

IMPAIRMENT OF CUSTOMER LOANS

Further submission by Legal Aid Queensland to
Parliamentary Joint Committee on Corporations and
Financial Services Inquiry

Impairment of Customer Loans

Introduction

Legal Aid Queensland made a submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the impairment of customer loans.

The submission was based on the experience of Denis McMahon, Senior Lawyer, Farm and Rural Legal Services, Civil Justice Services, Legal Aid Queensland.

On 19 November 2015 Mr McMahon attended a public hearing of the Parliamentary Joint Committee at Brisbane City Hall and gave evidence to the Committee. Committee member Mrs. Ann Sudmalis MP asked Mr. McMahon the following questions:

- Your submission referred to the power imbalance between financial service providers and their customers. Have you and your organisation, or the people you network with, considered how that power imbalance could be addressed?
- Have you got any specific examples of where a financial service provider has taken a different valuation held within the same service provider to support a particular purpose of the provider?
- Do you have any statistics that relate to where a farmer has been making loan repayments and then the financial service provider has had the property revalued at a lesser amount than when the loan was first taken out and taken the loan to be in default following the revaluation?

Following consultation by Mr McMahon with experienced farm debt mediators and Legal Aid Queensland lawyers who are familiar with the Financial Ombudsman Service (FOS), the following further submissions are made.

Addressing power imbalance between lender and borrower

Limitations of the current farm debt mediation process

Cap on the value of the claim and on amount of credit facility

Farmers and small businesses are unable to access the services of the FOS if their credit facilities are for amounts in excess of \$2M or if a dispute with their financial services provider is about an amount in excess of \$500,000.

The FOS jurisdiction set out in TOR 5.1(o) excludes claims exceeding \$500,000. TOR 5.1(r) further limits jurisdiction to exclude claims against a small business where the contract provides for a credit facility of more than \$2M.

Commencing court action to enforce rights is beyond the financial capacity of farmers seeking legal assistance with financial distress.

Legal Aid Queensland submits that:

- TOR 5.1(o) should be amended to increase the limitation for the applicability of TOR 5.1(o) to claims of up to \$3M where the debt is a farm debt; and
- TOR 5.1(r) should be amended to increase the limitation for the applicability of TOR 5.1(r) to \$10M where the credit facility is for a farm.

Exclusion where the farmer has engaged in dispute resolution elsewhere

The Queensland Farm Finance Strategy and other voluntary and legislated approaches throughout Australia provide that financial services providers must offer farm debt mediation before they take enforcement action.

If a farmer accepts an offer to mediate under any of the schemes, including the legislative schemes, the FOS will not consider the matter even where the farmer's complaint would otherwise fall within its jurisdiction. Presumably the FOS exercises its powers relying upon the discretionary exclusions provided in FOS TOR 5.2. that "*there is a more appropriate place to deal with the dispute, such as a court, tribunal or another dispute resolution scheme or the Privacy Commissioner*"

Generally farmers are unaware of their rights to refer matters to the FOS even if they fall within the current guidelines. Because of the 21 day time limit for accepting mediation, farmers often accept mediation before seeking advice to ensure that they are within the time limit.

It is common that only after advisors take instructions to prepare for mediation that concerns regarding responsible lending, the provision of documents, the conduct of case management and collection processes, or maladministration become apparent.

Legal Aid Queensland is of the view that there is currently no mechanism contained in any farm debt mediation process whether legislated or otherwise which requires a bank to produce documentation or information it used to assess the suitability of the loan or later credit limit increases (see Clause 27 of the Code Of Banking Practice) or to provide all relevant communication between the parties which the banker relied upon to make decisions.

Also, in the mediation process there is currently no obligation on the banks to take into account any breaches of the *Code of Banking Practice*. In one farm debt mediation, where there was an issue as to the appropriateness of the loan for the farmers circumstances, the bank representative advised that he would not discuss or consider these issues as they should have been referred to the FOS.

Legal Aid Queensland submits that:

- the FOS should have jurisdiction to consider a complaint about a financial services provider even where the financial services provider has offered to mediate the dispute and/or the client has accepted an offer to mediate the dispute; and
- the FOS jurisdiction should be widened to provide that if during a mediation, the mediator forms the view that the financial services provider has failed to provide adequate documentation to the farmer or has failed to adequately address genuine concerns raised during the mediation process relating to the conduct of the financial

services provider, the mediator can refer the matter to FOS should it fall within the extended jurisdiction.

Different valuations used for different purposes

The comments on page 5 of the original submission were based on anecdotal information obtained from clients over the years. An examination of LAQ's recent files do not reveal any further examples of the use of different valuations for different purposes in recent times, apart from the example provided on page 5 of the original submission.

Constructive default

Examples of where financial service providers have changed the terms and conditions of loans/facilities resulting in the borrower having difficulty meeting the new terms and conditions, or where financial service providers have exercised powers to call in loans on the basis of a revaluation of the property which values the property at a lesser amount than the amount at which the property was valued for the purpose of the original loan or facility, even where the borrower is otherwise complying with the terms and conditions of the loan/facility (referred to as constructive default) are as follows:

1. Farmers borrowed to purchase their first farm, on which they grew mangos and avocados, in 2009. The facilities were short term loans which provided the bank with the option not to renew them when they expired, which was inappropriate for the circumstances of the farmers. The farmers were required to make three repayments per year coinciding with their income streams.

Following two floods which severely damaged infrastructure and trees to the extent that all the avocados were destroyed, cash flow was disrupted. The farmers informed the bank that they were selling shares to meet the repayments. This was achieved shortly after the due date.

Following the appointment of a new bank manager, the bank undertook an internal valuation which valued the property at an amount less than the amount at which it was valued at the time at which the loans were taken out. Due to decreased values the facilities were now considered to be outside of the bank's guidelines.

The bank required the clients to sell farm assets, even though they were maintaining all payments. On expiry of one facility, the bank changed the payment requirements to monthly payments without consultation with the client. Consequently, the farmer had to lease additional ground to grow quick growing crops to meet payments.

The farmer initially fell into arrears due to timing issues but later met all payments. However, the bank proceeded to mediation on the basis of a concern for the ability of the farmer to meet ongoing commitments and that the security was now at risk given the decline in value of the property. At the time of the mediation there were no arrears and the loan had not been in arrears for some time. There were also substantial credit funds in their trading account.

2. In 2009 farmers took out three loans, two expiring in 5 years and one expiring in seven years. In 2013 the farmer negotiated with the bank an extension of time to pay a principal amount of \$20,000 while continuing to pay interest. The bank manager resigned and did not note the bank's records of this agreement. There were sufficient funds in the account to meet the interest payments as they became due. However, the bank withdrew the principal amount, putting the account outside its limit. There was no account manager for the farmers account for eight months.

On appointment of a new manager, the farmers applied for an increased overdraft which was approved 10 weeks later. During the 10 week period, the overdraft limit was exceeded but on approval the overdraft was within the new limit.

The bank subsequently referred the earlier default arising from the unilateral transfer of funds between accounts by the previous manager for mediation. At the time of mediation all facilities were in order and two were about to expire. The bank refused to renew these two facilities requiring the farmer to undertake a stud dispersal sale in a depressed cattle market.

The bank eventually required the farmers to sell their properties, which they were not able to refinance, due to a depressed market, resulting in a substantial loss and subsequent further financial hardship.

3. Horticulturalists employing up to 150 people at harvest time had an overdraft which increased by up to \$130,000 at harvesting time to meet harvesting expenses. Following a disease which struck their crop in 2012 the 2013 harvest was down-graded. The bank agreed to increase the overdraft by \$250,000 for the 2014 harvest.

When they became aware that they would be late with payments, they attempted to contact the bank to discuss the issue on a number of occasions but did not receive a response. After a new bank manager (the fifth within a year) took over the file, he referred the matter to head office which immediately requested payment and froze the overdraft. The bank also requested more financial information about the business.

The farmers had access to other funds and put all facilities in order. There was in excess of \$200,000 credit in a working account. However, the bank still proceeded with mediation seeking an end of the relationship.

The actions of the bank made it more difficult for the farmers to refinance their loans.

4. The farmers had experienced severe drought for over 10 years followed by severe flooding. In 2013 they were trading within their overdraft limit following the sale at the request of their bank of a grazing property for \$2,000,000. That property had been purchased in 2008 for \$2,700,000. The whole of the proceeds of sale of this property, at the request of the bank, was applied to reduction of bank debt including equipment loans.

The farmers continued to meet all interest payments as they fell due although their overdraft fluctuated outside its limits on occasions, without concern being raised by the bank. Equity in the property was substantial.

Cattle prices slumped and the farmers paid out an unsecured cattle account to a stock agent, resulting in their loan facility being temporarily outside of its terms. The bank required the facilities to be paid out in full even though they were in order and referred the matter for mediation. Cash flow projections demonstrated a capacity to maintain a positive position due to strong cattle numbers.

Refinancing will be difficult in these circumstances.

