Chapter 11

Role of banks

> I was not informed of the risk from NAVRA Financial advisors, I was not given a clear statement of advice, they did not consider my personal situation and had inadequate insurance. The Banks then enabled this bad practice by agreeing to lend money when my serviceability and assets were insufficient and no loan documents were ever given, until requested through the FOS [Financial Ombudsman Service] process.[1]

11.1 In the previous chapters, the committee focused mainly on the conduct of, and advice provided by, financial advisers and scheme promoters. Many of the growers, however, formed the view that the banks were in some way responsible for their current situation. They could not comprehend how they ended up in such parlous financial straits and clearly attribute their plight not only to their advisers' poor advice and unethical behaviour but to the complicity of the banks in financing their loans. In this chapter, the committee considers the role of the lenders in financing investors in MIS. The focus is on two banks in particular: the ANZ, which provided finance through Timbercorp Finance; and Bendigo and Adelaide Bank, which provided finance through Great Southern Finance.

11.2 Further, when the schemes collapsed, a number of growers complicated their financial predicament by following legal advice to stop making repayments on their MIS loans. The committee considers this matter in the following chapter.

Banks and responsible lending

11.3 Many investors caught out by the collapse of agribusiness MIS and burdened with significant loans were of the view that the banks should have taken more care and exercised due diligence when providing finance for the products.[2] For example, one such couple, referred to the banks' role in providing margin loans, warrants and loans for agricultural schemes without verifying the borrower's ability to repay.[3] They stated:

> Why were the banks allowed to fund these schemes as they did? Where were their responsible lending practices back then? For Tony and I, the 2007 and 2008 schemes combined came to approximately $286,000 between us. Even at the time of the last 2008 scheme we did not have sufficient assets to repay this amount. We could not have met serviceability

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1 Name withheld, *Submission 63*, p. [2]. It should be noted that Bendigo and Adelaide Bank responded to this submission as well as a number of others who criticised the bank.

2 Miles and Marion Blackwell, *Submission 173*, p. 1.

3 *Submission 65*, p. 1.

> criteria with which to repay this at the time, let alone now, 5 years later with accumulated and penalty interest added on top.
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> The repayments for both schemes between us interest only were approximately $2,300 per month, and when the capital began to be repaid this would total over $4,500 per month—this is more than a $1 million mortgage!!! Yet our 2006 tax return showed $95,000 income between us. Why were the banks allowed to lend this amount, when it was quite clear we would not be able to repay, should the grapevine returns not materialise? Everything hinged on the grapevines producing returns—without this, there was no way for us to repay the loans—so why were the banks allowed to lend on this basis?[4]

11.4 This investor asked, as did a number of other investors, whether Bendigo and Adelaide Bank acted lawfully or ethically when it failed to assess properly and approve each and every loan application and did not review the ability of investors to service their loan—could they actually afford the loan liability should the returns not transpire. There were also concerns about the bank:

- neglecting to point out to investors that should the grapevine returns fall short, they would be expected to service the loans and that their homes and other assets would be at risk if they did not;
- allowing investors to sign up under the illusion that this was a safe, self-funded investment backed by the Australian Government to encourage investment in agriculture;
- misleading investors into thinking that their loans were directly tied to the vinelots they purchased, giving them maps and details as to where their little pieces of land were; and
- providing commissions of 10 per cent to the accountants and financial advisers informing the investors.[5]

11.5 Some investors also levelled allegations of lax lending practices. For example, one investor with Great Southern stated:

> It would have also been beneficial if Bendigo bank had provided a clear concise copy of the loan application form! That way I would have been afforded the opportunity to clearly see the loan I was applying for.[6]

11.6 The investor went on to state that Bendigo and Adelaide Bank took no responsibility to ensure that Great Southern was doing the right thing in their practices or to whom they were lending money. He explained that the bank did not check to ensure that he met the lending criteria—that he could repay the money:

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4 Name withheld, *Submission 56*, pp. [4]–[5].

5 Name withheld, *Supplementary Submission 56.1*.

6 Name withheld, *Supplementary Submission 52*, p. [2].

> As I'm sure you've been told the Banks position is 'we had a loan servicing agreement in place with Great Southern, so if Great Southern did the wrong thing then it is not our fault'. Not responsible lending at all!
>
> Great Southern imploded in 2009 and Bendigo Bank have engaged bully boy tactics and are demanding full repayment of the loans at over 10% interest, plus early exit fees.[7]

11.7 This investor called on the bank to 'show some corporate and social responsibility/conscience'.[8]

11.8 A number of submitters argued that the banks should have exercised greater care when providing finance and been aware that the schemes were in trouble, with some suggesting that the banks were supporting insolvent companies.[9] In their view, the banks that were funding the schemes should have known better. For example, one submitter stated:

> Bendigo Bank claims that it is not responsible for the actions of its agent (GS Finance Pty Ltd) even though it provided hundreds of millions of dollars to fund GS projects—a Ponzi-like scheme that could not have operated without that funding. This had, apparently, been going on for some time prior to the GS collapse.
>
> So, why did Bendigo Bank provide millions of dollars through its agent (GS) to investors for MIS projects that did not or only partially ever exist?[10]

11.9 The investor could not fathom why the banks did not conduct due diligence and gave the example:

> …if I was to build a new house with a bank loan obtained from a broker, I'm sure the bank would want confirmation that a house could be built to that valuation and then confirm it actually was built at some point in time to secure their investment.[11]

11.10 Based on the succession of events in the Great Southern debacle, he could only conclude that 'Bendigo Bank sought to recover its own bad debts at the expense of misled and innocent investors'.[12]

11.11 Mr Huggins chronicled what he believed were the problem areas of the banks involvement in providing loans to retail investors in MIS, in this case the Commonwealth Bank of Australia (CBA). In his view, conflicts of interest were at the

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7 Name withheld, *Submission 52*, p. 1.

8 Name withheld, *Submission 52*, p. 1.

9 Name withheld, *Submission 100*, pp. 11–12.

10 Name withheld, *Submission 91*, p. [2].

11 Name withheld, *Submission 91*, p. [2].

12 Name withheld, *Submission 91*, p. [2].

very core of these problems. He was surprised that the CBA apparently entered into an arrangement where:

- it would provide finance for what were well understood to be highly speculative investments;
- the promoter acted as the administrator with respect to the finance that was to be provided by the CBA;
- the person who was providing advice about the scheme (and who stood to make a substantial commission if that advice was accepted) also produced evidence as to the client's income;
- the entire process from completing an application to making an investment/application for finance and for funds to be drawn down took approximately 24 hours;
- funds would be drawn down with respect to a loan before the client was informed as to the terms of the loan—the implication being that this was done so as to give the client no opportunity to consider their position and no opportunity to attempt to get out of the investment; and
- the Confirmation Notice (this document was not produced until months after the loan had been drawn down) and bank statements (this went on for a number of months) with respect to a loan would be sent to the promoter of the scheme instead of the client.[13]

11.12 Mr Peter Jack held the view that:

> The banks and other major institutions who underwrote this venture and also had their advisors sell this product need to be held accountable. I find it unfathomable that a bank such as ANZ can post billion dollar profits and consciously destroy the lives of so many Australian families this is corporate greed…[14]

11.13 Mr Craig Stranger, Managing Director of PAC Partners, formed the view that payments sought by KordaMentha on behalf of the Timbercorp banks were 'neither fair, nor reasonable'. In his opinion, the very same banks were the stakeholder most 'inside the tent' of Timbercorp, and therefore 'implicit in growing the business, plantations and therefore risk profile aggressively'. In his words:

> To show 'all care and no responsibility' after the event, and still seek full interest from unsophisticated retail investors is both immoral and unjust in my strong view.[15]

11.14 Investors were particularly upset with the banks for apparently placing their own interests before those of the borrowers. One investor indicated that the biggest

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13 *Submission 118*, p. 7.

14 *Submission 25*, p. 1.

15 *Submission 16*, p. 1.

risk was the company itself collapsing but even then, 'the bank could still recover its money from the growers—the loan documents were written to ensure this'. Referring to Timbercorp MIS, he explained:

> By insisting that the company finance itself through 'growers' who notionally borrowed money from Timbercorp Finance notionally provided by the bank, the bank was insulating itself from any risk associated with the company's performance or even the company's very existence.[16]

11.15 According to the investor, because the true nature of the investment had not been explained, the growers' were 'the Turkeys who…were taking all the risk off the shoulders of the bank'.[17]

ANZ

11.16 ANZ was one of a number of lenders to the Timbercorp Group and was aware that 'many Timbercorp investors borrowed from Timbercorp Finance or other lenders to purchase their investment'.[18] ANZ informed the committee that it provided finance to the Timbercorp Group: that 'the relationship was broad and extended beyond the $150 million grower loan facility with Timbercorp Finance'. Total ANZ lending to the group was around $500 million. ANZ made clear that:

- in early 2003, ANZ entered into loan securitisation arrangements with Timbercorp Finance, and later also provided it with a 'grower loan facility'—the securitisation allowed Timbercorp to securitise the grower finance so that the Group itself did not have to fund the full amount of the grower loans;[19]
- ANZ did not provide direct loans to Timbercorp investors and had no direct relationship with growers who borrowed money from Timbercorp Finance;[20]
- applications for investor loans were received, assessed and processed by Timbercorp Finance;[21]
- ANZ reviewed the Timbercorp Finance standard loan documentation, the loan application process, credit policy and procedures manual, and procedures for collecting and handling arrears as part of its due diligence and ongoing monitoring and assessment of the securitisation program; and
- ANZ regularly conducted analysis and testing of loan portfolio data and received monthly reporting on the portfolio, including information on compliance with pool parameters, default rates and arrears.[22]

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16 Name withheld, *Supplementary Submission 186.1*, p. 2.

17 Name withheld, *Supplementary Submission 186.1*, p. 2.

18 *Submission 145*, p. 8.

19 *Submission 145*, p. 11.

20 *Submission 145*, p. 10.

21 *Submission 145*, p. 11.

11.17 Commenting on its oversight of Timbercorp Finance, ANZ observed:

> Copies of completed loan documentation were held by Timbercorp Finance, not ANZ. However, ANZ performed a sample review on an annual basis of Timbercorp's borrower loan files. This sampling process did not disclose any irregularities in the borrower loan documentation reviewed. The staff, who conducted the audits on Timbercorp Finance, analysed the monthly reports and reviewed the credit processes and procedures, were familiar with standards for retail loan credit and reported their findings to an experienced team at ANZ who was satisfied with the reported processes.
>
> The monitoring and assessment performed by ANZ, as lender to Timbercorp Finance under the grower loan facility, mirrored that performed by ANZ's securitisation team.[23]

11.18 ANZ explained further that its credit rating of Timbercorp to April 2007 was 'quite good'; from April 2007 to July 2008 was 'acceptable'; and from that date until the collapse of Lehman Brothers in September 2008 was 'satisfactory'.[24] It maintained that its assessment of Timbercorp over the years was 'careful and responsive':

> In the 15 years of Timbercorp's existence leading up to 2009, Timbercorp's business was scrutinised by regulators, analysts, management, investors and other lenders, none of whom identified any particular or systemic flaw. It is not appropriate now to overlay that assessment with the knowledge of hindsight and the particular impact of the unfolding global financial crisis on Timbercorp.[25]

11.19 As at October 2014, investor-borrowers owed Timbercorp Finance $489 million. ANZ informed the committee that secured creditors, including ANZ ($93 million for Timbercorp Finance plus $14 million for Timbercorp Finance Trust) have specific rights to the repayments received on certain pools of loans.[26]

Resolving difficulties with outstanding loans

11.20 According to KordaMentha, the liquidator appointed to Timbercorp, at November 2014, the Timbercorp loan book had approximately 2,800 borrowers with 6,700 loans outstanding. The majority were in default and subject to legal recovery. At that time, it informed the committee that:

> Loan recovery was stayed from June 2009 to May 2014 while the Grower Investors pursued a Class Action through the Victorian Supreme Court, the Appeals Court, and ultimately dismissed by the High Court of Australia.

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22 *Submission 145*, p. 11.

23 *Submission 145*, p. 11.

24 The collapse of Lehman Brothers was a very large and significant corporate failing that unsettled world markets and marked a new phase in the global financial crisis.

25 *Submission 145*, pp. 27–28.

26 *Submission 145*, p. 28.

> Given the duration of the Class Action, we are approaching the statute of limitations period to commence recovery action against borrowers who remain in default and have instructed solicitors to commence recovery proceedings.[27]

11.21 KordaMentha explained its strategy for debt recovery:

> Prior to commencing legal proceedings every borrower is contacted in writing to advise proceedings will be commenced and attempt to engage in meaningful discussions to deal with their outstanding loan(s). Given the passage of time and the emotional engagement of many borrowers in the Class Action there has been reluctance from borrowers to engage in discussions with the Timbercorp Finance collection team.[28]

11.22 If a borrower engages with KordaMentha's collection team and advises that they are unable to take up the early repayment discount (15 per cent) or prepayment discount (10 per cent), KordaMentha reported that it then:

- deals with them on a case by case;
- asks them to complete a Statement of Financial Position to determine what they can repay;
- subject to the individual facts and circumstances, may also choose to independently verify (at its cost) the factual position of the borrower;
- if it is as represented, KordaMentha would usually agree an arrangement to accommodate the borrower's financial circumstances.

11.23 When the borrower engages with KordaMentha, it has 'generally agreed terms that normalise the interest rate and provide repayment terms that the borrower can manage'.[29]

11.24 By August 2015, 5,300 borrowers no longer had a debt with Timbercorp Finance. The remaining 2,200 with outstanding debts to Timbercorp Finance, which amounted to $380 million, had three options as outlined by Mr Korda:

- settle with a 15 per cent discount, which is non-negotiable;
- continue to litigate; or
- join the hardship process.[30]

11.25 Many submitters were highly critical of the conduct of the Timbercorp liquidators and ANZ. One such investor suggested that ANZ had directed the administrator KordaMentha to 'show no mercy and get every cent they could at

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27 Mr Mark Korda, correspondence to committee, 5 November 2014.

28 Mr Mark Korda, correspondence to committee, 5 November 2014.

29 Mr Mark Korda, correspondence to committee, 5 November 2014.

30 *Proof Committee Hansard*, 6 August 2015, p. 14.

13.5 % compound interest'.[31] A Timbercorp grower, Mr Tim Stanford, explained that the Agriculture Growers Action Group (AGAG) presented KordaMentha with a commercial settlement proposal, which was supported by a robust set of data. In his words, KM 'have not even entered the negotiating room on this but instead continue to offer a paltry and derisory 15% discount which has been rejected three times by Growers'.[32] As many investors observed 'In the time this has taken the debt of every Grower has doubled!' Mr Stanford stated:

> Instead they (KM) continue to pursue individuals (like a hunting pack) for legal debt recovery at a snail's pace, notionally safe in their belief that a 13% penalty interest rate makes a slow resolution the best commercial outcome for them.
>
> This strategy is absolutely ridiculous and not in the best interests of anyone but KordaMentha.[33]

11.26 He echoed the sentiments of many others:

> The ANZ have secured their money, the financial advisors have made their commission, KordaMentha are managing it in their best interests and the only person funding this is the poor investor who was duped in the first instance.[34]

11.27 Another grower complained:

> For the liquidators to be so forceful in trying to recoup our loans at such a high price is disgraceful and unfair. To have been a part of this investment for less than a year and now asked to pay back our loan with high interest and to have nothing to show for it is unbelievably unfair.[35]

11.28 It should be noted that once insolvency practitioners assume the administration and winding up of a failed scheme, they are required to recover any outstanding debts. In this regard, ANZ noted that a receiver's primary duty is only to collect and sell enough of the assets of the company to repay debt owed to secured creditors. A liquidator, on the other hand, is required 'to bring the company's affairs to an end and does not cease after secured creditors are repaid'. It stated further that in seeking repayment of loans from growers, the liquidator's specific duty is 'to salvage as much as possible for the benefit of creditors'. Further, collecting the assets of the company was part of a wider duty:

> In performing these duties, a liquidator is required to act impartially and to exercise appropriate skill, care and diligence. To comply with these duties,

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31 Name withheld, *Submission 42*, p. 5. See also, name withheld, *Submission 53*, p. 1 and *Submission 54*, p. [1].

32 Mr Tim Stanford, *Submission 17.* See Dinu Ekanayake, *Submission 21*, p. 1.

33 *Submission 17*, p. 1.

34 *Submission 17*, p. 1.

35 Name withheld, *Submission 18*, p. 1.

> a liquidator must have a proper basis to settle or compromise a debt, such as borrower hardship.[36]

11.29 KordaMentha also made clear that liquidators have a statutory duty to secure, preserve and receive assets for the benefit of all its creditors.[37]

Hardship provisions

11.30 One group of investors with Timbercorp felt particularly aggrieved about their current situation. They were clients of the Holt Norman Ashman Baker firm and had formed an action group—the HNAB–AG. As noted earlier, ASIC has banned Mr Holt for three years because, among other things, he failed to comply with numerous financial services laws.[38]

11.31 Mr Graham Hodges, Deputy CEO of ANZ, informed the committee that through his discussions with this action group, members of the senate economics committee and others, the bank had worked 'to support a more accessible, transparent and empathetic hardship program for Timbercorp investors'. He noted that the Holt Norman affected Timbercorp investors were being given special attention to help resolve their difficulties. According to the bank, a major initiative involved the liquidator appointing an independent advocate in September 2014 to assist and represent investor borrowers in financial hardship. Mr Hodges indicated that KordaMentha regularly updated him on the hardship program and the work of the advocate, Ms Catriona Lowe. He stated further:

> While we only have a limited ability to influence those outcomes we are encouraged by the quick and fair settlements that are occurring.[39]

11.32 In August 2015, Mr Mark Korda provided detail on the hardship process that had been in place since the end of the litigation, and of the substantial enhancements over the previous 12 months, including the appointment of the independent hardship advocate (IHA). He maintained that Ms Lowe was very well credentialed and was there to help people in hardship resolve their issues. He explained:

> She has an independent mandate and she is fiercely independent—recognising, though, that the borrowers do not have to pay her; Timbercorp pays her. She has a small team and works independently with all the borrowers. She also appoints independent former financial counsellors to assist the borrowers. The borrowers do not pay for any of these costs. We pay for them. Why is that? It is not anything magnanimous, we just think it is a good business decision. We need to clean this up and the sooner we

36 *Submission 145*, p. 28.

37 Additional information provided by KordaMentha, 4 December 2014, p. 2.

38 For detailed information see paragraph 8.37, and accompanying footnote 32.

39 *Proof Committee Hansard*, 6 August 2015, p. 53. KordaMentha approached Ms Catriona Lowe in November 2014 to discuss the role of the IHA. Ms Lowe commenced her role as IHA in December 2014. Ms Catriona Lowe, *Submission 200*, p. 1.

> clean it up, the quicker we can get out of there and the creditors get their money.[40]

11.33 Ms Lowe understood that the IHA program and the internal Timbercorp hardship process were 'the first of their kind in the world'.[41] She drew comparisons with the program to expedite the delivery of compensation to investors in Bernard Madoff's scheme in the United States and hardship programs in Australia offered by credit providers, utilities and the ATO. Ms Lowe acknowledged:

> The critical difference between these processes and the IHA program is the presence of adviser negligence, misconduct or deceit in a significant number of Timbercorp cases. In the other markets mentioned there are separate, and usually free processes to examine, and if appropriate provide redress for, misconduct. In the case of credit providers and utilities there are industry based EDR schemes and in the case of the ATO there is the Commonwealth Ombudsman. Whilst industry based EDR theoretically provides this redress for poor adviser conduct, in reality this redress is stymied by the limitations of adviser solvency and PI insurance.
>
> This difference is important not only in that it demonstrates a significant gap in the system, but critically in how it affects the expectations of applicants to the IHA program and KM.[42]

11.34 The committee looks at dispute resolutions mechanisms available to investors in MIS in chapter 17.

Progress under the hardship program

11.35 According to Mr Korda, as at 6 August 2015, there were 395 applications in hardship process, 110 had been dealt with and two had been rejected.[43] Elaborating on this process of determining eligibility for the hardship program, Mr Korda explained:

> You can go into the hardship process for many reasons: ill health, disability, business failure, loss of job, loss of long-term employment, death, divorce or bad advice from financial planners.[44]

11.36 Mr Korda stressed, however, that 'it is the position you are in, not the reason, that will determine the outcome of our hardship process'. He stated that KordaMentha consider the person's ability to repay the loan and, to emphasis this fact, repeated that it was the current circumstances that would determine the result and not the source of the problem.[45] He explained:

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40 *Proof Committee Hansard*, 6 August 2015, p. 15.

41 Ms Catriona Lowe, *Submission 200*, paragraph 19.

42 Ms Catriona Lowe, *Submission 200*, paragraphs 21–22.

43 Mr Mark Korda, *Proof Committee Hansard*, 6 August 2015, pp. 15 and 19.

44 *Proof Committee Hansard*, 6 August 2015, p. 14.

45 *Proof Committee Hansard*, 6 August 2015, p. 14.

> It's about whether you can pay or not, and let's deal with that issue, not the root cause of it.[46]

11.37 To illustrate what he meant by hardship, Mr Korda gave the example of a person who may owe $50,000 and have a house worth $500,000 with no mortgage. In his words, 'that is not hardship'.[47]

11.38 As noted earlier where hardship is not established, the current maximum discount that Timbercorp Finance is offering is 15 per cent: that is a lump sum payment of 85 per cent of the existing balance, which is the principal and accrued interest. Ms Lowe noted that cases that settle at 70 per cent or higher 'necessarily involve payment of a significant component of interest'.[48]

11.39 Ms Lowe informed the committee that where hardship is established the majority of cases, but not all, settle for between 20 and 70 per cent, which is a significant range. There are three broad categories:

- serious financial hardship, where a person has limited or no assets and no significant earnings once expenses are deducted;
- serious non-financial hardship, which cannot be termed serious financial hardship cases but where other serious elements are present such as 'significant physical or mental health issues'; and
- other cases where the elements of hardship are at a lower level and where some discount may be achieved but of lesser magnitude than for the two cases cited above.

11.40 Ms Lowe noted that the serious non-financial cases were the ones most likely to cause the IHA and KordaMentha to disagree on the appropriate resolution.[49]

Criticism of the IHA process

11.41 It should be noted that the spokespersons for the HNAB—AG have written to the committee expressing their strong disappointment with the hardship program. Their complaints include the time taken to conclude matters—many months, not a couple of weeks—and 'significant errors' made by the advocate in determining the statement of the financial position of at least two borrowers.[50] They also pointed to a number of alleged inaccurate statements made by Mr Korda in his testimony before the committee, including:

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46 *Proof Committee Hansard*, 6 August 2015, p. 16.

47 *Proof Committee Hansard*, 6 August 2015, p. 20.

48 Ms Catriona Lowe, *Submission 200*, paragraph 49.

49 Ms Catriona Lowe, *Submission 200*, paragraphs 12–18.

50 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, pp. [1]–[2].

> Inaccuracy in relation to KordaMentha's acceptance of IHA proposals. 23% were rejected by the liquidator at May 2015. This continues to occur at October 2015. In a recent case the IHA recommended waiver: however, the liquidator rejected it and demands a six figure sum.
>
> Inaccuracy regarding conclusion amounts and sensitivity to concerns. Contrary to the assertion of not being concerned with interest, KordaMentha pursues accrued interest on debt even demanding close to, or as much as 85%: this is the amount the liquidator pursued at the outset before the program (not 0–40% of doubled debt as claimed). There is reason to believe amounts demanded are arbitrary and involve agenda.[51]

Delays and inaccuracies

11.42 KordaMentha informed the committee that while the hardship program was 'in line with best practice', the time taken to resolve hardship claims was one facet of the process that was falling short.[52] He attributed the delay to two main causes:

- KordaMentha not actively pushing borrowers to provide information required to assess the hardship claim—KordaMentha is 'content to wait' for borrowers to provide the information 'without pressure of a defined timeframe'; and
- once a settlement offer is provided to a borrower, 'they may be unwilling to agree'. According to Mr Korda, 'we have been cautious to remove such borrowers from the hardship process, but we plan to take on a more proactive approach in this regard.[53]

11.43 Mr Korda provided the following update as at 23 December 2015[54]

Hardship claims		
Settlement agreement reached	179	40%
Settlement offer pending borrower acceptance	32	7%
Debtor petition bankruptcy (borrower files for bankruptcy)	5	1%
Rejected from hardship process	7	2%
Sub-total	**223**	**50%**
Review process on-going	220	50%
Total hardship claim	**443**	

11.44 According to Mr Korda, of the 443 total hardship claims to date, the hardship advocate had assisted 246 borrowers, settling 75 with 171 reviews ongoing.[55]

51 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, p. [1].

52 Additional information, Mr Mark Korda, 23 December 2015, paragraph 30.

53 Additional Information, Mr Mark Korda, 23 December 2015, paragraph 24.

54 Additional Information, Mr Mark Korda, 23 December 2015, paragraph 30.

55 Additional information, Mr Mark Korda, 23 December 2015, paragraph, 31.

11.45 Ms Lowe agreed with the view that the IHA process was 'taking longer than we would like'. From her perspective, the main reasons for the delay were:

- More people have sought to access the program than expected—since commencing the program, the IHA team has contacted more than 260 people involving more than 200 cases (as a number of cases involve a couple).
- At a number of points in the program it has been necessary to put the process of undertaking individual assessments and negotiations on hold in order to reach agreement with KM about the appropriate approach to particular issues or the parameters of the hardship program in general.
- The process has also been slowed by the need to facilitate communications regarding legal issues between Timbercorp and clients of the program (including the means of serving writs where the relevant limitation period is due to expire).
- Allowing people the time they need to engage.
- Information gathering can slow things down:
    - some people's financial situations are complex and therefore the amount of information needed to be gathered in order to understand the position can be extensive;
    - the mental health issues and level of anguish some people experience requires a careful and compassionate approach, which can take a significant amount of time and resource;
    - in some cases the process of assessment reveals that the information provided is incomplete and therefore further information is required;
    - often KM will require significant and detailed additional information in order to consider a proposal; and
- Complex negotiations can slow things down, particularly where IHA's assessment and Timbercorp's views are a long way apart.[56]

11.46 The IHA provided a different set of statistics on the progress made in resolving the hardship cases. They apply only to the cases that the IHA is managing.

Based on the flow chart which shows the various stages in the process, as at 20 January 2016:

- 20 matters (10%) were at the initial engagement stage, awaiting a referral to complete a statement of position;
- 32 matters (16%) were in the process of completing a statement of position;

56 Ms Catriona Lowe, *Submission 200*, paragraph 29. Ms Lowe's answer contains far more detail on the reasons for the delay.

- 16 matters (8%) were in the initial stages of assessment;
- 27 matters (14%) were in the final stages of assessment or awaiting final assessment;
- 36 matters (18%) were being negotiated;
- 66 matters (34%) have been settled;
- 1 matter (0.5%) has been classified as negotiations unsuccessful.[57]

11.47 In regard to the two errors that HNAB–AG mentioned, Ms Lowe was aware of only one such mistake. She explained that where such errors occur, IHA acknowledges, assesses and corrects their effect and, where the mistake is material in the context of a person's overall hardship situation, IHA's assessment is adjusted accordingly.[58]

Deed of settlement

11.48 Members of the action group were specifically concerned about a clause in the deed of settlement. Ms Susan Henry, Chair, HNAB–AG, claimed that Ms Lowe's solicitor colleagues advised people to sign a legal document that contained a false statement: namely that they were fully aware and informed on entering Timbercorp loans, consented and hence were responsible for the debt.[59] According to Ms Henry, KordaMentha argued that a clause accepting responsibility is required by law in order to release someone from the amount partially or in full to the ANZ. But in her view, this clause meant that effectively victims have no choice but to sign a legal document making a false statement, that they were informed and consented. She proposed rewording this clause in order to reflect the truth, which, in her view, would 'alleviate tremendous psychological distress—if still failing to provide justice'. Her proposed substitute clause could note:

> The debt (portion or full waiver) is determined as assessed within the parameters of the hardship program on the basis of the available documents which are considered to be legally binding regardless of how the person's signature was obtained and in view of there being no legally accepted proof under existing legislation that he or she was not aware, or properly informed, to consent. Claims of misconduct, deception and fraud have been alleged but have not been examined as the victim/s are in no psychological or financial position to pursue a criminal case and are mindful that no industry body exists which is competent and resourced to investigate. In

57 Ms Catriona Lowe, *Submission 200*, paragraph 28.

58 Ms Catriona Lowe, *Submission 200*, paragraph 38.

59 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, p. 18.

> addition, limitations of the legal system mean it is not a reliable avenue for achieving justice or determining facts.[60]

11.49 In respect of the wording of this particular clause in the deed of settlement, Mr Korda informed the committee that KordaMentha did not understand the allegation. He stated that Timbercorp Finance's settlement deeds for borrowers in the hardship program do not require borrowers to acknowledge that they were fully aware or informed on entering Timbercorp loans, consented and hence were responsible for the debt. It followed, according to Mr Korda, that there was no need for the proposed substitute clause.[61]

11.50 Commenting on the deed of settlement, Ms Lowe noted that KordaMentha had adopted a number of her suggested amendments to the document but not the complete removal of the confidentiality clause. KordaMentha did accept narrowing the scope of confidentiality requirements so that confidentiality only applies to the actual terms of settlement.[62] Even so, Ms Lowe formed the view that the agreement was 'sufficiently improved to justify going forward'.[63] She recognised the complex issues related to confidentiality and acknowledged that 'the absence of information about what to expect can exacerbate an already extremely difficult situation for people'.[64] Looking back, she informed the committee that it would have been preferable for the IHA and the liquidators to provide earlier information regarding the range of outcomes people might expect.[65] Ms Lowe explained further:

> …if programs such as the IHA program are to provide benefits, their credibility, consistency and fairness must be measureable. My view at this time is this program and future programs should borrow an idea from the External Dispute Resolution (industry ombudsman) sector. In that sector, outcomes are often confidential however the operation of the scheme, including audits of individual files, is subject to regular review and public report by an independent expert third party.[66]

Power to compromise debt and best interests of creditors

11.51 Ms Henry also noted that a legal mechanism existed by which KordaMentha has 'the power to choose to eliminate ('compromise') debt of amounts under $100,000 as well as seek the permission of creditors OR the court for debt over that amount'. In her assessment, this legal option 'has been, and continues to be, outright dismissed' in

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60 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, pp. 18–19.

61 Additional information, Mr Mark Korda, 23 December 2015, paragraphs 20–22.

62 Ms Catriona Lowe, *Submission 200*, paragraph 50.

63 Ms Catriona Lowe, *Submission 200*, paragraphs 51–52.

64 Ms Catriona Lowe, *Submission 200*, paragraph 55.

65 Ms Catriona Lowe, *Submission 200*, paragraph 55.

66 Ms Catriona Lowe, *Submission 200*, paragraph 56.

favour of pursuing borrowers who have been the 'victims of Mr Holt's collaboration with Timbercorp for misconduct-related debt'.[67]

11.52 In response to this observation, Mr Korda informed the committee that at a meeting of creditors in June 2009, the voting creditors passed a resolution unanimously that authorised the liquidators to, among other things, compromise a debt to the company if the amount claimed was more than $20,000.[68] KordaMentha has used this power to compromise 'a large number of debts owing to Timbercorp Finance'.[69] Mr Korda noted, however, that KordaMentha must exercise such authority 'in a manner consistent with its duty to act in the best interests of the company's creditors'.[70] Mr Korda explained further that the liquidators overriding purpose was to:

> …serve the best interests of those concerned in the winding up of the company, namely the creditors, and to ensure that action is taken for the proper realisation of the assets of the company or to assist its winding up. To do otherwise may constitute a breach of our duties as liquidators and render us liable to an action by a creditor or shareholder…[71]

11.53 As noted previously, a liquidator is obliged to pursue the interests of creditors diligently, thus any decision by the liquidator should be guided by such interests.

11.54 Overall, KordaMentha rejected the allegations that it had provided inaccurate or misleading information to the committee.

Loss of confidence in independent hardship advocate

11.55 Finally, Ms Henry highlighted a particular worry—loss of confidence in the independence of the IHA. She stated:

> The advocate's conduct is not that of an advocate but an intermediary for KordaMentha. Accounts underscore that victims are not treated with humanity or respect in the hardship program—indeed, distinct disdain is not uncommon.[72]

11.56 Ms Lowe's response to this criticism highlights the difficult task that confronts the hardship advocate and members of her team, who clearly appreciate that people should be treated with compassion and respect:

> Each member of the IHA team understands the gravity of the impact that the collapse of Timbercorp and subsequent events has had on the lives of

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67 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, p. 1.

68 Additional information, Mr Mark Korda, 23 December 2015, paragraph 14.

69 Additional information, Mr Mark Korda, 23 December 2015, paragraph 15

70 Additional information, Mr Mark Korda, 23 December 2015, paragraph 16.

71 Additional information, Mr Mark Korda, 23 December 2015, paragraph 16.

72 Ms Susan Henry to Senate Economics References Committee, 12 November 2015, p. 2.

> the people we work with. Indeed we are often witnessing that impact directly in our dealings with people. It is not possible to do justice to the devastation this situation has caused—the ripples that have spread through not only people's financial situations but also their relationships, their health and wellbeing and indeed their view of the world.
>
> The fact that [the] system is presently structured such that compensation is not practically obtainable when it is so clearly due only adds to the great sense of unfairness and injustice that attaches to the situation.
>
> Given this position it is understandable that a program that seeks to reduce debt payable rather than compensate for wrongs done may be considered inadequate.
>
> It is notable that despite this impact people are extraordinarily open, honest and responsive. In other cases, the trauma has clearly overwhelmed people's capacity to cope.[73]

11.57 Ms Lowe made the point that while she is paid by Timbercorp Finance, it does not employ her. She explained that her contract guarantees that she is not subject to direction and can terminate the agreement at any time if not satisfied with how the hardship programme is progressing.[74] Importantly, she identified a problem at the centre of the program which has clearly generated a deep sense of dissatisfaction with the IHA:

> …the profound mismatch between the expectations of applicants to the program and the liquidator, as to what the program should deliver.[75]

11.58 The committee agrees with Ms Lowe's view that this clash of expectations impedes the work of the IHA.

General assessment of the hardship program

11.59 From her perspective and summarising the effectiveness of the program, Ms Lowe stated:

> I initially accepted the engagement because I believed that I could assist borrowers in hardship to make arrangements that will make a real difference to their situation. However, it would be unacceptable for the program to provide the appearance of a solution if it is not delivering. For this reason, I feel it important to state publicly that I do not agree with the outcomes promoted by KM in all cases. Indeed in some cases I very strongly disagree.[76]

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73 Ms Catriona Lowe, *Submission 200*, paragraphs 33–36.

74 Ms Catriona Lowe, *Submission 200*, paragraph 2.

75 Ms Catriona Lowe, *Submission 200*, paragraph 25.

76 Ms Catriona Lowe, *Submission 200*, paragraph 41.

11.60 Ms Lowe was concerned that recently the scope of disagreement had expanded. She acknowledged that while the program had succeeded in finding resolutions in the vast majority of matters to date, she was concerned about the prospects for future resolutions on terms she would consider to be reasonable. Noting that the program was at 'a critical juncture', she identified two primary elements in discussions with KordaMentha:

- the scope of the liquidator's duty, and in particular the meaning of 'best interests' in the context of a duty to act in the best interests of creditors; and
- consistency within the IHA program.[77]

11.61 Referring to Mr Korda's testimony, Ms Lowe noted that liquidators have a statutory duty to conduct liquidation in the best interests of creditors. Her research indicated that the discretion to grant waivers is guided by this overarching duty to creditors, which, to her mind, posed the question what 'best interests' of creditors means. In her view, an interpretation of 'best interests' should be broader than bare financial interest. She accepted, however, that 'the correct interpretation as the law currently stands is not clear and it may be narrower than desirable'.[78]

Committee view

11.62 The committee is disappointed that an adversarial mind-set is undermining the work of the IHA. The work of the IHA had the potential to defuse the confrontational and ultimately damaging relationship between the liquidator and the borrowers. The committee takes the view, however, that despite falling far short of HNAB—AG's expectations, the appointment of a hardship advocate still offers a more productive and constructive way to resolve long-standing disputes.

Recommendation 13

11.63 The committee recommends that KordaMentha continue, through its hardship program, to resolve expeditiously outstanding matters relating to borrowers who are yet to reach agreement on repaying their outstanding loans from Timbercorp Finance.

11.64 The committee recommends that spokespeople for HNAB–Action Group consult with KordaMentha and the Independent Hardship Advocate on implementing measures that would help restore confidence, faith and good-will in the hardship program.

77 Ms Catriona Lowe, *Submission 200*, paragraph 42.

78 Ms Catriona Lowe, *Submission 200*, paragraph 44.

Bendigo Bank

11.65 As noted in chapter 2, Great Southern Finance (GSF) was the financing arm of the Great Southern Group.[79] Bendigo and Adelaide Bank Limited purchased certain loans from GSF and provided certain loans directly to scheme members.[80]

Agreement with Great Southern Finance

11.66 Bendigo and Adelaide Bank provided Great Southern with funds to provide loans at prevailing commercial rates to investors in its MIS. Some loans were written by Great Southern Finance and others by ABL Nominees Pty Ltd, a subsidiary of the bank. Loans written by GSF were 'subsequently "sold" (or assigned) each year to the bank', which is how GSF funded the loans it wrote.[81]

11.67 Bendigo Bank outlined the history of its involvement in providing finance to investors in Great Southern. In 2001, the bank established a program with Great Southern to acquire loans originated by GSF. The loans were either acquired or funded by the bank or wholly owned subsidiaries of the bank, ABL Nominees P/L or ABL Custodians P/L, in their capacity as trustees of various securitisation trusts.

> The first tranche of loans was acquired in 2002. The funding program was formalised in 2004 by the bank and Great Southern companies executing a loan sale and servicing deed.
>
> The purpose of the deed was to establish arrangements to allow GSF to assign loans to the bank, or related entities, on an ongoing and structured basis. The deed set out the terms under which GSF would sell loans to the bank, or related entities, including the eligibility and pool criteria for the loans and the credit policies to be applied when approving each loan. The deed also appointed GSF as the servicer of the loans. In 2006, the deed was amended to allow the bank, or related entities, to advance loans direct to investors while also retaining the option to purchase loans.
>
> The bank, or related entities, funded or acquired 49 tranches of loans under the terms of the loan sale and servicing deed. The loans were generally purchased within a short period after GSF advanced the loans. All loans assigned to the bank, or related entities, were purchased at face value—that is, no loans were acquired at a discount.
>
> The loan deeds provided to borrowers made them aware that GSF may at any time assign or transfer a loan to another party. The loan application also informed borrowers that GSF may exchange information with parties involved in securitisation arrangements. [82]

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79 Clarke v Great Southern Finance Pty Ltd (recs & mgrs apptd) [2012] VSC 260 (20 June 2012), [3]–[5].

80 Javelin purchased certain other loans from GSF.

81 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [21].

82 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [12].

11.68 According to Bendigo and Adelaide Bank:

> The securitisation or assignment of the beneficial interest in loans has been a standard part of the lending and securitisation markets in Australia since the mid-1990s. The general convention is that borrowers are not notified of any assignment as there is no legal obligation to do so. This was the approach adopted by the bank and Great Southern under the loan sale and servicing deed.[83]

11.69 In a joint letter dated 30 April 2009, the bank and Great Southern advised borrowers that the servicing of the loans would transfer to the bank to allow Great Southern to concentrate on its core business.[84] Administrators were appointed to the Great Southern group of companies in May 2009.

11.70 A number of growers joined a class action to challenge the standing of the PDS attached to their Great Southern scheme. They claimed that the PDS contained misleading statements and as a result they suffered loss and damage and, further, GSF and Bendigo and Adelaide Bank, among others, were liable for their loss. The growers also followed advice to cease making repayments on their Great Southern loans. After protracted legal proceedings, the court found in favour of Bendigo and Adelaide Bank, which, in effect, meant that the borrowers with outstanding loans assigned to the bank were valid and enforceable. In December 2014, the court made orders for the approval of a Deed of Settlement, which meet strong resistance from some growers, who firmly believed that the bank should be held accountable for their loss.[85]

Bank's due diligence

11.71 Bendigo and Adelaide Bank told the committee that GSF processed all applications for finance on behalf of the bank based on the information provided by investors. It stated further:

> GSF provided representations and warranties to the bank that all loans approved and funded by or assigned to the bank, or a related entity, satisfied the credit policy and eligibility criteria established by the bank; in particular, that the net asset position of borrowers and their capacity to repay the loans satisfied the bank's policy and eligibility criteria. Any loan made that failed to satisfy the bank's requirements was not funded by or assigned to the bank, or a related entity.[86]

11.72 It should be noted that Bendigo and Adelaide Bank cited the findings of the court which described the bank as:

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83 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [12].

84 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [12].

85 See Deed of Settlement proposed by Liquidators, May 2014; and name withheld, *Submission 53*, p. 1.

86 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [13].

> …an 'innocent third party' that established an arms-length commercial arrangement to provide loans to investors in Great Southern managed investment schemes or purchase loans from GSF.[87]

11.73 The committee takes particular note of Bendigo and Adelaide Bank's statement that:

> It is a fundamental tenet of any market economy that investors are entirely responsible for their own actions and investment decisions. Any suggestion that the bank should share the consequences of their investment decisions is ill-conceived. It undermines the whole principle behind the role of banks in the provision of capital to investors, business, and markets. It is apparent that the complainants were attracted by the upside potential of an aggressive, highly leveraged wealth creation strategy but were not prepared to accept the burden of the downside risk.[88]

11.74 The committee flatly rejects this assertion. It agrees that while investors must take reasonable steps to protect their interests and accept responsibility for their decisions, lenders must act prudently and responsibly when providing loans. Although not directly involved in arranging these full recourse loans, the committee believes that the lenders, in most case banks, were obliged to be diligent and responsible lenders ensuring that the loans to retail investors were serviceable and did not place investors in a parlous financial situation should the investment fail. Banks cannot outsource their responsible lending obligations to third parties such as the financing arm of an agribusiness MIS. A number of red flags should have alerted the banks to the potential for inappropriate lending—some investors would have struggled to meet an appropriate net tangible asset threshold, the very high loan to asset value (90 per cent of the value of the investment) and, the fact that the RE was both facilitating the loan and spending it'.[89] Both ANZ and Bendigo Bank and Adelaide indicated that they did monitor the activities of the finance companies' adherence to the banks' lending policies. The committee can only assume that in a number of cases, despite the banks' assurances, they did not carry out this function well. The banks were party to what can only be described as irresponsible lending.

Resolving difficulties with outstanding loans

11.75 Bendigo and Adelaide Bank informed the committee that it had not appointed an independent hardship advocate to assist clients experiencing hardship to reach agreement on their loans. Noting that the bank's focus was on building relationships directly with customers, it argued that:

87 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [17]

88 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [14].

89 Name withheld, *Submission 94*, p. [3].

> To appoint a consumer advocate to mediate between the bank and our Great Southern borrowers would prevent the bank having a direct and constructive relationship with those customers.[90]

11.76 To liaise with borrowers undergoing financial hardship, the bank has a specialised team, with many years of experience in dealing with such cases. According to the bank, the team has in-depth knowledge and training in the financial and non-financial issues that affect borrowers. The bank explained further that it:

> …has established processes to manage applications for financial hardship that are built around a philosophy of working with customers to achieve satisfactory outcomes that reflect the circumstances of each borrower. The specialised team is best equipped to work directly with Great Southern borrowers to resolve the outstanding loans.
>
> Many borrowers engage lawyers, accountants, or other financial advisors to assist them to resolve their position with the bank. The bank also encourages borrowers to discuss their financial and personal circumstances with an independent financial counsellor to assist them to formulate proposals to resolve their position with the bank. Borrowers, therefore, have access to advocates to promote the interests of their clients.[91]

11.77 The committee notes the assurances provided by Bendigo and Adelaide Bank that they have their particular hardship program with a highly experienced and appropriately skilled and trained team to help resolve matters. The committee, however, is of the view that the bank should consider following KordaMentha/ANZ's lead in appointing an independent advocate. In this regard, the committee notes that the bank cannot outsource its responsibilities for allowing borrowers to enter into unsafe loans. Even though the bank was not directly involved in arranging the loans and can legally distance itself from them, ethically it owed a duty of care to borrowers. As such, the committee believes that the bank should extend to those borrowers special consideration and support the appointment of an independent advocate as a gesture of good will.

Recommendation 14

11.78 The committee recommends that Bendigo and Adelaide Bank support the appointment of an independent advocate to assist borrowers resolve their loan matters relating to Great Southern.

Pattern of poor lending practices

11.79 In its June 2014 report, the committee examined lending practices, particularly those involving 'low doc' loans, and was highly critical of the lending

90 Bendigo and Adelaide Bank, answer to question on notice, hearing on 6 August 2015 (received 31 August 2015).

91 Bendigo and Adelaide Bank, answer to question on notice, hearing on 6 August 2015 (received 31 August 2015).

institutions. It noted that while the courts tended to accept that brokers were not agents of the banks (but agents of the borrower), the lending institutions did not come out of this period of lax lending practices blameless. The committee argued the banks and other lending institutions must have, or should have, been aware of the dubious practices employed by some of the brokers arranging loans but chose to ignore them. Moreover, in some cases, the lending institutions clearly failed not only to exercise the skill and care of a diligent and prudent banker but were negligent, even complicit, in misleading their customers. It should be noted that in its 2009 report on financial services and products, the Parliamentary Joint Committee on Corporations and Financial Services expressed some doubt about the degree to which banks acted 'ethically, appropriately, morally and prudently in their decisions to grant loans to some Storm customers'.[92]

11.80 The lending practices employed by some of those who provided finance to their retail clients to invest in MIS form part of this pattern of poor and irresponsible lending practices clearly identified in the committee's 2014 report. Indeed, the similarities are remarkable—that is: the banks absolving themselves from due diligence responsibilities, in effect outsourcing this core function. They paid no heed to an investor's ability to service the loan and turned a blind eye to high pressure selling techniques and misleading assurances by those arranging the loans, particularly about the risks attached to a recourse loan.

New credit laws

11.81 The *National Consumer Credit Protection Act 2009* (NCCP Act) was intended to address the regulatory issues and market problems prevalent before 2010 and to prevent the irresponsible lending practices that emerged between 2000 and 2008. Under the new credit laws, credit licensees must comply with the responsible lending conduct obligations in chapter 3 of the National Credit Act. If the credit contract or consumer lease is unsuitable for the consumer, then credit licensees must not:

- enter into a credit contract or consumer lease with a consumer;
- suggest a credit contract or consumer lease to a consumer; or
- assist a consumer to apply for a credit contract or consumer lease.[93]

11.82 These conduct obligations apply to credit providers—such as banks, credit unions and small amount lenders—and to finance companies, lessors under consumer leases and credit assistance providers such as mortgage and finance brokers. The legislation requires credit providers to make inquiries into whether the loan would meet the borrower's requirements and objectives. In other words, since the NCCP Act

92 Cited in Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 5.60.

93 ASIC, *Credit licensing: Responsible lending conduct*, Regulatory Guide 209, September 2013, p. 4.

came into force in 2010, both lenders and brokers have 'a positive obligation to make inquiries into a borrower's financial situation (i.e. that the loan will not cause substantial hardship), and to verify that assessment'.[94]

11.83 It is important to note, however, that loans made for the purposes of investment (other than for investment in retail property) are not covered by the legislative protections of the Uniform Consumer Credit Code (UCCC) or new credit laws introduced in 2010.[95] As ASIC observed in respect of agribusiness MIS:

> The NCCP Act and National Credit Code (in Schedule 1 to the NCCP Act) only apply to contracts under which credit is provided to natural persons or strata corporations (consumers) and that is wholly or predominantly for personal, domestic or household purposes or to purchase, improve or refinance residential property for investment purposes. Investment by the debtor (other than investment in residential property) is not a personal, domestic or household purpose (see s5 of the National Credit Code).
>
> The licensing and responsible lending requirements in the NCCP Act therefore do not address problems in lending practices relating to the promotion of agribusiness schemes.[96]

11.84 Nonetheless, ASIC does have some authority over credit facilities that are financial products. It stated that loans for the purposes of investing in MIS are credit facilities that are financial products under the ASIC Act and, as such, ASIC does have some jurisdiction. This responsibility, however, is limited to administering broad standards of conduct, including prohibitions on unconscionable conduct, misleading and deceptive conduct, and undue harassment and coercion.[97] According to ASIC:

> The enforcement of these prohibitions depends on the particular facts and circumstances of individual cases. Findings that they have been breached tend to be specific to each case and rarely set a general rule or precedent. The conduct standards in the ASIC Act are therefore at best an imperfect tool for a regulator seeking to address systemic or widespread issues.[98]

11.85 As clearly demonstrated in the committee's 2014 report, these particular powers were woefully inadequate in quashing the growth of irresponsible lending

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94 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 6.9; Consumer Action Law Centre, *Additional Information 8*, p. 1 to the inquiry into the performance of the Australian Securities and Investments Commission. For non-ADIs, the responsible lending obligations came into effect on 1 July 2010 and for ADIs on 1 January 2011. Being banks and mutuals, ADIs had a pre-existing code of practice, which had a similar obligation.

95 *Submission 34*, paragraph 112.

96 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 9.

97 *Submission 34*, paragraph 113.

98 *Submission 34*, paragraph 115.

practices. For example, ASIC informed the committee that the law on unconscionable conduct continued to evolve, but:

> …the courts have set a high bar for establishing unconscionability, particularly for commercial transactions. A general power imbalance between the parties or a contract that favours one party more than the other is not sufficient to support a claim of unconscionable conduct.[99]

11.86 In 2013, Treasury consulted on proposals for the regulation of, among other things, lending for the purposes of investment. Indeed, the then government released a draft National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 for public consultation calling for submissions on the exposure draft by 1 March 2013. The proposed draft bill flagged the intention to introduce regulations governing credit contracts where credit was predominantly for, *inter alia*, investment purposes and rules aimed at better informing consumers and preventing them from entering into 'unsuitable protected investment credit contracts'.[100] ASIC noted, however, that the proposed reforms did not progress: that a final policy decision had not been made on these proposals.[101] In any event, it noted:

> …the reforms proposed in relation to investment lending may not have resulted in the application of responsible lending obligations in relation to loans for the purpose of investment in managed investment schemes operated by properly licensed Australian financial services licensees.[102]

11.87 Furthermore, Treasury advised that:

> Full coverage of investment lending would require a referral of legislative power from the States and Territories. At the moment, the Credit Act includes compulsory licensing and responsible lending obligations. The States and Territories have not proposed to extend these obligations to include investment lending.[103]

11.88 The committee notes observations from some borrowers that they unfairly assumed all the risk when taking out loans to fund their investment in MIS. In 2010, three researchers suggested that there may be merit in requiring loans by MIS

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99 *Submission 34*, paragraph 114.

100 National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, Exposure draft, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/Credit-Reform-Phase-2-Bill-2012 (accessed 23 September 2015).

101 *Submission 34*, paragraph 116. See Department of the Treasury, National Credit Reform, Enhancing confidence and fairness in Australia's credit law, Green Paper, July 2010, http://archive.treasury.gov.au/documents/1852/PDF/National_Credit_Reform_Green_Paper.pdf and National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, Exposure draft, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/Credit-Reform-Phase-2-Bill-2012 (accessed 23 September 2015).

102 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 9.

103 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 6.

operators or associates for investments in MIS schemes to be made on a 'non-recourse' basis only. This approach would mean that the security was 'only the returns on the project rather than the investor's other assets' and that the MIS operator-lender would assume part of the risk of poor project outcomes for such loan-financed investments. They argued that this arrangement would 'likely induce lower loan-investment maximum limits'. In their view, another solution could be 'to impose a legislative maximum loan-to-valuation ratio as suggested by central banks in response to losses on mortgage loans in the Global Financial Crisis'.[104]

Committee view

11.89 Investment lending has been instrumental in facilitating significant financial loss for retail investors who borrowed to invest in agribusiness MIS.[105] In the committee's view, the responsible obligations imposed on brokers and lenders through the new credit laws should apply equally to the promoters, advisers and lenders involved in providing funds for investment purposes. The committee has no desire to stifle funding for investment but to put an end to situations where retail investors unwittingly enter into unsuitable loan arrangements.

11.90 The committee is firmly of the view that an urgent need exists to reform the disclosure obligations on those providing credit advice and on lenders who provide funds to retail investors for recourse loans. Accordingly, the committee calls on the government to take steps to ensure that consumers are better informed about borrowing to invest and are more adequately protected from unsuitable investment credit contracts. The committee is particularly concerned about consumers being encouraged to take out recourse loans, which means that, in the case of default, the lender can target assets not used as loan collateral. Evidence presented to the committee shows that, in many cases, investors did not appreciate that if their investment failed to generate the anticipated returns or failed completely, they would need to meet repayments from other sources and could be at risk of losing their home.

11.91 The committee was also extremely troubled by the numerous accounts of growers signing over a power of attorney to their adviser to arrange and refinance loans. Clearly, there was a serious breakdown in communication with growers unaware not only of the risky investment venture but of the high risk loan agreement they entered. This weakness in the regulatory framework around credit laws needs to be remedied. The consultation process, which commenced with the release of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, would provide an ideal starting point for reform and clearly should include recourse loans for agribusiness MIS. The committee understands a referral of legislative power

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104 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 10, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

105 See, for example, following chapter, paragraphs 12.2–12.12.

from the states and territories would be required to bring investment lending under the UCCC.

Recommendation 15

11.92 The committee recommends that the government initiate discussions with the states and territories on taking measures that would lead to the introduction of national legislation that would bring credit provided predominantly for investment purposes, including recourse loans for agribusiness MIS, under the current responsible lending obligations. The provisions governing this new legislation would have two primary objectives in respect of retail investors:

- **oblige the credit provider (including finance companies, brokers and credit assistance providers) to exercise care, due diligence and prudence in providing or arranging credit for investment purposes; and**
- **ensure that the investor is fully aware of the loan arrangements and understands the consequences should the investment underperform or fail.**

Recommendation 16

11.93 The committee recommends that the government consider ways to ensure that borrowers are aware that they are taking out a recourse loan to finance their agribusiness MIS and also to examine the merits of imposing a legislative maximum loan-to-valuation limit on retail investors borrowing to invest in agribusiness MIS.

Recommendation 17

11.94 The committee recommends that the Banking Code of Conduct include an undertaking that banks adhere to responsible lending practices when providing finance to a retail investor to invest. This responsibility would apply when the lender is providing finance either directly or through a third entity such as a financing arm of a Responsible Entity.