Submission to the Senate Economics Committee

Inquiry into THE POST – GFC BANKING SECTOR

The following submission is prepared by D. Lindsay Johnston, sole director of Agtion Consultancy Services Pty Ltd ("Agtion"), 14/10, 229 Macquarie Street, Sydney, NSW.

Terms of reference considerations

Principally this submission will deal with item (e) of the terms of reference: *"the need for further consideration of the state of the broader finance and banking sector".*

I note that many of the submissions already made to the inquiry deal with complaints about the behaviour and conduct of insolvency practitioners, and lawyers involved in enforcement action by secured creditors. I propose to make some comment on these matters due to the inseparability of these practitioners from either their appointer or client when dealing with an enforcement of securities or external administration. In my view the words *"the state of the broader finance and banking sector"* invites commentary into the practices of financial institutions, insolvency practitioners, lawyers and property valuers.

I attach hereto submissions I have made to previous inquiries that should be read as part of this submission:

1. Fair Trading Inquiry – dated 17 December 1996.
2. Inquiry into Competition within the Australian Banking Sector.
3. A response by D.L Johnston to the Proposals Paper: A modernisation and harmonisation of the regulatory framework applying to Insolvency Practitioners in Australia. (note with this submission I inserted my comments into the proposals paper. My insertions are in "CAPS" following highlighted sections of the paper.

The above three documents speak for themselves and are relevant as they each deal with matters that have been raised in this inquiry by the Insolvency Practitioners Association and/or one or more of the major banks.

I urge the Committee members to read my submission in its entirety and in the historical context. In this respect the attachments are integral to the submission as are the recommendations I have made in those submissions.

Some history of my involvement in insolvency and commercial litigation

I have nearly 20 years experience dealing in the matters relevant to the terms of reference.

Agtion became involved in the specialist consultancy discipline of a forensic analyst dealing in principally banking and insolvency matters as a result of it, and its associated companies being forced into so called “voluntary receivership” by a major bank in 1996. The companies and I commenced litigation after the companies were released from receivership in 1999. The legal battle against the bank continued until it was resolved in 2007. I am experienced in litigation mainly due to my need to appear and represent myself in Court, and from my practical experience obtained from working behind the scenes with lawyers in multiple client cases against banks.

Prior to 1999, I worked as an investigating field officer for Australians for Banking Justice (“ABJ”). This organisation was active in the period following the 1991 recession. I became involved during my period with ABJ in literally hundreds of cases involving the illegal, immoral and improper practices of banks and particularly receivers. In private practice I have continued the forensic analysis and commercial investigation into matters of bank and insolvency practitioner misconduct.

At various times I have also provided services to insolvency practitioners in bankruptcies and corporate insolvencies. This experience in my view provides me with a unique insight of practices across the board.

I offer the inquiry the benefit of my practical observations.

Observations

In the late 1990s clear evidence emerged that the worst banking practices were related to a major bank after a takeover of a smaller and weaker competitor. There was also the “wash-up” of the disastrous foreign currency loans fiasco in that era that led to rampant misconduct by the banks.

Regretfully when I compare the 4 Corners reporting on “Banks Behaving Badly” which went to air on 10 March 1997, to the recent 4 Corners programme titled “Happy Banking?” I must say some things seem to never change. This is despite numerous public inquiries and countless complaints to members of the Federal and State Parliaments and regulators relied on by bank customers to help them when the chips are down. Sadly little help has been forthcoming to the victims of banks.

One must not overlook the appalling regulatory failure if not lack of regulation in respect to small business protection. I concede that some improvements have been made since 1997, but the mere fact that there are so many complaints about Bankwest/CBA is indicative that asset rich small businesses are the chosen prey of predatory banks.

If there has been one particular success from the various inquiries, it must be the establishment of APRA and the better prudential regulation that has provided to protect the Australian economy. At least Australia did fare much better during and after the GFC as a result of stricter compliance with good governance practices than many other advanced economies.

The key point that emerges when I compare the 1990's to the post GFC period is the fact that in both periods the worst of bank conduct followed bad or non-existent prudential practices. In the 1990's it was the hybrid foreign banks, National Mutual-Royal Bank "NMR", Chase-AMP and the like that led with bad prudential practices, followed closely by of all things the raft of State Government owned banks and building societies emerging as banks, and all vying recklessly for a slice of the deregulated and untested free market that led to a series of "fire sale" takeovers by the members of the four major banks.

ABJ identified the major cause of what we styled "institutionalised shafting" at the time, as being a practice that emerged soon after a strong bank taking over a weaker bank at a discount price. Interestingly the businesses targeted for enforcement were never the insolvent ones. The enforcement target was always an asset rich entity, from which exorbitant fees and charges were extracted on the way down with the realised or liquidated assets always sold below valuation. This gives rise to the suspicion that the conduct by the takeover bank was deliberate to clear the takeover target loan book and to set off the unlawful gains against the disastrous loans that were incurred as a result of poor prudential practices in the period prior to takeover.

I recall that for example NMR was purchased by the ANZ Bank for about 70% of book value. Little wonder, with a bad loan book and a 30% margin for error that ANZ was one of the most targeted banks for criticism in respect to bad practices in that period.

Another major bank with a bad name at the time was the CBA. That bank ended up absorbing the Commonwealth Development Bank and most of the raft of State owned banks that the various Governments flogged off for "peanuts". CBA also had its own self inflicted foreign "bad" loan book to deal with unlawfully or as it saw fit.

Interestingly the strongest and "best practice" bank during the 1990s was the National Australia Bank. It avoided being embroiled in both large scale foreign currency loans and the dubious acquisition of banks that had previously exhibited poor prudential practices.

ABJ was left in no doubt that bad prudential practices and poor prudential regulation caused the spate of unlawful, immoral and improper conduct of banks that was publically aired on 10 March 1997. I was directly involved in bringing cases to the ABC's attention at that time.

Deja vu and its 2008/09, and we have had the HBOS in control of Bankwest and then the CBA takeover. How did this regulatory failure occur? Why was Bankwest allowed to run what can only be described as a reckless loan book? Why was the CBA allowed to takeover Bankwest at a discount of such magnitude that "institutionalised shafting" was almost a certainty? These are all questions that I would expect this inquiry to investigate, as it is now, and how it was in the 1990's, that the innocent borrowers who do business with banks the subject of a discounted takeover, become victims of circumstances almost invariably outside their control. The Parliament must not turn a blind eye to such practices and it must act this time round to bring conduct of this kind to an end.

It is my experience that disputes consumers have with financial institutions arise from:

1. A disagreement over pricing and/or whether the pricing or alteration of the pricing is compliant with a relevant term or terms of the contract; and/or

2. the financial institution acting unilaterally and unreasonably without any objective assessment of the consumers' capacity to service the loan and for it to reduce a credit limit or vary the terms of a loan without either prior written notification or discussion with the consumer. Too often the consumer is told that is was, a "head office decision" or "change of policy", a done deal and the notes for the decision are confidentially hidden from the consumer in the file. There is also the abuse of process, of a reliance on legal professional privilege to deny consumers access to documents during legal proceedings; and/or

3. confusion over or misuse of a term of the contract (express or implied); and/or

4. personality clashes between bank officers and consumers. Sometimes these disputes escalate to the extent that the dominate party, the bank officer, engages in "bullying tactics" to bring the perceived "delinquent" customer into line. In many of the cases that I have studied since the mid 1990s, the above outlined course of conduct seems to be common in most disputes. No doubt the changes that occur throughout the economic cycle have some influence on the way banks assess and perceive business performance, but it is inconceivable that the consistency of anti-competitive and unfair conduct by the banks does give rise to the suspicion that customers with good asset bases are being targeted for the purpose of profit exploitation.

Essentially four practices seemingly occur when a bank having acted recklessly and then finding itself under pressure, moves against a borrower. These are as follows:

1. The borrower is offered a deal, sometimes with minimal security and on favourable terms to entice them to borrow more and invest in expansion or to refinance. This may be done at the instigation of either the bank or the consumer. The customer is convinced by the bank officer selling the loan that there is a substantial asset surplus and the deal will be great for the customer; and

2. At a time suitable to the bank, the suggestion is made that the bank requires further security or that its security needs to be reviewed and the consumer is threatened with the withdrawal of facilities if their co-operation is not forthcoming; and

3. After the consumer has provided security to the bank's satisfaction the bank will call for valuations by a panel valuer, lower the LVR and revise its pricing and demand a margin increase; and

4. Should the consumer resist the attempt by the bank to increase its margin, the bank will threaten to, or carry out enforcement of its securities.

Needless to say any unfair conduct of a bank has a very destabilising influence on the consumer and often the business is placed under external administration with devastating consequences. At this point the bank has created what I term "self fulfilling prophesies". The bank purposefully creates an issue that it escalates into a dispute and it then makes all the determinations (usually exercising its power of attorney) to ensure that the borrower will not be able to refinance unless all of the bank's demands are met. In most instances refinancing or any form of exit is impossible in those circumstances. Consumers in general and small business consumers in particular, either out of ignorance or by the influence and at times the downright use of "bullying" tactics by banks, demand that the consumer will not utilise more than one financial services provider at any given time. I have seen instances of small business operators being threatened by bank managers and told to close an alternative account or suffer the consequence of the primary bank withdrawing its support and enforcing its securities. This type of anti-competitive behaviour by banks has the effect of making small business operators captive to the bank in respect to decision making and forces them to become price takers in respect to the bank's services and subsequently renders them unable to be entrepreneurial, as business should be. It follows that this anti-competitive conduct that restricts innovation must have a negative impact on national productivity.

Worse still, at times banks target whole industries or segments of industries and declare them off limits. Although I concede that a bank has a right, if not a prudential duty to ensure that it protects its depositors' funds, it cannot be allowed to use that requirement as an excuse to embark on unilateral enforcement action, to the detriment of the borrower with its only motive to protect its bottom line and force the customer to pay for its own mstakes. There exists an unfair imbalance. It appears to me that the CBA has definitely targeted certain industry sectors in the Bankwest fiasco.

A factor that was particularly well investigated by ABJ in the late 1990s was the use by banks of "dodgy" property valuations. Property valuation terms of reference for mortgage lending purposes are significantly influenced by the banks. As soon as the words "mortgage lending purposes" are used the customer should interpret that as code for the bank manipulating to valuation result to show a valuation below market value.

Valuers working in administrations involving me as an agent of either the Trustee or Liquidator have informed me that up to five different methods can be applied for a valuation of the same property, with each valuation result being dependent on the terms of reference provided to the valuer or adopted by the valuer.

Values of mortgagors' properties for mortgage lending purposes are invariably lowered to the bottom of the possible range and the terms of reference that are adopted deviate from the principle set out in the legal authority *Spencer –v-Commonwealth*. It appears that valuers acting conservatively under the influence of their bank appointers adopt a valuation based on a distressed sale outcome of the property being potentially sold as "mortgagee in possession" or by a bank appointed receiver.

The highest value method appears to arise when a property is to being valued for a deceased estate. These valuations often exceed the likely market value.

What happened to market value, within the meaning of *Spencer –v-Commonwealth*? Surely there is only one market value?

The issue of valuation manipulation is extremely serious. I urge the extensively investigate this point, as it is absolutely open to abuse under the current wording and interpretation of s.420A of the Corporations Act.

Banks invariably use their own in-house valuers or a valuer appointed from their panel who, for the reasons enunciated above and acting on the banks instructions, under value mortgagors' properties.

In this case the banks' anti-competitive behaviour is the misuse of restrictive trade mechanisms which deliver property valuation outcomes that protect the banks' strategic plans should there be a change in economic conditions generally, or should a consumer threaten to or actually commence legal action. It is just a further example of the misuse of market and financial power to act unfairly and in an anti-competitive manner to adversely influence, in this specific example, the property owner's right of equity of redemption.

I have noted some of the nonsense comments made to this inquiry and others in the past about how values rapidly change. Nothing said or done can justify market value changes of 50% or more in a year or so for a property when the publicised data for property values across the board show nothing like those figures. I have first hand information in respect to how a distress sale can be at market value.

In an administration where the appointed IP (my principal) obtained valuations the range from the lower end to high end differed by over 75%. The variation was explained when we examined the terms of reference used by the valuers. The property when finally sold at auction obtained a value that exceeded even the best valuation, made by a registered valuer, by a margin of 100%.
This was achieved by presenting the property well and ensuring that no one who was involved talked the value down. Notwithstanding the formal valuation, the agent involved did fairly accurately predict the sale price, but this was only conveyed privately in the course of conversation.

In many cases banks and more particularly receivers have a vested interest to talk down an asset value, as if there was to be an excess the registered proprietor, may avoid bankruptcy or liquidation and sue the bank or the receiver, who in turn might get sued by the appointing bank if there was a question about the propriety of his or her administration.

The problem with the current system is the undeniable fact that vested interests that feed off each other tend to work closely to ensure that maximum fees and other income are gouged out of every administration. It seems to me receiverships bring out the worst in everyone involved.

It is true that in many cases asset sale prices achieved at mortgagee sales or receiver's sales do come in under expectations of the registered proprietor. It is also true that receivers have turned into an art form the ability to "shop around" to obtain reports and advice that supports a lower value sale and when that is coupled with the other often evident fact that the receiver either discredits the registered proprietor by some means or locks them and their representatives and advisors away from properties and evidence, it is little wonder that on the odd occasion that when a claim does get to a Court hearing that the plaintiff is handicapped with defective evidence. As it stands at the moment the law is considerably biased in favour of the bank and/or receiver which is grossly unjust, given their financial power.

Proposals to promote competitive and fair banking conduct

Surely the people of Australia deserve a better system of banking and insolvency regulation that will force a bank and/or its receiver to act firstly in the national interest. The law must force them to open up their conduct to public scrutiny and then face the competitive pressures that other businesses face to produce the best possible outcome.

It is clear to me after various conversations with bank executives and some bank shareholders that there is an expectation that banks should be allowed to make mistakes, operate outside good prudential practice and when things go wrong like when the GFC struck, run off to Government for protection and at the same time be allowed to decimate small businesses to make asset recoveries no matter what the original loan contract stated. I recall being told on more than one occasion *"we don't care where the money comes from and we don't care how it is recovered".* This is an arrogant statement spoken in the knowledge that the bank has the financial power to do as it will with very little fear that in civil proceedings it will be out gunned in Court. Small business people need and deserve the protection of efficient and well administered regulation.

On the issue of regulatory failure I wish to bring to the attention of the inquiry that in February 1997, it was brought to the attention of the Australian Investments Commission that I had alleged that one Stuart Karim Ariff had committed perjury. The ASC ignored that complaint and furthermore its successor the ASIC ignored the fact that I had sued Ariff in the Supreme Court of NSW, yet ASIC registered that unsuitable person as a registered liquidator. I raise this point as it is clear that had either the ASC or ASIC, acted as they should, there would never had been the need for ASIC to have prosecuted Ariff on the 19 criminal counts that finally saw him jailed for 6 years. It galls me and many others (Ariffs victims since 1997) that so many people needed to suffer when a thorough investigation in 1997 would have revealed his total unsuitability to be an officer of the Court.

In my view Australia needs a banking system that works truly in the national interest and on this measure the current system is broken. We hear almost day in day out that Australia's productivity is falling, yet if conditions worsen it will be the banks and receivers that will be closing more and more productive businesses and destroying proprietors' equity, employees' futures and valuable infrastructure will end up as scrap.

We need this inquiry to recommend a Royal Commission into the activities that go on in this whole incestuous banking system with its wide powers of inquiry to provide the best possible recommendations to provide for a sustainable banking system that will be productive and fair.

I wish to advise the Committee that I am available to appear before it and give evidence, if that is the wish of the Committee.

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Lindsay Johnston

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