December 2015.

Allegations relating to prudential requirements

7.41 Allegations that loan impairments were related to attempts to meet prudential requirements were also made:

> At the time of the purchase, Bankwest was a Basel I accredited bank, and Commonwealth Bank was the first bank to move to Basel II advanced accreditation. So they had different capital profiles…Commonwealth Bank were having difficulty raising capital during this period, so the solution was to reduce the amount of customers that they had on the books.[54]

> …Bankwest was subject to the Bankwest act, which stopped Bankwest from being moved up to the Basel II advanced accreditation. That could not be moved up in line with Commonwealth Bank, which created a discrepancy of capital profile between the two banks. The resolution of that was that they could not raise the capital; therefore, they terminated the customers.[55]

52 Mr Trevor Hall, *Submission 109,* p. 2.

53 Name withheld, *Submission 10,* p. 11.

54 Mr Romesh Wijeyeratne, *Committee Hansard,* 13 November 2015, p. 15.

55 Mr Romesh Wijeyeratne, *Committee Hansard,* 13 November 2015, p. 15.

…

> We have just had the financial services inquiry, where the regional banks have put up their submissions, saying their cost of capital is three times that of first tier banks like the CBA, and you can imagine a Bankwest having a heavier loading of commercial loans and maybe having four or five times the cost of capital because of the APRA requirements. The CBA immediately in 2009, if you read their financial statements, tried to get advanced accreditation for Bankwest so they could reduce its cost of capital. What was in the way was that commercial loan book.[56]

Commonwealth Bank's response to allegations regarding prudential requirements

7.42 The Commonwealth Bank provided the following information in response to the allegations regarding deliberate impairments in order to meet prudential requirements:

- 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.[57]

Allegations relating to project Magellan

7.43 The following allegation about project Magellan was made:

> I have provided a folder of approximately 100 personal impact statements from victims of 'Project Magellan' This code name was created by the CBA to describe 'a review of our portfolio' that resulted in the mass impairments of Bankwest commercial clients following the purchase of Bankwest by the CBA. It is difficult to believe that this mass impairment was actually given a code name but it is true.[58]

7.44 A submitter made further allegations about the timing and role of project Magellan:

> A further provisioning review ensued. This was code---named "Project Magellan". During Project Magellan, BankWest instructed valuers to revalue customer's loan security on a 'worst--- case scenario' to potentially trigger an LVR default.

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56 Mr Iyad Rafidi, *Committee Hansard*, 13 November 2015, pp 24–25.

57 Commonwealth Bank, *Answers to questions on notice*, taken on 1 December 2015, received on 24 December 2015.

58 Mr Peter McNamee, *Submission 107*, p. 18.

> As a result of Project Magellan, BankWest both provisioned and impaired, and appointed Insolvency Practitioners to its customers loans in the FY10 period to approximately 332 Performing Loans. This represented a combined loan value of approximately $2.65 billion.[59]

Commonwealth Bank response to allegations relating to project Magellan

7.45 The Commonwealth Bank responded to the allegations, informing the committee about what project Magellan was and how it started:

> As unexpected losses continued to emerge from the Bankwest commercial loan portfolio, it was decided that a thorough review needed to be undertaken of loans, including ensuring that current independent valuations were obtained to reflect the deteriorating property market. This was conducted as part of Project Magellan, which commenced in April 2010 and resulted in a significant increase in loan impairment expense. The purpose of Project Magellan was to evaluate the adequacy of loan impairment expense for accounting purposes.[60]
>
> We commissioned an exercise to look at 47 per cent, by dollar value, of all of the commercial books in Bankwest: We looked at 1,200 files to make sure that they were properly classified and in order, basically. As a result of that exercise, we set aside further collective and specific provisions on accounts. That was an exercise to make sure, once and for all, we had the correct provision.[61]

7.46 The Commonwealth provide further information in Figure 7.1 on the level of Bankwest accounting provisions for impaired loans and subsequent write-offs over several years. Figure 7.1 shows the increase and decrease in impairments and write-offs and indicates that there is a significant time lag between when a loan book has a significant number of impairments and when write-offs subsequently occur.[62]

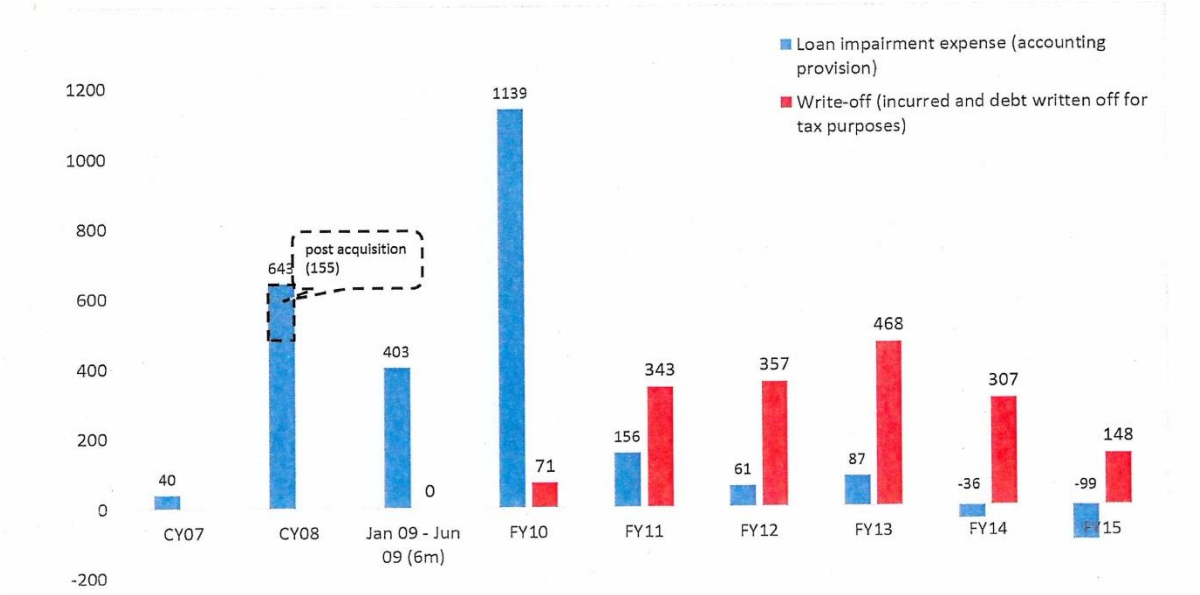
59 Mr Trevor Hall, *Submission 109*, pp 6–7.

60 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, p. 4–5.

61 Mr David Craig, Group Executive for Financial Services, and Chief Financial Officer, *Committee Hansard*, 2 December 2015, pp 11–12.

62 Commonwealth Bank, *Tabled document*, 2 December 2015.

Figure 7.1 Bankwest provisions for loan impairment and write-off in $million



Source: Commonwealth Bank, *Tabled document*, 2 December 2015.

ASIC comments on the Bankwest loan book

7.47 ASIC informed the committee that when a loan book is purchased by another financial institution, as was the case when the Commonwealth Bank acquired Bankwest, the Commonwealth Bank assumed all the rights and obligations for those loan contracts that Bankwest had established and, as a result, the rights of the Commonwealth Bank to act in relation to those loans were limited by the contracts that were in place with those borrowers. ASIC also indicated that:

> Although ASIC has only received around 60 reports of misconduct about this issue, what we have observed is that there is a variety of borrowers in different circumstances. Some borrowers had loan facilities that were not renewed by the Commonwealth Bank. The Commonwealth Bank was in a position to decide not to renew loan facilities, even though perhaps those loan facilities had been renewed previously. In other circumstances the borrowers had missed repayments and, therefore, the Commonwealth Bank was simply exercising the rights that it has under the contract to enforce those contracts.[63]

Committee view

7.48 The previous section discussed allegations put to the committee that there was a deliberate strategy by the Commonwealth Bank to over-impair loans in order to seek financial gain through a range of mechanisms. After considering the evidence and responses it has received, the committee notes that despite the significant spike in loan impairments, it has not been able to determine that the impairment of loans was soley

63 Mr Michel Saadat, Senior Executive Leader, ASIC, *Committee Hansard*, 23 November 2015, p. 9.

motivated by clawbacks or warranties. While the contractual arrangements associated with the acquisition of Bankwest may have played a role, the evidence before the committee points strongly to a culture of placing profit and return to shareholders ahead of the interests of borrowers.

7.49 The above allegations relate to whether there was a strategic, management driven motive to impair loans to access clawbacks or warranties. The committee notes an alternative possibility that the problems were caused in part by motivations of bank officers driven by remuneration incentives that cause them to be over optimistic when initiating loans. Senior management in banks are responsible and should be held accountable for the conduct of bank staff and their treatment of borrowers.

7.50 Motivation aside, the committee does however, remain concerned about that the way these matters were handled which reinforces the need for the recommendations that have been made in preceding chapters of this report.

7.51 The committee notes that the price adjustment mechanism created a potential incentive for Bankwest, when owned by HBOS, to under-impair loans, to make the loan book look better. This would have strengthened their claim for an increase in the Bankwest sale price. As no allegations about this have been put to the committee, the issue is simply noted here for completeness.

7.52 In proceeding with the price adjustment mechanism, both HBOS and the Commonwealth Bank engaged the services of major accounting firms, KPMG and PWC respectively, to conduct assessments of the levels of impairment of the Bankwest loan book. The arbitration of provisions for impaired loans (also presumably based on the same accounting standards) was carried out by Ernst & Young as the independent expert. The fact that the three assessments differed by hundreds of millions of dollars[64] would suggest that despite the same accounting and prudential standards being used, identifying which loans were impaired and the extent of the impairment was an uncertain process requiring commercial judgements in a significant number of cases.

7.53 Even if there was no deliberate strategy by either HBOS or the Commonwealth Bank to under or over-impair loans, the practical outcome was that a group of up to 67 loans[65] were likely to have been in financial difficulty, yet the technical decision on whether they were impaired may have been left undetermined for many months throughout the sale negotiations and price adjustment process. For the affected businesses, that elapsed time without action to address financial difficulties possibly compounded their problem.

7.54 The above uncertainty on the level of loan impairments demonstrates and quantifies the level of discretion that banks have in impairing loans. Such a broad

64 Commonwealth Bank of Australia, *Answers to written questions on notice*, taken on 22 September 2015, received on 8 October 2015, Appendix 1, PwC letter to the Commonwealth Bank of Australia, 6 October 2015, p. 2.

65 Commonwealth Bank of Australia, *Sale deed – draft completion balance sheet dispute notice*, 20 April 2009, p. 8.

discretion must be subject to appropriate monitoring and accountability. There are many loans for which the accountability is limited due to the lack of an applicable dispute resolution scheme. A discussed in chapters 2, 3 and 4 the committee is therefore recommending substantial improvements to dispute resolution schemes, codes of practice and the regulation and monitoring of lending.

Landmark

7.55 This section summarises allegations put to the committee regarding ANZ's acquisition of the Landmark loan book and ANZ's response to those allegations.

7.56 Landmark is a diversified rural merchandise business which, at the time it was acquired by ANZ, was a division of the Australian Wheat Board. Landmark Financial Services (LFS) was a division of Landmark that, at the time of its acquisition by ANZ, provided agribusiness lending of about $2.4 billion, had debenture (akin to deposit) accounts of about $300 million and had about 10,000 customers.[66]

Allegations relating to ANZ's acquisition of Landmark

7.57 The committee heard the following allegations in relation to ANZ's acquisition of the Landmark loan book:

> ANZ decided to purchase the book debts of the AWB in these various farming arrangements for about 16 per cent of the total value of the capital of farms and securities to which they referred. From a banking point of view it was a pretty good deal.
>
> The difficulty then began for many farming families, because they were resumed by enforcing security arrangements entered into nominally with Landmark in some cases up to 22 years but then reduced to periods of two months or five months, placing farmers in an impossible situation commercially. Just imagine, if you had a 22-year loan as a small business, which is what a farm is but with particular special circumstances, namely the prospect of unanticipated drought, floods, market.[67]

7.58 Another submitter alleged that the ANZ bank is currently defaulting performing loans that it acquired when it purchased the 10,000 loans that formed the Landmark loan book.[68] One submitter raised the following question:

> …why would ANZ want to buy the Landmark loan book in March 2010, knowing that its customers were farmers, and then make representation to those customers that ANZ was an agribusiness specialist to induce them to sign a contract but then systemically put a considerable section of those customers and their valuable viable businesses into forced liquidation almost immediately after signing over?[69]

66 ANZ, *Supplementary submission 49,* p. 3.

67 Mr Peter King, Private capacity, *Committee Hansard,* 16 February 2016, p. 2.

68 Mr Peter McNamee, *Submission 107*, p. 14.

69 Mr Rodney Culleton, *Committee Hansard,* 16 February 2016, p. 27.

7.59 Allegations regarding ANZ's involvement with Landmark as a purchaser of securitised loans were also made:

> …in the case of ANZ it looks as though they had become a very significant securitised lender…it appears as if ANZ decided—its AWB loan position was at risk—to emerge from the shadows, take front-line positions in relation to lending operations to farmers direct, not through the AWB or through Landmark. As a result, it was able to renegotiate terms of credit.[70]

ANZ's response to allegations regarding Landmark

7.60 ANZ responded to allegations regarding the purchase price of the Landmark loan book, informing the committee that ANZ did not purchase Landmark for 16 per cent of the value of the Landmark loan book. ANZ indicated that it acquired the Landmark loan book at net book value after appropriate provisions for approximately $2.2 billion and that the sale price for the Landmark deposit book was also its book value of approximately $300 million. ANZ also provided the following information:

> We reiterate that ANZ aims to work with commercial customers in default to help them get back on track. Less than 0.1 per cent of all commercial customers are subject to ANZ enforced insolvency action.
>
> It has been alleged that ANZ enforcement action has been taken at short notice, but we are unaware of any case where this is correct. Details of a number of customer matters have been provided on a confidential basis to the Committee. These show that enforcement action is only taken after negotiations with customers or attempts to negotiate with customers over a period of time.
>
> Claims that ANZ truncated long term loans to periods of two to six months are incorrect. Customers in default are given time to sell down assets to get back on track. It would appear that a six month deadline given to sell an asset has been mistakenly construed as a truncated loan period.[71]

7.61 ANZ also informed the committee that it considers that there may be some confusion between loan impairment and contractual rights of recovery, so it provided the following information for clarification:

- Loan impairment is a financial accounting process that does not give rise to any rights of recovery against a customer. An account can be in default but not impaired, and vice versa; and
- Impairment without contractual default may occur where an assessment is made, for example, that a business is in decline and although the customer has not defaulted, ANZ has formed a view that a loss will ultimately result.[72]

7.62 ANZ also responded to allegations that it acquired Landmark to reduce its securitisation exposure:

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70 Mr Peter King, Private capacity, *Committee Hansard*, 16 February 2016, p. 5.

71 ANZ, *Supplementary submission 49*, pp 2, 4.

72 ANZ, *Supplementary submission 49*, p. 2.

> ANZ was a financier to the Australian Wheat Board (AWB), but did not have a relationship with Landmark prior to the acquisition. ANZ and Rabobank provided wholesale funding for the AWB/Landmark loan book under a securitisation trust structure in which Permanent Custodians Limited (PCL) acted as the trustee. ANZ's component of the wholesale funding was around $1.1 billion. AWB and Landmark were the administrator/servicer under the trust, which meant they were responsible for the day to day dealings with customers. Whilst customers dealt with Landmark, their loan was legally offered by and owed to PCL.
>
> ANZ rejects Peter King's evidence at the 16 February hearing that the decision to purchase LFS was as a result of ANZ's exposure as a securitisation lender to the AWB. ANZ's lending under the securitisation funding was not a factor that influenced the transaction.[73]

7.63 ANZ acknowledged that it had found some problems with the way it had operated and that there are some individual customer matters where ANZ should have managed issues differently, with more empathy, responded more quickly and been more transparent:[74]

> I would like to acknowledge, having reviewed many of the 123 submissions to the inquiry—and, in more detail, the 11 related to ANZ customers, of which five are related to Landmark—that there are some cases where we should have done a better job of working with our customers. As well, there have been examples where we could have done a better job of ensuring that those who act as our agents or who are appointed by us—lawyers, receivers or others—behave in a way that is acceptable to the bank and to our customers.
>
> It is clear to me that, for some Landmark customers, we should have done more to explain what ANZ's acquisition of the loan portfolio meant to them…Most disappointing to me are the individual cases where we did not meet the standards of customer support that I would expect of our bank.
>
> Our experience of the Landmark acquisition has led us to review our practices and introduce some new measures at ANZ…The staff have greater flexibility to help good farmers manage their way through tough times.[75]

Committee view

7.64 The committee considered allegations regarding deliberate impairments or defaults of performing loans associated with ANZ's acquisition of Landmark. After considering the evidence and responses it has received, the committee has not been able to conclusively determine that this occurred. As with the Bankwest evidence,

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73 ANZ, *Supplementary submission 49,* p. 3.

74 Mr Graham Hodges, Deputy Group Executive Officer, ANZ, *Committee Hansard,* 13 November 2016, p. 64.

75 Mr Graham Hodges, Deputy Group Executive Officer, ANZ, *Committee Hansard,* 13 November 2016, pp 64–65.

motivation aside, the committee is concerned at the way many of these matters were handled and that the extant system of checks and balances appears incapable of providing protection or redress to small business customers. The committee welcomes ANZ's acknowledgement that its treatment of customers could be improved and that it is now implementing better practices. The committee will follow with interest developments in ANZ's approach to resolving issues with customers and encourages all lenders to take an open and constructive approach to helping borrowers resolve their difficulties, especially in light of the significant power imbalance that may exist between lenders and borrowers.

7.65 The committee also notes action taken by the ANZ—without admission of regulatory breach—to significantly improve the financial circumstances of some customers with whom they have been in dispute. This leads the committee to conclude that:

- The decision by ANZ implies that they recognise that the extant system of checks and balances is inadequate to protect small business customers and to ensure a fair and transparent relationship with the bank and that unilateral action by them is the best way to rectify their previous—possibly unintentional—abuse of the power they hold;
- Other lenders should engage independent experts to critically examine contentious cases to determine what, if any, restitution may be appropriate in the light of the standards developed by the ASBFEO; and
- That funding be provided to ASBFEO—acting as a tribunal—to consider legacy cases in the event that lenders do not choose to examine contentious cases as suggested above.

Recommendation 11

7.66 The committee recommends that:

a. lenders should engage independent experts nominated by the Australian Small Business and Family Enterprise Ombudsman to critically examine contentious cases to determine what, if any, restitution may be appropriate in the light of the standards developed by the Australian Small Business and Family Enterprise Ombudsman with particular regard to unconscionable conduct; and

b. that funding through a user pays industry funding model be provided to Australian Small Business and Family Enterprise Ombudsman —acting as a tribunal—to consider cases retrospectively in the event that lenders do not choose to voluntarily examine contentious cases as recommended above.

Senator David Fawcett

Chair

Dissenting report: Labor committee members

1.1 This inquiry was established to examine the impairment of customer loans as a matter of public interest. At the completion of this year-long inquiry and many hours of discussion with loan providers and banks, the committee was not able to obtain a satisfactory explanation for the spike in impaired commercial loans in the years following the Global Financial Crisis (GFC). Throughout the inquiry, loan providers consistently maintained that: they always acted in the best interests of the customer; the number of impairments was insignificant in relation to the volume of their business; and the process they initiated to recover funds was only started after the customer failed to meet their obligations. In stark contrast, many submissions suggested that bank behaviour appeared to be unusually aggressive in shutting down commercial loans. Some evidence suggested that the practices adopted by banks to handle impaired loans made it particularly difficult for loan customers to seek alternative financing and retain their businesses as a result of loan impairment.

1.2 Labor members of the committee believe that the causes of increased impairment of loans in the post-GFC period remain unclear. There are a number of complex factors, including increased pressure on financial institutions during their transition to a dramatically changed financial and economic environment post-GFC. The changed economic environment may have led to greater pressure on banks to generate higher return on equity, which could have been at the expense of consumer outcomes.

1.3 Labor members of the committee concur with most of the findings of the committee's majority report and its recommendations.

1.4 We agree with the finding that there has been a persistent pattern of abuse arising from the asymmetry of power in the relationship between lender and borrower. However, we do not agree that the evidence received in this inquiry is sufficient to conclude that there was no widespread or systemic illegal or unethical behaviour by banks.

1.5 Labor members of the committee believe that there is more evidence of banking misconduct that needs to be investigated. Recent media reports highlighting the Comminsure scandal, the tampering of loan documents (revealed on Four Corners, 1 May 2016), various financial planning scandals, bank bill swap rates and other matters indicate that there may be broader systemic issues with the behaviour of banks.

1.6 Labor members of the Committee consider that the evidence presented at the inquiry has highlighted the need for further examination of the banking and financial services sector, to examine:

- how widespread instances of illegal and unethical behaviour are within Australia's financial services industry;
- how Australia's financial services institutions treat their duty of care to their customers;

- how the culture, ethical standards and business structures of Australian financial services institutions affect the behaviour of these institutions;
- whether Australia's regulators are really equipped to identify and prevent illegal and unethical behaviour;
- comparable international experience with similar financial services industry misconduct and best practice responses to those incidents; and
- other events as may come to light in the course of investigating the above.

1.7 Labor members of the Committee believe that the handling of impaired customer loans by banks should be considered as part of any Royal Commission into the financial services industry.

1.8 Labor members of the Committee do not believe that the announcements made on the 20 April 2016 in the government's response to the ASIC Capability Review were sufficient to get to the bottom of the broader systemic issues in the industry.

1.9 The behaviour of banks and financial services companies, including that revealed in evidence to the Committee, has led to real reputational harm to Australia's financial services industry. Labor members of the Committee believe that a Royal Commission is the only way to restore confidence in the Australian financial services industry.

Recommendation:

That a Royal Commission be established to examine the banking and financial sector, and particularly:

- **how widespread instances of illegal and unethical behaviour are within Australia's financial services industry;**
- **how Australia's financial services institutions treat their duty of care to their customers;**
- **how the culture, ethical standards and business structures of Australian financial services institutions affect the behaviour of these institutions;**
- **whether Australia's regulators are really equipped to identify and prevent illegal and unethical behaviour;**
- **comparable international experience with similar financial services industry misconduct and best practice responses to those incidents; and**
- **other events as may come to light in the course of investigating the above.**

Senator Deborah O'Neill **Senator Chris Ketter**

Deputy Chair

Ms Julie Owens MP **Mr Tim Watts MP**

Appendix 1

Submissions Received

1. Mr Errol Opie and Ms Ann Marie Delamere
2. Name Withheld
3. Mr Richard B. Wright and Mrs Barbara Ann Wright
4. Code Compliance Monitoring Committee (CCMC)
5. Name Withheld
6. Mr John Hollioake
7. Name Withheld
8. Mr & Mrs Peter and Leonie Randles
9. Dr Barry Landa
10. Name Withheld
    - Response by Commonwealth Bank of Australia
11. Ms Katie Shafar
12. Mr Colin Power
13. Mr Dario Pappalardo
14. Mr & Mrs Max and Diane Lock
15. Mr Anthony Thomas Rigg
    - Supplementary to submission 15
16. Mr Ken Grech
17. Mr & Mrs Joseph and Gail Courte
18. Name Withheld
    - Supplementary to submission 18
19. Mr Barry Alcock
20. Mr Frank Galea
21. Name Withheld
22. Aurora Lifestyle Holdings Pty Ltd
23. Mr Leslie John Reid
24. Kelgon Development Corporation Pty Ltd
25. Mr Paul Topping
26. Name Withheld

27. Mr Joshua Hunt
28. Mr Michael Sanderson
29. Mr & Mrs Terrence and Sidney Mytton-Watson
30. Ms Deborah Perrin
31. Mr Bill Ringrose
32. Name Withheld
33. Ms Catherine Kearney
34. Mr Greg Bloomfield
35. Mr Allan R. Jones
36. Mr George Lizier
37. Rural Business Tasmania
38. Australian Restructuring Insolvency & Turnaround Association
    - Response by Mr Sean Butler to this submission
    - Response by ARITA to Mr Butler's response
39. Mr & Mrs Philipp and Lynne Kreutzer
40. Name Withheld
41. Mr Paul Earley
42. Mr Brent Renouf
43. Lord Terry Prest
44. Australian Government Department of Agriculture
45. Australian Securities & Investments Commission
46. Financial Ombudsman Service Australia
47. Australian Bankers' Association
48. Commonwealth Bank of Australia
49. ANZ
    - Supplementary to submission 49
50. National Australia Bank
51. Customer Owned Banking Association
52. Mr William David Wallader
53. Directors of Gippsland Secured Investments Ltd
54. Ms Kerry Neville
55. Legal Aid Queensland
56. Consumer Credit Legal Service (WA) Inc.

57. Whelans Group Investments Pty. Ltd.
58. Mr John D. Williams
59. Name Withheld
60. Mr Ian Colquhoun
61. Tasmanian Small Business Council
62. Ms Robyn Toohey
    - Supplementary to submission 62
63. Ms Suzi Burge
64. Mr Lynton Freeman
65. Mr Gerard O'Grady
66. Mrs Yvonne Hitchenor
67. Mr Ken Winton
68. Mr Eric Fraunfelter
69. Banking and Finance Consumers Support Association (Inc)
70. Name Withheld
71. Mr Yves El Khoury
72. Mr Warren Barber
73. Mr Bradley McVicar
74. Mr & Mrs Colin and Narelle Christian
75. Santalucia Group
76. Mr John McClymont
    - Supplementary to submission 76
77. Mr Greg Bishop
78. Mr Robert Barr
79. Mr Don Turner
80. Bank Victims Pty Ltd
81. Mr & Mrs Tim and Jean Cashmore
82. Mr & Mrs John Paul & Esther Sterndale
83. Dr Evan Jones
84. Mr Robert Johnston
85. Mr Jerry and Jill Bennette
86. Mr Roy Lavis
87. Mr John Dahlsen

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88. The Provincial Finance Group (Provic)
89. Allied Hospitality Ltd
90. Mrs Kathryn Johnson
91. Mr Nashaat Sedhom
92. Confidential
93. Ms Charalambia Evripidou
94. Mr Stephen Hosking
95. Danielle & Peter Schaumburg
96. Name Withheld
97. Mr Milton Wilde
98. Mr Peter Ward
99. Ms Jean Andersen
100. Mr Adrian Bryant
101. Mr Trevor Eriksson
102. Ms Faye Andrews
103. Mr Vittorio Cavasinni
104. Mr Bruce White
105. Mr Alan Mackenzie
106. Dr William Grealish
107. Mr Peter McNamee
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    - Response by Commonwealth Bank of Australia
108. Lamont Group
109. Mr Trevor Hall
    - Supplementary to submission 109
    - Response by Commonwealth Bank of Australia
    - Response by Commonwealth Bank of Australia to supplementary
110. Confidential
111. Name Withheld
    - Response by Commonwealth Bank of Australia
112. Confidential
113. Mr Sean Butler

114. Ms Rita Troiani and Ms Janine Barrett
115. Integrity New Homes
116. Bank Reform Now
117. Kerry Budworth
118. Mr Alan Manson
119. Mrs Bhadra Macken
120. JMA Parties
121. Ms Leane Browning
122. Ms Sue Ganz
123. Mr & Mrs Rodney and Ioanna Culleton
124. Mr Chris Evanian
125. The Australian Property Institute
126. Westpac
127. Confidential
128. Confidential
129. Confidential
130. Confidential
131. Confidential
132. Confidential
133. Confidential
134. Confidential
135. Confidential
136. Confidential
137. Confidential
138. Confidential
139. Confidential
140. Confidential
141. Mr Adrian Beamond and Ms Deborah Smith
142. Mr Gerry Vallianos
143. Ms Jean Vallianos
144. Mr Adrian Ljubic
145. Mr Lawry Bredhauer
146. Mr Jeff King

147. Ferrier Hodgson
148. Mrs Dimity Hirst
149. Tartaglia Nominees
150. Mr Said Chamel Antanios
151. Ms Jen Smith
152. Name Withheld
153. Confidential
154. Confidential
155. Confidential
156. Confidential
157. Confidential
158. Confidential
159. Confidential
160. Confidential
161. Confidential
162. Confidential
163. Confidential
164. Confidential
165. Confidential
166. Confidential
167. Confidential
168. Confidential
169. Confidential
170. Confidential
171. Confidential
172. Confidential
173. Confidential
174. Confidential
175. Confidential
176. Confidential
177. Confidential
178. Confidential
179. Confidential

180. Confidential
181. Confidential
182. Confidential
183. Mr Guy Goldrick and Mr Robert Mitrevski
184. Name Withheld
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185. Mr James R. Harker-Mortlock
186. Confidential
187. Confidential
188. Confidential
189. Unhappy Banking
190. Mr Bruce Bell and Mr Frank Bertola
191. Mr William John Jamieson
192. Mr Richard Morton
193. Mr Tony Mollison
194. Mr John Hall
195. Bourne Parties

Additional information received by the committee

1. Tabled Document: tabled by ANZ at a public hearing in Sydney on 13 November 2015.

2. Tabled Document: tabled by ANZ at a public hearing in Sydney on 13 November 2015.

3. Tabled Document: tabled by Mr Trevor Hall at a public hearing in Sydney on 13 November 2015.

4. Tabled Document: Opening statement tabled by the National Australia Bank at a public hearing in Sydney on 18 November 2015.

5. Tabled Document: Opening statement tabled by the Australian Bankers' Association at a public hearing in Sydney on 18 November 2015.

6. Tabled Document: Opening statement tabled by Westpac at a public hearing in Sydney on 18 November 2015.

7. Tabled Document: Document tabled by Legal Aid Queensland at a public hearing in Brisbane on 19 November 2015.

8. Tabled Document: Opening statement tabled by the Commonwealth Bank of Australia at a public hearing in Canberra on 2 December 2015.

9. Tabled Document: Document tabled by the Commonwealth Bank of Australia at a public hearing in Canberra on 2 December 2015.

10. Tabled Document: Opening Statement tabled by the Royal Institution of Chartered Surveyors at a public hearing in Sydney on 4 April 2016.

Answers to questions on notice

1. Answers to written questions on notice from the Commonwealth Bank, asked on 22 September 2015, received 8 October 2015.

2. Answers to written questions on notice from the Code Compliance Monitoring Committee, asked on 23 October 2015, received 4 November 2015.

3. Answers to written questions on notice from the Tasmanian Small Business Council (TSBC), asked on 27 October 2015, received 6 November 2015.

4. Answer to written question on notice from the Commonwealth Bank, asked on 22 September 2015, received 10 November 2015.

5. Answers to written questions on notice from the Commonwealth Bank, asked on 12 November 2015, received 23 November 2015.

6. Answers to questions on notice from Mr Peter and Danielle Schaumburg , asked at a public hearing on 19 November 2015, received 23 November 2015.

7. Answers to written questions on notice from the Commonwealth Bank, asked on 23 November 2015, received 2 December 2015.

8. Answers to questions on notice from Mr Tim Boman, asked on 19 November 2015, received 3 December 2015.

9. Answers to written questions on notice from The Australian Property Institute, asked on 2 December 2015, received 9 December 2015.

10. Answers to questions on notice from the Australian Restructuring Insolvency & Turnaround Association, asked on 18 November 2015, received 10 December 2015.

11. Answers to questions on notice from Legal Aid Queensland, asked at a public hearing on 19 November 2015, received 11 December 2015.

12. Answers to written questions on notice from The Treasury, asked on 1 December 2015, received 14 December 2015.

13. Answers to written questions on notice from the Commonwealth Bank, asked on 12 November 2015, received 16 December 2015.

14. Answers to written questions on notice from the Commonwealth Bank, asked on 1 December 2015, received 24 December 2015.

15. Answers to questions on notice from the Commonwealth Bank, asked at a public hearing on 2 December 2015, received 24 December 2015.

16. Answers to questions on notice from the ANZ, asked on 17 & 18 November 2015 and at a public hearing on 13 November 2015, received 29 December 2015.

17. Answers to written questions on notice from the ANZ, asked on 1 December 2015, received 29 December 2015.

18. Answers to written questions on notice from the Legal Services Commission of South Australia, asked on 18 December 2015, received 7 January 2016.

19. Answers to written questions on notice from Legal Aid ACT, asked on 18 December 2015, received 21 January 2016.

20. Answers to written questions on notice from Legal Aid Western Australia, asked on 18 December 2015, received 22 January 2016.

21. Answers to written questions on notice from The Australian Property Institute, asked on 17 December 2015, received 25 January 2016.

22. Answers to written questions on notice from the Commonwealth Bank, asked on 15 December 2015, received 27 January 2016.

23. Answers to written questions on notice from the Commonwealth Bank, asked on 17 December 2015, received 28 January 2016.

24. Answers to questions on notice from the National Australia Bank, asked at a public hearing on 18 November 2015, received 29 January 2016.

25. Answers to written questions on notice from the ANZ, asked on 28 January 2016, received 28 January 2016.

26. Answers to written questions on notice from the Australian Bankers' Association, asked on 1 December 2015, received 29 January 2016.

27. Answers to written questions on notice from Legal Aid Queensland, asked 18 December 2015, received 29 January 2016.

28. Answers to questions on notice from the Australian Securities and Investments Commission, asked at a public hearing on 23 November 2015, received 4 February 2016.

29. Answers to written questions on notice from the Australian Securities and Investments Commission, asked on 1 December 2015, received 4 February 2016.

30. Answers to questions on notice from the Commonwealth Bank, asked at a public hearing on 2 December 2015, received 5 February 2016.

31. Answers to written questions on notice from the ANZ, asked on 15 January 2016, received 15 February 2016.

32. Answers to written questions on notice from the Commonwealth Bank, asked on 1 December 2015, received 18 February 2016.

33. Answers to written questions on notice from Westpac, asked on 18 November 2015, received 29 February 2016.

34. Answers to written questions on notice from NAB, asked on 2 December 2015, received on 22 March 2015.

35. Answers to questions on notice from Price Waterhouse Coopers, asked on 16 & 18 February 2016, received on 15 March 2016.

36. Answers to written questions on notice from the Commonwealth Bank, asked on 9 March 2016, received 31 March 2016.

37. Answers to written questions on notice from the Royal Institution of Chartered Surveyors, asked at a public hearing on 4 April 2016, received on 12 April 2016.

38. Answers to written questions on notice from the Australian Taxation Office, asked at a public hearing on 4 April 2016, received on 13 April 2016.

39. Answers to written questions on notice from the Commonwealth Bank, asked at a public hearing on 4 April 2016, received on 15 April 2016.

40. Answers to written questions on notice from ANZ, asked at a public hearing on 4 April 2016, received on 29 April 2016.

Appendix 2
Public hearings and witnesses

Melbourne, 16 October 2015

DAVIS, Mrs Sally, Chief Executive Officer, Code Compliance Monitoring Committee

DOOGAN, Mr Christopher, Independent Chair, Code Compliance Monitoring Committee

FADER, Mr Geoffrey C, Chair, Tasmanian Small Business Council

FIELD, Mr Archer, Research Manager, Tasmanian Small Business Council

FIELD, Mr Philip Andrew, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia

McGREGOR, Mr Robert, Compliance Manager, Code Compliance Monitoring Committee

Sydney, 13 November 2015

BROWN, Mr Gerard, Group General Manager, Corporate Affairs, ANZ

ERIKSSON, Mr Trevor, Private capacity

HALL, Mr Trevor, Private capacity

HODGES, Mr Graham, Deputy Group Chief Executive Officer, ANZ

LEET, Mr Glenn, Director, Integrity New Homes Pty Ltd

McNAMEE, Mr Peter, Private capacity

O'BRIEN, Mr Rory Francis, Private capacity

RAFIDI, Mr Iyad, Private capacity

WARAKER, Mr Steven (Ross), Private capacity

WIJEYERATNE, Mr Romesh, Private capacity

Sydney, 18 November 2015

ARNOLD, Ms Kim, Technical and Education Director, Australian Restructuring Insolvency and Turnaround Association

CAVASINNI, Mr Vittorio, Private capacity

EVANIAN, Mr Chris, Private capacity

FERRIER, Ms Narelle, Technical and Standards Director, Australian Restructuring Insolvency and Turnaround Association

GILBERT, Mr Ian, Director, Banking Services Regulation, Australian Bankers' Association

GREEN, Mr Geoff, Head of Strategic Business Services, National Australia Bank

LEE, Mr David, Chief Credit Officer, Credit Restructuring, Westpac Banking Corporatio

MALCOLM, Mr William, General Manager, Credit Risk, Westpac Banking Corporation

MURRAY, Mr Michael, Legal Director, Australian Restructuring Insolvency and Turnaround Association

PEARSON, Mr Anthony, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association

RAYNER, Mr Ken, Member, API Submission Committee, and New South Wales Divisional

Councillor, Australian Property Institute, New South Wales Division

SHEEHAN, Professor John, Chair, Government Liaison, and Past President, Australian Property

Institute, New South Wales Division

WILLIAMS, Mr Timothy Michael, General Manager, Group Strategic Business Services, National Australia Bank

WINTER, Mr John, Chief Executive Officer, Australian Restructuring Insolvency and Turnaround Association

Brisbane, 19 November 2015

BOMAN, Mr Tim, Private capacity

LAVIS, Mr Roy, Chief Executive Officer, CEC Group Ltd

McMAHON, Mr Denis Darcy, Senior Lawyer, Farm and Rural Legal Service, Civil Justice Services, Legal Aid Queensland

POWER, Mr Colin, Powers Hotel Holdings

SCHAUMBURG, Mr Peter, Private capacity

SCHAUMBURG, Mrs Danielle, Private capacity

Canberra, 23 November 2015

BROWN, Mr Adrian, Senior Executive Leader, Australian Securities and Investments Commission

DAY, Mr Warren, Senior Executive Leader, Australian Securities and Investments Commission

SAADAT, Mr Michael, Senior Executive Leader, Australian Securities and Investments Commission

Canberra, 2 December 2015

COHEN, Mr David, Group Executive for Corporate Affairs, and Group General Counsel, Commonwealth Bank of Australia

CRAIG, Mr David, Group Executive for Financial Services, and Chief Financial Officer, Commonwealth Bank of Australia

Sydney, 16 February 2016

ANDREWS, Mr Wayne, Partner, PricewaterhouseCoopers

BRENNAN, Mr Patrick, General Manager, Policy Development, Australian Prudential Regulation Authority

CARROLL, Mr Justin, Partner, PricewaterhouseCoopers

CULLETON, Mr Rodney Norman, Private capacity

GREGSON, Mr Scott, Executive General Manager, Consumer Enforcement, Australian Competition and Consumer Commission

GRUMMITT, Mr Neil, General Manager, Credit and Operational Risk Services, Australian

Prudential Regulation Authority

JONES, Mr David, Director, Mergers and Authorisation Division, Australian Competition and Consumer Commission

KING, Mr Peter Edward, Private capacity

LAITHWAITE, Mr Marcus, Partner, PricewaterhouseCoopers

McGOVERN, Dr Mark Francis, Private capacity

MENZEL, Mrs Margaret Frances, Private capacity

SCOTT, Mr Warren, General Counsel, Australian Prudential Regulation Authority

WATERHOUSE, Mr Paul Antony, Chairman, Australian Valuers Institute

Sydney, 4 April 2016

ARMSTRONG, Mr Tim, Head, Micro and Small Business, South, National Australia Bank

BROWN, Mr Gerard, Group General Manager, Corporate Affairs, ANZ Banking Group Ltd

CAREY, Ms Annamaria, Assistant Commissioner, Banking and Finance Strategy, Australian Taxation Office

COHEN, Mr David, Group Executive for Corporate Affairs, and Group General Counsel,

Commonwealth Bank of Australia

DE LUCA, Mr Rob, Managing Director, Bankwest

GREENE, Mr Geoff, Head, Strategic Business Services, Melbourne, National Australia Bank

HARDIE, Mr Robert, Manager, Corporate Affairs, Oceania, Royal Institution of Chartered Surveyors

HODGES, Mr Graham, Deputy Group Chief Execuive Officer, ANZ Banking Group Ltd

NOLAN, Mr Peter, Oceania Director, Royal Institution of Chartered Surveyors

PARKER, Professor David, Fellow, Royal Institution of Chartered Surveyors