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LF Economics

Australia: A Haven for White-Collar Criminality and Control Fraud

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Section 1: Executive Summary

Over the last decade, concerns have been growing among the Australian public regarding the activities of the private sector, especially the corporate sector, in its dealings with consumers. The FIRE (finance, insurance and real estate) sector is at the forefront of accusations regarding fraud and other criminal wrongdoings. Almost every week, there is coverage in the mass media of criminal activity allegedly carried out by the FIRE sector against investors, businesses, households and individuals. Despite this media attention, there is evidence to suggest regular and widespread criminality has been committed by the FIRE sector since the 1980s.

It is argued by LF Economics there exists systemic criminal activity in the FIRE sector, placing consumers at grave risk of having their finances and livelihoods destroyed. The evidence pointing to this is based on the research of the world's leading academic specialist in banking, financial and corporate fraud, Professor William K. Black, and Australia's leading financial consumer activist and President of the Banking & Finance Consumers Support Association (BFCSA), Denise Brailey.

The term control fraud refers to those committed by the controlling agents of firms: executives and managers. These frauds are the domain of white-collar criminals and are rendered largely invisible by organisational power and influence, like the church abuse scandal. Control frauds are generated and amplified by the neo-liberal agenda which has significantly and regressively altered Australia's credit-based banking system since the 1980s, operating by the modes of privatisation, deregulation, self-regulation, desupervision and de facto decriminalisation. This institutional setup has and will inevitably continue to generate increasingly larger toxic and recurring control frauds.

While penalties for white-collar crime need to be strongly expanded, acting on the available evidence is the first prerequisite to enforcing the rule of law against white-collar criminality as both government and regulators are seemingly reluctant to take action against control frauds in operation. Accountability and transparency needs to be restored in our banking and financial system, as confidence in the economy is built on the essential pillar of trust. The committee should recommend another inquiry with the widest terms of reference possible, focusing on the numerous control frauds plaguing the economy, and a Royal Commission which will inevitably uncover a cesspit of immense criminality committed by the FIRE sector, covered up by regulators.

Section 2: Introduction and Terms of Reference

- a) Evidentiary standards across various acts and instruments;
- b) The use and duration of custodial sentences;
- c) The use and duration of banning orders;
- d) The value of fine and other monetary penalties, particularly in proportion to the amount of wrongful gains;
- e) The availability and use of mechanisms to recover wrongful gains;
- f) Penalties used in other countries, particularly members of the Organisation for Economic Co-operation and Development [OECD]; and
- g) Any other relevant matters.

LF Economics argues there are systemic control frauds operating within the Australian FIRE sector, with the full knowledge of ASIC, APRA and the RBA. None of these public organisations, however, have taken any meaningful action to identify, uphold the law and impose penalties on those engaged in white-collar criminality, let alone suggesting such penalties be increased. The authorities know of these control frauds but refuse to act upon this knowledge (enforce the rule of law); this is the first issue the inquiry must address in order to understand how to better approach penalties such as custodial sentencing, banning orders, monetary penalties, enforced undertakings and mechanisms to recover wrongful gains.

Due to the lack of both identification of control fraud and enforcement of existing laws on the part of government, modification of penalties for while-collar crimes may do little to stem control fraud. As part of an inclusive analysis, however, changes to penalties is an important step needed to bring the highly criminogenic FIRE sector into line. Accordingly, LF Economics strongly supports the strengthening of penalties for such crimes in Australia as suggested in the recommendations below, including the submission to this inquiry by Denise Brailey: financial consumer activist, criminologist and president of the Banking & Finance Consumers Support Association (BFCSA). There are other submissions bringing much needed insights to this neglected aspect of penalties for white-collar crimes.

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It does not help when the LNP and ALP both refuse to investigate serious allegations of widespread control fraud (euphemistically called “misconduct in the financial services industry”) via a Royal Commission as put forward by Greens Senator Peter Whish-Wilson.¹ Both political parties take campaign contributions from the FIRE sector which may explain their reluctance to investigate the allegations of control fraud. Long trails of victims are now left to fend for themselves, unassisted and blatantly ignored by regulators that should be striving to bring justice to these victims. Regulators refusing to investigate and prosecute criminality may themselves be in breach of law.

Given the paucity of analysis and investigation into these issues, LF Economics takes the liberty of expanding upon (g) by offering a comprehensive analysis of why control frauds are thriving in the current economic and political environment. By doing so, a strong case emerges whereby penalties for white-collar crimes are in need of strengthening.

¹ Ferguson and Danckert (2015); Ferguson et al. (2015).

Section 3: The Spectre of Control Fraud

3.1 Control Fraud in the United States

The recent economic and financial disaster in the United States present a useful case example providing lessons for other countries whose economies have undergone the regressive neo-liberal agenda of privatisation and deregulation, especially in the FIRE sector. Australia is no different, with the Hawke-Keating government embarking upon an expansive program of so-called reform during the 1980s. This was continued by the Howard government during the late 1990s and into the 2000s. It is worth bearing in mind that the US tends to lead Australia in such policymaking, so the former can be seen as a window into the near future for the latter. By studying recent events in the US, it may help to illuminate some instructive lessons for what may transpire in Australia.

It is undeniable the United States experienced a significant real estate cycle during the 2000s, primarily in the residential sector, driven by the rampant growth in private debt.² A significant proportion of mortgage debt issued was fraudulent, considerably in excess of borrowers' capacity to service over the short and long-term.³ Fraudulent lending is usually associated with the bursting of the US housing bubble post-2006, when a large cohort of subprime mortgage borrowing was publicly exposed in the ashes of the collapse. Millions of Americans were provided finance without proper assessments undertaken of their capacity to make debt payments.

Subprime mortgages are usually known as low-doc and no-doc loans, designed for the self-employed and those with irregular incomes and/or credit histories not meeting the criteria to obtain a conventional (prime) mortgage. Subprime lending reached the heights of absurdity with so-called NINJA loans, where aspiring owner-occupiers and investors without an income, job or assets were provided with mortgages they were clearly unable to service. Banks used creative accounting to manipulate loan application forms (LAFs) and inflate assets and incomes, manufacturing a positive assessment of borrowers' capacity to service much larger loans than was possible.

² Shiller (2005); Talbott (2003, 2006).

³ Black (2011); Lewis (2010).

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Borrowers sometimes falsified their details, creating 'liar loans' if their applications were successful.⁴ Some mortgages were so predatory that borrowers could not even make the first payment.⁵ Regardless of the creative accounting employed, millions of borrowers in the US were provided with jumbo-sized loans based on this practice. When the housing market boomed in the early to mid-2000s and the unemployment rate remained low, non-performing loan rates and foreclosures were kept in check. Once the housing bubble collapsed, however, the economy quickly deteriorated. Unemployment and subprime borrower defaults surged, triggering a tidal wave of foreclosures that continue to this day. In effect, many borrowers were entrapped by FIRE sector fraud and have become modern-day debt serfs, often languishing in negative equity.⁶

The subprime scandal was exacerbated by a variety of exotic mortgages with obscure titles that borrowers could not properly understand, for instance, Option ARMs, 2/28 hybrid ARMS and Alt-A loans. Many of these loans had a honeymoon period consisting of low interest rates for the first year or two before resetting to much higher rates, resulting in ballooning interest payments.⁷ These subprime mortgages were predatory, as lenders did not expect borrowers to amortise the loan over the contract period. The second stage of the subprime crisis was set in motion by lender securitisation. Mortgages were bundled into RMBS and CDOs, before being on-sold to unsuspecting investors by investment banks. Additionally, the ratings agencies frequently provided AAA ratings for these securities, misleading investors into believing they were high-quality and low-risk, when, in fact, the CDOs often comprised the highest risk mortgages repackaged by investment banks.⁸

Securitisation transferred the risks from lenders to investors, so if borrowers defaulted en masse, investors would be left holding worthless securities.⁹ Commercial lenders issuing subprime mortgages were not overly concerned about default risk, because these loans were shifted off

⁴ Baker (2009: 94-95).

⁵ Lewis (2010).

⁶ Hudson (2006).

⁷ Cassidy (2009: Chapter 19); Talbott (2006: Chapter 4).

⁸ Lewis (2010).

⁹ Cassidy (2009: Chapters 19 and 20).

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their balance sheets. The financialised economy's culture of opportunistic and short-term decision-making drove bank and non-bank lenders to pursue profitability through over-lending, rather than consider the long-term harmful effects of a credit boom and housing bubble.

The Savings and Loan (S&L) crisis that took place in the US during the 1980s, instigated by management, provides a case example of the complacent attitude of authorities and regulators towards predatory lending. US regulators, mostly captured by the S&Ls, were reluctant to investigate the unmistakable fraud. A lone journalist in 1982, Stephen Pizzo, editor of the tiny media outlet *Russian River News* in the equally small town of Guerneville in northern California, noticed the once prudent thrift, Centennial Savings, was issuing significant amounts of credit.¹⁰ His investigation into Centennial and other thrifts led to the publication of the book *Inside Job: The Looting of America's Savings and Loans*, exposing the extensive fraud committed by S&Ls.¹¹

It was co-authored with Mary Fricker, sub-editor of *Russian River News* and Paul Muolo, who worked for *National Thrift News*, widely considered the leading publication of the S&L industry at the time. The investigation and unmasking of extensive control frauds by a team of three determined journalists and a small number of committed regulators within the Bank Board (William K. Black and Edwin Gray), while the captured government, regulators and economics profession lay dormant, is an indicator of the FIRE sector's effectiveness in suppressing investigations into white-collar fraud.

It took until 1989 for the government and Bank Board to take the widespread S&L control frauds seriously enough to move against the industry, particularly the worst offender, Lincoln Savings and Loan Association. By 1993, the last of the control frauds were dealt with. Up until then, the S&L crisis was the worst financial control fraud in US economic history. The mainstream neo-classical economics profession, however, refuted any notion that an extensive regulatory approach or overhaul was necessary to prevent fraud from occurring; the 'market knows best' line of fallacious thinking.¹² A decade and a half later, the bursting of the largest housing bubble on record exposed the colossal subprime mortgage control fraud, causing far greater economic losses than those

¹⁰ Anderson (2008: Appendices 9 and 10).

¹¹ Pizzo et al. (1989).

¹² Black (2013).

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stemming from the S&L control fraud. Little to nothing had been learnt from prior history and experience:

Bankers, economists, and their political allies proved that they did not “know better.” Instead, they have confirmed the title of my book – *The Best Way to Rob a Bank Is to Own One*. Indeed, the change since the time I wrote this book is that officers controlling a bank now possess a vastly superior means of looting the bank because they can now do so with near immunity from prosecution. Policy makers have not simply failed to learn from experience and been condemned to repeat financial crises. They aggressively did the opposite of what experience suggested. They made the financial world far more criminogenic. The incentives they created through the three D’s (deregulation, desupervision, and de facto decriminalization) proved so perverse that they increased the epidemic of accounting control fraud that drives our recurrent, intensifying financial crises.¹³

While the focus is on the recent subprime mortgage scandal, it is far from the only crime committed by the FIRE sector in the US and elsewhere. The recent history of global banking is replete with examples of conspiracies, money laundering for drug cartels, collaboration with state sponsors of terrorism, financing of illegal arms sales, handling money for paramilitary organisations, illegal siphoning of money from pension and savings accounts, mortgage and securities fraud, gaming of laws and regulations to strip wealth from asset-rich individuals, frequent insider trading, pushing junk-grade investments in return for commissions, ‘front-running’ markets via computer-based high-frequency trading, charging unlawful fees, creative bank balance sheet accounting to conceal insolvency, ‘ratings agency shopping’ to ensure subprime junk securities receive investment-grade ratings, and manipulation of inter-bank lending rates, precious metals and derivatives markets. The FIRE sector has morphed into a legally sanctioned economic mafia, assuming an untouchables status and mimicking behaviours normally associated with criminal cartel racketeering. Unfortunately, these white-collar crimes are aided by weak government supervision and regulation, with rare enforcements culminating in fines rather than criminal prosecution and jail.¹⁴

¹³ Black (2013: 270).

¹⁴ Egan and Soos (2014: 236).

3.2 William K. Black's Control Fraud Framework

The extensive research and work by William K. Black, a former litigator and regulator who helped clean up the Savings and Loan control frauds during the 1980s and early 1990s in the United States, provides a framework to understand how control frauds develop and spread throughout the FIRE (finance, insurance and real estate) sector. Black is currently a professor of economics and law at the University of Missouri-Kansas City in the US and published a book in 2005 called *The Best Way to Rob a Bank Is to Own One: How Corporate Executives and Politicians Looted the S&L Industry*. The book details the extensive and highly damaging control frauds committed by S&L executives and the battle within the Bank Board, the thrift regulator, between those who supported deregulation and reregulation.¹⁵

Black later developed the concept of control fraud based on his previous experience and the research by two US economists, George Akerlof and Paul Romer, particularly their 1993 paper entitled "Looting: The Economic Underworld of Bankruptcy for Profit".¹⁶ The term 'control fraud' refers to the systematic, highly-damaging, institution-driven and directed nature of frauds, in contrast to common low-level street frauds. A control fraud occurs when executives (the controllers of the firm) use the institution they manage as a conduit to commit criminal activity, typically to boost profits, remuneration and bonuses. The weapon of choice wielded in cases of control fraud is accounting, confirming that the pen (or computer) really is mightier than the sword. According to Black's framework, control frauds in the FIRE sector use the following strategy:

Fraudulent lenders produce guaranteed, exceptional short-term "profits" through a four-part strategy: extreme growth (Ponzi-like), lending to uncreditworthy borrowers, extreme leverage, and minimal loss reserves. These exceptional "profits" render "private market discipline" perverse, often defeat regulatory restrictions, and allow the CEO to convert firm assets to his personal benefit through seemingly normal compensation mechanisms. The short-term profits also cause the CEO's stock options holdings to appreciate. Fraudulent CEOs that follow this

¹⁵ Black (2013).

¹⁶ Akerlof and Romer (1993).

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strategy are guaranteed to obtain extraordinary income while minimizing the risks of detection and prosecution.

The optimization strategy for lenders that engage in accounting control frauds explains why such firms fail and cause catastrophic losses. Each element of the strategy dramatically increases the eventual loss. The record “profits” allow the fraud to continue and grow rapidly for years, which is devastating because the firm grows by making bad loans. The “profits” allow the managers to loot the firm through exceptional compensation, which increases losses.¹⁷

The first element of the control fraud strategy is extreme loan growth, only made possible by lending to subprime borrowers. This leads to a situation called adverse selection, as lenders issue larger loans to increasingly uncreditworthy borrowers. While this strategy is extremely risky over the long-term, it produces rapidly rising assets and profits, leading to greater executive remuneration and bonuses in the short-term:

The reason that extreme growth optimizes accounting fraud is obvious, but the concept that *deliberately* making uncreditworthy loans optimizes short-term accounting profits is counter-intuitive. The first two ingredients in the accounting fraud formula are related. Lenders in a mature market such as home mortgages cannot simply decide to grow rapidly by making *good* loans. Lenders can grow rapidly by making good loans through two means. They can acquire competitors (a strategy that inherently cannot be followed by a very large number of lenders) or they can drop their yields and seek to compete on the basis of price (i.e., their mortgage interest rate in this context). Their competitors are almost certain to match any reduction in mortgage interest rates, so the latter strategy generally fails to provide substantial growth while the lower price leads to reduced “profit” margins. Lending to the uncreditworthy, however, allows exceptional growth and allows one to charge a higher interest rate. The combination maximizes accounting income.¹⁸

Relevant laws and regulations stipulate loan amounts must not exceed borrowers’ assessed repayment capacities, based on their recent wages and other income. Lenders have an obligation

¹⁷ Black (2010: 1, 12).

¹⁸ Black (2010: 17).

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to calculate income flows of potential borrowers as part of the risk assessment associated with extending finance, particularly with large, long-term loans like mortgages:

We have known for a century that a home lender that does not underwrite a loan, including verifying the borrower's income, will produce endemic "adverse selection." That means that the lender will have a "negative expected value." In plain English, it means that such loans will cause severe losses to the lender. An honest home lender does not make liar's loans. While the phrase "liar's loans" may suggest to the reader that the borrower was lying about his income, our experience was that it was overwhelmingly the lenders that put the lies in the loans. Our experience confirmed our theory – lenders engaged in accounting control fraud deliberately made bad loans in accordance with the accounting control fraud recipe for a lender.¹⁹

Extreme loan growth is the primary ingredient in generating episodes of significant asset market mispricing. More accurately, it is the acceleration of private debt: the change in the rate of growth, also known as the second derivative.²⁰ Mainstream neo-classical economics argues bank lending is inhibited by government creation of base money, deposits, capital adequacy requirements and/or reserves held with the central bank, so banks are restricted from lending too much. This perspective is encapsulated by the 'financial intermediation' and 'fractional reserve' theories of banking. The anthropological, historical, theoretical and empirical evidence, however, demonstrates these theories are false.²¹

Banks are capable of generating an infinite amount of credit 'out of thin air' to provide to willing borrowers, creating extra demand in the economy without reducing it elsewhere. Banks essentially create credit on a computer and lend it, with no real cost of supply, only afterwards making adjustments to meet regulatory stipulations on capital adequacy requirements. This is the empirically-correct 'credit creation' theory and was the accepted view of banking since the 1850s before it was later overturned by the neo-classical dominated economics profession in favour of falsified theories designed to maintain the status quo of private, unregulated banking.

¹⁹ Black (2013: 279).

²⁰ Keen (2013, 2015).

²¹ Graeber (2011); Keen (2011); Werner (2014a, 2014b, 2015).

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Given time, rapid loan growth (debt acceleration) causes asset prices to inflate above fundamental factors, which in the case of the residential housing market, are rental income, construction costs, inflation, population growth, GDP and household income. This leads to periodic and extreme mispricing in asset markets, typically the land market as it remains the single largest tangible market in state capitalist economies today. Bank and non-bank lenders engage in a race to maximise profits and share prices, with managers and officers striving to meet lending targets to achieve bonuses. Soon enough, they cross the line from prudent lending to imprudent lending and then finally into committing fraud by issuing loans to the most uncreditworthy borrowers by falsifying (inflating) their income and assets. Hence control fraud can amplify asset bubbles, as Black warns:

The accounting control fraud optimization strategy hyper-inflates and extends the life of financial bubbles, which causes extreme financial crises. The most “criminogenic environment” in finance for accounting control fraud will attract an initial cluster of frauds. The factors that make a finance sector most criminogenic are the absence of effective regulation and the ability to invest in assets that lack a readily verifiable asset value. Unless those initial frauds are dealt with effectively by the regulators or prosecutors they will produce record profits and other firms will mimic them. Those control frauds can be a combination of “opportunistic” and “reactive” (moral hazard). If entry is relatively easy, opportunistic control fraud is optimized. If the finance sector is suffering from severe distress, reactive control fraud is optimized. Both conditions can exist at the same time, as in the early years of the savings and loan (S&L) debacle.

When many firms follow the same optimization strategy in the same financial field a financial bubble will arise, extend, and hyper-inflate. This further optimizes accounting control fraud because the rapid rise in values allows the frauds to hide the real losses by refinancing the bad loans. Mega bubbles can produce financial crises.²²

Unfortunately, mainstream neo-classical economists dismiss the notion widespread fraud can be perpetrated by firms on the basis of the efficient markets hypothesis. It is claimed that shareholders and other rational agents operating in financial markets are capable of detecting fraud and thus would not do business with lenders engaging in these practices. This line of

²² Black (2010: 1).

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reasoning is why the economics profession has supported the neo-liberal agenda of FIRE sector privatisation, deregulation, self-regulation, desupervision and de facto decriminalisation over the last several decades. Black explains:

Traditional economics and modern finance theory have failed to understand or counter even hyper-inflated financial bubbles, the financial crises they cause, and the resultant severe recessions. This failure arises from a more basic failure – modern finance theory is fatally flawed. The theory is premised on the existence (indeed, the virtual inevitability) of “efficient markets” absent government “interference.” While there are variant definitions of “efficient markets,” even the weakest meaningful definition requires that the markets (1) not make *systematic* pricing errors and (2) move consistently towards more accurate pricing when there are random pricing errors.

“Private market discipline” was the dynamic asserted to make contracts efficient. Creditors are assumed to understand the risk of fraud, to have the ability to protect by contract against the risk, and to take effective action to protect against fraud. Honest, low-risk borrowers (and issuers of stock) are assumed to have the incentive to “signal” their status to lenders and investors and to have the *unique* ability to send such signals. Lenders and purchasers of stock are presumed to be rational. Rational lenders and purchasers do not want to be defrauded. Modern finance theory, therefore, presumed that lenders and purchasers of stock would only deal with companies that sent “honesty” “signals.” It follows that “control fraud” is impossible.²³

It is astounding that control fraud is dismissed as a key variable sustaining recurrent episodes of land market bubbles and financial instability; it is as if neo-classical economists have completely ignored centuries of history. Every debt-financed boom in the US land market since British settlement has been amplified through control fraud, and it is obvious the latest land market cycle was associated with colossal fraud in the subprime mortgage market.²⁴ The idea that self-interested rational actors are capable of detecting and preventing control fraud has been disproven by history and current international events. The long-term analysis of real estate cycles

²³ Black (2010: 2).

²⁴ Anderson (2008); Lewis (2010).

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in the US over the last couple of centuries by economist Phillip Anderson suggests two reasons why fraud is never uncovered during the boom phase of a land bubble.²⁵

The first is that bank management operates in what is essentially a black box, so that no one on the outside understands the intricacies of the control frauds. Banking executives are politically and economically powerful, protected by the most highly-paid, educated and experienced lawyers available. Bank shareholders, bondholders, depositors, borrowers, rank-and-file employees and the public often have no idea as to what executives are doing behind closed doors. Regulators that are granted extensive powers to investigate the banking system, financial markets and enforce the law are likewise ignorant or have been captured by the FIRE sector to ensure their compliance. Mass media coverage and public awareness of control fraud is hampered because, as Black notes, “Financial institutions commonly refused to make criminal referrals when they discovered embezzlement by senior officers because they feared adverse publicity.”²⁶

The second reason fraud is disguised during a real estate boom is investors and associated support industries are too busy speculating and making paper profits (phantom wealth) to care about what is happening outside of their immediate, self-interested environment. The short-term thinking promoted by financial capitalism safeguards the inner workings of bank management from close inspection. Once the bubble bursts and causes economic havoc, for instance, skyrocketing unemployment and asset price deflation, the control frauds become apparent, but by then it is too late. Only voices from the fringe see through the deception and raise concern, while the government, regulators, economics profession and the public are seemingly oblivious to the clear and present dangers generated by rampant control frauds.²⁷

White-collar criminals masterminding control frauds tend to be wealthier than the median, have access to the best legal services, occupy positions of power and influence, are lauded by the mass media and political class, and participate in the endlessly revolving door between government and the corporate sector. It is more difficult to identify the control frauds committed by white-collar criminals relative to blue-collar, and the considerable resources of the former ensures a more

²⁵ Anderson (2008).

²⁶ Black (2010: 3).

²⁷ Black (2013); Pizzo et al. (1989).

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difficult task for the authorities to successfully identify and then prosecute their crimes. This is made even more onerous when public executives running the regulatory authorities come from the same 'gene pool' as the control frauds. Shared education, class, commitments, prerogatives and identity leads to a situation of the 'fox guarding the hen house' whereby regulators do little to nothing to identify and prevent executives from running and profiting from control fraud.

3.3 The Application of the Control Fraud Framework to Australia

An important dimension of the extreme private sector debt growth over the last few decades is the possibility of widespread predatory lending and fraud committed by the FIRE sector. Every developed country, including Australia, has laws and regulations preventing predatory lending, defined as providing debt to a borrower in full knowledge they have little, or no ability, to service debt payments over the contract period.²⁸

Identifying whether a similar form of subprime fraud is widespread in Australia's banking system and housing market deserves close scrutiny. Deregulation and privatisation of the financial sector since the 1980s has increased competitive pressures and the potential for fraud, as lenders are provided with an incentive to maintain robust profitability via strong credit growth. To determine the possibility that control fraud is occurring in the economy, a two-step approach is taken. The first is to apply Black's control fraud framework and interpret the trends in the data. Secondly, the documentary evidence gathered by Denise Brailey will be examined in the context of the framework.

Substantial evidence of subprime fraud has been accumulated by Denise Brailey, Australia's leading financial consumer activist, criminologist and president of the Banking & Finance Consumers Support Association (BFCSA). The BFCSA is a public-interest organisation dedicated to protecting investors and the pursuit of compensation for victims of predatory finance. Having worked in this field since the 1980s, Brailey has witnessed first-hand the financial and social destruction wrought by a multitude of scams and predatory lending, including the 'finance brokers scandal' in Western and South Australia, and the 'mortgage solicitor scams' stretching down the east coast from Queensland to Tasmania.²⁹

Data for four of the five elements of the control fraud framework (loan growth, leverage, loss reserves and executive remuneration) are publicly available. The ABS and RBA keep extensive and updated records of private sector debts, and bank and non-bank lenders provide detailed accounts

²⁸ Keen (2005).

²⁹ Brailey is responsible in part and in whole for sixteen federal and state inquiries investigating the predations of the FIRE sector and complacent regulators between 1997 and 2015.

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of assets and liabilities, from which leverage ratios and loss reserves can be calculated, including the extensive records compiled by APRA. Information relating to executive remuneration is also reported, and is readily available in the mass media. What is kept hidden from the public is the alleged fraud committed by the FIRE sector against borrowers: the last element, declining underwriting standards. Lenders and regulators do not keep publicly available records of fraud for obvious reasons, any more than common thieves would establish an online database allowing the public to track their criminal activity and stolen loot. It is for this reason why the analysis in this submission focuses heavily upon declining underwriting standards as it is the most difficult of the five elements to provide evidence for.

3.3.1 Extreme Loan Growth

To determine if the issuance of loans or debt has demonstrated an extreme growth pattern or Ponzi-like trend, time series employing measures of debt could assist in illustrating this. While there are no definitive measures of debt, there are several useful proxies: the stock of debt to GDP, household disposable income and net residential property cash flow.³⁰ It is the growth in the stock of debt rather than principal and interest payments that are of concern. Nevertheless, there has been a considerable increase in the interest payments to household disposable income ratio even as the nominal mortgage interest rate has fallen over the last couple of decades. The debt service ratio, a superior measure as it includes amortisations, has also risen over the long-term.³¹

The growth of interest-only loans has assisted with keeping a lid on debt payments, with interest-only loans accounting for approximately 41 per cent of all new mortgage loan approvals as of 2015Q3. In 2015Q2, interest-only loans accounted for 28 per cent and 70 per cent of all new owner-occupier and investor mortgage approvals respectively.³² The high proportion and growth of interest-only loans is alarming as they present risks rarely mentioned: the lack of equity built up within the loan's interest-only period (through non-repayment of principal) and the high degree of

³⁰ Demonstrating the trends in debt in nominal and real terms is useless for obvious reasons: the growth in GDP, incomes and rents almost always outstrips the rate of inflation.

³¹ Drehmann et al. (2015: 100-101, Graphs 4 and 5). The debt service ratio is in line with other nations previously and currently experiencing housing bubbles (BIS 2016a; Mohommad et al. 2015: 10, Figure 3).

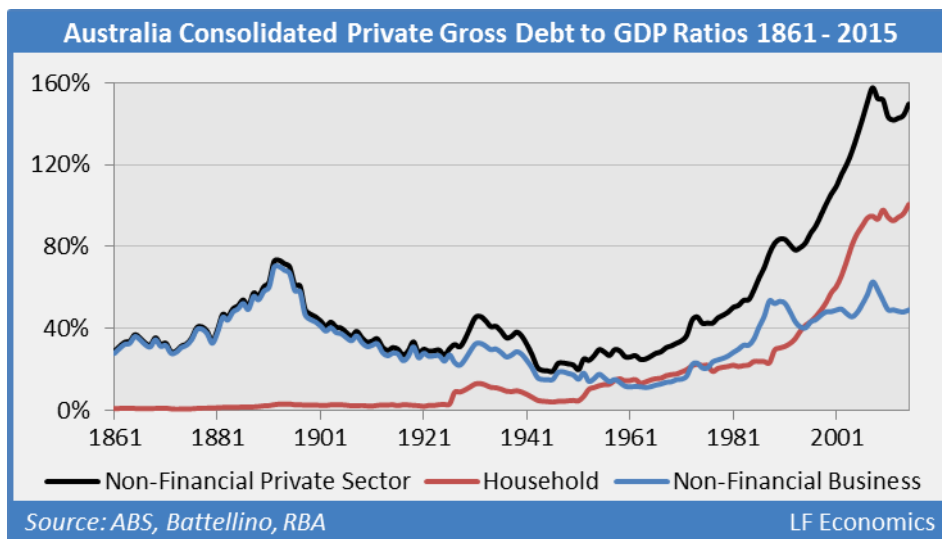
³² APRA (2015: Table 1c); RBA (2015: 22, Graph 2.5).

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leverage prompted by the investor cohort's faulty assumption that housing prices will always increase.

The long-term consolidated household debt to GDP ratio, covering 1861 to 2015 and comprised mostly of mortgages and a small remainder of personal debt, has boomed in a near-exponential curve since the late 1980s. This ratio peaked in 2010 at 98 per cent, declined slightly over the next several years and has now reached a new peak of 101 per cent in 2015. Between 1960 and 2010, Australia's household sector has experienced the largest growth in debt relative to GDP compared to other developed nation economies.³³

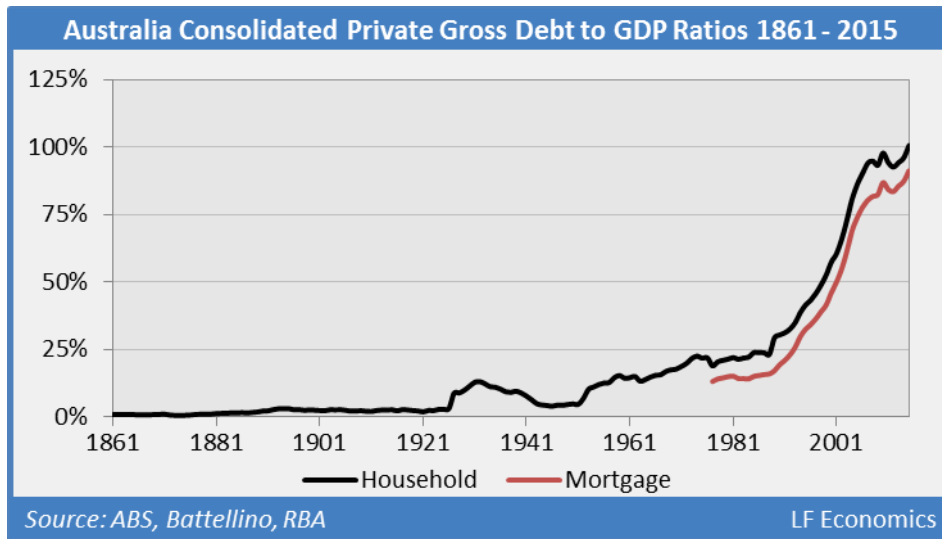
Figure 3.3.1.1



Driving this record-breaking surge is mortgage debt, financing the recent housing price booms in Sydney and Melbourne, while personal debt has remained steady in absolute terms (declining relative to GDP). Total non-financial private sector debt, which includes both the household and non-financial business sectors but excludes the non-banking financial sector, has clearly experienced an exponential boom over the last several decades, peaking in 2008 when the global financial crisis (GFC) hit. The ratio peaked at 158 per cent and has fallen due to significant deleveraging by the non-financial business sector. In recent quarters, however, this sector has begun to leverage once more.

³³ Jordá et al. (2014a: 13, Table 2); Jordá et al. (2014b).

Figure 3.3.1.2



The above figures present debt series in consolidated terms, rather than unconsolidated. The former reports debt that is netted out within the sector, and only records the debts owed to other sectors, whereas unconsolidated debt is the actual debt a sector owes, irrespective of to whom.³⁴ For the household sector, the difference between both measures is minor, as few households own the debts of others and almost all household debt is owed to a different sector, specifically the bank and non-bank financial sector.

For non-financial business sector debt, firms are more likely to own the debts of others, so the difference between the stock of consolidated and unconsolidated debt is greater. Caution must be taken when using measures of consolidated debt due to the assumption of intra-sector solvency; an assumption the GFC revealed to be precarious. Consolidated debts disguise the risk of intra-sector debts that can become overwhelming and threaten financial stability.³⁵

The following figure presents the trends in unconsolidated debts for all three subsectors of the private sector. The unconsolidated household and non-financial business sector debt ratios are indeed larger than the consolidated ratios. As of 2015Q3, the former is 123 per cent and the latter 83 per cent. A non-banking financial sector debt time series has also been constructed (possibly

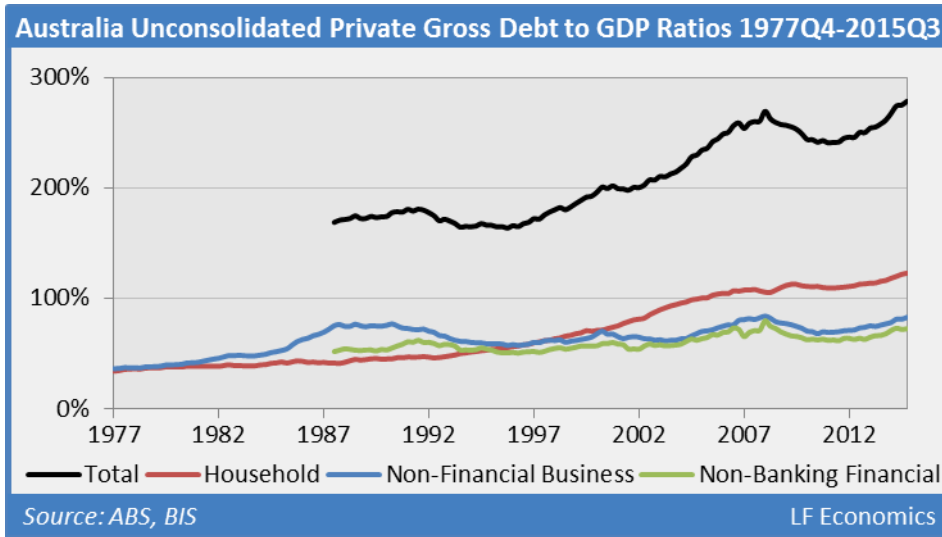
³⁴ BIS (2015a, 2015b); Dembiermont et al. (2013). The definition of unconsolidated debt also incorporates other forms of debt instruments such as bills of exchange and one name paper.

³⁵ Ramsay and Sarlin (2014).

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for the first time in Australia), which closely tracks the trend in the non-financial business sector debt, at 73 per cent.³⁶ This results in a colossal total private sector unconsolidated debt ratio of 279 per cent.

Figure 3.3.1.3



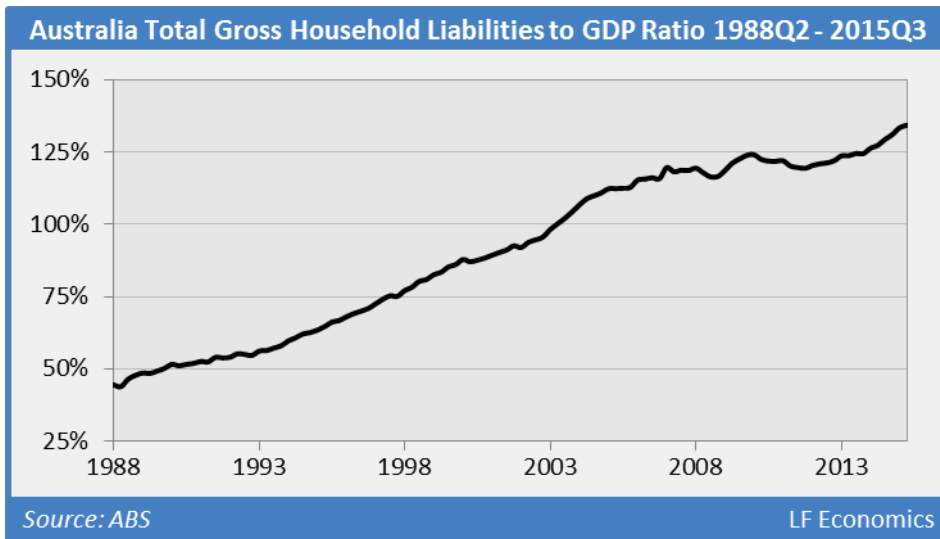
While both the non-financial business and non-banking financial sector debt ratios have remained steady since the late 1980s, the household sector debt ratio has ballooned since this period. By this measure, Australia now has the second most indebted household sector globally as of 2015Q3, recently surpassing Denmark which held first place for many years.³⁷ By the most inclusive measure of total household sector liabilities, which the RBA uses to calculate the household debt to income ratio, Australia’s household sector has accumulated \$2.2tn at 134 per cent of GDP.

³⁶ There is a paucity of data regarding non-banking financial sector debt in Australia. Dobbs et al. (2015: 10, Exhibit E7) estimate this ratio at 61 per cent as of 2014Q2. An older estimate puts it at 91 per cent as of 2011Q2 (Roxburgh et al. 2012: 5, Exhibit E4), while another estimate demonstrates it to be slightly larger than the household debt ratio (Nie 2011: 26, Exhibit 1).

³⁷ BIS (2016b). Switzerland now holds first place, at 124 per cent. In recent quarters, Switzerland has not experienced strong household loan growth; the rise in its ratio is partially the result of falling nominal GDP. Denmark is currently suffering from the same malaise, which has slowed the decline in its ratio.

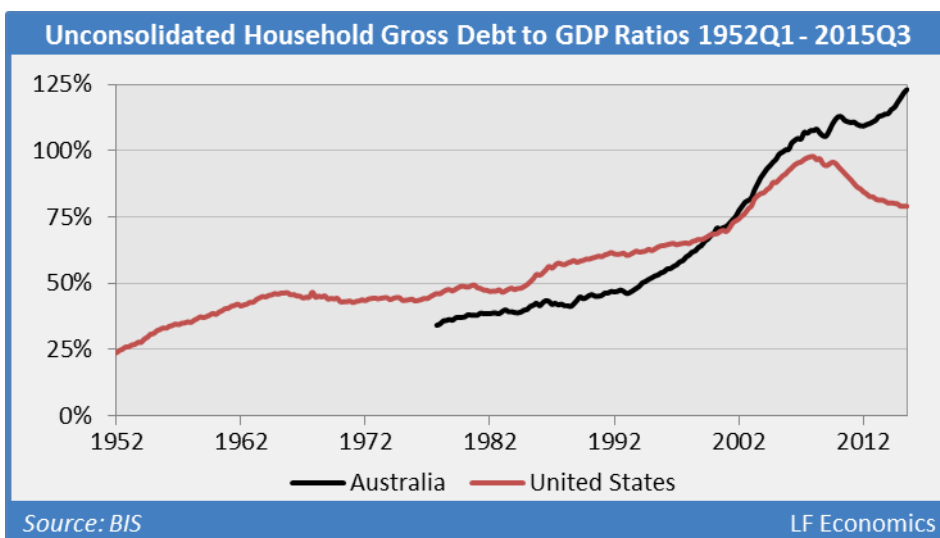
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Figure 3.3.1.4



Considering the adverse events in the US mortgage markets and economy, it is of concern Australia's unconsolidated household sector debt to GDP ratio is far in advance of the US at its peak. The obvious implication is that if the ratio reached as high as it did in the US, peaking at 98 per cent in 2008Q1, through mass issuance of fraudulent mortgages, it remains a distinct possibility Australia may have an even larger mass of toxic mortgages.

Figure 3.3.1.5

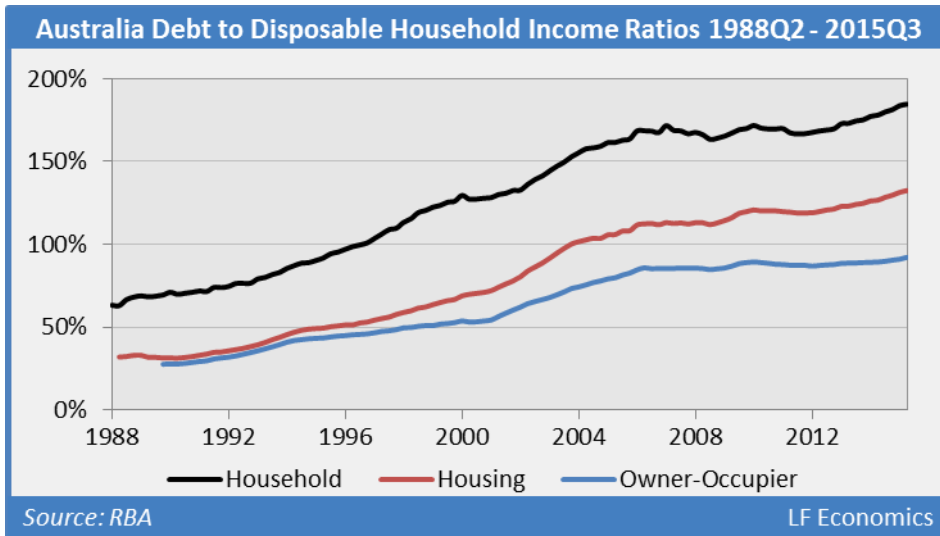


Not only has the stock of mortgage debt increased relative to the size of the economy, it has also risen against household disposable income, soaring from 63 per cent in 1988Q2 to a peak of 185

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per cent in 2015Q3.³⁸ The housing and owner-occupier ratios are also establishing new peaks every quarter henceforth as mortgage debt continues to surge while household income experiences weakening growth due to the downturn in the terms of trade and the mining sector, poor productivity and rising underutilisation (unemployment and underemployment). As of 2015Q3, the housing and owner-occupier ratios are 133 per cent and 92 per cent respectively.

Figure 3.3.1.6



The final measure is the debt to cash flow ratio (D/CF). It compares a sector's stock of debt with the net income available to service it; essentially a measure of leverage. The D/CF ratio is a more meaningful measure of leverage because typical debt to GDP ratios assumes the entirety of national income is available to pay debts. In the case of the housing market, the numerator comprises consolidated mortgage debt and the denominator, cash flow, is equivalent to net imputed and actual rents. The stock of consolidated and unconsolidated household debt has been compared to GDP and household disposable income; the D/CF ratio allows for a more precise measure as it compares the stock of mortgage debt directly to the net cash flows generated by the non-financial housing assets owned by the household sector.³⁹ Ramsay and Sarlin argue in favour of this ratio:

³⁸ Australia is ranked on the upper end of the OECD and BIRC nations in terms of the debt to income ratio (Dobbs et al. 2015).

³⁹ Consolidated debt data are used as it is only available in this form for owner-occupier and investment mortgage debt. The equivalent cash flow for the total housing and investment stock is gross rental income

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While leverage is oftentimes linked to the vulnerability of a nation, and hence systemic risk, one less explored measure of leverage is the debt-to-cash flow ratio (Debt/CF). Cash flows certainly have a well-known, academically verified connection to the ability of corporations to service and repay corporate debt. The relationship commonly known as the debt-to-cash flow (henceforth Debt/CF) ratio when used in the context of corporate finance, measures the number of years of savings required to retire an entity's outstanding debt. Beyond studies in corporate finance, a closely relevant line of work uses measures of debt relative to income streams as country-level early-warning indicators. While the debt-to-income ratio has commonly been used to illustrate the association between high leverage and losses in credit and output, it misses consumption versus savings decisions.⁴⁰

The D/CF ratio is categorised into four zones, weighing the relative amount of leverage in a sector: inefficient, stable, warning and crisis. In the first zone, the amount of debt is considered too low, producing sub-optimal returns for firms. Leverage can be increased safely without compromising financial stability. The stable zone represents the most efficient range of leverage, where returns are maximised without affecting stability or increasing risk. This is the zone that governments, corporations and households should strive to occupy. The next is the warning zone, where high sector leverage may cast doubt on solvency and the ability to meet debt repayments.

The crisis zone indicates leverage is too high and poses serious risks to solvency and financial stability. These categories should be treated with caution as there are no definitive guidelines for determining what an appropriate amount of leverage is. Rather, they are rules of thumb. The GFC has provided a convenient way to test the validity of the D/CF ratio, with a number of countries affected by housing bubbles transitioning into the warning and crisis zones.⁴¹ A ratio of 4 or less indicates inefficiency, stable (5 to 14), warning (15 to 24) and crisis (25 and above).⁴²

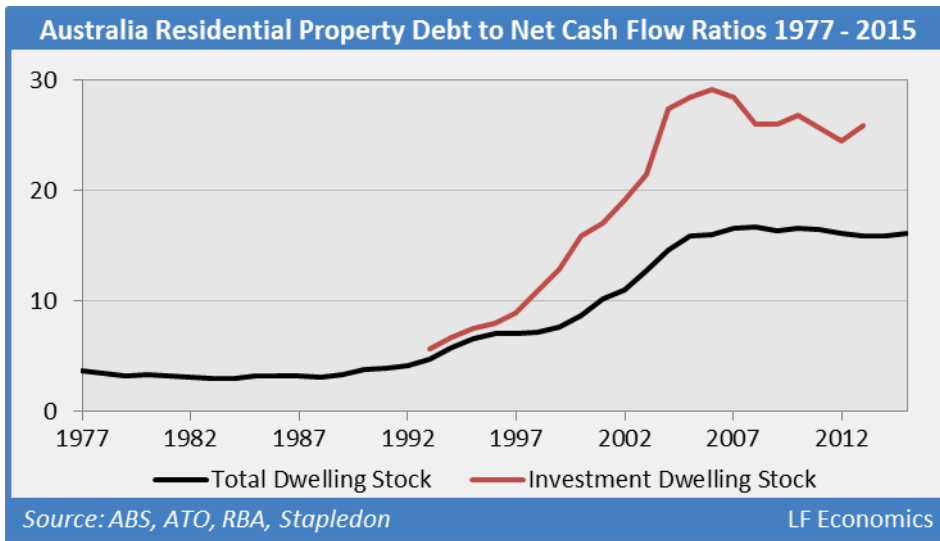
minus expenses, before principal and interest payments. The cash flow for the housing stock is derived from ABS estimates, whereas the cash flow for the investment stock is based on actual data from property schedules submitted to the ATO.

⁴⁰ Ramsay and Sarlin (2014: 3).

⁴¹ Ramsay and Sarlin (2014).

⁴² Ramsay and Sarlin (2014: 16, Table 5).

Figure 3.3.1.7



It is evident that the D/CF ratio has increased radically for the total dwelling stock, especially the investment dwelling stock. The D/CF ratio for the former trended between 3 and 4 from 1977 onwards, remaining in the inefficient zone until 1992. It then transitioned into the stable zone in 1993 until 2003. Soon after, the D/CF ratio reached a peak of 17 in 2008 and has since steadied to 16 in 2015 (the warning zone). The reason for this stabilisation is that rental income surged during the GFC between 2007 and 2009 due to heightened population growth creating temporary dwelling shortages while mortgage debt growth has slowed in the post-GFC era.

As with the total dwelling stock, the investment dwelling stock ratio has boomed but to a larger degree. From a ratio of 6 in 1993, it transitioned into the warning zone in 2000, reaching a peak of 29 in 2006; almost quintupling from the starting value. This is well into the zone indicating crisis. The ratio dipped temporarily into the warning zone in 2012 at 24 but increased back to 26 in 2013. The D/CF ratio for the investment dwelling stock is set to rise in the coming years as investment mortgage debt has surged but investment rental income growth has begun to stagnate.⁴³ Without a sustained period of mortgage deleveraging and/or significant growth in imputed and actual

⁴³ According to CoreLogic RP Data's annualised nominal asking rental price index as of 2016M01, rent growth was zero for all dwellings, -0.3 per cent for houses and 1.5 per cent for units (CoreLogic RP Data 2016: 4). In inflation and household income adjusted terms (the rent to inflation and rent to income ratios) the results are even worse from a property investor's perspective. The long-term trends indicate rental price growth will continue to decline.

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rents, the D/CF ratios for the total and investment dwelling stocks will remain historically elevated and in the warning and crisis zones respectively into the near future.

It is clear according to the long-term measures of debt detailed above which compare the trends in private sector debt, especially household and mortgage debt, to GDP, household disposable income and net cash flows (net rents), significant loan growth has occurred, far outstripping the growth of the income-generating capacity of the economy, households and non-financial housing assets. The household sector has experienced the largest growth in debt, more so than the non-financial business and non-banking financial sectors. As of 2015Q3, Australia has the world's second-most indebted household sector, having experienced the fastest surge in household debt to GDP since 1960 relative to other developed nations. This provides strong support for the first element of Black's control fraud framework: extreme or Ponzi-like growth in debt.

Given recent trends, it is possible the household sector will continue to gradually leverage over the next several quarters despite the recent slowdown as indicated by the latest mortgage finance data, which may have been caused, in part, by APRA's recent foray into the mortgage market by implementing weak macroprudential controls on investment property loans. With the cash rate sitting at 2 per cent, the RBA cannot cut much further to boost lending given cuts to 1 per cent or below may trigger a balance of payments crisis as the ADIs' foreign creditors may decide to curtail their lending. This could also prompt capital flight. If such a crisis were to occur, it may have the perverse effect of raising interest rates.⁴⁴ Also, lenders may not be able to pass on any future rate cuts in full due to capital raisings to boost their inadequate loss reserves and rising foreign funding costs.

3.3.2 Leverage, Loss Reserves and Executive Remuneration

The next two elements of the control fraud framework can be observed via the leverage employed and capital charges (loss reserves) the major Australian banks hold (the 'Big Four'). It is notable Australia has the highest banking concentration in the world, with the Big Four holding 80 per cent

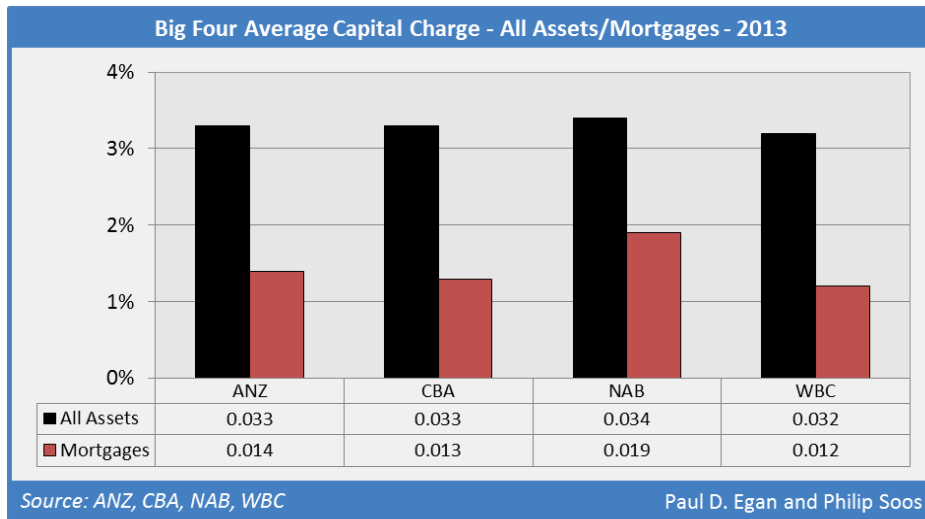
⁴⁴ Survey data reveals one quarter of property investors would have difficulty in meeting the cost of any increase in interest rates from their present level, no matter how slight, and more than 50 per cent would experience potential financial stress if rates were to rise by 3 per cent (DFA 2016).

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of banking assets and 88 per cent of residential mortgages.⁴⁵ These banks have used extreme leverage and set aside pitiful loss reserves to maximise return on equity and profits.

In 2013, against the entire loan portfolio, these banks were extremely leveraged: ANZ (30.3x), CBA (30.3x), NAB (29.4x) and WBC (31.3x). Against the residential mortgage portfolio, the banks were geared: ANZ (71.4x), CBA (76.9x), NAB (52.6x) and WBC (83.3x). The average capital charge providing for bad and doubtful debts was: ANZ (1.4%), CBA (1.3%), NAB (1.9%) and WBC (1.2%).⁴⁶ The Big Four banks provide the bulk of lending and financial system assets and have used the generous, opaque and manipulated internal ratings-based (IRB) regulatory framework to fortuitously determine wafer-thin capital buffers.⁴⁷ More recently, WBC was leveraged 77 times against its mortgage loan book, holding capital of 1.32 per cent against \$468 billion. In 2014, minimum tier one capital was \$105 billion for all banks, held against \$4.3 trillion of assets. This implies a total leverage ratio of 41, no better than the maximum allowable ratio of 42 back in 2004.⁴⁸

Figure 3.3.2.1



⁴⁵ IMF (2012: 12).

⁴⁶ Egan and Soos (2014: 401-404 - Table 3.2.2.3).

⁴⁷ Egan and Soos (2014: 425-443).

⁴⁸ Joye (2015).

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The Big Four's basic strategy for extreme returns stems from lending into a residential property bubble via exponential growth in household sector debt to fuel asset prices, while gaming PDs, EADs and LGDs under opaque IRB models so that very low capital ratios can feed additional loans with lower underwriting standards.⁴⁹ Dynamic LVR or mortgage rehypothecation, combined with Basel II regulations that permitted lowering of mortgage risk-weights, has amplified leverage while simultaneously decreasing already minimal loss reserves.

Indeed, Australia's Big Four banks have managed a ROE significantly above that of the US, the UK, the Eurozone and Japan, and in line with Canada, another developed nation economy afflicted with a housing bubble. The same trends are evident in the share price to book ratio, with Australia and Canada having a ratio of 2 with the other nations at 1.⁵⁰ The average capital charge held by the Big Four against the residential loan book ranges from only 1.2 to 1.9 per cent based on Basel Pillar 3 disclosures, which is wafer-thin. Although the Big Four have recently sought to increase loss reserves, especially at the urging of the Financial System Inquiry (FSI), it is an illusion given an increase of only a couple of percentage points in the housing non-performing loan rate will exhaust the capital.⁵¹

The extreme leverage employed within the mortgage portfolios by the Big Four increases both profitability and executive remuneration, as Black notes: "The greater a firm's leverage, the higher the ratio of its debt to its capital, the greater its return on capital. The greater its return on capital, the more likely its stock to increase in value, and the larger the executive compensation."⁵² Extreme loan growth, particularly in mortgages, has led to record-breaking profits of the Big Four which, in turn, leads to very generous remuneration for CEOs.⁵³

⁴⁹ It is notable that under Basel I regulations, the standard risk-weight for mortgages was 50 per cent, requiring a 4 per cent capital charge in the event the LVR was below 80 per cent. Following the transition to Basel II regulations in 2006, for mortgages with a LVR below 80 per cent, the risk-weight fell to 35 per cent, so that under general circumstances (mortgage insurance), only \$2.80 was held against each theoretical \$100 of mortgage value.

⁵⁰ RBA (2015: 11-12, Graphs 1.16 and 1.17).

⁵¹ Kohler (2015).

⁵² Black (2010: 18).

⁵³ Egan and Soos (2014: 410 - Table 3.2.3.1); RBA (2015: 44, Table 3.3).

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In the 2013-14 financial year, the returns to the Big Four CEOs was extreme: Gail Kelly (WBC, \$12.8mn); Mike Smith (ANZ, \$10.7mn); Ian Narev (CBA, \$8.1mn) and Cameron Clyne (NAB, \$7.7mn, 2012-13 FY).⁵⁴ The results differed in the 2014-15 financial year, with executive remuneration increasing for Mike Smith (ANZ, \$10.84mn) and Ian Narev (CBA, \$8.32mn). The new CEO for the NAB, Andrew Thorburn, was paid a lower \$5.48mn. The CEO of WBC, Gail Kelly, quit and was replaced by Brian Hartzler, who made \$5.74mn in the first nine months in his new position.⁵⁵ This was significantly lower than the outgoing CEO's last pay package.

3.3.3 Declining Underwriting Standards

Denise Brailey alleges that since the early 2000s, lenders have engaged in widespread subprime fraud through over-lending to owner-occupiers and property investors, far in advance of their ability to finance debt payments from their incomes. At the centre of the alleged fraud are the LAFs, altered by lenders without the knowledge, authority or consent of borrowers. The value of borrowers' assets and incomes are radically inflated, justifying the approval of large loan sums that increase profitability through higher interest payments. As defaults typically peak several years after loan origination, subprime borrowers struggle for an extended period before eventually succumbing, benefitting banks that realise borrowers' equity on foreclosure and sale. Similar to the US, Australian mortgage fraud is more closely linked with low-doc and no-doc mortgages than conventional (prime) mortgages.

The process of alleged fraud begins with a potential borrower completing a three page LAF detailing their current assets and incomes, which is then returned to the broker or the bank if dealt with directly. In the back office, the broker inputs the borrower's details into a password-protected online 'service calculator'; an application determining the amount of credit the lender, associated with the broker, is willing to provide. The service calculator amounts to a black box, as brokers are not provided with any information as to how this application functions. A loan estimate is simply provided based on the details entered. This is where the first form of alleged fraud is committed: the service calculator manipulates the total debt service ratio (TDS), making

⁵⁴ Yeates (2014). Nicholas Moore, the CEO of Macquarie Group, received \$13.1 million.

⁵⁵ Yeates (2015).

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borrowers appear as though they can service mortgages beyond their financial capacity.⁵⁶ The results are noted on the service calculator form (SCF) and income work sheet (ICW), and along with several other pages, are attached to the original three page LAF and faxed to the lender. Usually, an additional eight pages are added to the LAF to make eleven in total, and this is considered the broker's copy of the LAF.

The second phase of the alleged fraud is committed when the credit assessors (CA) at the commercial lender receive the faxed copy of the LAF (the bank's version). The CA then alters the assets and income of the borrower, creating the illusion the borrower is wealthier than they really are. Items that are added include luxury vehicles, investment properties, stock market portfolios, imputed rents, secondary incomes, exaggerated primary employment income, and even the anticipated rise in the capital value of the borrower's home or investment property (estimated and unrealised future capital gains). White-out liquid is often used to erase the original details, allowing the CA to make alterations. Once the changes have been made, the newly inflated asset and income figures are again inputted into the bank's service calculator, 'confirming' the borrower can service a mortgage that is really too large. By this stage, the bank's copy of the LAF can amount to more than thirty pages.

When the borrower's details are sufficiently manipulated to the point of loan approval, the CA notifies the broker of the outcome and the borrower receives the mortgage. The banks' own lending criteria suggests that for a subprime mortgage to be approved, the borrower needs to have an Australian Business Number (ABN) for a minimum of two years as proof of their employment status. Yet, for those without an ABN, the business development managers (BDMs) at the banks were instructing brokers how to create ABNs for borrowers online, in one day, to ensure speedy mortgage approval.⁵⁷ The LAF fraud is explained by Brailey:

The fraud is in misrepresenting the true income. It was very easy for several years, for all of us, to blame the brokers who, to use their analogy, fudged the figures. But what I have

⁵⁶ This ratio is used as a guide by lenders to provide an assessment of a potential borrower's capacity to pay. It is a simple formula: total household debt (including property taxes) divided by gross household income. The higher the household income, the lower the ratio.

⁵⁷ Senate (2012b: 102, 208).

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found out since is that, through a service calculator, each BDM would teach the brokers to use a service calculator online and put in certain parameters such that the calculator, belonging to the bank - engineered by the bank - would actually bring out a figure that was highly inflated, based on a possible rental from a property. But we even have vacant blocks of land on them. What, are the cows paying rent? There is just no truth in the document at all. But the end problem was the whole idea that they would get a tax advantage and that was calculated in - capital gains and all these incentives. The emails actually tell them that that is what the calculator does. As one broker put it very simply to me: 'Denise, without a calculator, we did not know what figure to put in. We put in the figure that the calculator brought to us. We were told to do that back at the office after we had the signature.' Therefore, there was no knowledge on the part of the consumer.⁵⁸

The borrower does not know about the additional pages added to the original LAF or the second copy held by the banks. Borrowers have the legal right to receive a copy of both the brokers' and banks' LAFs, but this never occurs. Even on rare occasions when borrowers realise their LAFs may have been altered, they are faced with difficulties in retrieving the entirety of the document, and Freedom of Information requests are not applicable to the private sector. With the assistance of the BFCSA, borrowers did find one method to assist in document discovery. Lenders were contacted and asked to provide the borrower with a copy of their LAF on the basis the original documents had been 'misplaced' or 'lost'. As banks are enormous institutions where one hand does not know what the other is doing, the customer relations departments initially complied with these requests. By mistakenly releasing the banks' copy of the LAF, they had provided the smoking gun proving borrowers' details were altered to approve jumbo-sized subprime mortgages. After the story of LAF manipulation surfaced in the mass media around 2010, banks realised their 'mistake' and allegedly instructed managers to either shred documents or obstruct LAF requests.

When faced with a request for a LAF, lenders take one of three actions: 1) deny they have a copy of the LAF, that is, declare the borrower has the original and complete three page LAF; 2) state any additional documentation is the property of the bank and they are not under any legal obligation to provide it to the borrower; or 3) direct the borrower to speak with the bank's lawyers. The third option simply places the borrower on a merry-go round as the law firm will advise the borrower to speak with the bank again. Both parties claim the other is responsible for providing the LAF, but, in

⁵⁸ Senate (2012a: 45).

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fact, there is an unspoken commitment on behalf of both the bank and lawyers to never fulfill the request.⁵⁹ Borrowers who are legally entitled to a copy of their LAFs are typically informed by lenders the documents have either been destroyed, are not relevant, or are internal to the bank.⁶⁰ Lenders appear to be peddling these excuses to stonewall borrowers' efforts at discovery, fearing the LAFs may be used against them in future legal proceedings. To date, neither ASIC (Australia's financial markets regulator), the Financial Ombudsman Service (FOS) or the Credit Ombudsman Service Limited (COSL) have used their extensive powers to demand LAFs be released to borrowers and neither has any lender voluntarily provided LAFs to borrowers.⁶¹

The FOS is an ASIC-approved external dispute resolution (EDR) scheme established in July 2008, financed by banking and other lending institutions. It is the amalgamation of the Insurance Ombudsman Service Limited, Financial Industry Complaints Service and the Banking and Financial Services Ombudsman, creating a centralised and superficially convenient one-stop-shop for resolving complaints regarding banking and financial matters, without resorting to costly legal action through the courts. The FOS should be considered with some suspicion as it is financed by lenders. This distrust is partially warranted, as the FOS will only consider claims of \$500,000 and under and merely \$280,000 can be written off, including interest and charges.⁶²

As of 2015Q4, the average size of new mortgages sold nationwide was \$476,479.⁶³ This means most mortgages will never be written-off in their entirety, even if the majority of value is based on fraudulent and predatory lending. Inadequate avenues for restitution through the FOS constitute a favourable outcome for the banks, because borrowers seeking a more just outcome must instead engage lenders through the court system with expensive legal representation. The EDRs also have a statute of limitations so that if a borrower, from the date of approval plus six years, does not file a complaint, the EDRs will not adjudicate the dispute.

⁵⁹ Senate (2012a: 48).

⁶⁰ Klan (2012a).

⁶¹ Klan (2012b); West (2013).

⁶² Senate (2012a: 46). FOS has increased the total compensation awarded to \$309,000, a mere rise of \$29,000 (FOS 2016).

⁶³ AFG (2016: Table 1).

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It is apparent there is no upper limit for the alleged fraud perpetrated by lenders, while aggrieved borrowers are limited in their justified claims for compensation. Further, borrowers receive less favourable outcomes under the FOS than pursuing lenders through the courts directly. Unfortunately, COSL, which adjudicates disputes for non-bank lenders, provides even worse representation than FOS. It has allegedly never sided with a mortgage borrower. When disputes are lodged with the FOS, the organisation provides the lender (called a financial services provider or FSP) the opportunity to resolve the case through its own internal dispute resolution process (IDR). FSPs have 45 days to resolve the dispute or 21 days for cases presenting financial difficulties.

Based on earlier precedents set by the FOS and COSL, cases proceeding through FSPs' IDRs have an outcome which is easily ascertainable in advance: lenders do not find in favour with aggrieved borrowers, because they conveniently are unable to find any evidence of predatory lending and LAF fraud committed by their own staff. As the FOS, COSL and the IDRs have proven ineffective in finding fault with lenders, aggrieved borrowers have the final choice of seeking redress through the court system. Legal action is a near impossibility for most middle and low-income borrowers as they have neither the legal understanding nor savings to fund expensive legal services necessary to threaten or sue lenders.⁶⁴

Victims of predatory lending, having lost their homes, savings and most of their superannuation in a last-ditch attempt to prevent foreclosure, do not have the funds to fight lenders all the way to the Supreme and High courts, especially against banks' senior counsel who earn thousands of dollars an hour. Worse still, even when FOS awards some compensation to aggrieved borrowers, the FSPs often do not comply with the determinations, simply refusing to pay. The FSPs could be in administration or liquidation, or advise FOS they have insufficient funds.⁶⁵ Given the industry-friendly nature of FOS, lenders can continue to stonewall, adding to the borrowers' suffering.

Complaints to the FOS have increased over the last couple of years, driven by rising numbers of households in financial difficulty, natural disasters, the ongoing impact of the GFC, expansion of jurisdiction under national credit law and growing awareness of the FOS in the community. The FOS received 32,307 disputes in 2013, down 11 per cent from the previous year. This followed an

⁶⁴ Klan (2012c).

⁶⁵ FOS (2014).

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increase of 19 per cent between 2011 and 2012 and a 27 per cent increase between 2010 and 2011.⁶⁶ Half of all disputes (49 per cent) relate to one product line: credit, with disputes in this category decreasing by 12 per cent from 2012.⁶⁷ Consumer credit products comprised the vast majority of accepted credit disputes at 89 per cent, with those relating to business finance, guarantees, and margin loans rounding out the rest.⁶⁸ Out of the accepted number of credit disputes, 38 per cent were for home loans, 35 per cent for credit cards and 14 per cent for personal loans.⁶⁹ Interestingly, while the number of credit disputes fell by 6 per cent in 2013, the number of maladministration in lending cases more than doubled.⁷⁰

A handful of borrowers have successfully pursued legal action against predatory lenders. John O'Donnell, a Sydney resident, had been unemployed for about eighteen months when a salesperson acting on behalf of a firm called Streetwise convinced him to take out a loan against the equity in his home to invest in a property development. Despite having no income and his wife making only \$23,000 per annum, the Brisbane-based lender Firstmac provided them with a \$500,000 loan. Streetwise later became bankrupt, having been run into the ground by the jailed Kovelan Bangaru, leaving the couple with an enormous debt to service and nothing to show for it.⁷¹ The O'Donnell's sued Firstmac, eventually ending up in the Supreme Court which directed the loan to be cut by 75 per cent after it was discovered that Streetwise, acting as the broker, had falsified their assets and incomes to justify the provision of such a large mortgage.⁷²

A string of recent court cases have found in favour of borrowers, with some mortgages invalidated entirely. This must be disquieting for the banks, for if enough borrowers realise they are victims of fraud, residential mortgage loan books may take a substantial hit. This explains why some lenders are choosing to settle with borrowers by writing down a proportion of the loan value, rather than

⁶⁶ FOS (2013: 47).

⁶⁷ FOS (2013: 52).

⁶⁸ FOS (2013: 57).

⁶⁹ FOS (2013: 59).

⁷⁰ FOS (2013: 57).

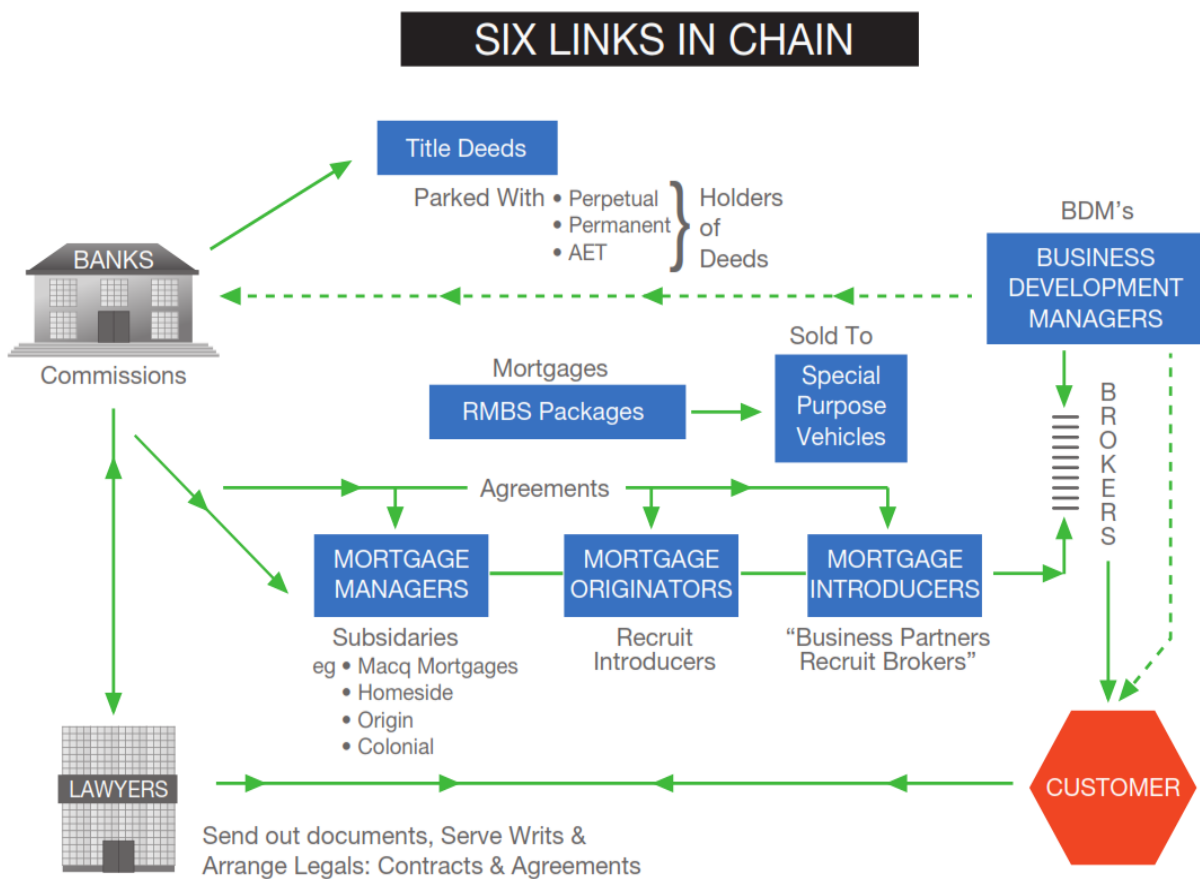
⁷¹ Anonymous (2005).

⁷² Klan (2012c).

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risk an adverse court finding that orders loans be completely forgiven.⁷³ Herein lays the true purpose of the bank-financed FOS: it exists to downgrade alleged fraud into mere disputes, herding aggrieved borrowers away from the courts where further dangerous precedents and judgments could be made in favour of complainants.⁷⁴ To effectively hide the alleged fraud committed via service calculators and LAFs, lenders have used a long, complex and opaque chain stretching from the brokers' offices to the BDMs: the mortgage broker channel. Brailey calls the linkages between these actors the 'six degrees of separation'. It allows both major banks and smaller lenders to keep their hands clean of alleged fraud, while ensuring the blame falls on brokers.⁷⁵

Figure 3.3.3.1: Six Degrees of Separation⁷⁶



⁷³ Klan (2012d).

⁷⁴ Only a minority of complainants have the financial resources to undertake legal action and there is no certainty of a favourable court ruling. Lenders also aggressively defend any allegations of criminality.

⁷⁵ West (2013).

⁷⁶ BFCSA (2013, personal communication).

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The chain's complexity suggests it is purposefully designed to hide the banks' alleged fraud, providing a legal liability escape clause through plausible deniability. Under normal circumstances, banks would simply advertise subprime mortgages directly and hire more loan officers to meet demand. No bank manager with a sound understanding of business principles would seek to establish and deal with a complicated brokerage chain and pay fees and commissions, especially since services can be provided directly to the public at a lower expense ratio and with less bureaucracy to increase profits. Instead, banks have chosen the opposite approach, which is wasteful and inefficient.⁷⁷ Brailey testified that:

There were six links purposely designed in this structure, and it is the structure that I and my members are aggrieved by. The banks provided commissions for mortgage managers, mortgage originators and mortgage introducers that came down in a chain to employing brokers. The brokers copped the full brunt of the blame that they were falsifying loan application forms. I have brought along with me today a small bundle—I have 4,000 of these—of documents relating to every bank represented by the top banks, as demonstrated by their names. The four majors are in there. They are all responsible, through a series of emails from banks to brokers, instructing the brokers how to get their deals across the line—'make the deal fit' was their usual interpretation. They targeted older people, carers, people on parenting allowance and the aged pension. These are all on flyers sent to 40,000 representatives throughout Australia, from the banks.⁷⁸

Emails provided to the BFCSA by banking and broker insiders provide evidence of lender culpability. These emails detail how lenders are the ultimate driver of the alleged fraud, with the BDMs providing instructions to brokers on how to complete LAFs, create ABNs and to use the online service calculators to ensure loans 'get over the line' (approved).⁷⁹ Lenders did not care whether or not the data entered was valid, and neither did they bother to verify borrowers' details, as simple checks would immediately reveal many borrowers had insufficient incomes to service debt payments. The indifferent attitude lenders had towards the verification of borrowers' details was noted by Brailey:

⁷⁷ Senate (2012a: 46-47).

⁷⁸ Senate (2012a: 44).

⁷⁹ West (2013).

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So we see that the path to rectification centres on this premise: any lender who approved a loan without verifying the loan application data with the borrower was imprudent, negligent and in many cases just plain reckless. Indeed, most of the loans would have been rejected if the lenders had made a simple phone call to the borrowers - they chose, in a corporate decision, not to do so - and ascertained the borrowers' true financial circumstances, that would have revealed those flaws in the system and those practices. In the case of the 25 Australian Banking Association members, they are also in breach of their contract with the borrower to assess the borrower's ability to repay the loan, as provided for in article 25 of the Code of Banking Practice. No lender, and no holder of loan securities, including the government, should be allowed to maintain any loan which the lender would not have given had it applied the simplest of lending criteria tools - namely, verifying the loan application details with the borrower. And that simply was not done.⁸⁰

Australian law stipulates a mortgage must be approved on the basis of the borrower's ability to finance the principal and interest payments out of income, preventing banks from lending against the value of the home as the only form of collateral. This has not prevented lenders, however, from approving mortgages based on the equity in the owner-occupied home.⁸¹ This law explains the incentive lenders are faced with to inflate assets and incomes to ensure mortgages are approved. Unfortunately, some lenders bring further financial harm to borrowers in danger of default by outrageously providing buffer loans (lines of credit or LOCs) to enable borrowers to continue debt payments.⁸² Naturally, this arrangement is unsustainable as borrowers inevitably require additional loans to pay down the principal and interest on the earlier loan; essentially Ponzi and predatory finance combined. When jumbo-sized loans were too large for the borrower to service for even a short period, LOCs were approved the same day as the mortgage.

The reasons for providing buffer loans are threefold. The first is that lenders can cover up the loan affordability issue for at least six years, thus extending the life of the mortgage past the EDRs' time limit. If borrowers were to default almost immediately – within a matter of weeks and months –

⁸⁰ Senate (2012a: 44).

⁸¹ Klan (2012c).

⁸² Similar to the predatory credit card practice of offering further cards and honeymoon periods to entice an ever-larger amount of principal attracting onerous fees and interest charges, despite borrowers' increasing financial difficulties.

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suspensions of imprudent lending would almost certainly arise. This leads to the second reason: if borrowers were to default too soon after mortgage approval, lenders would miss a further window of opportunity to charge usurious fees and interest rates. Refinancing fees can amount to tens of thousands of dollars depending on the size of the loan and penalty interest rates can reach as high as 18 per cent.

Lenders can maximise income extraction from borrowers in a short period of time, without immediately rendering them insolvent, by herding them into a form of structured bankruptcy with usurious fees and interest. It is analogous to paying off the mortgage on credit card terms. The third reason for providing buffer loans is to act as a form of legal defense. As buffer loans enable borrowers to temporarily service debt payments, bank lawyers can claim in the EDRs and courts that borrowers could indeed 'afford' the payments for years, so the loan was by definition affordable; imprudent or predatory lending did not take place. This line of argument was used successfully by bank lawyers in FOS disputes for years until Brailey, through painstaking effort, managed to convince the case managers otherwise.

A prime example of combined predatory and Ponzi finance took place in the case of Michael and Karen Cook, a couple from New South Wales who were the victims of imprudent lending. After experiencing some trouble in paying down existing debts, the Cooks took out a 25 year mortgage from the CBA, secured against their home, to the value of \$110,000 in 1998. Unfortunately, they defaulted on the loan in 2000 and were unable to secure another line of credit. To avoid foreclosure on their home, they obtained a twelve month interest-only loan in 2001 to the value of \$120,000 at 11.75 per cent (loan 1), secured by the first mortgage, costing \$5,208 in fees. Later in the same year, the Cooks defaulted on their new loan, taking out yet another 12 month interest-only loan of \$138,000 (loan 2) at 8.75 per cent, again secured against their first mortgage.

By 2002, Michael Cook managed to obtain a \$12,000 advance from his superannuation account, using it to finance the debt payments on loan 2. Shortly after, the Cooks again defaulted, taking out another 12-month loan of \$174,000 at 7.5 per cent (loan 3), secured against the first mortgage. Later in 2002, they took out a fourth loan worth \$22,000, secured against the second loan, at an interest rate of 102 per cent with a default rate of 144 per cent per annum, to make repayments on loan 3 (loan 4). By early 2003, they were in default on loans 3 and 4, later obtaining

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an additional two loans to the value of \$245,000 (loan 5), with \$15,000 in transaction costs. The first loan was \$200,000 at 13.8 per cent, and the second \$45,000 at 19.5 per cent, secured against the first and second mortgages, respectively. The average rate of interest on loan 5 was 10.31 per cent, and was used to repay loans 3 and 4, the transaction costs of loan 5, and the rates and utility bills.⁸³

It is evident the Cooks descent into a debt mire resulted from simply borrowing more to pay down the previous loans, including fees and transaction costs. Considering their moderate combined income of approximately \$40,000 per annum, the lender of loan 5 provided far more credit than was justified, resulting in Ponzi finance. The loan was provided on the premise the Cooks could not feasibly finance the debt payments out of their incomes. Assuming an unblemished credit history, the most the Cooks could arguably service was \$170,328, substantially less than the \$250,000 actually provided, especially given the usurious interest rates, fees and transaction costs.⁸⁴ When the lender took the matter to court, the judge found in favour of the Cooks, adjusting the loan and interest rate commensurate to their ability to pay. While buffer loans were not used in this case, it emphasises the willingness of lenders to provide credit regardless of the borrowers' ability to pay.

Providing details on the pervasiveness of alleged fraud is more difficult, however, given the small sample size publicly available from the BFCSA. The organization has 1,170 people and 651 members; most are couples, explaining the difference. About a quarter of the LAFs have been analysed, comprising an aggregate \$97.63 million in value. Almost 39 per cent of LAFs have falsely stated borrowers were self-employed, and the majority of fraudulently-tampered loans were provided through a broker rather than banks directly. It appears the most at-risk group is aged between 51 and 65, possibly reflecting the targeting of what the financial sector calls 'ARIPs' or asset-rich, income-poor individuals, composed mostly of pensioners or baby boomers set to retire.⁸⁵ Brailey states that every BFCSA client has a LAF subjected to fraud, both prime and subprime loans.⁸⁶ Approximately 10 per cent or more of prime loans may have also been subject

⁸³ Keen (2005: 4-6).

⁸⁴ Keen (2005: 11).

⁸⁵ Senate (2012a: 47); West (2013). In essence, the banks are targeting those with valuable assets and sizeable equity.

⁸⁶ West (2013).

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to fraud.⁸⁷ If this trend is extrapolated to the entire Australian residential loan book worth \$1.5 trillion, then subprime mortgages may actually represent tens of billions worth of mortgages, if not hundreds of billions, creating an enormous risk to the banking and financial system.⁸⁸

Table 3.3.3.1: BFCSA Loan Application Fraud Statistics⁸⁹

BFCSA	Figure
Memberships	651
People (most members are couples)	1170
Survey	
Sample size	23.5%
Actual respondents (per person/couple)	153 pp/c
Total loans	250
Total loan book surveyed	\$97.63 million
Average loan size	\$390,522
Average number of loans (per person/couple)	1.63 loans pp/c
Fraud	
Falsely stated as self/employed on the LAF	38.8%
Fraudulent full doc loan arranged by Bank Managers/Officers	14.8%
Fraudulent low doc loan arranged by Bank Managers/Officers	20.8%
Total 'toxic loans' arranged by Bank Managers/Officers	35.6%
Fraudulent loans (full and low doc) arranged by Brokers	64.4%
Homes lost: arranged by Bank Managers/Officers	24.24%
Homes lost: arranged by Brokers	75.76%
Age of Borrowers	
Under 40	6.5%
41 - 50	20.9%
51 - 65	55.6%
66 - 70	11.1%
71 over	5.9%

Despite the BFCSA notifying the regulators of the alleged fraud, to date, ASIC has failed to act and uphold the laws it is bound to enforce. Politicians are also loath to grant any inquiry a broad terms of reference and sweeping powers to investigate white collar crime in the FIRE sector. In exasperation, the BFCSA created a public online archive (Evernote), archiving scanned copies of

⁸⁷ Hoffman (2013).

⁸⁸ Consolidated mortgage debt as of 2015Q4.

⁸⁹ Derived from West (2013).

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borrowers' LAFs including email and written correspondence with the regulators.⁹⁰ A prima facie case of fraud exists, with notes written by the borrowers attached to the online LAFs describing the multiple additions and alterations made by CAs.

The modifications generally consist of two phases: the first is to falsely inflate the value of assets and incomes, and the second is to validate the alterations by illegally initialing and signing the forms to provide the appearance borrowers have inputted and approved the details. In some cases, LAFs have up to three distinctly different sets of handwriting, indicating CAs were using white-out to change the handwritten income figures after the LAFs were faxed to lenders. Some caution is advisable, as this information regarding alleged service calculator and LAF fraud has come from only one source, the BFCSA. There is scant other publicly available information to verify the allegations of fraud made, apart from Senate testimony, media articles and the online LAF archive. Nevertheless, *BusinessDay*, an arm of Fairfax Media, supports Brailey's claims:

BusinessDay reviewed the documents of dozens of victims – which are lodged on Brailey's Banking and Finance Consumers Support Association (BFCSA) website – and found the evidence supported Brailey's claims of systemic fraud. ASIC and the banks have long argued that any irregularities that Denise Brailey has identified were the fault of rogue mortgage brokers. Further, they have claimed the problem is contained to 'low-doc' loans (usually for small business). However, Brailey's submission found that 36 per cent of all 'toxic' loans had been arranged directly by bank officers, with no broker involved. And 18 per cent of all toxic loans were 'full doc' loans, arranged by banks and not brokers. The overall numbers in Brailey's survey are large and involve complaints against most banks and mortgage providers. The survey is taken from almost 800 loans, involving almost 1,200 people (many are couples) who have failed to get a response through official channels and came to her for help. The bulk of the claims pertain to the 'Big Four' – ANZ, Westpac, CBA and National Australia banks – who dominate the mortgage market.⁹¹

The public would know more if the regulators had bothered to properly investigate the claims made by the BFCSA. Both APRA and ASIC have known about the allegations since 2003 when they were approached by Brailey with evidence of fraud. The response of the regulators was to deny

⁹⁰ The archive can be found through the BFCSA website.

⁹¹ West and Tan (2013).

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there was sufficient evidence of fraud and suggested any complaints be taken to the FOS; a predictable response due to increasing regulatory capture in an economy dominated by the FIRE sector. In 2005, the ATO conducted its own investigation into mortgage fraud, following the detection of numerous anomalies in tax returns filed with the office. Discrepancies were noted in the declared income of some taxpayers, based on the wide divergence between stated incomes and jumbo-sized mortgages.

The ATO initially believed these taxpayers had intentionally understated their incomes to minimise or evade tax, with the large mortgages providing a sign their actual incomes could be much larger officially stated on tax returns. Brailey met with the ATO in that year to assist with the investigation, providing evidence these taxpayers were not illegally understating their incomes but that lenders were fraudulently issuing massive mortgages far beyond their capacity to service over the long-term. The ATO then promptly shut down the investigation, advising Brailey to seek assistance from ASIC. The regulator did nothing.⁹²

As recently as 2013, ASIC has denied even receiving the tampered LAFs that provide evidence of alleged fraud. Brailey instructed BFCSA members to send more than one hundred formal letters of complaint to ASIC, with approximately half having the LAFs attached. ASIC admits to having received seventy of these letters, but has obstinately refused to investigate further, telling BFCSA members to secure legal services and deal with the matter on their own. In essence, ASIC's response amounts to providing aggrieved borrowers with 'bugger off' letters, confirming that 'Australia's world class regulator' has acquiesced to rogue financier activity and is unlikely to pursue action against lenders.⁹³

Oddly enough, an organisation with a budget of \$400 million dollars (ASIC) has claimed not to have found any evidence of fraud, but an unpaid, financial consumer-rights activist has managed to find a mountain of it. The CBA investment planners scandal that broke in the media in 2013 offers further evidence of how disinclined ASIC has become to investigate the wrongdoings of the Big Four, having sat on evidence from whistleblowers for sixteen months. ASIC's gross incompetence is exemplified by its failure to act on evidence of fraud and forgery of rogue CBA financial planners

⁹² Senate (2012a: 48).

⁹³ West (2013).

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for three and a half years, despite this information coming directly from the bank.⁹⁴ Recently, ASIC has come under fire from all quarters:

In recent years, ASIC has routinely been described as a toothless tiger, a dog with no bite and a keystone cop when it comes to enforcement. It has been criticised for being too slow to act, lacking transparency, being captured by the big end of town and having a “glass jaw”. But most of all its credibility has been questioned in relation to the court cases it has lost over recent years due to perceived bungling - AWB, One.Tel, Opes Prime and Westpoint. Professor Michael Adams, dean of law at the University of Western Sydney, says in the AWB case people were open to corruption and they got the “tiniest” slap on the wrist.

In the Reserve Bank currency notes scandal, it was missing in action. This has been compounded by what seems to many to be a ruthless pursuit of a handful of small fry to build up the scorecard rather than taking on senior executives and directors in big companies over breaches of continuous disclosure. Indeed a high-profile barrister argues that litigation funder IMF Australia has become the de facto public corporate enforcement arm - done with about 20 staff, compared with ASIC’s estimated 1900. “IMF does not do enforceable undertakings in backrooms, nor take no prisoners. And they win,” he says.⁹⁵

This culture of complacency is unsurprising given the revolving door between government, regulators and the FIRE sector. The head of ASIC, Greg Medcraft (on a taxpayer-funded salary of \$700,000), was hand-picked by the Gillard government to lead the regulator in May 2011, but then was shortly thereafter questioned about his previous role in the subprime securitisation scandal in the US. Medcraft held a senior position at Societe Generale, overseeing the bank’s US RMBS business during the period it is alleged to have engaged in unlawful conduct. The bank is the target of a lawsuit by the US Federal Housing Finance Agency, accused of negligence, failing to perform due diligence and misleading the government-sponsored mortgage lenders Fannie Mae and Freddie Mac. Medcraft’s appointment to ASIC was also questioned on the basis that he managed

⁹⁴ Ferguson and Vedelago (2013).

⁹⁵ Ferguson et al. (2013).

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to sidestep the ALP's election policy of advertising executive public sector roles, raising the suspicion of political favouritism as he was formerly a member of the ALP.⁹⁶

Australian law regarding whistleblowing has exacerbated the purposeful ignorance of regulators because little protection is afforded to those coming forward with evidence of wrongdoing, thus acting as a disincentive and actually discouraging disclosures in the public interest. Despite proposals for reform, virtually nothing has been done to remedy the meager protections afforded to whistleblowers.⁹⁷ At least one regulatory step in the right direction was taken with the enactment of the *National Consumer Credit Protection Act (2009)* (NCCP). Commencing on 1st July 2010, the Act enforces a national framework regulating credit, including a responsible lending obligation for banks.

Lenders and brokers can no longer ignore potential borrowers' financial circumstances when assessing their eligibility for mortgages; they must make reasonable efforts to verify borrowers' incomes and are held liable for improper lending.⁹⁸ The NCCP is not retrospective, meaning a substantial and unknown number of predatory loans are still being serviced. Up to 20 per cent of all loans written in the year to 2008 were subprime, and they are six times more likely to be in arrears than prime loans. Arrears rates have doubled in the past two years as the new NCCP regulations have prevented some borrowers from refinancing, causing a falling trend in the volume of subprime mortgages.⁹⁹ This is circumstantial evidence of pre-2010 subprime loans failing NCCP standards and supports claims of predatory lending around this time.

A claim favoured by government and the FIRE sector is that predatory subprime loans cannot exist because, if there were any to a significant degree, the non-performing loan rate would have risen to reflect this as borrowers eventually default under the weight of the jumbo mortgage

⁹⁶ McKenzie et al. (2011).

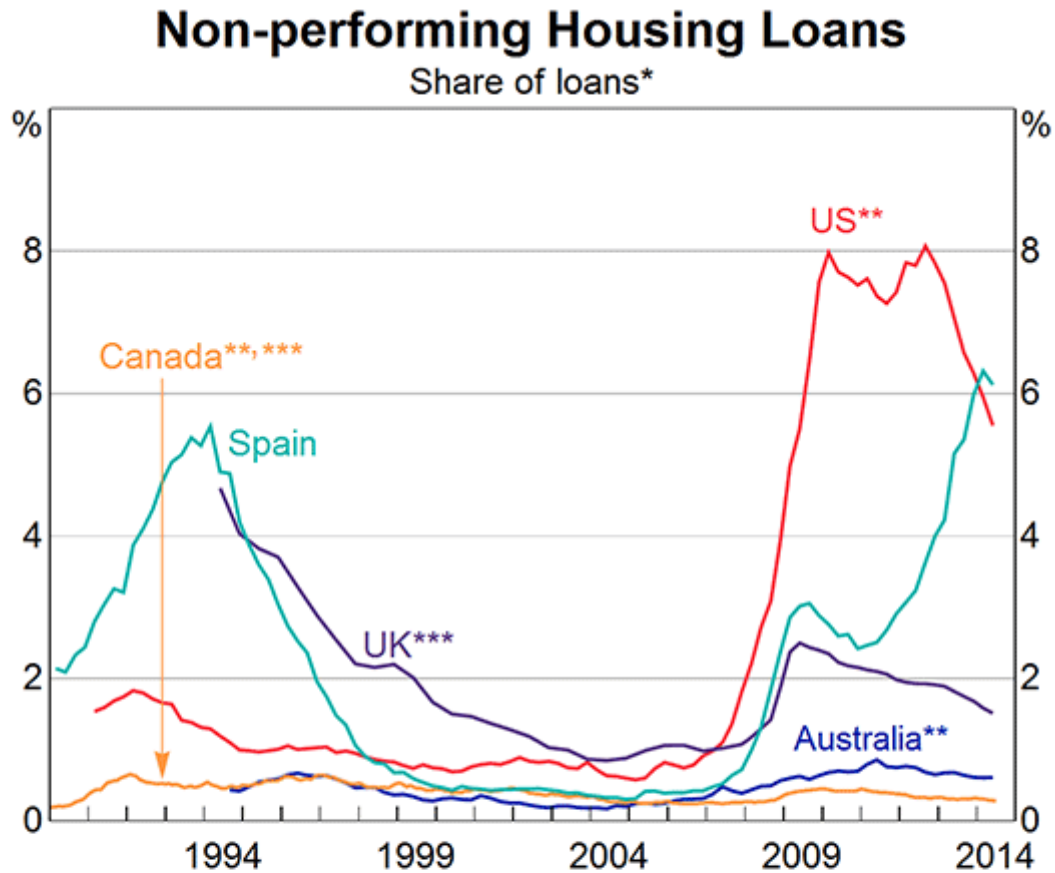
⁹⁷ Williams (2013). The new whistleblowing protection legislation currently considered by the federal government appears to discourage, rather than encourage, whistleblowing (Appleby et al. 2013).

⁹⁸ Senate (2012b: 102).

⁹⁹ Klan (2012e); Senate (2012b: 103).

payments.¹⁰⁰ This line of reasoning is also used to deny there is a housing bubble and therefore the market cannot suffer a large decline in dwelling prices.

Figure 3.3.3.2¹⁰¹



* Per cent of loans by value; includes 'impaired' loans unless otherwise stated; for Australia, only includes loans 90+ days in arrears prior to September 2003

** Banks only; for Canada, only includes the six large Canadian banks, and HSBC Canada and Manulife Bank

*** Per cent of loans by number that are 90+ days in arrears

Sources: APRA; Bank of Spain; Canadian Bankers' Association; Council of Mortgage Lenders; FDIC; RBA

Interestingly, the data demonstrates a rising NPL rate is a lagging, not leading, indicator of troubles in the housing and mortgage markets. The rate was 1 per cent or less during the 2000s for the US and Spain as their housing bubbles grew. During the expansion phase of a bubble, both underutilisation (unemployment and underemployment) and NPLs are low due to strong

¹⁰⁰ Senate (2012b: 105).

¹⁰¹ Aylmer (2014: Graph 2).

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economic growth brought about by runaway credit creation. Only after housing prices peak and then fall does the NPL rate rapidly increase. As the debt accelerator turns negative and credit creation no longer provides a strong stimulus to economic growth, underutilisation surges. Declining household sector consumption and business investment amplifies the downturn. During the FIRE sector meltdowns, the rate reached a peak of 8 per cent in the US and an initial rate of 3 per cent in Spain before austerity measures and the Euro crisis drove that economy into such dire conditions the rate blew out past 6 per cent. The UK also suffered a major financial crisis but not to the extent of the other two nations. Canada, as with Australia, also has a housing bubble which has not yet burst; the NPL rates have remained relatively low as a result.

Asset prices are determined at the margin; it only takes a relatively small turnover to significantly influence the trend in housing prices. It is stated that “78 per cent of borrowers are ahead in their repayments by an average of 7 payments”, inferring a large margin of safety.¹⁰² The RBA has also said “Furthermore, although the gross household debt-to-income ratio has risen to new highs, households continue to build up mortgage buffers and indicators suggest that financial stress in the household sector remains low.”¹⁰³ Averages or medians, however, disguise the fact that only a small percentage of mortgages are required to become NPLs to drastically deform the housing and mortgage markets, and only after housing prices peak and then decline. Clearly the pre-GFC NPL rate for the US does not provide any indication of the dangers posed by predatory lending and the large cohort of fraudulent loans. It is interesting to note government and the FIRE sector have not yet realised the NPL rate cannot be used as a leading indicator of housing market and financial stress.

The number of foreclosures and NPLs could also be higher than what is reflected in official statistics lenders are required to provide the regulators. Denise Brailey has uncovered a process whereby FOS, acting in the interests of lenders, reduces the number of foreclosures and NPLs by coercing aggrieved borrowers into determinations which disguise these as normal sales and the termination of performing loans. This may act to lower the NPL rate, suggesting the mortgage market is not experiencing as much stress as the official numbers demonstrate. Refinancing or the provision of extra buffer loans, including intentionally taking years to foreclose upon borrowers so

¹⁰² Sier (2016).

¹⁰³ RBA (2015: 19).

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as to spread out defaults across time, could serve to forestall the rise in NPLs. This is another area of the FIRE sector mortgage control fraud which bears further investigation.

Furthermore, analysis of mortgages and RMBS by the ratings agencies may not indicate any incidence of predatory lending if the agencies use the LAFs supplied to them by the lenders, where the inflated assets and incomes are accepted as legitimate. Even if the ratings agencies were to conduct an examination of loan quality by matching tax file numbers and other relevant data to ascertain the facts, there is no guarantee the agencies would warn about the discovery of fraudulent mortgages. These agencies are dependent on fees from lenders for their revenues and profits; as was demonstrated in the US, they were willing participants in promoting the control frauds whereby they knowingly gave investment-grade ratings to toxic subprime junk.¹⁰⁴ If ratings agencies abided by the rule of law, they would have lost revenue and market share as lenders switched to a competitor willing to break the law to maximise profits. This perverse incentive structure ensures the continued compliance and subordination of the ratings agencies to lenders. It is difficult to see how the agencies in Australia would act differently to those in the US with the same structure in place.

Foreign investors may also be adversely affected given purchases of RMBS issued by Australian bank and non-bank lenders, containing fraudulent mortgages that could rapidly become impaired. If this is the case, the RMBS will devalue or even turn out to be worthless, like the RMBS and CDOs in the US. Approximately half of all Australian asset-backed securities are held by non-residents.¹⁰⁵ Many financial institutions and in particular ratings agencies may now be subject to civil legal suits domestically, and more worrying, abroad in international jurisdictions (especially in the US) where their wholesale lenders have provided funding to Australian lenders under a false pretense (quality of the mortgage books).¹⁰⁶

¹⁰⁴ Black (2011); Lewis (2010); Taibbi (2013).

¹⁰⁵ Aylmer (2014: Graph 5).

¹⁰⁶ In Parliamentary testimony in 2012, Denise Brailey warned that the multi-billion dollar purchases of RMBS by the AOFM during the GFC were riddled with fraudulent mortgages (Senate 2012b: 101-108). This could be tantamount to defrauding the federal government.

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Due to a lack of both domestic enforcement and prosecution resulting in penalties, it is therefore possible external wholesale lenders and other stakeholders could file suit in their own jurisdictions against Australian bank and non-bank lenders engaged in control frauds, leaving them exposed to large settlement claims. In other OECD nations, for instance, the US Department of Justice and the Securities and Exchange Commission today imposes heavy fiscal penalties on financial firms engaging in inappropriate or illegal misconduct where US citizens or institutions have been sold or offered a security (such as fixed income) from abroad based on falsified and fraudulent information. Should the foreign equivalents of ASIC across multiple nations impose penalties on Australian lenders, the overall sum of fines could become overwhelming.

3.4 Noxious Outcomes

According to the five elements of Black's control fraud framework, there is evidence to strongly suggest control fraud is present within Australia's banking and financial system. The mortgage loan book has rapidly grown over the last two decades, indicated by the exponential rise in household and mortgage debts relative to GDP, household income and net cash flows. The Big Four banks have employed extreme leverage, especially against the residential loan book and have minimal loss reserves. The record-breaking banking sector profits stemming from this strategy has led to massive multi-million dollar remuneration for executives. While data on four of the five elements are publicly available (loan growth, leverage, loss reserves and executive remuneration), less is known about the scale of predatory lending in the mortgage market. Episodes of declining underwriting standards have been well documented by the BFCSA, but the true extent has yet to be revealed.

Academia could offer an independent voice against these control frauds, but the legal and economics professions are mute before the FIRE sector, which employs many directly and indirectly. This has held true in the US, given the unchecked, pervasive and recurring control frauds run by the FIRE sector over the last several decades. Indeed, there does not appear to be a single economist or criminologist in Australian academia that specialises in the topic of control fraud as Black does in the US.

Due to the extensive research carried out by the BFCSA, there is plenty of evidence to detail how the mortgage control fraud operates, evidenced by thousands of LAFs and leaked emails from the FIRE sector, especially from lenders to the broker channel. Government, regulators and economists cannot pretend to not have noticed beforehand, even though this is, unfortunately, standard fare. Once the details of this widespread criminal activity becomes more widely acknowledged, regulators and public executives should be prosecuted for negligence and dereliction of duty alongside the FIRE sector executives who have committed and profited from the control frauds.

The FIRE sector cannot operate efficiently when substantial profits are derived from the widespread issuance of fraudulent products in accordance with the corrupt subprime mortgage

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lending model. Policy and culture has been twisted to promote profits over the financial well-being of the public. The objective of the FIRE sector is to be the beneficiary of unverified lending practices, viewing the lack of oversight by regulators as a loophole to be mercilessly exploited. As such, there is a strong case for reregulation, given the subprime loan bomb is primed to explode within the \$1.5 trillion dollar mortgage market. The primary concern is potentially hundreds of thousands of families may be in danger of foreclosure once the private debt Ponzi scheme inevitably collapses under the weight of its own inefficiency and corruption.

Australia has suffered through many asset bubbles which government and the economics profession has chosen to ignore. Economists should have learnt from the smoking craters left by the numerous booms and busts in the FIRE sector during the 1840s, 1890s, 1930s and the dual commercial and housing bubbles of the mid-1970s. These cycles led the economy into severe recession and depression.¹⁰⁷ Instead of tightening regulation of the FIRE sector and developing dynamic disequilibrium empirically-based models of financial and asset markets, the ideologically-based 1981 Campbell Report, dominated by falsified equilibrium perspectives, advocated privatisation and deregulation.¹⁰⁸ By the time of the 1997 Wallis Report, economists had the benefit of hindsight of examining the aforementioned cycles, including the 1987 stock market bubble and crash, the late 1980s dual commercial and housing bubbles, and the lead-up to the largest stock market bubble in Australian economic history, the Dot-Com era. Unfortunately, the recommendations of the Wallis Report were more of the same.¹⁰⁹

The economics profession in Australia (and elsewhere) are wilfully blind to countervailing evidence which demonstrates the harms caused by neo-liberal agenda of allowing the FIRE sector to become a profit centre to be maximised rather than a cost centre to be minimised.¹¹⁰ The reason why this agenda is advocated is obvious: booming private debts enhance the profits, market share and political power of the FIRE sector. The FSI eventually put a fairly weak brake on this momentum of neo-liberal ideology given the worldwide economic fracturing caused by the GFC,

¹⁰⁷ Egan and Soos (2014).

¹⁰⁸ Committee of Inquiry into the Australian Financial System (1981).

¹⁰⁹ FSI (1997).

¹¹⁰ Hudson (2006, 2010a, 2010b, 2010c); Hudson and Bezemer (2012).

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recommending Australia's record-breaking taxation expenditures be curtailed and that banks hold larger loss reserves, among other policies.¹¹¹

While the FSI's recommendations amounted to very mild reform of the FIRE sector which was still predictably opposed by the vested interests, it did not investigate the issue of control fraud. The few mentions of the term fraud were in reference to identity and personal theft.¹¹² In other words, the minor types of fraud committed against lenders and occasionally borrowers, typically by third parties. It did not occur to the FSI it could be an important avenue to investigate the constantly growing cesspit of control frauds committed by the FIRE sector against the public for which there is evidence going back to the 1980s. By the 2000s and certainly the 2010s, there is overwhelming evidence of the existence of control frauds given the orgy of widespread looting.

The rise of control frauds and exponential private sector debt has resulted in the (domestically focused) Big Four banks posting annual profits of between \$20 and \$30 billion. These profits are considerable for a nation of only 24 million people. The answer to why the banks are making these record-breaking profits lies within examining the five elements of the control fraud framework, with significant evidence of declining underwriting standards, as the BFCSA has revealed through extensive research into mortgage lending. Every subprime mortgage, including a minority of prime loans, has been subject to fraud and forgery, rendering them toxic. Furthermore, not all subprime loans have been issued through the broker channel; 36 per cent were issued directly by lenders. These toxic loans continue to be sold in 2016, with the tainted, post-2010 National Consumer Credit Protection Act (NCCP) loans now coming to light as predicted.

Even a recent investigation by ASIC has revealed worrying signs into the issuance of interest-only home loans. The study looked at the underwriting practices of 11 ADIs (bank and non-bank lenders) for a three year period between 2012 and 2014. Along with conducting an industry survey on interest-only loans, ASIC also reviewed 140 loan files relating to both owner-occupation and property investment. Not surprisingly, the study "found examples of practices that place lenders

¹¹¹ FSI (2014); Tyson (2014: 3 - Figure 1).

¹¹² FSI (2014).

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at risk of breaching responsible lending obligations.”¹¹³ In many cases, it was found that lenders had not considered serviceability, adequacy and living expense requirements:

Our review identified some practices where lenders may be at risk of not complying with their responsible lending obligations. In particular, we found that:

- (a) in 40% of the files reviewed, the affordability calculations assumed the borrower had longer to repay the principal on the loan than they actually did (by using the full term of the loan to calculate principal repayments, rather than the residual term);
- (b) in over 30% of files reviewed, there was no evidence that the lender had considered whether the interest-only home loan met the borrower’s requirements; and
- (c) in over 20% of files reviewed, lenders had not considered the borrower’s actual living expenses when approving the loan, but relied instead on expense benchmarks.

For example, we reviewed numerous files where the stated requirement or objective of the consumer was ‘to purchase a property’, with no information stating the reason an interest-only home loan had been selected. Statements of this type do not support the decision to provide an interest-only home loan rather than another type of loan, and are inadequate as they suggest that the consumer did not have any requirements or objectives for the loan itself or the features or terms on which it was offered.¹¹⁴

The RBA has also issued warnings about declining lending standards:

For several years, overall mortgage lending standards have been tighter than they were in the lead-up to the global financial crisis: ‘low-doc’ loans are rare; genuine savings are expected to fund at least part of the deposit; and it is now common practice to apply a buffer to the interest rate when calculating allowable loan sizes. However, lending standards appear to have been somewhat weaker around the turn of this year than had been apparent at the time, or would be desirable in the current risk environment. Standards have since been tightened. This was in part necessary because nominal housing price growth might be expected to be slower on average – and periods of absolute price declines to be more common – now that the earlier transition to a low-inflation, higher-debt state has been completed. The recent tightening

¹¹³ ASIC (2015: 5).

¹¹⁴ ASIC (2015: 9).

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should therefore be understood as addressing the need for a permanently stronger level of lending standards, as well as reversing some of the slackening in serviceability standards that had started to occur in response to strong lending competition.¹¹⁵

and

Recent investigations by regulators have revealed that housing lending standards in recent years have been somewhat weaker than had originally been thought (though still better than in the years leading up to the global financial crisis). In some cases, practices have not met prudential expectations, potentially placing lenders at risk of breaching their responsible lending obligations under consumer protection laws. In particular, poor documentation and verification by lenders in many instances suggests that some borrowers may have been given interest-only loans that were not suitable for them. Serviceability assessments also seem to have been especially problematic: the common (and prudent) practice of applying a buffer to the interest rate used when calculating the allowable new loan size had in some cases been undermined by overly aggressive assumptions in other parts of the serviceability calculations (for details, see 'The Australian Financial System' chapter). As a result, some borrowers have had less of a safety margin against unexpected falls in income, increases in expenses or increases in interest rates than it had appeared.¹¹⁶

and

APRA also undertook a 'hypothetical borrower exercise' in early 2015 to investigate the range of housing lending standards. The survey required a number of lenders to provide serviceability assessments for four hypothetical borrowers – two owner-occupiers and two investors. The results revealed large variations in serviceability practices across the industry and some cases where practices were less prudent than is desirable. Specifically, some lenders' serviceability assessments were based on: a lower level of living expenses than declared by the borrower; optimistic judgements of the reliability of borrowers' income; and/or implicit assumptions that interest rates on a borrower's existing debts would not rise. ASIC's recently released review of lenders' interest-only housing lending included similar findings, and also noted instances where the lender did not make reasonable enquiries that the interest-only

¹¹⁵ RBA (2015: 1-2).

¹¹⁶ RBA (2015: 21-22).

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loan was suitable for the borrowers' circumstances and their capacity to repay. Overall, the findings of these reviews suggest that banks' lending practices, at least those relating to serviceability assessments, were somewhat looser than had been previously understood (although lending standards overall were still better than in the years leading up to the financial crisis).¹¹⁷

These are findings which Denise Brailey had warned about a decade and a half earlier, having observed over one thousand LAFs, with most of the mortgages interest-only, issued on the basis of fraud. It is near unbelievable it has taken ASIC unto 2015 to perform such an investigation, arriving at weak conclusions that lenders may be at risk of breaking prudent lending standards. The RBA has simply referenced the study, including one by APRA, and has drawn no significant conclusions. If ASIC were serious about conducting a thorough investigation into interest-only loans and the mortgage market, it could have used the LAFs gathered by the BFCSA which number far larger than the 140 loan files ASIC reviewed. Doing so, however, would immediately expose the immense torrent of fraudulent interest-only mortgages, mostly no- and low-doc, though some are officially registered as prime loans.

To abide by the party line, ASIC has maintained the 'politically correct' conclusion: while there may be some evidence that ADIs have not adhered precisely to responsible lending guidelines, there is no evidence of fraud, let alone widespread control fraud. ██████████, an ASIC commissioner, went so far as to claim (lie) "ASIC has not received any documents from her in the form of LAFs (Loan Application Forms) which show any evidence of fraud".¹¹⁸ For many years, Denise Brailey has directed BFCSA members to provide ASIC with the lenders' version of the LAFs including a page listing the discrepancies. There is no possible way ASIC could claim it had not received any evidence of fraudulent LAFs; rather, ASIC would prefer to stick its head into the sand and pretend nothing is amiss, claiming it has enforced the financial markets with a strong hand.

Lenders have also intentionally engaged in the illegal practice of 'third line forcing': coercing borrowers into taking credit cards from either lenders or third-party providers they neither need

¹¹⁷ RBA (2015: 35).

¹¹⁸ West (2013). At least ██████████ truthfully admitted to Denise Brailey that it was the lenders, not the brokers, running the mortgage control fraud: "Yes Denise, there is no doubt the banks are the engineers".

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nor want with the obvious intent of extracting the maximum amount of interest possible. Unlike nominal mortgage interest rates which have fallen steadily since the peak in 1990, credit cards today still attract interest rates of around 20 per cent and are often issued with considerable limits of \$20,000 to \$30,000 with large penalty fees and rates. It is not unheard of for BFCSA members to have maxed out up to ten credit cards to make repayments on the multiple buffer loans issued to 'assist' them with making repayments on multiple jumbo interest-only mortgages. This has resulted in a ludicrous maelstrom of fraud, predatory lending, Ponzi finance, unserviceability and usury, causing financial devastation and eventual bankruptcy. This, in turn, has led to a cesspit of social destruction: homelessness, poverty, divorce, hopelessness, family breakdown, self-harm, mental illness and suicide.

The primary difference between US and Australian subprime predatory lending is the former tended to target NINJAs (no income, no job and no assets), while Australian lenders have and continue to target ARIPs: people who had equity in their home and were debt-free, mostly pensioners and families on low to moderate incomes. Borrowers were provided with buffer loans to mask unaffordability issues for the first several years. Regulators have failed to prevent these disgraceful and abhorrent activities due to negligible oversight and lack of enforcement actions.

Government agencies, regulators and EDRs (ASIC, APRA, ATO, AFP, RBA, Treasury, FOS and COSL) have extensive political, economic and legal powers to investigate the FIRE sector, even if the area under investigation is not in their direct jurisdiction. Executive public employees with taxpayer-funded salaries of over half a million dollars could wield their immense power and influence to carry out an extensive analysis of the control frauds, but none appear willing to tackle the FIRE sector heavyweights. The failure to conduct an investigation to date leads one to question why these organisations are funded, if serious allegations of white-collar crime, backed by thousands of evidentiary documents, are not taken seriously. Given how corrupt the FIRE sector regulatory apparatus is in Australia, it is remarkable they have not yet lobbied legislators to redefine presently criminal actions as legal, which would be the ultimate victory for control frauds.¹¹⁹

When regulators eventually take action, they inevitably target low-ranking 'fall guys' and 'dupes' to be thrown under the bus, figuratively speaking, for minor violations of the law, who tend to be

¹¹⁹ Black (2010: 6).

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sellers within the broker chain. Those in the corporate boardrooms who have masterminded the control frauds are ignored and allowed to continue 'business as usual'. This should come as no surprise, as "accounting control fraud inherently poses a far lower risk of prosecution for a CEO than does embezzlement while providing greater gains in income and status."¹²⁰ ASIC's course of action has been mirrored in the United States, where prosecutors have targeted small-time fraudsters, while either avoiding, or enforcing pitiful settlements against the worst control frauds; often worth a fraction of the original proceeds of crimes committed.¹²¹ Critically, rank and file employees should not be held responsible, given it is impossible for firms to remain so thoroughly corrupt without the active support of executives and managers, who subvert internal and external underwriting controls to facilitate predatory lending.¹²²

Financialisation of the economy has granted immense political and economic power to the FIRE sector in direct proportion to their growing share of economic activity.¹²³ Regulatory capture has led to government-appointed guardians playing the role of impotent patsies, refusing to take substantive action against these offenders, even when abuses are flagrant. The world over, regulators with considerable political, economic and legal power have either sidestepped or directly refused to investigate the FIRE sector. This non-committal stance may relate to public executives sharing a value system more closely aligned with the wealthy and powerful elite than the common people they are supposed to protect.

While the fallout from control fraud has hurt those at the margins, it has not yet led to observable macroeconomic effects across Australia; thus, the attitude among regulators is to not 'rock the boat' and let business continue as usual. Australia's credit-based banking system, liberated from responsibility by privatisation, deregulation, self-regulation, desupervision and de facto decriminalisation, has and will inevitably continue to generate toxic and recurring control frauds. The FIRE sector cannot be allowed to profit from the control frauds they run. Government has a

¹²⁰ Black (2010: 4).

¹²¹ Taibbi (2014).

¹²² Black (2010: 18-21).

¹²³ ALP Senator Sam Dastyari has claimed ten corporations have taken control of Australian politics, stifling democracy and economic progress: all of the Big Four banks are named (Hutchens 2016).

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civic obligation to prosecute those who perform criminal acts on innocent parties; we know this as the rule of law.

The numerous control frauds will be catastrophic for investors, borrowers and the public if the FIRE sector is not investigated immediately via a Royal Commission, with the widest terms of reference available. If the government is serious about cleansing the FIRE sector to restore confidence and trust, reregulation is imperative. As Black recommends, “Regulatory enforcement is often the quickest way to ensure that cheaters lose.”¹²⁴ Unfortunately, the reason why such an investigation has not yet been undertaken is precisely because it would reveal an infestation of control fraud in operation, especially in the mortgage market, obliging the supervising authorities to suppress criminal activities, and ending the housing bubble forthwith.

This decision may come back to haunt regulators if the extent of fraud poses future danger to the financial system. Indeed, some senators have expressed alarm about alleged systemic fraud and are calling for a Royal Commission to investigate the actions of lenders and brokers.¹²⁵ Political and regulatory reticence to act on allegations of widespread lending fraud is a scathing indictment on the state of modern democracy in Australia. The creeping plutonomy is further leveraging its political influence to cement an ‘untouchables’ status that pardons criminal activity. This must be put to an end.

¹²⁴ Black (2010: 27).

¹²⁵ Klan (2012f). Some politicians from the Green and National parties have shown an inclination towards initiating Parliamentary inquiries and supporting a Royal Commission into the FIRE sector but both the Liberal and Labor parties are resolutely opposed.

Section 4: Recommendations

LF Economics supports, and the BFCSA has advocated for many years, numerous recommendations for FIRE sector reform to prevent the recurrence and growth of control frauds, enhancing protections for the public. It is hoped that the committee takes these recommendations seriously.

4.1 Penalties and Fines

4.1.1 Private Sector Executives and Financial Institutions

1. The temporary suspension of a lending institution's loan license for 1 to 3 months if found guilty of control fraud.
2. Custodial sentence terms and fines for control fraud should be measured on a case-by case basis. For instance, a one year imprisonment term for executives including a \$1 million dollar fine imposed against the financial institution for every single offence or infringement with a maximum term of 25 years.
3. Temporary suspension of operating licenses of three to six months for credit rating agencies providing artificially high ratings to financial products not backed by the available evidence. For instance, granting an investment-grade AAA rating to a RMBS which has a high proportion of subprime loans and/or mortgages affected by control fraud. The suggested penalty should comprise a \$1 million dollar fine per rating per financial product where the agency cannot reasonably provide a sound justification.
4. Mandatory prison sentences for executives and senior managers who were either directing the control fraud or were aware of control fraud occurring but refused to alert the appropriate authorities.
5. Leniency should be granted with respect to penalties applied to an executive or manager who admits directing a control fraud, whether it is to law enforcement, regulators or the mass media.

4.1.2 Public Executives

1. Mandatory ten year prison sentences for public executives in relevant legal, economic and regulatory departments where it can be proven:
 - a. They intentionally did not enforce the rule of law in regards to control fraud.
 - b. Prevented public servants from investigating and prosecuting instances of control fraud.
2. Mandatory five year prison sentences for public executives in relevant legal, economic and regulatory departments where it can be proven:
 - a. They were aware of control fraud and failed to warn the public and other appropriate authorities.
 - b. Prevented public servants from airing concerns about control fraud.
 - c. Threatened staff against whistle-blowing.

4.1.3 Recovery

1. Where it can be proven a borrower's loan was approved on the basis of fraud:
 - a. The entirety of the loan should be extinguished.
 - b. The borrower is provided compensation equal to the fraudulent loan's value by the issuing financial institution.
2. Wholesale lenders, purchasers of lender RMBS and depositors recover the difference between the current and potential interest payments due to financial products not reflecting actual market risks plus damages.

4.1.4 Prevention

1. The RBA should immediately revoke access to the Committed Liquidity Facility (CLF) in the event of a financial crisis until a Royal Commission is held into the FIRE sector.
2. Bank and non-bank lending institutions facing bankruptcy should be nationalised:
 - a. To prevent the occurrence of moral hazard and reduce the incidence of control fraud.
 - b. To ensure those who committed control fraud do not benefit from government interventions, for instance, the CLF and wholesale funding guarantees.

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3. Expand education and awareness about the threats posed by control fraud. In Australia, there are only several people who appear to understand the issues at hand. The federal and state/territory public sectors need to fund the expansion of expertise in identifying and prosecuting control fraud, reducing the need for agents in the private sector to engage in potential career suicide and risking adverse social effects from whistle-blowing.
4. A comprehensive range of macro-prudential tools should be implemented to subdue credit growth in a pro-cyclical financial system, particularly those affecting the loan to value (LVR), debt servicing (DSR) and debt servicing to income (DSTI) ratios.¹²⁶ Quantitative restrictions are placed on the share of new mortgages with moderately high LVRs (60 to 79 per cent), and significantly strengthened for mortgages with an LVR of 80 to 89 per cent. Mortgages with an LVR of 90 per cent and above, interest-only loans, parental guarantees and parental co-borrowing should be disallowed. Mortgage debt is capped at a multiple of ten times the imputed or actual annual rental income of the property being purchased to prevent a positive feedback loop forming between rising housing prices and debt.¹²⁷ The '30-10-30 Plan' should be a future policy consideration following a severe downturn in the housing market. This policy enforces a deposit of 30% (a maximum LVR of 70%), lenders are required to hold the equivalent of ten months of mortgage payments that is earned by the borrower as a buffer during difficult times or becomes the last instalment at the end of the mortgage, and mortgage debt payments are capped at a maximum of 30% of household disposable income.¹²⁸ The purpose of these macro-prudential policies is to assist in containing the first element of Black's control fraud framework: extreme loan growth. This helps establish a warning system providing regulators with signals as to which lenders may be engaged in potential control fraud, allowing for prompt action to be undertaken.
5. The development of a new RBA risk assessment framework including a range of macroeconomic, banking, market-priced and qualitative indicators:
 - a. Macroeconomic metrics include the stock and flow of credit to all sectors of the economy (household, non-banking financial, non-financial business, and government sectors), sectoral leverage, associated DSRs and estimations of credit quality.

¹²⁶ Rogers (2013: 16-17).

¹²⁷ Keen (2011: 398-400).

¹²⁸ David (2015).

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- b. Banking sector metrics include capital adequacy as a proportion of total asset value (not RWAs), liquidity ratios, non-performing loan rate, asset quality in high-risk sectors (e.g. residential housing), proportion of high-LVR and interest-only lending, asset concentration on bank balance sheets, and the level of specific provisions for bad debts.
- c. Market-priced metrics include the divergence of asset prices from long-term averages (e.g. P/I and P/R ratios), credit spread between market/deposit and lending rates, proportion of securitised, offshore and short-term wholesale funding, degree of foreign investment, loan to deposit ratios, and the average maturity profile of debt.
- d. Qualitative measures include lending standards and risk appetite, ratio of prime to non-prime/subprime lending, trends in loan control frauds, rapid bank network growth and the intensity of financial sector competition.¹²⁹

¹²⁹ Rogers (2013: 17 - Table 2).

4.2 General

1. The establishment of a Royal Commission, with the broadest terms of reference to capture all actors and beneficiaries of control frauds: lenders, insurers, property developers and builders. A Royal Commission is critical to laying the groundwork for genuine consumer protection legislation, particularly since hundreds of thousands of Australians have fallen victim to substantial losses during the past three decades.
2. ASIC's role as consumer protector must come to an end, with preference given to establishing a new and more effective regulator unburdened by a dysfunctional institutional culture.
3. A new Federal Bureau of Consumer Protection should be established, incorporating a Serious Fraud Office, to deal with corruption and white-collar crime.
4. An "Office of the Whistleblower" is established within the new bureau to facilitate anonymous tip-offs.
5. If ASIC is provided with future powers to broadly monitor meta-data under the proposed enforcement regime, then special monitoring of mortgage lending processes is warranted, including all contacts with the seller channel, promotional agents, appraisers, contract lawyers and insurers.
6. Consumers require mandatory notices detailing Australia's weak consumer protection legislation and feeble regulatory apparatus, which notes that regulators rarely assist victims of predatory finance, leaving them stranded to pursue costly and time-consuming action through the legal system.
7. Government must recognise the entrenched conflicts of interest between financial product manufacturers, promoters and sellers.
8. In place of corporate secondments to ASIC, it is preferable to have persons with requisite legal or investment banking experience join the Australian Public Service, and then be bound by associated codes of conduct and fiduciary duty to the Australian public in their daily activities as an ASIC employee.
9. Hidden secondments to ASIC from the FIRE sector must cease. All secondments must be disclosed in an annual report, detailing the staff member(s) involved, their parent institution, the period of time engaged, the ASIC division in which they were placed, and their alleged area of expertise that is considered essential. ASIC must develop an explicit conflict of interest

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policy to prevent industry representatives' direct involvement in decision-making that may influence their employer's financial prospects.

10. Financial advisers must immediately be limited to 'general advice' and be named as 'sellers' of financial products to provide clarity to consumers.
11. All sellers must be licensed and referred to as such by name, with a clear notification of whom the agents are acting for.
12. All 'financial strategies' and 'cash flow charts' are removed from the sales process, as they generate unrealistic projections of future incomes.
13. Consumers need to be warned that markets have been flooded with inappropriate investment offers. Public awareness should be raised regarding rampant and unchecked control frauds, unsafe mortgage loans, and other unregulated activities that radically increase the risk threshold for investors.
14. Any financial products and/or strategies sold through marketing seminars must be in writing, presented prior to signing and with a forty-eight hour 'cooling-off' period to permit the borrower to understand their circumstances properly, without pressure.
15. The argument of agency cannot be circumvented by lawyers of financial product manufacturers; consumer protection is paramount (see *Schmidt 2010 Vic Sup Ct*).
16. Misleading codes of conducts that are not actually applied in practice should be banned (see S25.1 of the Bankers' Code regarding prudent lending affordability).
17. All lenders must sign a 'clean loan policy' agreement as the Code of Banking Practice is grossly ineffective and therefore regularly ignored by its members and the FOS.
18. The Financial Ombudsman's Service and the Credit Ombudsman's Service should be the subject of a dedicated public inquiry with a view to investigating the extraordinary consumer dissatisfaction with outcomes, resulting in the abandonment of such services in the best interests of consumers.

4.3 Subprime Mortgages

1. All documentation relating to all mortgages, whether no-, low- or full-doc loans, should be released to borrowers. While this directive is in force, no document should be classified as 'commercially sensitive'.
2. To minimise the opportunity for fraud, forgery and further alterations, all mortgage borrowers must be given a copy of the LAF, the attached Service Calculator Form and Worksheet, at the point of signing.
3. Every borrower must be given a copy of the entire loan application form at the point of signing (not just the usual three pages).
4. Every applicant must be permitted to fill in their own LAF in their handwriting. Should another person's handwriting appear during processing then the LAF must immediately be sent back to the client for verification.
5. Just prior to settlement, a second copy of the eleven-page LAF must be sent to the borrower with a warning to check all details contained therein. When sent to borrowers, this document must not be hidden in a sizeable mortgage contract bundle.
6. Borrowers must be warned (preferably using a large font) to seek independent legal advice prior to signing contracts with any lenders.
7. Borrowers must be given the right to withdraw the LAF should it show discrepancies.
8. The service calculator engineered by lenders should be outlawed. It is not acceptable to use these calculators to exaggerate incomes without the knowledge of the borrower.
9. The 2005 ASIC exemption Class Order 1122/05 must be revoked immediately.
10. Income must be verified on all loans with suitable evidentiary documents.
11. Lenders generating LAFs for approval via online platforms must send a copy to borrowers by email or post immediately prior to settlement. Borrowers should have three working days to check there are no discrepancies or additional details adverse to their interests.
12. Automatic penalties must be implemented for lenders who approve loans in an illegal manner and/or fail to look after the borrower's best interests. This should also result in the complete extinguishment of the loan under a 'clean loan policy'.

4.4 Debenture-Funded Investments and Other Hybrid Securities

1. A mandatory warning is provided to all consumers who invest with firms funded via debentures: you may lose the entirety of your capital.
2. All investors must be given a chance to redeem their capital immediately, due to the concerns of misleading and deceptive conduct, predatory lending and the formation of Ponzi structures tied to control frauds.
3. The promoter must declare which lender is involved in the facilitation of the project.
4. The directors must declare their own share of investment funds directly from their own accounts and not hidden in complex trusts.
5. Potential customers are advised to seek independent legal advice as to the content of the product on offer and given a forty-eight hour cooling-off period to allow for additional research.
6. An auditor's report must be provided to each potential client to assess the risk level of projects not yet begun.
7. ASIC should establish a team of investigative experts to handle the reading of any public offers raising funds from debentures, as they did pre-1999 and prior to being released to the public.
8. Penalties, such as automatic life-long bans for directors, senior managers and/or associated directors are imposed when significant losses are experienced by investors.
9. Spruiking and advertising for toxic financial products should be banned.
10. More stringent penalties are required when control frauds target older persons who are unable to recover from financial ruin.

Section 5: Conclusion

The government and public have been subject to a false and misleading view of the FIRE sector that is overly focused on its continued expansion as a profit centre to be maximised rather than a cost centre to be minimised. The 'big end of town', particularly the Big Four banks, are dictating political views, legislative processes and policy directions, made possible by the swarm of lobbyists paid out of record-breaking profits generated by massive private sector indebtedness. The evidence of losses, the constant barrage of consumer grievances, a steady stream of complaints against ASIC, the regulator's favouritism of the engineers and lenders' undue influence over the ombudsmen services should give the committee pause when considering future recommendations to stem control frauds. Victims repeatedly express that a Royal Commission will let them tell their stories and assist in uncovering mountains of evidence of foul criminality in the FIRE sector.

Australians have been betrayed by the regulatory agencies' neglect and continual siding with lenders and corporate management, despite their full knowledge of the catastrophic pain endured by many who have lost their homes, assets and life savings. The committee should take note of the immense suffering of victims. A strict focus on rules, regulations, standards, codes and penalties will have a negligible effect on control frauds because these crimes are simply ignored in reality. Two decades of fruitless inquiries and tweaking of innumerable rules and regulations has merely contributed to the losses endured by typical 'mum and dad' investors, now into many tens (perhaps hundreds) of billions of dollars. The nation already has an abundance of appropriate laws and regulations to contain and dismantle these control frauds, yet regulators are averse to enforcement, rendering these powers null and void. Australia's record household sector indebtedness and associated mortgage control fraud risks bringing the FIRE sector down and seriously impairing the economy.

This inquiry should not be limited to yet another narrow probe into the FIRE sector. The evidence strongly suggests that control frauds are currently in operation, with the FIRE sector actively seeking new targets to raid. An extensive analysis of the evidence is contained in the body and appendices of this submission. For government to effectively uncover the full extent of control frauds and begin cleansing a patently corrupt FIRE sector, a Royal Commission is necessary. LF Economics urges the committee to strongly recommend this course of action.

Appendix A: Fraudulently Altered Loan Application Forms

A.1: Introduction

As evidence of control fraud, specifically declining underwriting standards, a couple of loan application forms (LAFs) are shown in this appendix. They were selected from an online archive called Evernote, established by Denise Brailey and the BFCSA, having published many LAFs demonstrating fraud. For the sake of space and conciseness, only two LAFs are shown. Those who are interested in viewing more of these LAFs can access the archive through the BFCSA website.

The first is from one of the Big Four banks, Westpac, and the second is from a smaller lender, Adelaide Bank. The LAFs have been 'sanitised' in that personal and unnecessary financial details have been redacted to ensure privacy of the borrowers. Both LAFs are adjoined with a one page summary of the alterations implemented by the lenders behind the scenes. The list of discrepancies have been written by the borrowers themselves, not Brailey or the BFCSA, as only the borrowers know their true circumstances and can thus identify the fraudulent alterations.

Credit assessors and bank officers have illegally altered borrower details by falsely inflating the value of assets and incomes to 'justify' issuing much larger mortgages than would otherwise be the case. It is important to note two details. The first is that it is the lenders, not the brokers, who are involved in illegally altering the LAFs. Brokers are unwittingly engaged in control fraud as lenders coerce them into using the 'serviceability' or 'amortisation' calculators as covered above. Brailey has many emails leaked from the broker chain demonstrating lenders will not do business with brokers unless this calculator is used to fudge the borrowers' details.

Secondly, these are not 'liar loans' where borrowers have knowingly and illegally falsified their details to secure a larger mortgage on preferential terms. Brailey has never come across a liar's loan; claiming this to be the case is a strategy employed by lenders to falsely place blame upon the borrowers. It is only after borrowers experience financial difficulty and make contact with the BFCSA do they learn to obtain the lenders' copy of the LAFs and then realise the alterations that were made to facilitate control fraud in order to bankrupt them and seize their assets.

A.2: Westpac LAF

DISCREPANCIES.

- + PREDOMINANTLY. INVESTMENT. - INCORRECT.
(OWN HOME.)
- + CURRENT OCCUPATION - INCORRECT.
- + SHARES. - INCORRECT. (NIL SHARES OWNED).
- + MOTOR VEHICLE - OVER INFLATED BY \$10K.
- * PERSONAL EFFECTS. - OVER INFLATED BY \$100K.
- MONTHLY INCOME - EXAGGERATED. BY. \$14500.
- RENTAL INCOME " BY. \$3456.
- ANNUAL GROSS INCOME " BY. \$28,000
- OCCUPANCY. - INCORRECT.
HOME WAS OWNER OCCUPIED.
- VALUATION - INCORRECT. INFLATED BY \$25,000



Westpac Banking Corporation
ABN 33 007 457 141

Personal Finance Application

Before you sign this form please read the section titled Protection of Your Privacy Declarations & Authority shown in the Acknowledgements and Consents section.

This loan application is made to Westpac Banking Corporation (the "Lender")
The predominant purpose (i.e. more than 50%) of the loan is for the following:

Predominantly investment

1

Office use -
Application No

Loan Purpose (specify what you will use the funds for)
1. Other

Total Amount
\$861,000.00

Your Personal Details

Applicant			Co-Applicant		
Title Mr			Title		
Family Name			Family Name		
First Name			First Name		
Middle Names			Middle Names		
Sex Male	Date of Birth		Sex	Date of Birth	
Marital Status Single	No. of dependants (excl. spouse) 0		Marital Status	No. of dependants (excl. spouse)	
Driver's licence no.	Expiry Date		Driver's licence no.	Expiry Date	
Westpac Customer? Yes	If yes, since when?	First home buyer? No	Westpac Customer?	If yes, since when?	First home buyer?

Your current home address:

Your current home address:

Time there
From: [redacted]
Home phone number
Resident of (if not Australia)

Time there
From: [redacted]
Home phone number
Resident of (if not Australia)

Previous address (if current less than three years)

Previous address (if current less than three years)

Time there
From: [redacted]
To: [redacted]

Time there
From: [redacted]
To: [redacted]

For Westpac employee applications only	Office Use
	Applicant ID no. [redacted]
Applicant Salary no.	

For Westpac employee applications only	Office Use
	Applicant ID no. (IDV) [redacted]
Applicant Salary no.	

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Other Details

Applicant		Co-Applicant	
Mailing Address Same as current address		Mailing Address	
Housing Status Mortgage / Buy		Housing Status	
Landlord Name (if applicable)	Landlord Phone	Landlord Name (if applicable)	Landlord Phone

Your Employment Details

Applicant		Co-Applicant	
Current Occupation Property - advisor / investment manager		Current Occupation	
Type of Employment <small>eg. Full time, part time, retiral, temporary etc.</small>		Type of Employment <small>eg. Full time, part time, retiral, temporary etc.</small>	
Full Time	Self Employed? Yes	Full Time	Self Employed?
Name and Address of current employer <small>(or accountant if self employed)</small>		Name and Address of current employer <small>(or accountant if self employed)</small>	
SELF EMPLOYED			
Time there From:	Work phone number	Time there From:	Work phone number
PREVIOUS EMPLOYMENT DETAILS <i>Previous occupation</i>		PREVIOUS EMPLOYMENT DETAILS <i>Previous occupation</i>	
Self Employed?	Type of Employment	Self Employed?	Type of Employment
Employer's name		Employer's name	
Phone	Time there From: To:	Phone	Time there From: To:

Office Use		Applicant		Verification of Employment/Income		Co-Applicant	
<input type="checkbox"/> A New Customer	<input type="checkbox"/> B Existing Deposit Account Holder	<input type="checkbox"/> C Existing borrower	<input type="checkbox"/> A New Customer	<input type="checkbox"/> B Existing Deposit Account Holder	<input type="checkbox"/> C Existing borrower		
Name & Salary no.	<input type="text"/>	Verifying Officer's Signature	<input type="text"/>	Date	<input type="text"/>		

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Your Financial Position - Assets (what you own)

		Primary Applicant (includes Joint assets)	Total of all Other Applicant assets
Property assets	Total Market Value		
Total value of Property Assets:	\$2,850,000	\$2,850,000	\$0
Cash/Bank Accounts	Total value of Cash/Bank Accounts:	\$3,500	\$0
Shares/Unit Trusts/Bonds/Debentures (cash value only)		\$85,000	██████████ \$0
Life Assurance/Superannuation (cash value only)		\$0	\$0
Motor Vehicles (market value)		\$35,000	\$0
Furniture, Personal Effects and Other (market value)		\$150,000	██████████ \$0
Total Assets		\$3,123,500	██████████ \$0

Income

		Primary Applicant Income	Total of all Other Applicants Income
Monthly Net Income (after tax)	Base monthly income (net)	\$14,500	██████████ \$0
	Overtime/Bonuses	\$0	\$0
	Social Security Benefits/Pensions	\$0	\$0
	Annuities/Superannuation	\$0	\$0
	Total Rental Properties Income	\$3,466	██████████ \$0
	Rental Income - Property being purchased (if applicable)	\$0	\$0
	Interest	\$0	██████████ \$0
	Other Income	\$0	\$0
	Sub-Totals	\$17,966	██████████ \$0
Total Monthly Net Income (Applicant + Co-Applicant)		\$17,966	
		Primary Applicant	Total of all Other Applicants
Annual gross income (before tax)		\$288,000	██████████ \$0

Your Financial Position - Liabilities (what you owe)

	Total Monthly Payment	Primary Applicant Liabilities	Total of all Other Applicants Liabilities
Total Property related liabilities secured against assets	\$3,276	\$1,413,000	██████████ \$0
Other instalment loans (eg. personal loans, leasing)	\$0	\$0	\$0
Lines of credit (eg. overdraft, credit cards, store cards)	\$148	\$5,001	\$0
Other liabilities (eg. taxation etc)	\$0	\$0	\$0
Total Liabilities		\$1,418,001	\$0
Other monthly payments		Primary Applicant Monthly Payment	Total of all Other Applicants Monthly Payment
Description			
Rent/Board (which you will continue to pay after drawing this loan)		\$0	\$0
Other		\$0	\$0

494-1531679-35

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Details of Property to be Mortgaged (if available)

First Property

Address Details



Type of title
Freehold

Property Type (house, villa, vacant land etc)
House (Detached)

Occupancy
Non-Owner Occupied

Year Built Dwelling Area Area of Land

Estimated Market Value Purchase/contract price
\$1,075,000.00 \$0.00

Name of State/Territory where you will sign the mortgage

HOUSE/BUILDING INSURANCE POLICY DETAILS (IF KNOWN)

Company

Policy no.

Expiry date Annual Premium Insured Amount

Name & address

Solicitor/Conveyancer details (if applicable)

Phone

Fax

Second Property

Address Details

Type of title

Property Type (house, villa, vacant land etc)

Occupancy

Year Built Dwelling Area Area of Land

Estimated Market Value Purchase/contract price

Name of State/Territory where you will sign the mortgage

HOUSE/BUILDING INSURANCE POLICY DETAILS (IF KNOWN)

Company

Policy no.

Expiry date Annual Premium Insured Amount

Other Security

You have provided details of other security? No

Existing Security
Yes

Office use only

Charge Position
First

Nature
Residential

Instrument
Mortgage over freehold Property

Existing Security

Office use only

Charge Position

Nature

Instrument

ACKNOWLEDGEMENTS AND CONSENTS

ANTI-MONEY LAUNDERING AND COUNTER-TERRORISM FINANCING ACT 2006 REQUIREMENTS - ALL PEOPLE

I state that the account(s) will be held in the name(s) of a person(s) and will not be held in trust.

Are you or any of the co-applicants known by any other name?

Yes No

If yes, give details of other name(s)

Note: It is an offence under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 to give false or misleading information.

PROTECTION OF YOUR PRIVACY DECLARATIONS & AUTHORITY

PERSONAL INFORMATION

I agree that Westpac Banking Corporation and any other member of the Westpac Group (the "Lender") may exchange with each other any information about me including:

- any information provided by me in this document;
- any other personal information I provide to any of them or which they otherwise lawfully obtain about me; and

transaction details or transaction history arising out of my arrangements with Westpac Banking Corporation.

If the Lender engages anyone (a "Service Provider") to do something on their behalf (for example a mailing house or a data processor) then I agree the Lender and the Service Provider may exchange with each other any information referred to above.

Westpac Banking Corporation might give any information referred to above to entities other than the Lender and the Service Providers where it is required or allowed by law or where I have otherwise consented (this includes the consents I have provided below).

I agree that any information referred to above can be used by the Lender and any Service Provider to assess my application for the products I have selected, to administer and market the Altitude rewards program or other relevant programs relating to any credit card products I have selected, and for account administration, planning, product development and research purposes.

484-1531879-05

5

I understand that I can access most personal information that the Lender holds about me (sometimes there will be a reason why this is not possible, in which case I will be told why).

I understand that if I fail to provide any information requested in this form, or do not agree to any of the possible exchanges or uses detailed above, my application may not be accepted by Westpac Banking Corporation.

To find out what sort of personal information the Lender has about you, or to make a request for access, please contact: 132032.

The Westpac Group means Westpac Banking Corporation and its related bodies corporate.

CREDIT INFORMATION

The Lender means Westpac Banking Corporation, any manager, any servicing company or any authorised agent of the Lender who for the purposes of the Privacy Act is a credit provider.

Notice that credit information may be given to a credit reporting agency

The Privacy Act (1988) allows the Lender to give a credit reporting agency certain personal information about me which I authorise the Lender to do. This information includes:

- my identification;
- that credit has been applied for and the amount;
- that the Lender is a current credit provider to me;
- details of payments which become overdue for more than 60 days and for which collection action has commenced;
- that payments are no longer overdue;
- details of cheques drawn by me which have been dishonoured more than once;
- that in the Lender's opinion I have committed a serious credit infringement; and
- that the credit provided to me by the Lender has been paid or discharged.

Authority to obtain certain credit information

To enable the Lender to assess my application for personal or commercial credit I authorise the Lender to obtain:

- from a credit reporting agency, a credit report containing personal or commercial information about me in relation to personal or commercial credit provided to me; and
- from a business which provides information about the commercial creditworthiness of persons, information about my commercial activities or commercial creditworthiness.

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PF001

Authority to exchange credit information with other credit providers

I authorise the Lender to give to and obtain from other credit providers named either in this application or in a credit report issued by a credit reporting agency any information about my credit worthiness, credit standing, credit history or credit capacity.

This information may be used to:

- assess my application for credit and / or my credit worthiness;
- assist me to avoid defaulting on my credit obligations; and
- notify other credit providers of a default by me.

Authority to disclose certain information to joint applicants

I understand that if the Lender declines my credit application due to adverse information on my personal credit file, then each applicant for the credit may be notified that the application has been declined wholly or partly on information derived from a personal credit report relating to me.

Authority to exchange credit information for securitisation purposes (if applicable)

I authorise the Lender to give to and obtain from persons involved in securitisation arrangements, any report or information about me in relation to personal or commercial credit provided to me, including any information about my credit worthiness, credit standing, credit history or credit capacity. Securitisation arrangements may include purchasing, funding, managing or processing credit.

Banker's Opinion

I authorise the Lender to give and receive a banker's opinion for purposes connected with my business, trade or profession.

Authority for Mortgage Insurers (if applicable)

Mortgage insurance protects the Lender against any shortfall from a mortgagee sale of the security property. A claim paid under mortgage insurance will be recovered by the mortgage insurer directly from the borrower(s) and/or guarantor(s).

I authorise a mortgage insurer to obtain my credit report, containing personal or commercial information about me, from a credit reporting agency, and for the Lender to disclose a report or information to a mortgage insurer:

- to assess whether to insure;
- to assess the risk of insuring the Lender and the risk of default by me of the mortgage credit given to me;
- for any other purpose in connection with the contract of mortgage insurance between the Lender and the mortgage insurer.

In connection with my application for mortgage finance insurance, I acknowledge that the Lender may provide personal information about me to mortgage insurance companies. Should I wish to obtain details of the identity of these organisations and how to contact them, the Lender will provide me with such details.

I acknowledge that my personal information is collected by these organisations for the purposes set out above, as well as any variation or claim under the insurance policy and other risk, internal management and compliance purposes. In this respect, these organisations may disclose your personal information to their related companies, service providers and advisers, credit reporting agencies, reinsurers and government and regulatory bodies.

If my personal information is not provided to these organisations, I acknowledge that the Lender may not be in a position to provide the mortgage finance requested.

OTHER ACKNOWLEDGEMENTS AND CONSENTS

I confirm that the information contained in this application and the financial information supporting it are in all respects complete and correct. I acknowledge that the Lender will rely on this information when making its decision.

I acknowledge that the Lender has the right to confirm the details of the information provided in this application.

I acknowledge that this application form is not to be regarded as an offer or acceptance of credit under any legislation relating to the provision of credit. The information I have provided in this form will not become part of any contract for credit which may come into existence between me and the Lender.

I authorise the Lender to use this application to assess and approve products which I have selected.

I understand that only the Lender can decide whether this application is approved and that any person who may have introduced me to the Lender has no authority to give that approval.

I consent to the Lender giving to any guarantor(s) or indemnitor(s) all information, including credit reports and copies of documents, which the Lender sees fit concerning me, the credit provided to me and any security.

I consent to the Lender exchanging information concerning my financial affairs with any person acting on my behalf, including my agent, accountant, solicitor or broker.

DIRECT MARKETING

Members of the Westpac Group would like to be able to contact you or send you information regarding other products and services. Your terms and conditions document will explain what action to take should you not wish to receive this information.

CREDIT CARD ACKNOWLEDGEMENTS AND CONSENTS

For Altitude Gold, Earth Gold & 55 Day Gold Credit Cards:

I acknowledge that the minimum credit limit for an Altitude Gold, Earth Gold and 55 Day Gold credit card is \$5,000. If upon assessment I am only eligible for a limit less than the minimum, I authorise the Lender to consider me for an Altitude, Earth or a 55 Day credit card, as the case may be.

For Altitude Platinum, Earth Platinum & 55 Day Platinum:

I acknowledge that the minimum credit limit for Altitude Platinum, Earth Platinum and 55 Day Platinum is \$8,000. If upon assessment I am only eligible for a limit less than the minimum, I authorise the Lender to consider me for an Altitude Gold or Altitude credit card, Earth Gold or Earth credit card, 55 Day Gold or 55 Day credit card as the case may be.

If I have applied for Altitude or Altitude Gold and my application is approved, I agree to abide by the Altitude Rewards Terms and Conditions and the Consumer Credit Card Conditions of Use.

If I have applied for an Altitude Platinum and my application is approved, I agree to abide by the Altitude Platinum Rewards Terms and Conditions and the Altitude Platinum Conditions of Use.

If I have applied for Earth or Earth Gold and my application is approved, I agree to abide by the Earth Conditions of Use.

If I have applied for Earth Platinum and my application is approved, I agree to abide by the Earth Platinum Conditions of Use.

If I have applied for a Low Rate MasterCard, Low Rate Visa card, No Annual Fee MasterCard, 55 Day MasterCard, 55 Day Visa card, 55 Day Gold MasterCard, 55 Day Gold Visa card or 55 Day Platinum Visa card, I agree to abide by the Consumer Credit Cards Conditions of Use.

NOMINATION OF APPLICANT TO RECEIVE NOTICES

All applicants MUST reside at the same address

I/We nominate: (specify the full name of nominee)

to receive notices and other documents on behalf of me/all of us.

I/We acknowledge that any of us has the right to cancel his/her nomination by advising the Lender in writing at any time.

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SIGN HERE - ALL PEOPLE

BY SIGNING BELOW:

- (a) I/we acknowledge that I/we have read and understand each section of this application form;
- (b) I/we agree to and give each of the authorities, consents, acknowledgements and confirmations set out in;
 - the "Employer's Authority to disclose salary and employment details" on page 8; and
 - the section titled "Declarations and Authorities" on pages 5 - 6; and
- (c) If a name is completed in the section opposite "Nomination of Applicant to Receive Notices" I/we also make the nomination set out opposite.

Signature/s

Signature 

Date



ACKNOWLEDGEMENTS AND CONSENTS (cont.)

Employer's Authority to disclose salary and employment details to the Lender

- I authorise my employer to disclose any salary and employment details to the Lender to assist in the assessment of this application.
- I authorise the Lender to provide a copy of this authority to my employer and any co-applicant's employer (if they ask for details of the Lender's authority to obtain that information) but not any other part of the accompanying credit application.

Signature/s

Name of Applicant

[Redacted]

Signature

[Redacted]

Date

[Redacted]

PROVISION OF CREDIT - PURPOSE DECLARATION

I/We declare that the credit to be provided to me/us by Westpac Banking Corporation is to be applied wholly or predominantly for business or investment purposes (or for both purposes).

IMPORTANT

You should **not** sign this declaration unless this loan is wholly or predominantly for business or investment purposes.

By signing this declaration you may lose your protection under the Consumer Credit Code.

Signature of [REDACTED]

Date:

HOW CAN WE HELP YOU?

NAME: PHONE:

ADDRESS:

Personal Transaction/Savings Account

- | | Applicant Only | Joint |
|---|-----------------------|-----------------------|
| <input type="radio"/> Westpac Choice | <input type="radio"/> | <input type="radio"/> |
| <input type="radio"/> Westpac eChoice | <input type="radio"/> | <input type="radio"/> |
| <input type="radio"/> Classic Plus | <input type="radio"/> | <input type="radio"/> |
| <input type="radio"/> Westpac Reward Saver | <input type="radio"/> | <input type="radio"/> |
| <input type="radio"/> Other, specify type of account
..... | <input type="radio"/> | <input type="radio"/> |

Credit Card *Primary Applicant Only*

- | | |
|---|---|
| <input type="radio"/> Low Rate MasterCard | <input type="radio"/> Low Rate Visa |
| <input type="radio"/> 55 Day MasterCard | <input type="radio"/> 55 Day Visa |
| <input type="radio"/> 55 Day Gold MasterCard | <input type="radio"/> 55 Day Gold Visa |
| <input type="radio"/> No Annual Fee MasterCard | <input type="radio"/> 55 Day Platinum Visa |
| <input type="radio"/> Earth MasterCard and American Express | <input type="radio"/> Altitude Platinum Visa and American Express |
| <input type="radio"/> Earth Gold MasterCard and American Express | |
| <input type="radio"/> Earth Platinum MasterCard and American Express | |
| <input type="radio"/> Altitude MasterCard and American Express | |
| <input type="radio"/> Altitude Gold MasterCard and American Express | |
| <input type="radio"/> Altitude Platinum MasterCard and American Express | |

For Altitude Gold, Earth Gold & 55 Day Gold Credit Cards:

I acknowledge that the minimum credit limit for an Altitude Gold, Earth Gold and 55 Day Gold credit card is \$5,000. If upon assessment, I am only eligible for a limit less than the minimum, I authorise the Lender to consider me for an Altitude, Earth or 55 Day credit card, as the case may be.

For Altitude Platinum, Earth Platinum & 55 Day Platinum:

I acknowledge that the minimum credit limit for an Altitude Platinum, Earth Platinum and 55 Day Platinum is \$8,000. If upon assessment, I am only eligible for a limit less than the minimum, I authorise the Lender to

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consider me for an Altitude Gold or Altitude credit card, Earth Gold or Earth credit card, 55 Day Gold or 55 Day credit card as the case may be.

If I have applied for Altitude or Altitude Gold and my application is approved, I agree to abide by the Altitude Rewards Terms and Conditions and the Consumer Credit Card Conditions of Use.

If I have applied for an Altitude Platinum and my application is approved, I agree to abide by the Altitude Platinum Rewards Terms and Conditions and the Altitude Platinum Conditions of Use.

If I have applied for Earth or Earth Gold and my application is approved, I agree to abide by the Earth Conditions of Use.

If I have applied for Earth Platinum and my application is approved, I agree to abide by the Earth Platinum Conditions of Use.

If I have applied for a Low Rate MasterCard, Low Rate Visa card, No Annual Fee MasterCard, 55 Day MasterCard, 55 Day Visa card, 55 Day Gold MasterCard, 55 Day Gold Visa card or 55 Day Platinum Visa card, I agree to abide by the Consumer Credit Cards Conditions of Use.

I would like to collect my new credit card from the following Branch

Branch no

Can we help you with any of the following insurances?

- Yes No Landlords Protection
- Yes No Buildings/Contents
- Yes No Mortgage Secure*

Please note that:

- The approval of your loan application may be conditional upon building insurance
- The decision to take out insurance or not will have no bearing on the interest rate offered
- Insurance may be obtained only from an insurer acceptable to the Lender

*You may wish to consider how you will repay your debt if you cannot work for any reason, including death or disability. Mortgage Secure can help repay your loan in the event of death or terminal illness

A.3: Adelaide Bank LAF

- We were not given a copy of the loan document at the time of signing, for our own records..
- Loan was unaffordable at the time
- Repayments were made from savings
- We were expected to service this loan by monthly instalments of \$2590 in addition to paying existing monthly home loan instalments to another Bank of \$3505 making a combined total of \$6095. In our opinion this is “unconscionable” lending as it was totally unaffordable .
- Our combined income amounted to just \$21,000 per annum
- Actual income overstated in loan application. Annual income listed as \$600,000 – absolutely false. If we were earning \$600,000 a year why would we be seeking a loan of \$435,000.
- Bank did not contact us to verify income
- Section 25 of Code of Banking practice not observed
- Latest account statements not requested
- Value of assets overstated eg. Superannuation listed as \$365,000 – false . Superannuation holdings ceased in 2007- This loan was taken out in June 2009 .
- Loan application completed in 3 different types of handwriting . Handwriting is not ours .
- Copy of loan contract obtained from lender is not signed by us. It is unsigned . Therefore in a legal sense the loan is not ours .
- Accountant listed on LAF is not our personal accountant .
- We were listed as self-employed . – false - We were unemployed
- We were not employed by The Family Trust as listed . – absolutely false .
- Occupation listed as Investor and Consultant – absolutely false
- Cash reserves of \$1.26m that the Bank claimed we held was in actual fact a deficit of \$740,000 as it was offset against a loan of \$2,000,000. This was not checked with us by the bank .Further more the cash reserves and loans ceased prior to loan application. Just another false claim by the Bank.
- We were aged 72 and 76 at time of application

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• EMPLOYMENT DETAILS •		
CURRENT EMPLOYMENT	BORROWER 1	BORROWER 2
PRESENT EMPLOYER	FAMILY TRUST	FAMILY TRUST
EMPLOYER ADDRESS		SOUTHBRAT QLD P/CODE
EMPLOYER PHONE	WORK ()	WORK ()
LENGTH OF SERVICE	3 YEARS 2 MONTHS	3 YEARS 2 MONTHS
OCCUPATION	INVESTOR + CONSULTANT	INVESTOR + CONSULTANT
EMPLOYMENT STATUS (Choose one)	<input type="checkbox"/> FULL TIME <input type="checkbox"/> PART TIME <input type="checkbox"/> CONTRACT <input type="checkbox"/> CASUAL <input checked="" type="checkbox"/> SELF EMPLOYED	<input type="checkbox"/> FULL TIME <input type="checkbox"/> PART TIME <input type="checkbox"/> CONTRACT <input type="checkbox"/> CASUAL <input checked="" type="checkbox"/> SELF EMPLOYED
ACCOUNTANT'S NAME AND ADDRESS (Self employed applicants only)	SPECTRUM FINANCIAL	SPECTRUM FINANCIAL
ACCOUNTANT'S PHONE	WORK ()	WORK ()
PREVIOUS EMPLOYER (IF LESS THAN 3 YEARS WITH CURRENT EMPLOYER) OR SECOND JOB (IF ANY): <i>N/A</i>		
EMPLOYER		
EMPLOYER ADDRESS		
EMPLOYER PHONE	WORK ()	WORK ()
LENGTH OF SERVICE	YEARS MONTHS	YEARS MONTHS
OCCUPATION		
EMPLOYMENT STATUS (Choose one)	<input type="checkbox"/> FULL TIME <input type="checkbox"/> PART TIME <input type="checkbox"/> CONTRACT <input type="checkbox"/> CASUAL <input type="checkbox"/> SELF EMPLOYED	<input type="checkbox"/> FULL TIME <input type="checkbox"/> PART TIME <input type="checkbox"/> CONTRACT <input type="checkbox"/> CASUAL <input type="checkbox"/> SELF EMPLOYED
• INCOME DETAILS •		
GROSS INCOME (BEFORE TAX)	BORROWER 1	BORROWER 2
INCOME BASIS QUOTED	<input type="checkbox"/> P.W. <input type="checkbox"/> P.F. <input type="checkbox"/> P.M. <input checked="" type="checkbox"/> P.A.	<input type="checkbox"/> P.W. <input type="checkbox"/> P.F. <input type="checkbox"/> P.M. <input checked="" type="checkbox"/> P.A.
CURRENT EMPLOYER	\$ 300,000	\$ 300,000
SECOND JOB (if any)	\$	\$
CURRENT RENTAL* (if any)	\$	\$
INVESTMENT (if any)	\$	\$
OTHER	\$	\$
TOTAL INCOME	\$ 300,000	\$ 300,000

*Attach more sheets if necessary

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• SECURITY PROPERTIES •			
SECURITY 1		SECURITY 2 - <i>N/A</i>	
ESTIMATED VALUE/ PURCHASE PRICE	\$ <i>800,000</i>	\$	
ADDRESS			
	F/CODE	F/CODE	
TITLE DETAILS	LOT <i>10</i> PLAN <i>RP142885</i>	LOT	PLAN
PROPERTY TYPE	<input type="checkbox"/> HOUSE <input type="checkbox"/> UNIT <input checked="" type="checkbox"/> VACANT LAND	<input type="checkbox"/> HOUSE <input type="checkbox"/> UNIT <input type="checkbox"/> VACANT LAND	
PROPERTY TYPE	<input type="checkbox"/> OWNER OCCUPIED <input checked="" type="checkbox"/> INVESTMENT	<input type="checkbox"/> OWNER OCCUPIED <input type="checkbox"/> INVESTMENT	
LEASE DETAILS (if any)	RENT \$ <i>N/A</i>	RENT \$	
ACCESS FOR VALUER SECURITY 1 & 2	CONTACT <i>N/A - Vacant Land</i>	CONTACT	
	WORK ()	WORK ()	
	MOBILE	MOBILE	
WILL THIS BE YOUR ADDRESS AFTER SETTLEMENT?	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>	
SECURITY 3 - <i>N/A</i>		SECURITY 4 - <i>N/A</i>	
ESTIMATED VALUE/ PURCHASE PRICE	\$	\$	
ADDRESS			
	F/CODE	F/CODE	
TITLE DETAILS	LOT	PLAN	
PROPERTY TYPE	<input type="checkbox"/> HOUSE <input type="checkbox"/> UNIT <input type="checkbox"/> VACANT LAND	<input type="checkbox"/> HOUSE <input type="checkbox"/> UNIT <input type="checkbox"/> VACANT LAND	
PROPERTY TYPE	<input type="checkbox"/> OWNER OCCUPIED <input type="checkbox"/> INVESTMENT	<input type="checkbox"/> OWNER OCCUPIED <input type="checkbox"/> INVESTMENT	
LEASE DETAILS (if any)	RENT \$	RENT \$	
ACCESS FOR VALUER SECURITY 3 & 4	CONTACT	CONTACT	
	WORK ()	WORK ()	
	MOBILE	MOBILE	
WILL THIS BE YOUR ADDRESS AFTER SETTLEMENT?	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>	
YOUR SOLICITOR (if any)	CONTACT <i>SELF ACTING</i>		
<i>N/A</i>	PHONE ()		
	FAX ()		

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ASSETS AND LIABILITIES

Name(s) _____ Date **21/05/09**

Assets		Liabilities	
	Present Value	Limit(s)	Current outstanding
Deposit Account (1)	\$29,500	Home Loan	\$0
Deposit Account (2)	\$75,500	Investment Loan	\$800,000
Other Cash Assets (Share/Bonds)	\$150,000	Overdraft	\$0
Property Assets (list Address & Value)			
Unit	\$700,000		
Land	\$400,000		
Total Property Assets	\$2,400,000		
Total Number of Motor Vehicles	No. 1		
Total Value of Motor Vehicles	\$10,000		
Total Other Assets (eg insured value of contents and valuables, boat etc) - please specify			
Furniture - \$75,000			
Appliance/valuable - \$365,000			
Total Assets (1)	\$3,150,000		
		Total Liabilities (2)	\$800,000
		Total assets (1)	\$3,150,000
		Less Total liabilities (2)	\$800,000
		Net assets (=1-2)	\$2,350,000

Handwritten notes: WILKIE, STGB, Same, Loan, Asset

Income (average monthly)		Expenditure (average monthly)	
	Gross (p.a.)	Net (p.m.)	
Base salary			Credit commitments
Income earner 1	\$300,000	\$15,291	loan repayments for this facility
Income earner 2	\$300,000	\$15,291	loan repayments for other loans
			loan repayments for HPs
			Credit/store cards
Other income			Other commitments
Regular overtime		\$0	Total living expenses
Government benefits/pension		\$0	(Includes: Motor Vehicle, Rates, Electricity, Gas, Telephone, Food, Clothing, Personal, Home Insurance and Education Expenses.)
Part-time/casual employment		\$0	Rent/board
Dividends/interest		\$0	Insurance - contents/medical etc
Commission		\$0	Life/income replacement insurance
Rest received		\$0	Child maintenance
Monthly gross	\$	\$0	Other - please specify
Other - please specify		\$0	
		\$0	
Total net monthly income (3)		\$30,582	Total net monthly expenditure (4)
			Total net monthly income (3)
			\$30,582
			Less Total monthly expenditure (4)
			\$26,533
			Uncommitted monthly income (=3-4)
			\$22,929

Handwritten notes: NET

Declaration of Signature

I/We declare that the details contained within this Personal Statement of Financial Position are true and correct.

Signature	Date	Signature	Date
	21/05/09		21/05/09
Print name		Print name	

SEPARATE STATEMENT OF FINANCIAL POSITION TO BE COMPLETED BY EACH APPLICANT UNLESS MARRIED OR DEFACTO

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COPY

• ADELAIDE BANK AND CHALLENGER LOAN/QUIR DOC DECLARATION OF FINANCIAL POSITION •

This declaration must be completed and signed by ALL borrowers for LoDoc or Quir Doc loan programs

To: **Adelaide Bank a division of Bendigo and Adelaide Bank Limited** (Lender)
Perpetual Trustees Victoria Limited (Lender)
Australian Executor Trustees Limited (AET) (Lender)

1. **Loan Details**

Loan Amount	\$ 480,000	Interest Rate	6.95 %
Maturity Date/Term	30 years	Monthly Repayment (est)	\$ 2,780

The Lender recommends that all applicants seek independent legal and financial advice prior to obtaining a loan.

2. **Borrower Details**

	Borrower (1)	Borrower (2)
Full Name		
Company Name		
Employment Status	<input checked="" type="checkbox"/> Self Employed/Company <input type="checkbox"/> PAYG	<input checked="" type="checkbox"/> Self Employed/Company <input type="checkbox"/> PAYG
ABN or ACN if self employed or a Company	No: Registered: 91,04,3,2006	No: Registered: 01,04,2006
Occupation	GST: <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No INVESTOR	GST: <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No INVESTOR
Industry	PROPERTY + SHARES	PROPERTY + SHARES

3. **Declaration of Financial Position**

I/We certify warrant and represent to you that:

(a) I/We have fully disclosed to the Lender all details of my/our income;
 (b) I am/We are satisfied that my/our obligations to the Lender will not adversely impact on my/our ability to meet all my/our financial obligations (including living expenses) as and when they fall due;
 (c) I/We confirm that I/we can comfortably afford all repayments resulting from this loan without incurring substantial financial hardship; and
 (d) I/We have requested the Lender to assess this facility without the documentary evidence of my/our income.
 (e) I am/We are aware of our financial obligations under our proposed loan with you.

I/We acknowledge that the Lender is relying on this statement in considering whether or not to approve my/our loan application:

Income	Borrower (1)	Borrower (2)
Self Employed: Net Profit Before Tax	\$ 300,000	\$ 300,000
PAYG: Gross Income p.a.	\$	\$
+ Current rent received	\$	\$
+ Parenting Allowance *	\$	\$
Total Taxable Income	\$ 300,000	\$ 300,000
Total Assets	\$ 3,150,000	\$ 3,150,000
Total Liabilities	\$ 800,000	\$ 800,000
Net Assets	\$ 2,350,000	\$ 2,350,000

Signature/s of all borrowers		
Date Declaration signed	21/05/2009	21/05/2009
Witness Name		
Signature/s of all witnesses		
Date Declaration witnessed	21/05/2009	21/05/2009

• A fully completed and signed original must be held on the Mortgage Manager's file.
 • The declarant/s are required to sign any/all alterations made to this form.
 • At the time of application, ABN must be current, registered for GST and have been held for a minimum of two years.
 • If loan is predominantly for business or investment purposes (more than 50% of loan funds are to be used for non-personal purposes), all borrowers must complete a Declaration of Purpose Regulation 16 form.
 • **Prima Facie Loans only** - If you present documentation (which is satisfactory to the Lender) at a later stage, in order to verify income, it will be compared with the income that has been declared (above). This comparison will be used by the Lender in assessing whether you are eligible for a decrease in interest rate. Any rate change will be at the Lender's discretion and subject to the facility being conducted within the loan Terms and Conditions.
 • Supplementary income source in the form of Parenting Allowance for dependants under the age of 13 is acceptable provided you have a primary income type of PAYG or Self employed.

Appendix B: Australian Lenders and Mortgage Control Fraud

The BFCSA has a register of complaints, of which the following Australian bank and non-bank lenders are alleged to have manipulated mortgage loan application forms to intentionally defraud unsuspecting borrowers with the ultimate goal of bankrupting them and seizing their assets. Some of the following lenders may currently have different names than what appeared on the BFCSA register due to closures, mergers and acquisitions.

Table B.1: Australian Bank and Non-Bank Lenders	
Advantagedge	La Trobe Financial
Australia and New Zealand Banking Group	Liberty Financial
Bendigo and Adelaide Bank	Macquarie Bank
Bank of Queensland	National Australia Bank
Banksia Financial Group	RAMS/RHG
Bankwest	Pepper Financial Services Group
Bluestone	Perpetual Trustees Vic
Commonwealth Bank of Australia	Permanent Trustees
Citibank Australia	Provident
Firstmac	St. George Bank
GE Money	Suncorp Bank
Homeside	Westpac Banking Corporation
ING Direct Australia	Wizard Home Loans

Appendix C: History of Control Frauds in Australia

Foreign Currency Loans Scandal

- **When:** 1980s.
- **Control Fraud Participants:** Big Four banks and some minor lenders.
- **Victims:** Non-corporate businesses.
- **What Happened:** The major banks issued loans to non-corporate businesses denominated in foreign currencies, supposedly to benefit borrowers via lower interest rates. Borrowers were herded into these loans, sometimes without their explicit knowledge. They were also poorly advised in relation to the foreign exchange risk – the rise in payments associated with a weakening of the Australian currency – and excessive fees and penalty interest rates imposed for breaching loan covenants. Foreign currency loan liabilities soon spiralled out of control as the Australian dollar weakened against contracted currencies, notably the Swiss franc, the Japanese Yen and the US dollar. In nominal terms, the size of principal and interest payments increased until they were beyond the capacity of businesses to service, causing widespread defaults after business equity and the proceeds of asset sales were exhausted.
- **Losses:** Business insolvencies and personal assets estimated at several billions of dollars.
- **Government/Regulator Action:** None.
- **Macroeconomic Risk:** Low.

Finance Broker Scandal

- **When:** 1992 – 1998.
- **Control Fraud Participants:** Lawyers, brokers, developers, construction firms, accountants and valuers.
- **Victims:** Elderly ‘mum and dad’ investors and self-funded retirees.
- **What Happened:** Hundreds of millions of dollars in funds were solicited via a long chain involving the control fraud participants, particularly from the states of Western Australia and South Australia. Monies were entrusted to state-licensed brokers who invested in high-risk commercial development schemes (developer ‘black holes’), devouring never-to-be-seen-again savings. This control fraud took place over many years, but the office of Fair Trading in both states steadfastly refused to help victims.
- **Losses:** Around \$200 million. Many lost their entire life savings, although litigation by IMF Australia Limited (now IMF Bentham Limited) and RECA in WA managed to recover approximately \$90 million by suing the WA state government and law firms, and from the proceeds of asset sales. Payouts were not received until 2007, even though victims had been stranded in limbo since 1998.
- **Government/Regulator Action:** The WA state government and the Commissioner for Fair Trading initially refused to act to help consumers, only later reacting in response to adverse media coverage. Multiple calls for an inquiry led to the establishment of the Temby Royal Commission in WA in 2001, the same year IMF Australia Ltd. initiated its lengthy court action. Police eventually laid four hundred fraud charges, leading to the jailing of seventeen brokers. In contrast, the SA government refused to take any action in helping to recover an estimated \$80 million in lost funds. Despite the successes of court actions in WA, an estimated \$120 million was still lost.
- **Macroeconomic Risk:** Low.

Mortgage Solicitor Scandal

- **When:** 1992 – 1999.
- **Control Fraud Participants:** Lawyers, developers, brokers, commercial construction firms, valuers and accountants.
- **Victims:** Retirees, and later on, pensioners.
- **What Happened:** These control frauds operated up the entire east coast of Australia, from Tasmania to Queensland, and were similar to the 1990s Finance Broker Scandal, except that lawyers did not use brokers as agents (except in Tasmania). Lawyers provided financing at 2 per cent over prevailing bank rates to typical ‘mum and dad’ investors so they could purchase severely overvalued real estate – sometimes 400 per cent above fair market value. An aura of legitimacy was provided by lawyers hailing from long-standing firms with a seemingly impeccable record. Documentation was readily doctored, deceiving investors into believing their funds were being used for specific and secure real estate projects, when it was really being pocketed by lawyers or used in junk-grade investments. The control fraud operated as a figurative ‘washing machine’, with no one knowing exactly where the funds were sequestered, except for the lawyers operating the scheme. In Tasmania, licensed brokers were used as agents to provide an additional degree of legal separation, but the ‘back room boys’ always held their hand firmly on the operating levers.

Law firms functioned as Ponzi scheme operators, with new retirees’ money provided to questionable developers and their associates to pay monthly instalments for existing investors. Few retirees ever held first rank mortgagor status (title) over their investment and were instead ranked in the second, third or even fourth position, meaning their security interest was not protected. The original first mortgage security promised to investors was secretly switched over in favour of lenders (who then lent further funds to the developer clientele) and all investors were changed without their knowledge to second, third and fourth mortgage ‘security’. Lenders managed to recover all their funds, while consumers lost all of their funds and their incomes stopped immediately, forcing them to apply for the pension. Banks ensured their own risks were covered and knew investors of first mortgage securities were left unprotected from financial ruin. Lawyers handled all the contracts and title changes, with many title deeds reported as ‘missing’ so

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new ones could be issued. The Bernie Madoff-type structure meant that ‘robbing retiree Peter to pay retiree Paul’ was a scam destined to fail. For over half a decade, investors were paid regularly on time, before the stream of new entrants dried up, causing the collapse of the law firms and erasing investor monies, with the contagion rapidly spreading throughout the industry. State law societies exercised de-facto control of these firms, for many of the lawyers directly involved were registered members, with some even participating in the ethics committees.

- **Losses:** First mortgagors lost 50 per cent of their capital, whereas those subordinated further in mortgagor rank (most retirees) lost 100 per cent of their capital. Many retirees were left in an impoverished and untenable position, unable to claim the pension following a government determination that they still possessed capital above the allowable threshold for income support. ASIC informed the federal Treasury that \$350 million had been lost by 1999, but the real figure was closer to \$1.3 billion when the total losses of law firms and societies in the eastern states were included. This figure rises to \$1.5 billion if the structurally similar WA and SA broker finance scandals are also included.
- **Government/Regulator Action:** Consumer complaints were routinely ignored, but ASIC eventually intervened following a barrage of media criticism. ‘Getting tough’ led to the disbarring of a number of society lawyers and the stipulation that legal professionals required an ASIC financial services licence in the future, under similar circumstances. Ironically, some of ASIC’s licence holders subsequently caused further collapses that cost investors hundreds of millions of dollars in lost funds. Nothing else was done, despite revelations that ASIC held a secret list naming 127 law firms and lawyers suspected of participating in control frauds. No charges were laid and no monies were ever recovered in NSW, Victoria or SA. In Tasmania, a federal Parliamentary Inquiry into the state’s Law Society culminated in the jailing of four lawyers as well as the recovery of \$80 million in funds.
- **Macroeconomic Risk:** Low.

Queensland Two-Tier Marketing Scam

- **When:** Mid-1990s.
- **Control Fraud Participants:** Banks, developers, valuers and real estate agents.
- **Victims:** Out-of-state residential property investors.
- **What Happened:** Distressed, unsaleable properties from the early 1990s recession were marketed to gullible 'mum and dad' investors at prices far above current market value. The purchase of properties at inflated prices allowed every control fraud actor to take a cut of the surplus proceeds. The winners were the banks, their lawyers, developers, construction operators and promoters.
- **Losses:** The typical loss was around \$100,000 to \$200,000 per investment property, leading to many foreclosures.
- **Government/Regulator Action:** ASIC, and its predecessor agency ASC, laid the blame upon valuers and agents, even though banks were the most culpable as the financial engineers. No further action was taken.
- **Macroeconomic Risk:** Low.

Property Spruiker Investment Scams

- **When:** 1999 – 2014 (ongoing).
- **Control Fraud Participants:** Property spruikers, insurers, developers, accountants, lawyers, valuers and banks.
- **Victims:** First-time investors and typical ‘mum and dad’ investors.
- **What Happened:** Government-initiated ‘wealth creation’ seminars suggested consumers needed to be educated regarding the intricacies of real estate ownership for investment purposes. Property spruikers ran ‘education workshops’ sold at public seminars across Australia. Certain spruikers formed ‘educational classes’ and others built their businesses around club memberships. None of the high costs of borrowing or the associated risks of property cycles was conveyed to the unsuspecting public. Often, these seminars were promoted as if with ASIC’s blessing. After signing on for courses, the ‘students’ were enticed into high-cost loans from lenders providing funding facilities, in joint arrangements with the spruikers. Lenders wanted a regular flow of potential clients, to steer them into property investments and developments. To boost loan approvals, two major banks provided loan facilities and also lavishly funded the more notorious spruikers, with high-class venues and teams of lawyers. The spruikers were instrumental in enticing home owners to use home equity loans for property investment, only to lose their homes within four years. Some of the publishing materials boldly declared ‘approved by ASIC’. On-the-spot credit cards were also provided to help pay the \$10,000 - \$15,000 fees for the sham ‘education’ course, which provided fake credits and mock exams for entrance to university-level programs. Banks showered sellers with commissions for each investor signing up for a credit card and/or a mortgage loan.

At the height of the ‘wealth creation’ business, one of the more notorious groups had registered 111 companies and boasted of owning 200 personal properties and achieving millionaire status. Within two years, the group collapsed and the properties boasted of were merely ‘options to purchase’, a strategy created by banks and their ‘high flying’ customers, identified as ‘distressed’ developers. Members were provided with the same options to purchase properties that were inflated by an average of \$100,000 above market value. These projects were usually sold off the plan. Deliberate overvaluation was

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undertaken by appraisers friendly to spruikers. In one case, a well-known insurer pocketed premiums from this racket and the promoter sensibly reinsured himself, but despite the promises, none of the investors' substantial losses were covered. By 2003, one such group had collapsed, making a mockery of the spruiker's claim as a 'wealth creator'. The misfortune of hundreds of participants who believed they were investing for their future became a bonanza of riches for liquidators who seized assets to discharge liabilities. The promoters made a fortune. Real estate investors lost everything they owned. ASIC ignored the mounting consumer complaints as these activities gained significant media coverage.

- **Losses:** Sham educational courses and credit cards provided by these spruiker groups led to losses of over \$100 million. Young investors remained burdened with these debts for many years, while older investors lost their savings and often their homes to liquidators in an outcome similar to the subprime mortgage scandal. Total losses are estimated at over \$200 million, stemming from home foreclosures and lost investment funds. One major bank forgave a handful of mortgages – around twenty in total.
- **Government/Regulator Action:** Considerable publicity surrounded ASIC's failure to seize the passports of spruikers, after three fled the country and set up businesses in other nations. In 2005, public outrage forced ASIC to seek the extradition of three spruikers, but they failed to investigate the obvious links to the major banks. Eventually, ASIC laid criminal charges against four of the spruikers and pursued criminal charges, resulting in custodial sentences. ASIC's persistent excuse was 'there is a lack of evidence'. ASIC did not attend the creditors' meetings out of apparent disinterest, despite their central enforcement role in financial markets.
- **Macroeconomic Risk:** Moderate.

ANZ & Macquarie Bank Singaporean Rate-Rigging Scandal

- **When:** 2013.
- **Control Fraud Participants:** ANZ and Macquarie Bank.
- **Victims:** Unknown.
- **What Happened:** The Monetary Authority of Singapore (MAS) discovered that 133 traders had attempted to rig key borrowing and currency rates. ANZ and Macquarie Bank were two of twenty lenders involved in the scandal, and consequently censured by the MAS. Three quarters of the traders either resigned or were fired, with the rest required to forfeit bonuses. None of the ANZ traders were dismissed, but the bank claimed that a small number of staff had been subjected to disciplinary action. It is unknown whether Macquarie Bank disciplined or fired its traders.
- **Losses:** Unknown.
- **Government/Regulator Action:** The MAS forced the ANZ and Macquarie Bank to set aside an additional \$S100-300 million in reserves. No further investigation into bank actions was undertaken by domestic authorities.
- **Macroeconomic Risk:** Low.

NPA and Securrency Scandal

- **When:** 1998 – 2007.
- **Control Fraud Participants:** Reserve Bank of Australia (RBA) subsidiary Note Printing Australia (NPA) and former, half-owned subsidiary Securrency.
- **Victims:** N/A.
- **What Happened:** Agents of the NPA and Securrency allegedly engaged in bribery of foreign officials in Indonesia, Malaysia, Nepal, Vietnam and elsewhere to advance their business, which involves the printing and sale of polymer banknotes. Former and current senior RBA officials have claimed that they were unaware of possible bribery concerns until 2009, although internal documents suggest that these matters were raised with the former deputy governor of the RBA, Ric Battellino, on at least one occasion in mid-2007.
- **Losses:** Unknown – potentially millions in lost offshore payments.
- **Government/Regulatory Action:** The RBA, Australian Federal Police (AFP) and ASIC initially balked at investigating the allegations of bribery, only responding following reports in the mass media. The AFP has since laid charges against nine former NPA and Securrency employees and the companies themselves. Bribery investigations and prosecutions have proceeded in international jurisdictions.
- **Macroeconomic Risk:** N/A.

CBA Takeover of BankWest Scandal

- **When:** 2008.
- **Control Fraud Participants:** Commonwealth Bank of Australia (CBA), BankWest and valuers.
- **Victims:** Hoteliers, publicans, the catering industry and other small and medium enterprises (SMEs).
- **What Happened:** BankWest, based in Perth, Western Australia, was previously owned by HBOS, a banking and insurance firm in the UK. Due to difficulties experienced by HBOS during the GFC, BankWest was eventually sold to the CBA for a reported \$2.1 billion in October 2008, although the true figure remains secret. The CBA employed a predatory strategy of 'cleaning out' the commercial loan book to make a discounted acquisition. Businesses were intentionally bankrupted via two methods that placed borrowers in breach of loan covenants. Firstly, a downwards revaluation of assets was used to artificially increase the loan to valuation ratio (LVR). Secondly, banks pushed businesses into turn-around divisions when they contravened accepted EBITDA multiples (earnings before interest, tax, depreciation and amortisation) following agreed upon capital investment. The LVR strategy was especially pernicious, as valuers reassessed property holdings on a monthly basis at borrowers' expense until thoroughly debased appraisals triggered adverse commercial loan conditions. In some cases, there is email evidence to suggest bank officers were directly interfering in valuations, insisting that appraisers further lower their assessments.

Receivers were called in if control fraud victims were in technical default (LVR \geq 100 per cent) and/or unable to bring the newly assessed LVR within acceptable limits via the injection of additional capital, lender refinancing, or by full loan repayment within 30 days (or other legally stipulated periods). Victims had often never missed a single loan payment, but still received legal letters informing them they were in default. Business owners were then thrown out of their premises and rendered insolvent.

- **Losses:** Unknown, but can be reasonably estimated at several billion dollars due to several thousand borrowers investing several million dollars each. Heavy losses were experienced

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in WA, and also in NSW and QLD where BankWest had rapidly expanded their bank presence.

- **Government/Regulator Action:** None. Several victims testified before the 2012 Senate inquiry into the post-GFC banking sector, but no recommendations were made to stem this form of control fraud – indeed the CBA/BankWest scandal was ignored in the subsequent report. Senators did not recommend a Royal Commission into the banks, despite prima facie evidence of a conspiracy by the CBA and BankWest to perpetrate fraud against defenceless businesses.
- **Macroeconomic Risk:** Low – although the Big Four banks are still using this method to force SMEs such as cafes and farms into technical default.

CBA Financial Planning Scandal

- **When:** 2003 – 2012.
- **Control Fraud Participants:** Commonwealth Bank of Australia (CBA), CBA financial planners.
- **Victims:** ‘Mum and dad’ investors.
- **What Happened:** In May 2014, the mass media revealed that a number of staff within the CBA’s Financial Planning division and subsidiary Financial Wisdom had manufactured fraudulent documents and forged signatures, while providing grossly inadequate financial advice to clients. High-risk products were recommended that yielded large bonuses for planners, particularly in the run-up to the Global Financial Crisis, leading to thousands of investors incurring substantial capital losses when the value of financial instruments sharply fell. In 2009, the CBA pushed documentation through the legal department in order to provide legal privilege in the event of client lawsuits.

A June 2014 Senate committee report alleged that attempts were made to cover-up bank misconduct in the financial planning arm. Concerns were also expressed over wholly inadequate compensation payments to victims (\$52 million to date), as it appears a superficial attempt to skirt firm regulatory penalties. The CBA has been forced to re-open compensation arrangements after around 4,000 clients were not advised they could receive independent assessments of CBA compensation offers, up to the value of \$5,000. Unsurprisingly, the ‘rogue financial planner defence’ has been recycled by senior executives, alongside an insincere apology and hollow promises of reform.

ASIC was also singled out for delaying 16 months before acting on a whistle-blower tip-off received in 2008; this required the whistle-blower’s attendance at ASIC’s head office in 2010. Further criticisms included the lack of regulator support for victims, and the use of an enforceable undertaking between 2011 and 2013 (an internal risk management review) instead of court action against the CBA, for this acts as a far greater deterrent to financial institutions.

- **Losses:** Unknown – potentially hundreds of millions of dollars, given thousands of investors were affected.

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- **Government/Regulatory Action:** ASIC has banned eight financial planners from the sector. The Senate committee made 61 recommendations, including a Royal Commission into the actions of both the CBA and ASIC (with one dissention), the removal of CBA control over compensation arrangements, stiffer corporate penalties, university qualifications and licensing requirements for financial planners, and the establishment of an “Office of the Whistleblower” within ASIC that can deal with anonymous tip-offs. Committee members were scathing of the lack of integrity and fairness in compensation payments to victims, and inadequate enforcement undertakings agreed to by ASIC. Essentially, the majority of committee members opined that the credibility of both institutions was damaged, particularly ASIC’s competence in managing, implementing and monitoring equitable processes and outcomes for victims of predatory control frauds. The federal government has ignored the recommendation of a Royal Commission, instead handballing it to the financial system inquiry which is considering the broader regulatory framework. ASIC’s performance has similarly been excused, without penalties or opprobrium that is sorely deserved.
- **Macroeconomic Risk:** Moderate - concerns have been raised about other financial planning arms, including Macquarie Private Wealth and PUMA.

Debenture-Funded Pyramid Business Scams

- **When:** Late 1990s – 2014 (ongoing).
- **Control Fraud Participants:** Corporations funded via listed/unlisted and rated/unrated debentures, banks, developers, valuers and off-the-plan sellers.
- **Victims:** Typically ‘mum and dad’ investors, pensioners and retirees.
- **What Happened:** Directors form a company funded with only several thousand dollars of their own start-up capital and then produce and market ‘prospectuses’ to gullible, cashed-up investors. Client registers of ASIC-licensed financial planning firms are used to identify targets, and prospective investors are sent glossy advertising material promoting a grand artistic impression of future property developments. Companies receive income streams when investors purchase debentures, typically for the development of real estate projects that are estimated to require between \$30 and \$100 million in capital to proceed. Investors are universally told that real estate prices always rise, thus guaranteeing them windfall capital gains in the future. In reality, projects are often not completed, with some not even passing the planning phase. Investors’ money is almost always directed to interstate projects to prevent ‘drive by traffic’ accidentally confirming the absence of development.

The status of securities underpinning an advertised project is an illusion. For instance, in a \$60 million project which raises \$30 million in the first round offer, this money is held in trust and investor security is composed of ‘shares in project’. This enables a second phase of bank funding for high-risk developer projects, such as those involving distressed properties – providing investors with mortgage security and title. What is undisclosed, however, is their subordination in mortgagor status that ranks them in second to fourth position. Furthermore, without declaration by company directors, funding is shuffled between different projects and not the one advertised in the prospectus. The change in the status of mortgage security holdings means firms devolve into Ponzi schemes, with payments to existing investors only sustained by a continual influx of new entrants. Investors are ignorant of the risks and become easy prey for the predations of directors before the company collapses, on average, six years later. Those who ask for their money to be returned earlier are dissuaded by a plethora of excuses for why this is impossible.

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- **Losses:** \$37 billion confirmed to date, rising to a possible \$55 billion. Potentially over \$100 billion is at risk.
- **Government/Regulator Action:** Victims are often treated with contempt, and have no recourse against the control fraud participants unless they take part in a privately-funded class action lawsuit. ASIC has known about these control frauds since the early 2000s but has consistently refused to take action on jurisdictional grounds, despite the courts admonishing their inaction on debentures as early as 2004. In a handful of cases pursued by ASIC, such as the Storm Financial group collapse, they have short-changed victims by agreeing to inadequate financial compensation terms in legal proceedings. A regulator preference for passivity has been established, allowing a host of companies to collapse under the weight of their own corruption, wiping out tens of billions of dollars in the process. Responsible company directors are repeatedly bailed out with golden parachutes and are virtually immune to prosecution following free passes granted by ASIC or the mismanagement of their court cases by relevant authorities.
- **Macroeconomic Risk:** Moderate - regulator idleness raises the risk of future collapses involving tens of billions of dollars more in investor funds.

Subprime Mortgage Scandal

- **When:** 1996 – 2014 (ongoing).
- **Control Fraud Participants:** All Australian bank and non-bank lenders, bank lawyers and broker channels.
- **Victims:** Primarily ARIPs (asset rich, income poor) retirees and pensioners, and FHBs (first home buyers) using government grants - though every demographic group is targeted.
- **What Happened:** This control fraud has the greatest potential to cause a severely adverse macroeconomic impact due to the involvement of every single Australian bank and non-bank lender. Hundreds of thousands of households may have been entrapped. This massive control fraud has similarities to the US model, where lenders targeted NINJAs (no income, no job or assets). Australian lenders distinguish themselves, however, by focusing their predatory lending on ARIPs – the asset rich, income poor. Borrowers' loan application forms (LAFs) are manipulated by means of computerised and password-protected 'service calculators'. Lenders provide these black box applications to brokers on the pretext of assisting with calculating tax advantages, but in reality, it helps approve unrealistically large loans. Borrowers are provided with loans far beyond their capacity to service out of disposable income over the contact term. Bank lawyers assist with drafting contracts, ensuring independent legal advice is unavailable.

The LAFs are then sent to the lender, where credit assessors use whiteout liquid to add and/or alter assets and incomes. Signatures are also forged on additional pages of the LAF, remaining hidden from the borrower. The amended LAF is then put through the service calculator again for the third and final round of fraud. Jumbo interest-only loans are finally granted to novice 'mum and dad' investors, even though they are designed to implode within a period of five years, causing them to lose everything. Bridging or buffer loans are often granted in the years preceding borrower default to extract additional economic rent (penalty interest rates and fees) that increase the profitability of fraud.

- **Losses:** Potentially more than 200,000 families and \$100 billion at risk. A contagion effect could greatly amplify the potential losses across the economy.
- **Government/Regulatory Action:** RBA, ASIC, APRA, ATO, AFP, Treasury, FOS and COSL refuse to investigate serious allegations of predatory subprime lending; all deny systemic

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fraudulent lending has taken place. Broker channels have instead become the 'fall guy' for faulty financial products, conveniently shifting the blame from financial engineers onto 'rogue sellers' who play a relatively minor role. ASIC executives are well aware that lenders have engaged in predatory finance, and possess a thick BFCSA-generated evidentiary file that meets the necessary threshold for criminal referrals in many cases. Both government and regulators appear fearful of confirming a massive control fraud in their midst that may trigger the collapse of the housing bubble. Consequently, an appropriate investigation has not been forthcoming to ascertain the true size and extent of the control fraud.

- **Macroeconomic Risk:** Extreme. The heralded changes to consumer protection legislation introduced in 2010 (NCCP) has failed, with subprime mortgage fraud still running rampant.

Overview of Control Frauds in Australia

Table C.1: Overview of Australian Control Frauds		
Control Fraud	Period	Losses (\$)
Foreign Currency Loans Scandal	1980s	Several billion
Finance Broker Scandal	1992-1998	\$200 million
Mortgage Solicitor Scandal	1992-1999	\$1.3 billion
Queensland Two-Tier Marketing Scam	Mid-1990s	\$100-200k per IP
NPA and Securrency Scandal	1998-2007	N/A
CBA Takeover of BankWest Scandal	2008	Several billion
CBA Financial Planner Scandal	2003-2012	100s of millions
ANZ & Macquarie Bank Singaporean Rate-Rigging Scandal	2013	Unknown
Property Spruiker Investment Scams	1999-2016	Over \$200 million
Forced SME/Farmer Insolvency Scandal	Mid-1980s-2016	Several billion
Debenture-Funded Pyramid Business Scams	Late 1990s-2016	Over \$60 billion
Subprime Mortgage Scandal	1996-2016	Potentially >\$100bn
<i>Source: Brailey, Jones, Authors' estimates</i>		LF Economics

Appendix D: Control Fraud Thematic Analysis

- Control fraud participants are most often lawyers, managers, executives, brokers, accountants, developers, appraisers, builders, and bank/non-bank lenders. Shell corporations are heavily used. The Big Four banks feature prominently, as they provide the majority of loan facilities to the household and business sectors.
- The preferred victims are asset-rich, income-poor retirees and pensioners (ARIPs), first home buyers, and naïve investors in general – those with limited market knowledge and experience, and relatively low debt burdens.
- Control fraud lenders or their agents regularly approve loans purposefully inflated relative to borrowers' true incomes. Unsustainable loans are intended to reap excess profits and the later seizure of assets within an average five-year timeframe – a clear breach of s25.1 of the Australian Bankers Code of Conduct.
- Control frauds prefer to invest in residential and commercial property developments or acquisitions, either directly or via debentures.
- The subprime mortgage lending market is a hotbed of control frauds. Relative to the prime (full-doc) mortgage market, low-doc and no-doc processes provide greater opportunity for the circumvention of responsible lending policies and the establishment of lower underwriting standards.
- All control frauds share a Ponzi-like structure – a continual influx of new investors is required for the acquisition of property, completion of proposed development projects, the maintenance of securities payments, and to prevent the eventual collapse of the scheme.
- Lenders mastermind the control frauds, but utilise broker, seller and other channels to facilitate loan approval in around two-thirds of cases. Although profits are diluted through commissions, lenders are investing in plausible deniability: alleged ignorance based on several degrees of legal separation and supposed culpability of distant actors.
- Control frauds are usually paired with aggressive marketing strategies and seminars, spruikers and/or sellers on commissions and deceptive publications (sometimes 'ASIC-approved') promising large and guaranteed returns on trophy projects. Prepared lender materials provided to spruikers suggests they target rich pickings – the low-hanging ARIP fruit in the elderly cohort.
- Control frauds may share one or more of the following additional characteristics:

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- An express intent to default businesses and/or households to seize valuable assets e.g. 30-year interest-only loans designed to fold within five years;
- Intentional default or transition of borrowers into turn-around divisions yielding further economic rents based on contrived breaches of LVR and EBITDA covenants, even when clients have never missed a loan repayment;
- Large up-front fees or other prohibitive entry costs;
- Extraction of maximum economic rent via usurious interest rates, fees and penalties well above benchmark rates;
- Tapping of existing home-owner or business equity for investment loans;
- Loan contracts that appear superficially affordable, but which are designed to increase, rather than reduce, the principal and interest payment burden over time via the liberal use of bridging/buffer loans and prohibitive lender refinancing;
- Black-box service calculators using exaggerated future estimates of tax-advantaged income to facilitate subprime loan approval;
- Loan documentation fraud and forgery that inflates assets and income;
- Failure of bank agents to fulfil their statutory obligation to confirm the identification details of borrowers under the *Anti-Money Laundering and Counter-Terrorism Financing Act (2006)* – falsely ticking a check-box list of necessary criteria;
- Failure of lenders to verify borrowers’ basic details and financial circumstances with simple phone calls at any time prior to loan approval;
- Bank officers or their agents filling out loan documentation on a borrower’s behalf and failing to provide a copy, or only producing a partial version that excludes material demonstrating forgery and fraud;
- The shredding of mortgage documentation by lenders or their agents that evidences fraud and forgery. As some lenders explicitly advised: “shred the Loan Application Forms within 12 days of settlement”;
- Lender refusal to provide loan documentation to aggrieved borrowers on specious legal grounds;
- Appraisal and legal contracts completed by in-house or ‘friendly’ lawyers and valuers;
- Investment in low-grade (junk) residential or commercial property investments or ‘phantom investments’ (Bernie Madoff pyramid-style structures);
- Investor subordination in mortgagor status/rank on associated titles;

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- Intentionally inflating the value of proposed property acquisitions to skim funds;
 - Lender directions for sellers to use one-day ABNs to qualify borrowers for business loans and to disguise their non-proprietor status;
 - At the lender's behest, agent creation of ABNs using a borrower's tax file number without their explicit knowledge;
 - Marketing of interstate projects to prevent the untimely discovery of fraud; and
 - The illegal shifting of funds between projects without formal disclosure.
- Most control frauds operate for years and are only brought to an end by a catastrophic collapse in the Ponzi structure, rather than via regulatory enforcement or enhanced consumer protection legislation.
 - The majority of victims receive poor representation from ombudsmen such as FOS or COSL, losing the entirety of their savings and, for retirees, their homes. Young victims are also left with crippling debts over non-existent assets, limiting their future prospects.
 - The emergence of seventeen lenders – including the four major banks – with an identical blueprint for subprime mortgage fraud is prima facie evidence of a criminal conspiracy borne of an active cartel with malicious intent. The BFCSA possesses a large case file with more than 2,000 victims of control frauds – a statistically significant sample that confirms a host of loans have been approved based on inflated assets and income.
 - Only the financial engineers (lenders) reap long-term benefits from control frauds – most other participants in the long and toxic chain are also entrapped, with their financial livelihoods destroyed. It is the lenders, therefore, who bear the ultimate responsibility for material harms caused, having decided to recklessly approve toxic loans.
 - Extensive control frauds are designed to exceed the eligibility threshold for dispute resolution (\$500,000 in assets) so regulatory mechanisms can be sidestepped. Existing compensation arrangements are also woefully inadequate, with a maximum payout of only \$280,000, designed to short-change bona-fide victims and enabling fraudsters to profit, even after adverse findings against them.
 - Government and regulatory reticence is evident in failing to address claims of widespread and endemic control frauds across decades. ASIC is particularly culpable, having treated victims with cold indifference and contempt, while simultaneously defending their inaction towards the engineers of control frauds, usually on spurious jurisdictional, evidentiary or other grounds.

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- Maladministration in lending by domestic financiers has become the norm. Only a Royal Commission with the broadest possible terms of reference will help uncover the totality of white-collar crime that threatens to destabilise the banking and financial system, and by extension, the Australian economy.
- In the more subtle variants of control fraud, lenders do not provide loan facilities directly to those investing in managed investment schemes outside of the traditional model e.g. phantom plantations and horticultural investments. Rather, financing is extended by non-bank financial institutions that engage in loan maladministration, but these contracts are then transferred to major lenders shortly before the companies collapse, often without the knowledge of investors. Consequently, lenders are empowered to take court action that enforces the repayment of contracts within 30 days (or another legally stipulated period), leading to the seizure of valuable assets in most cases. Despite an obvious lack of procedural integrity in these contracts and surely knowing the original loans were subject to fraud and extended in bad faith, banks assert their claims are legally valid and thus 'fully recoverable'.

Appendix E: Key Forensic Indicators of Predatory Lending

- Eleven-page LAFs which are presented to borrowers as a ‘complete’ three-page copy.
- No copies of LAFs provided to borrower(s) at the point of signing.
- The ‘ABN for a day’ scam which disguises non-proprietor status, low borrower incomes (less than \$75,000) and fake ABNs.
- Police have found a ‘multiple copies’ system in effect – each version (copy) of the LAF was different, with changes attributable to internal lender processes after the receipt of the original faxed copy. Sellers were told to retain the original, which may differ significantly from the final internal lender version.
- Lenders avoid scrutiny or blame by insisting upon a broker’s hand-writing on the LAF.
- Forgery is demonstrated by up to three visibly different sets of hand-writing on a majority of LAFs – most alterations are made by external agents and internal staff using ‘cut and paste’ methods.
- Similarly, the income on the original service calculator forms (SCF) differs from internal lender copies – they are altered after they are received, according to credit assessor (CA) notes. The CA’s version of the calculator is geared differently with an altered net servicing ratio (NSR) factor. Neither CAs nor sellers are aware of this fact, yet they “must be attached.”
- The CA’s can then “adjust the calculated approval of the loans” – lender code for jumbo-sized loans well beyond the limits of normal serviceability criteria. In the UK, police discovered CAs were using “gallons of white-out”.
- In some instances, lenders ordered aggregators and brokers to shred the original wet-ink copies of loan documents just twelve days after settlement. The express intent is to destroy any remaining evidence of an ongoing control fraud that has entrapped the borrower.
- Many borrowers report lenders provided a congratulatory letter stipulating loan sums far higher than they had applied for or had agreed to, for instance, following an application for \$250,000, one borrower was advised: “good news, \$350k approved”.
- This practice encourages greater use of additional loan facilities – buffer monies in the form of bridging loans and prohibitive refinancing options. Superficially, borrowers can ‘afford payments’, but they can only meet payment terms with additional financing and not from existing income.
- Lenders fail to make simple verification checks with borrowers via a telephone call.

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- Secret valuations undertaken by lenders which demonstrate a \$100,000 discrepancy before and after approval – borrowers were not made aware they are now at risk of losing their homes.
- Self-insurance and loan mortgage insurance (LMI) scams are used to disguise higher loan to value ratios that may reveal fraud.
- Email evidence of internal lender staff encouraging brokers to “pump up the volume” (increase the rate/number of loan approvals).
- Commissions and bonuses are quota-driven and originate from the lenders. Payments are influenced by a lender product assessment process regarding the ‘success or failure of approval (rates)’. Trailing commissions also encourage the inappropriate targeting of borrowers.
- The bonuses of lender staff increase with rising institutional profitability and associated greater market capitalisation – executives are rewarded commensurately from the top down.
- All bank and non-bank lenders have used the same model with identical fraud mechanics, suggesting a banking cartel has formed in the FIRE sector.
- Maladministration in lending has become the norm and led to the victimisation of thousands of borrowers. A thorough investigation by state and territory police is needed to address white-collar crimes that intend to seize borrower collateral, principally via disguised processes of fraud and forgery, and abuse of computerised processes.

Appendix F: Characteristics of ASIC

Dimension	Notes
Stakeholder Relationships	<ul style="list-style-type: none"> The banking and financial sector reports excellent working relationships with ASIC, while victims of predatory lending are scathing of their contemptuous treatment and limited practical assistance provided – primarily due to dismissals of their complaints. ASIC regularly meets with industry liaison contacts, but is usually absent for creditor/victim meetings or is unwilling to provide strong representation for the aggrieved.
Exercise of Powers and Enforcement of Relevant Acts	<ul style="list-style-type: none"> ASIC rarely undertakes forensic investigations, initiates court actions or issues criminal referrals, particularly if maladministration concerns the major lenders or is systemic. ASIC prefers the softer touch of enforced undertakings with recalcitrant institutions and the application of woefully inadequate pecuniary penalties. Relatively minor fraudsters or ‘rogue individuals/planners/entities’ are generally pursued as the ‘fall guy’ for control frauds. ASIC’s presence as a ‘friend of the court’ most often results in their endorsement of patently inadequate compensation arrangements for victims – shielding lenders from harsher punishments and suitable precedents. Applications for relief are commonly granted to institutions, despite the obvious commercial benefit and implied erosion of consumer protections e.g. online bank superannuation calculators transforming into marketing, rather than educational tools, due to the hidden impact of fees. ASIC fails to strictly apply relevant sections of the Corporations Act - former insiders report that regulatory directions and relief applications are influenced by the political and economic clout of major lenders and financial services companies during industry liaison meetings. ASIC policies, legal interpretations (such as jurisdictional purview), rules and decisions are often interpreted to the benefit of industry: waiving of fees, failure to undertake public consultation, exception to normal Parliamentary approval processes for class orders (disallowable instruments), grandfathering of legislative clauses benefitting industry, and supposed powerlessness to act on cases of rampant fraud.

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<p>Institutional Culture</p>	<ul style="list-style-type: none"> • Former staff have attested to an environment of favouritism, harassment, bullying and intimidation, with lax enforcement of regulations, even when clear breaches are alleged. • Senior ASIC management are often hand-picked representatives of the banking and financial sector ‘revolving door’, making them amenable to industry influence. • Senior management reportedly have a ‘glass jaw’, with hostility shown to whistle-blowers or any suggestion that reform is required due to alleged improper and unlawful directions.
<p>Secondment Policy</p>	<ul style="list-style-type: none"> • The hidden nature of the secondment policy and the murky role of staff on loan from the banking and financial sector is reported to contribute to conflicts of interest – decision-making is influenced by the sector from afar due to internal lobbying for beneficial changes to law and policy.
<p>Efficiency</p>	<ul style="list-style-type: none"> • Poor – ASIC is idle or very slow in responding to allegations of industry impropriety, though they must deal with a wide range of complex legal and financial matters. • The worst ASIC decisions suggest management is culpable for the scale of losses incurred – these decisions provide a prima facie case of malfeasance in public office. • \$6.4 billion in taxpayer funding since 1998 has failed to protect hundreds of thousands of Australians from predatory lending and the loss of their life savings. • Over the past fifteen years, the BFCSA has uncovered fraud within the sector costing tens of billions of dollars (not identified by ASIC), despite the regulator having hundreds of investigators and a budget totalling more than \$300 million per annum. • Negative news stories most often prompt ASIC into making public statements, gestures and long overdue responses, not the identification of breaches of the Corporations Act. • On rare occasions, ASIC management admits policies do not work e.g. disclosure policy, but no attempt is made to remedy the situation.

Appendix G: Forensic Report

G.1: Lenders Engineer Intentionally Faulty Financial Products

The BFCSA has identified the perpetrators behind devious and deceptive products expressly designed to cause financial harm to borrowers – nearly every single domestic bank and non-bank lender. The most senior executives within the banking and financial sector have produced, endorsed and implemented a blueprint for white collar crime that is wide in scope and broad in its application. Marketing and sales procedures targeting naïve investors are also invented by banking executives and provided to agents of the lender to facilitate fraud.

The motive for lenders is simple: billions of dollars in profit can be made through a combination of unconscionable lending, toxic products, loans designed to fold within several years, and subsequent liquidation or foreclosure proceedings that yield valuable assets via legally enforceable undertakings. The BFCSA has thoroughly studied and investigated multiple cases over the last ten years and identified 17 specific lenders whom form part of an active cartel.

Control frauds are assisted by an army of Credit Assessors (CAs) hired as bank officers but trained as teacher/sellers – so called ‘Business Development Managers’ (BDMs). Brokers, financial planners and accountants are also engaged to form part of a long ‘seller’ chain. Intermediaries are used to shield the lenders from blame and legal accountability, but agreements between the respective parties reveals the ultimate criminal intent of lenders. Insurance companies are also key enablers and are usually aware of fraud components, leading them to craft specific agreement clauses which limit their liability.

The success of control frauds is dependent upon sellers, managers and other lender agents being deceived into believing they are simply ‘helping people to realise their dreams.’ Those questioning suspected paperwork and procedural illegalities are assured by bankers: “our lawyers have given the green light that the products are saleable and in compliance etc. (with laws, regulations and codes of conduct).”

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Over the last fifteen years, a number of brokers and ex-brokers have personally disclosed they questioned processes underpinning control frauds, but were rebuffed by their superiors. In a number of instances, many in the selling chain also fell afoul of predatory lending practices and incurred substantial losses, including their homes and life savings.

Australian lenders differentiate themselves from their American and global compatriots who focused lending toward the 'NINJA' cohort: 'no income, no assets and no job.' Instead, domestic banks favour the promotion of products to 'ARIPs' – asset rich and income poor households, such as pensioners who typically have valuable equity locked up in their homes. Additional target groups include low-income households, especially those on disability support pensions, and first home buyers using government grants to enter the market.

Bank and non-bank lenders specifically mark ARIPs who have valuable existing assets and no debt for aggressive marketing strategies, for this greatly increases the profitability of fraud via grossly inflated loans, lower underwriting standards, and the intended seizure of collateral.

A number of careful steps help disguise the 'grand theft ARIP' lending structure and imprudent loans which are really weapons of financial mass destruction – usually 30-year interest-only loans designed to fold within a five to six-year window. In both the sub-prime and prime loan pools, approvals are based on unverified and purposefully inflated assessments. The return on equity for control frauds is exceptional, explaining why other demographic target groups also become victims of predatory lending.

The mechanics of control frauds is explored in detail in Part 5, but the elaborate scheme has several common components:

- Black-box service calculators (SCs) are used to approve grossly inflated sums relative to the borrower's true capacity to service the loan from existing income.

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- Paperwork is doctored to reflect phantom assets, over-stated incomes and fictional vocational occupations in order to 'get loans over the line', explaining the growth in LAF forms from 3 to 11 pages (or more).
- Documentary evidence of illegally obtained and manufactured (guaranteed) loan approvals is usually shredded to eliminate the paperwork trail that could lead to legal discovery via civil or criminal procedures.

Financing is most often provided for direct property investment or for debenture schemes that solicit funds for major property developments (which may not eventuate), highlighting the central role of other control fraud actors – subsidiary and shell companies, developers, insurers, appraisers, accountants, lawyers, property spruikers and others. In recent years, subtle control frauds variants have emerged within horticultural and phantom plantation schemes, and via investment firms controlling superannuation funds on behalf of investors.

Bank engineers have extended finance masquerading as prudent loans for decades – escaping detection and punishment despite defrauding a continual supply of retirees who were previously debt-free and lived moderately comfortable lifestyles. The BFCSA has evidence of the lenders' role as 'control fraud masterminds' based on copies of communications between lenders and their seller channel, helping to establish their culpability.

The BFCSA is resolutely determined to expose the principal role of lenders in control frauds, in addition to the plight of countless victims whose livelihoods have been destroyed. Consumers will remain vulnerable to Australia's own subprime and other lending scandals, already two decades old, unless firm police action is taken to investigate the financial and banking sector architects. Forensic investigations and criminal prosecutions with the distinct possibility of imprisonment remain the greatest deterrents to white-collar crime.

- Bank and non-bank lenders (particularly the 'Big Four' banks) have assumed the characteristics of a cartel by fashioning identical control fraud products, processes and mechanisms, including manipulation of internal approval processes to facilitate predatory mortgage loans.
- CAs who approve toxic loans are acting under explicit orders originating from senior

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lender management, including those two-thirds whom act as an agent of the lender.

- Brokers are merely sales agents of the lender and follow a set of instructions provided for them in order to receive commission payments.
- Fraud and forgery has been enabled by the lenders' purposeful design of SCs to generate inflated loan sums and the shredding of altered documentation.
- In addition to the marketing of faulty products, the seller channel is also used by lenders to provide several degrees of legal separation from the 'pointy end' of the crime – poorly trained sellers have become the 'fall guy' and provide a 'rogue financial broker/planner' defence.

G.2: Weapons of Fraud, Preparatory Planning, Criminal Intent and Sales Strategies

2.1: Weapons of Fraud

- The Service Calculator Form (SCF) and the Income Creating Wealth (ICW) worksheet.
- Loan Application Form (LAF).
- Above-average interest rates, fees and penalties.
- Inter-lender 'bad loan swapping' to avoid detection.
- Refinancing of large sums using pensioners' accrued home or business equity e.g. arrangement of multi-million dollar loans.
- Contrived breaches of loan to value ratio (LVR) covenants via downwards re-valuations conducted by lender-friendly appraisers.
- Contrived breaches of EBITDA covenants following agreed upon capital investment.
- 'Turn-around divisions' for commercial borrowers.
- Acquisition of loan portfolios already subject to control fraud by a smaller financial entity – allowing fully enforceable legal undertakings against borrowers.

2.2: Preparatory Planning and Criminal Intent

- Lenders mask unaffordable, predatory loans via prohibitive bridging loans, refinancing options and other buffer monies imposing a high rate of interest and fees.
- For commercial borrowers, 'turn-around' divisions are used to extract additional interest and penalties, before an eventual enforced default.
- Future borrower default is planned after a six-year period has elapsed – lender liability is extinguished following the expiry of the statute of limitations for maladministration in lending.
- Agents of the lender and other sellers are purposefully involved in the lending chain to provide a degree of plausible deniability, even though profits are diluted in this manner.
- Commission-based sellers are inadequately trained to identify control frauds and high-risk investment structures.
- Lenders fail to perform simple borrower verification checks.
- Loan documentation fraud and forgery is evidenced in a significant BFCSA sample (2,000+ applications) e.g. incomes inflated by \$150,000, different hand-writing styles for

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the 'borrower' fields in loan documentation (a practice known to the ATO since 2005).

- Lender staff or their agents do not permit borrowers to complete their own forms – only signatures are required.
- 'One-size-fits-all' SCs are pre-designed for loan approval.
- Evidence of executive orders to shred original documents to disguise loan fraud, with some sellers refusing to do that – material evidence is still available to fraud investigators.
- Refusal to release copies of fraudulent documents to borrowers on specious legal grounds e.g. 'commercial confidence'.

2.3: Sales Strategies

- Marketing strategies and the target market are defined by lenders.
- The 'six degrees of (legal) separation', commission-based seller network is established by lenders; though 36% of all sales are internal to banks (no broker channel is used).
- Prime targets are enticed to try a financial investment plan for a short period e.g. two years.
- Investments are advertised as secure, with returns guaranteed – 'no risk of losing your home... property prices always rise'.
- Up to \$3 million in refinancing for elderly pensioners e.g. multi-decade loans approved for 90-year olds, serviceable only via additional financing in the form of buffer monies.
- Generous funding of property spruikers and associated seminars to encourage a continual supply of investors.

G.3: Target Market and Motivating Factors

3.1: Target Market

- Principally debt-free ARIP households, but first home buyers and other demographic groups with limited market knowledge are also targeted, for they are more easily defrauded.
- Most complainants are aged between 50 and 90 years old – older ‘mum and dad’ investors have little knowledge of risks attached to financial products on offer, and thus more willing to trust lenders based on their reputation and market dominance.
- The majority of homeowners targeted by lenders are debt-free, having paid off their homes over 25 years or more.
- Bank agents act as sellers and direct lender-directed financial strategies toward targets without disclosure of product risks – borrowers are convinced by spiels of easy riches or the fearful prospect of an impoverished retirement.
- In some instances, sellers also report they have become victims of control fraud.

3.2: Motivating Factors

- Lenders are explicitly seeking the borrower’s (intended victim’s) collateral assets that provide security for an investment loan(s).
- Lower underwriting standards in the subprime pool increase the scope for control frauds.
- Subprime control frauds operating within the property sector provide the greatest return on equity relative to the performance of other legitimate loan portfolios – executive remuneration is influenced by a definite ‘control fraud multiplier’.
- The likelihood of control fraud detection, investigation and criminal prosecution is low – current pecuniary penalties are insufficient to deter white collar criminals.
- The seller network provides sufficient cover for systemic control frauds – ‘rogue brokers/planners’ are the default lender defence.

G.4: The Perfect Product - One Size Fits All

4.1: The Control Fraud Microeconomic and Macroeconomic Landscape

Lender Cartel Status
<ul style="list-style-type: none"> • The emergence of seventeen lenders (including the Big Four major banks) with an identical blueprint for subprime mortgage fraud is prima facie evidence of a criminal conspiracy borne of an active cartel – brokers did not know each other and neither did borrowers. • All major lenders have implemented identical control fraud structures and products, a similarly ill-trained seller network focused on commissions, and used carbon-copy paperwork and procedures. • The Big Four banks feature prominently in all control frauds, as they provide the majority of loan facilities to the household and business sectors. • Fraud mechanics and concepts have been adopted from overseas jurisdictions and are simple for lenders to establish in the current, lax regulatory environment. • Only the financial engineers (lenders) reap long-term benefits from control frauds – most other participants in the long chain are entrapped and have their financial livelihoods destroyed.
Lending Structure and Targets
<ul style="list-style-type: none"> • The profitability of control frauds incentivises lenders to continually increase the volume of toxic lending. • The subprime mortgage lending market is a hotbed of control frauds. Relative to the prime (full-doc) mortgage market, low-doc and no-doc processes provide greater opportunity for the circumvention of responsible lending policies and the establishment of lower underwriting standards. • Lenders use 30-year interest only loans that are designed to never be paid off – providing an opportunity to default businesses and households to seize valuable collateral – ‘safe and secure’ products are/were never able to deliver financial security. • Borrowers are only allowed to fall into default from the sixth year onwards in order to side-step the statute of limitations for civil remedies. • CAs receive senior lender directives to alter LAFs to ‘make the loan fit’ and to ‘pump up the volume’ (increase the number/rate of loan approvals).

Selling the Dream

- Prepared lender materials provided to spruikers suggests they target rich pickings – the low-hanging, debt-free ARIP fruit in the elderly cohort, in addition to first home buyers and investors with generally limited market knowledge.
- Most victims of predatory lending did not ‘decide to borrow’ and expected unsolicited loan offers to be rejected – unaware they were specifically targeted for owning a valuable asset(s) and surviving off a low-income e.g. pension.
- The lenders utilise broker, seller and other ill-trained channels to disguise high-risk products and their inappropriate transference to customers – the high turnover of staff in this industry makes it easier to conceal crimes from sellers or BDMs.
- Lenders are willing to dilute their profits by engaging the seller network because this represents an investment in a plausible defence: alleged ignorance of fraud based on several degrees of legal separation and the supposed culpability of distant actors.
- Lender branding is used to instil trust in borrowers and reinforce the implied credibility of the financial product.
- Control frauds are designed to exceed the eligibility threshold for dispute resolution (\$500,000 in assets) so existing regulatory mechanisms enabling compensation can be sidestepped.

Legal Contracts and Appraisals

- Appraisal and legal contracts are completed by in-house or ‘friendly’ lawyers and valuers to circumvent independent legal advice.
- Bank officers or their agents fill out loan documentation on a borrower’s behalf and fail to provide a copy of the signed LAFs (or only abridged versions disguising fraud) – documented evidence exists for every major bank and non-bank lender, in all states and territories.
- In some cases, lenders provided directions for sellers to use one-day Australian Business Numbers (ABNs) to qualify borrowers for business loans and to disguise their non-proprietor status – including agent creation of ABNs using a borrower’s tax file number without their explicit knowledge.
- CAs are forbidden to telephone customers – a strict ‘no contact’ clause is in effect.
- Bank agents fail to verify borrowers’ basic details and financial circumstances with simply enquiries at any time prior to loan approval – a failure to fulfil their statutory

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obligation to confirm identification details of borrowers under the *Anti-Money Laundering and Counter-Terrorism Financing Act (2006)*.

Serviceability Calculators

- Secret, black-box SCs are used by sellers to generate exaggerated future estimates of tax-advantaged income to facilitate loan approval and are marked: “not to be shown to the borrower”.
- The SC was devised for *one size fits all projections* to be written down as “actual income”. It produces complex calculations of tax advantages and is used by those unfamiliar with such tools. Each seller and BDM is told it is part of the legal process – ‘lawyer-approved’, but cannot be shown to borrowers, nor copies provided. The seller is none the wiser, but expressly instructed by lenders not to show any copies of these documents to the borrower.
- The Net Servicing Ratio (NSR) values derived from the same SC are different across the seller, CA and insurer versions.

Indicators of Fraud and Forgery

- Every LAF in the BFCSA sample pool (2,000+ applications) is subject to obvious fraud that inflates assets, income and vocational status – similar to the Scotland Yard findings for European banks, ‘gallons of white out’ is used in *internal* bank procedures, *after* the faxed documents are received.
- Similarly, many documents contain forged ‘cut and paste’ signatures or poorly imitated forgeries inserted by bank staff.
- The guaranteed approval of purposefully inflated loans relative to borrowers’ true incomes is textbook unconscionable lending, and solely used to increase loan volumes, profits, commissions, shareholder value and senior management remuneration.
- The three page LAF signed by the borrower(s) has another eight or more pages added and filled in by bank staffers or agents in the seller-chain (under instruction) – evidenced by document discovery via the Courts and a small number of full-copy LAFs provided to borrowers following their mistaken release by lenders.
- Loan contracts are made to appear superficially affordable, but are designed to increase, rather than reduce, the principal and interest payment burden over time via the liberal use of bridging/buffer loans and prohibitive lender refinancing.
- Lenders or their agents regularly shred mortgage documentation that evidences fraud

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and forgery. As some lenders explicitly advised: “shred the loan application forms within twelve days of settlement”.

- A borrower requesting their full loan documentation (an unabridged LAF) is informed the material is ‘commercial in confidence’ and cannot be released, thus preventing confirmation of their defrauded status.

Courts and the Regulator

- Nine cases have been funded in four Supreme Court jurisdictions – lenders lost each case and relevant precedents have been set (earlier civil cases were also won with BFCSA assistance).
- The Australian Securities and Investment Commission (ASIC) have admitted the lenders are the engineers of control frauds: “no doubt about it”.
- As ASIC regularly asserts in external correspondence, allegations of fraud are matters for the State and Territory Police, particularly since substantial documentary evidence is available for forensic investigation – many cases are likely to meet the necessary legal threshold for a successful criminal prosecution.

G.5: Fraud Mechanics and Crime Concealment Methods

5.1: Deceptive Intent

- Control fraud processes are intended to produce and transfer faulty products to the public – the manufacturer blueprint is designed so the wheels fall off the financial vehicle within several years.
- Buffer loans are an essential part of the financial strategy to disguise unaffordable and predatory financing – fraudulent loans are designed to *increase in size over time*.
- Between 2006 and 2012 average loans started at around \$350,000 (plus a \$50,000 buffer loan), but had risen to \$600,000 within four years via usurious interest, fees and penalties.

5.2: Motive – Greed and Profit

- Control frauds increase lenders' profits, return on equity, the share price, market share, shareholder returns, and remuneration to senior management in the form of valuable share options and performance bonuses.
- The \$50 billion ARIP cohort with untapped household equity is irresistible to fraudsters in the banking and financial sector.

5.3: Detection Avoidance Measures

- Predatory lending is not opportunistic, but carefully planned and executed over a prolonged period – decades in the case of forced insolvencies, subprime lending and pyramid-style debenture scams – minimising the probability of close scrutiny by relevant authorities.
- Domestic lenders' techniques ensure long-term success and mirror those of global banks – LAF copies are not provided to borrowers, direct contact with customers is purposefully avoided, and income is not verified.
- A lender preference for rising loan volumes and increased profitability means the catastrophic losses of borrower savings, homes and businesses are disregarded.
- The seller network is not privy to internal fraud mechanics, removing possible threats to the control fraud blueprint implemented by 17 specific lenders in Australia *at the same*

time – prima facie evidence of an active cartel in operation.

- A ‘cosy arrangement’ is established between lenders and hand-picked law firms in order to superficially fulfil legal contract and borrower contact requirements, despite Courts frowning upon the practice of lawyers serving ‘two masters’ simultaneously.
- Victims of predatory lending are unable to compare their individual cases to identify control fraud strategies in common, but these methods and processes have now been confirmed by thorough analysis of the 2,000+ cases in the BFCSA pool.
- Victims are mired in debt and have negligible remaining assets or savings to seek expensive legal remedies and eventual compensation – the likelihood of detection is therefore remote.

5.4: Lender Omissions

- As described by Colin Neave in 2001 ABOS policy, lenders have failed to inform borrowers of product risks and vigorously avoided all client contact.
- Lenders made a collective decision to only present three page LAFs when compelled during Court proceedings, purposefully omitting all relevant pages doctored by internal staff under instruction from executive management.
- Borrowers are only shown a three page LAF at inception (the pre-approval phase), with an additional eight pages or more added after signatures are obtained – lenders falsely state before the Courts that borrowers have seen a complete copy and faithfully signed relevant clauses: “I have fully read and understood everything.”
- Legal discovery is frustrated unless defence lawyers knew specifically what to look for – lenders are not forthcoming with crucial paper-trail elements corroborating their involvement in a criminal conspiracy.
- Lawyers engaged by lenders fail to inform the Courts that staff were ordered to use “ABNs for a day” to qualify borrowers for business loans and to disguise their non-proprietor status – a direct breach of rules and regulations in the Bankers Code of Conduct.
- Similarly, lawyers have omitted to explain in court proceedings: forged signatures, SCs generating fudged incomes and fake borrower occupations e.g. 75 year-old ‘landscapers’.

5.5: Control Fraud Strategy and the Seller Network

- The core of the criminal conspiracy is laid bare by the lender strategy employed – simple, outwards steps leading 11,000 agents to believe they were not party to, nor committing, fraud.
- Lenders are ultimately responsible for predatory loans – they developed the product, marketing and financial strategies based on flawed financial advice that risked the borrowers' financial livelihoods.
- The ASIC Commissioner noted in early 2014: *"the sellers did not all wake up one morning, have an epiphany and design their own personal calculator"* – sellers are isolated by the tyranny of distance, with only the occasional crossing of paths when meeting with lenders.
- Regulators and the BFCSA concur that most sellers are honest – the 100 per cent rate of fraud in every mortgage loan case examined (income tampering) suggests lenders are culpable for changes *after the signature is obtained and without the borrowers' knowledge, consent or authority.*
- Forged handwriting on loan documentation is different from the sellers, with second and even third stylistically different forms appearing on documents *after the fax has been sent in for lender processing.*
- Sellers complete paperwork in 64 per cent of cases, meaning bank managers are directly involved in completing 36 per cent of total loans subject to fraud – all were taught to use the same SC that inflates incomes.
- The fraud strategy is not limited to only the sub-prime (low-doc, no-doc) lending pool, *18 per cent of fraudulent loans in the BFCSA pool have prime (full-doc) status.*
- The BFCSA possesses material evidence of lender culpability – multiple, internal emails providing instructions to the seller network to shred original documents subject to tampering.
- Lender instructions to use one-day ABNs for non-proprietors ('dressed up business loans') is also evidenced via abnormally low borrower incomes (usually less than \$75,000) and the production of fake ABNs that are easily discovered when cross-referenced with the ATO website.
- The ATO has already expressed alarm at the meteoric growth of hundreds of

‘professional investors’ in the elderly ARIP cohort and has reached similar conclusions regarding allegations of foul play, but following the transfer of files to ASIC, this evidence has not been referred to the Commonwealth Director of Public Prosecutions.

5.6: Knowledge as Intent

- A critical point to note: when lenders outsource field work via the seller channel in order to increase the potential for high-volume lending, legal advice suggests this exhibits deliberate intent to circumvent liability, even though lenders are responsible for manufacturing products designed to yield borrower collateral in less than six years.
- Lenders’ deceptive intent is also starkly observed in misleading marketing material produced and distributed to the seller network that specifically targets the debt-free, ARIPs (the elderly) – borrowers with strong incomes prove too difficult to default, smaller profits flow from those already in debt, and the value of asset seizure is greater for retirees and pensioners.
- The toxicity of loans is evidenced by their design – it is nonsensical to offer *30-year interest-only loans to people aged 55 to 90 years who own their own homes* when a host of safer financial investment options are available.
- Lenders demonstrate a cold indifference to the consequences of control fraud: bankruptcy, foreclosure on the family home, debts over non-existent assets, the loss of life savings, and potential homelessness.
- Australia’s tame regulatory regime has exacerbated the dynamics of control fraud and compounded victim losses, while lenders have simultaneously reaped massive and illegal windfalls.
- All of these activities are covered under specific provisions of the Crimes Act: criminal intent, misleading and deceptive conduct, and omission of obvious fraud and forgery.

G.6: Forensic Checklist for Fraud Investigators

Table 6.1: Fraud Focus Areas and Indicators for Police Investigation

- Eleven page LAFs which are then presented to customers as a three page ‘complete’ copy.
- No copies of LAFs provided to the borrower(s) at the point of signing.
- The ‘ABN for a day’ scam which disguises non-proprietor status, low borrower incomes (less than \$75,000) and fake ABNs.
- Police have found a ‘multiple copies’ system in effect – each version (copy) of the LAF was different, with changes attributable to internal lender processes *after* the receipt of the original faxed copy. Sellers were told to retain the original, which may differ significantly from the final internal lender version, thus exhibiting the scale of fraud.
- Lenders avoid scrutiny or blame by insisting upon a broker’s hand-writing on the LAF.
- Forgery is evidenced by up to three visibly different sets of hand-writing on a majority of LAFs – most alterations are made by external agents and internal staff using ‘cut and paste’ methods.
- Similarly, the income on the original SCF differs from internal lender copies – they are altered *after* they are received, according to CA’s notes. The CA’s version of the calculator is geared differently with an altered NSR factor. Neither CAs nor sellers are aware of this fact, yet they “must be attached”.
- The CA’s can then “adjust the calculated approval of the loans” – lender code for jumbo-sized loan sums well beyond the limits of normal serviceability criteria. In the UK, Police discovered CAs were using “gallons of white-out”.
- In some instances, lenders ordered aggregators and brokers to shred the original wet-ink copies of loan documents just twelve days after settlement. The express intent is to destroy any remaining evidence of an ongoing control fraud that has entrapped the borrower.
- Many customers report lenders sent them a congratulatory letter stipulating loan sums far higher than they had applied for, or had agreed to e.g. following an application for \$250,000, one customer was advised: “*good news, \$350,000 was approved*”.
- This practice encourages greater use of additional loan facilities – buffer monies in the form of bridging loans and prohibitive refinancing options. Superficially, borrowers can

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'afford payments', but they can only meet payment terms with additional financing and not from pre-existing income.

- Lenders' failure to make simple verification checks with borrowers via a telephone call.
- Secret valuations undertaken by lenders which exhibit a \$100,000 discrepancy before and after approval – customers are not made aware they are now at risk of losing their home.
- Self-insurance and loan mortgage insurance scams are used to disguise higher LVRs that may uncover fraud.
- Email evidence of internal lender staff encouraging brokers to “pump up the volume” (increase the rate/number of loan approvals).
- Commissions and bonuses are quota-driven and originate from the lenders. Payments are influenced by a lender product assessment process regarding the 'success or failure of approval (rates)'. Trailing commissions also encourage the inappropriate targeting of customers.
- The bonuses of lender staff increase with rising institutional profitability and associated greater market capitalisation – senior management are rewarded commensurately from the top down.
- All bank and non-bank lenders have used the same model with identical fraud mechanics, suggesting a banking cartel has formed in the banking and financial sector.
- Maladministration in lending has become the norm and led to the victimisation of thousands of borrowers. A thorough investigation by State and Territory Police is needed to address white collar crimes that set out to seize borrower collateral, principally via disguised processes of fraud and forgery, and abuse of computerised processes.

G.7: Conclusion

Widespread practices of criminal activity, left unattended and unpunished, metastasise and became the new sectoral 'norms', as fraudsters are emboldened. Numerous investigations of lender predations have already been completed. Intelligence has been painstakingly gathered over more than a decade, meaning the BFCSA can produce an impressive array of documentation to substantiate every single statement declared in this document.

Investigators must remember the 'Big Four' banks control 85 per cent of the mortgage market, thus, they remain a prime target for successful prosecutions. Throughout 2014, APRA and the RBA have registered a strong surge in interest-only loans and expressed their own concerns over bad lending practices within the banking and financial sector. Surprisingly, investigations to date have failed to unearth corroborating evidence of systemic problems, or revealed breakthroughs in unravelling the true state of mortgage lending. Consequently, these products are still being sold and approved.

For more than a decade, senior management in our most respected financial institutions, lauded for being 'wealth creators', have implemented pernicious control frauds hostile to the financial livelihoods of consumers - normal, everyday Australians going about their business. Long-term successes have led lenders to assume they have attained an 'untouchables status' and are sufficiently protected from criminal sanctions for their actions.

White-collar criminals mistakenly believe police have their hands tied on jurisdictional grounds or will not pursue aggressive forensic investigations to piece together the grand financier web of deceit that has entrapped a multitude of victims, causing immeasurable emotional, financial and physical harm.

Appendix H: Recourse and Non-Recourse Lending

In the US, mainstream neo-classical economists defended the exponential growth in mortgage debt, claiming that borrowers would not default en masse because loans had recourse (full-recourse), rather than non-recourse status. The legal difference is usually set by state rather than federal law. If a mortgage is recourse, borrowers are legally liable for the full value of the mortgage if they default. Conversely, non-recourse loans do not legally oblige borrowers to pay back the difference between the loan sum and the sale value of the property.

The significance of the recourse liability is borrowers must honour their promise to pay. Even if housing prices fall, owners have an incentive to keep servicing debts and not sell their home. If a borrower with a recourse mortgage experiences financial difficulty and stops repayment, the lender can foreclose on the property, recouping the value of the mortgage. This is not considered a serious problem for either the borrower or lender if the sale value of the property is equal to or larger than the value of the loan. The issue arises when the property's value is less than that of the mortgage. If the mortgage is recourse, the lender can pursue a deficiency judgment against the borrower to make a claim on their remaining assets. The intent of recourse mortgages is to encourage conservative borrowing and minimise bank losses, as the lender can begin legal proceedings against the borrower if they default and the property sells for less than the outstanding debt liability. Recourse lending is therefore asserted to limit risks to lenders and the financial system as a whole.

It is commonly thought the majority status of non-recourse mortgages in the US led borrowers to assume irresponsible amounts of debt for housing speculation, thus generating a bubble. In contrast, Australia is declared to have a greater level of structural safety, based on more prudent borrowing standards (leading to modest lending) and the vast majority of recourse mortgages on banks' loan books.¹³⁰ For millions of borrowers in the US, the collapse in property values has placed them in negative equity, meaning their largest asset is worth less than the outstanding debt liability to the bank. Many owners are motivated to cut their losses and abandon the property dream, leading to the coining of the term 'jingle mail' as a steady stream of bankrupts mailed their

¹³⁰ REIA (2010); Stapledon (2009).

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keys to their lenders. Those who default on their mortgages do so for two reasons. The first category experience financial difficulty and cannot make repayments, usually due to unemployment or underemployment. The second category of defaulter, despite their healthy financial circumstances, makes a strategic decision to cease mortgage payments after property values have plummeted, recognising they are unable to make a viable return on their investment.

Those adopting the latter stratagem will find it more difficult to secure finance in the future, following a downgrade in their personal credit rating lasting several years. Nevertheless, defaulting may be a wise choice because bad credit ratings are often expunged in less than a decade, while a poor housing investment could theoretically take decades to repay as prices deflate in real terms. Considering the opportunity cost of not defaulting, it is rational for individuals to pursue this course of action. The double-standard in societal treatment of personal versus banking sector default is also worth noting. The financial sector demonises debt defaulters and ensnares them under punitive contractual arrangements, but in the event of a banking crisis threatening insolvency, banks immediately seek debt forgiveness, restructuring and bailouts at taxpayer expense. This hypocrisy has not gone unnoticed.¹³¹ In summary, non-recourse lending in the US was believed to be a major factor in the formation of its housing bubble, while Australia's recourse mortgages are alleged to have prevented the rapid accumulation of debt and the same potential outcome.

The problem with this line of reasoning is the evidence shows the opposite.¹³² Out of the fifty states and one district in the US, eleven have non-recourse mortgages, while the remaining thirty-nine states are recourse. The legalities in the remaining eleven states are varied; some allow for the first mortgage to be non-recourse, but all proceeding mortgages are recourse. Courts are frequently the final arbitrator of whether a borrower is liable for the full value of a mortgage in a non-recourse state. Florida and Nevada, for instance, are two states that experienced the largest housing cycles, yet mortgages were recourse. Borrowers in these states helped form a housing bubble by adopting irrational investing behaviour, despite facing liability for the full value of the

¹³¹ Starkman (2014). Throughout the last five thousand years of recorded history, regardless of the type of economy and society, the wealthy have always practised communism amongst themselves in terms of debt arrangements, but for those below them, a contract is a contract is a contract (Graeber 2011).

¹³² Ghent and Kudlyak (2011).

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loan. In contrast, California and Oregon, similarly affected by housing bubbles, have non-recourse loans. It is evident that if recourse mortgages prevented imprudent borrowing, the largest housing bubble in US history would not have formed.

The US bubble burst with dramatic consequences, with real housing prices plummeting by 42 per cent nationwide between the peak in 2006Q1 and the trough in 2012Q1.¹³³ There was no marked difference in overvaluation between recourse and non-recourse states, indicating this variable is not a protective factor. For instance, recourse and non-recourse states have similar default rates when considering residential properties with an appraisal value of \$US200,000 or less at origination. Recourse states only established a relationship with default rates when the appraisal value was greater than \$US200,000; the higher the value, the greater the default rate. It is possible the wealthy have fewer reservations about strategically defaulting. In non-recourse states, owners were more likely to default when reaching a position of negative equity.¹³⁴

Other countries with recourse loans experiencing severe housing cycles include Ireland, Japan, the Netherlands, Denmark, and Spain. Countries with recourse mortgages and overvalued housing markets that have not yet undergone a significant correction include Australia and Canada.¹³⁵ These examples suggest the threat of default, leading to an outstanding mortgage liability and possible court-enforced asset forfeiture, is an irrelevant consideration for most borrowers. In a booming economy, investors in the grip of speculative mania will always anticipate housing prices to rise, particularly if government and FIRE sector disinformation reinforces the belief that prices reflect the fundamental forces of supply and demand. Borrowers radically increase leverage to maximise returns, confident in the assessed improbability of a housing bubble. For these reasons, the significant legal liability attached to recourse loans does not limit risks to either lenders or borrowers. Consequently, during the US housing bubble collapse, this false sense of confidence and an epidemic of fraud left many borrowers with a mountain of unserviceable debt.¹³⁶

¹³³ Shiller (2016).

¹³⁴ Ghent and Kudlyak (2011).

¹³⁵ Lea (2010).

¹³⁶ It is never noted that if recourse mortgages did enforce conservative borrower behaviour, the opposite occurs on the lending side, as banks take advantage of borrowers' legal obligation by lending more freely.

Appendix I: List of Federal and State Inquiries

Since the mid-1990s, there have been many federal and state inquiries into the predations of the banking and financial sector, including the impotent regulator ASIC. Denise Brailey has lobbied for, provided submissions and testified before many of these inquiries. While these inquiries have proven invaluable in exposing the wrongdoings of control fraud participants and the intentional passivity of the regulators, especially ASIC, a Royal Commission is the final and necessary step to publicly unveiling the crimes committed against many Australians by the FIRE sector.

1. Les Smith Inquiry into the Ministry of Fair Trading's Real Estate Business Unit (1997).
2. Premier Geoff Gallop Review into the Boxes of Missing Documents (1999).
3. Report of the Gunning Committee of Inquiry into the Finance Brokers Supervisory Board (2000).
4. Select Committee into the Finance Broking Industry in Western Australia (2000).
5. Senate Select Committee on Superannuation and Financial Services Inquiry into Matters Relating to Superannuation and Financial Services (2000).
6. Royal Commission into the Finance Broking Industry (2001).
7. Parliamentary Joint Committee on Corporations and Financial Services Inquiry on Regulations and ASIC Policy (2002).
8. Ministerial Council on Consumer Affairs Inquiry into Spruikers and Property Scams (2003).
9. Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Regulation of Property Investment Advice (2005).
10. Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Financial Products and Services in Australia (2009).
11. Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the collapse of Trio Capital (2012).

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12. Senate Standing Committees on Economics Inquiry into the post-GFC banking sector (2012).
13. Senate Economics References Committee Inquiry into the performance of the Australian Securities and Investments Commission (2014).
14. Financial System Inquiry (2014).
15. Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry (2014).
16. Senate Economics References Committee Inquiry into the Scrutiny of Financial Advice (2015).

Appendix J: Subprime Mortgage and Debenture Control Frauds

The banking and financial sector tend to favour two diabolical control frauds they have devised to confiscate savings and assets: debenture capital-raising schemes and subprime mortgage lending. As suggested in bank emails to the seller channels and marketing seminars, the affected targets are typically retirees and pensioners on low-incomes. Together, these two control frauds have robbed consumers of tens of billions of dollars over the last two decades, with the potential for losses to exceed \$200 billion in the near future. In both instances, the financial planner and broker channels (untrained sellers) are used for the following four reasons:

- 1) To vigorously avoid all legal and financial responsibility and liability, ensuring the risks are clandestinely transferred to the borrower.
- 2) The probability of enforcement actions is reduced in an already lax regulatory environment with additional degrees of lending separation, aided and abetted by deregulation, self-regulation, desupervision and de facto decriminalisation of white-collar crime.
- 3) Executives and managers can still achieve obscene bonuses and incentive payments for highly-profitable control frauds after accounting for agent commissions that dilute returns.
- 4) Predations are likely to remain unpunished due to successful lobbying by vested interests for further financial deregulation that creates a power imbalance favouring lenders over investors and consumers.

As identified by the BFCSA, the following is a brief timeline of Ponzi activities of just one debenture-funded company, involving the banking and financial industry, including property developers and builders.

- In 2000, Denise Brailey briefed an ASIC commissioner regarding debentures that were being sold with security amounting to IOUs in the form of Promissory Notes. The prospectus was a 'look-alike prospectus' known as an Information Memorandum.
- The prospectus was fabricated by lawyers and one non-executive director position was even held by a Victorian judge. A director position was also suspected of being occupied by a former ASIC employee.

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- In 2001, Ms Brailey had a roundtable discussion with ASIC's chief barrister, the Director of Enforcement and a Commissioner, where they again "expressed concern."
- By 2004, ASIC had taken one of the companies within this group to civil court, asking the judiciary for clarification over its own jurisdiction. The judge explained this matter was indeed within ASIC's purview and the reasons why. The amount of capital raised from vulnerable investors amounted to \$100 million in 2001, but had grown rapidly to \$600 million by 2005.
- The company collapsed at the end of 2005, owing \$680 million in funds to mostly retirees who had lost their entire life savings.
- The Ponzi structure meant that after one year, most investors' funds were switched between multiple projects without disclosure, sometimes up to eight times. Those who asked for their funds back were almost always deterred and unsuccessful in their attempts.
- All investors were paid a monthly income until the weight of the Ponzi collapsed due to insufficient additional participants entering the scheme. The grinding existence of penury without an income was worsened by news delivered only three weeks later: investor capital had been extinguished at 100 cents in the dollar.

In 2005, former ASIC chairman, Jeffrey Lucy, admitted that there was \$5 billion potentially at risk in debenture schemes, later revised in 2007 by the acting chairman, Tony D'Aloisio, to \$37 billion at risk. Later that same year, an ASIC list was released that identified even more entities, but the total assessed figure did not change. D'Aloisio advised Parliament there were four categories of debenture finance and the totals did not fully denote all categories.

At that stage, Denise Brailey believed the real figure was closer to \$80 billion when every type of company and category of financing was encompassed. The BFCSA has been studiously compiling a preliminary Register of Losses relating to those companies that have already collapsed; this research is a work in progress. The data demonstrates \$55.7 billion in lost funds, with \$100 billion potentially at risk. ASIC is aware of the potential for widespread and cascading investor losses, but they lack the unwavering conviction to identify and prosecute these control frauds.

The second, and possibly more dangerous control fraud, is the subprime mortgage scandal stretching from coast to coast. Borrowers are intentionally sold defective financial products,

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primarily interest-only loans, which are designed to implode and allow the forfeiture of valuable collateral. Hundreds of thousands of households may have been caught by this 'debtor prisoner's dilemma'. This massive control fraud is similar to the US model, where lenders targeted NINJAs (no income, no job or assets). Australian lenders have adopted comparable techniques, but have instead focused their predatory lending on ARIPs – the asset rich, income poor.

Borrowers' loan application forms (LAFs) are manipulated by means of computerised and password-protected 'service calculators'. Lenders provide these black box applications to brokers on the pretext of assisting with calculating tax advantages, but in reality, it helps generate unrealistically large loans for approval. Borrowers are provided with loans far beyond their capacity to service out of disposable income over the contractual term. Bank lawyers assist with drafting contracts, ensuring independent legal advice is unavailable that may unravel the deception.

Jumbo interest-only loans are granted to novice 'mum and dad' investors, even though they are designed to default within three to five years, causing them to lose everything. Bridging or buffer loans are often granted in the years preceding borrower default to extract additional profits (penalty interest rates and fees). The BFCSA database indicates clients have an average loan value of \$400,000, despite being on annual incomes of only around \$30,000. Without exception, these mortgages should never have been approved, and have consequently ballooned to \$600,000 several years after issuance.

Potentially more than 200,000 families and \$100 billion are at risk from one control fraud. The effects could easily gather momentum and greatly amplify the potential losses across the economy. The RBA, ASIC, APRA, ATO, AFP, Treasury, FOS and COSL all spurn opportunities to investigate serious allegations of predatory lending; the existence of systemic fraudulent lending is denied. Broker channels have instead become the 'fall guy' for faulty financial products, conveniently shifting the blame from financial engineers onto 'rogue sellers' who play a relatively minor role.

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