SENATE ECONOMICS REFERENCES COMMITTEE

Inquiry into the post-GFC banking sector

Questions on Notice taken by ASIC at the public hearing on 8 August 2012

Question 1 (Hansard Ref: p. 55)
Senator CAMERON: When you say ASIC will act on issues if they are raised, the evidence we had from the previous witness [Denise Brailey] was that correspondence had gone to ASIC seeking some support on the FirstMac and Streetwise issues and no support was forthcoming. Is that correct?
Mr Kell: I am not in a position to comment on individual matters. What I can say is that ASIC had some complaints brought to it about low doc loans. These instances have almost exclusively, from my understanding, all concerned loans made prior to the GFC and prior to the introduction of the national consumer credit protection regime in July 2010. In some cases they involve matters where a finance broker has been charged by the police, so another agency is taking action. In some cases ASIC sought follow-up information to these complaints, but I am not in a position to comment on the particular matter that you have raised. If you want us to take a question on notice, we are happy to do so.
Senator CAMERON: You are not indicating to me that you would comment on a specific matter; you just want time to have a look at the question that is raised.
Mr Kell: I would have to understand whether it is a matter ASIC has looked at, whether it is still looking at it or whether it might face confidentiality constraints. I am not able to provide that sort of information at the moment.
Senator CAMERON: What I am interested in—and there might be other views on this—is you said if matters are raised with ASIC then ASIC would deal with them. That is contrary to the evidence we had in this particular matter. If you could, have a look at the Hansard on that matter from the previous witness and come back to us, firstly, with what steps ASIC took in the matter and, secondly, what steps as an institution ASIC has put in place to deal with any forthcoming issues of that type. Is that clear?
Mr Kell: I am very happy to do that. I think that would allow a more considered response to those issues.

Firstmac and Streetwise
ASIC intervened in foreclosure proceedings seeking to enforce low doc loans commenced by Tonto Home Loans Australia Pty Ltd (now Firstmac) and Permanent Trustee Company Ltd to repossess the homes of Streetwise investors which had been mortgaged to secure moneys lent to them by Tonto to invest with Streetwise. ASIC's intervention was welcomed by the lawyers acting for the borrowers in the case who were the subject of legal proceedings to repossess their houses. ASIC did not provide funding to Ms Brailey to take legal action in relation to Firstmac and Streetwise.

ASIC intervened to assist the Court in relation to the construction and application of the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) ("the ASIC Act"), and in particular the construction and application of the unconscionability provisions in Part 2 Div 2 of the ASIC Act. In short, ASIC argued that the actions of the credit provider were unconscionable in the circumstances, having regards to the manner in which the low doc loan transactions in question were arranged through various intermediaries (eg finance brokers, loan originators and managers).

ASIC's intervention involved appearances before the NSW Supreme Court in 2009, the NSW Court of Appeal in 2011 and the High Court in 2012. The High Court refused Firstmac's application for special leave to appeal the decision of the NSW Court of Appeal. As a result the decision of the NSW Court of Appeal stands which found that:

- Streetwise (the finance broker) was not the agent of the lender and the lender's conduct would therefore not be unconscionable under the ASIC Act; and
- the contracts were unjust under the *Contracts Review Act 1980 (NSW)* and relief was granted to the borrowers in accordance with their specific circumstances to avoid the relevant unjustness.

It is noted that the Full Court of the NSW Court of Appeal, in its decision on costs handed down on 9 May 2012 stated that, "... *without the slightest intended disrespect to counsel for the respondents to the appeals, the presence of ASIC was of great assistance in the conduct of the appeals.*"

For more information on ASIC's intervention in these proceedings, see media releases 09-39AD, 09-169AD and 11-314AD.

ASIC separately pursued enforcement action against Kovelan Bangaru of the Streetwise group of companies, resulting in Mr Bangaru being extradited from the US, convicted of fraud in 2010 and sentenced to a term of imprisonment of 8 years and 6 months (for more information see media releases 05-240, 07-98, 08-114, 10-181AD and 10-272AD). The NSW Court of Criminal Appeal recently dismissed Mr Bangaru's appeal of both the conviction and the sentence.

Unconscionability

The courts have set a high bar for establishing unconscionability. Generally each decision turns on the particular facts of each transaction and often the court's decision is based on a combination of several factors (see for example "Knowledge and neglect in asset based lending: When is it unconscionable or unjust to lend to a borrower who cannot repay?" by Dr Jeannie Paterson (2009) 20 Journal of Banking and Finance Law and Practice 18 or "Asset Lending and the improvident borrower" by Lee Aitken (2012) 86 Australian Law Journal 134.) Generally, there is a lower threshold for establishing that a loan was unjust.

In determining whether a transaction is unconscionable the courts look to whether the borrower is under a special disability or disadvantage (such as poor English language comprehension or infirmity of mind or body) and if the lender had sufficient knowledge of this to make the lender's conduct, in acting to its own advantage in the circumstances, unconscionable. However, there is no set definition of what constitutes a special disadvantage.

In *Tarzia v National Australia Bank Ltd[1996] ANZ ConvR 379*, the Federal Court found that: "...[it] cannot be the position that a combination of ignorance of English, age and lack of business experience necessarily puts a person at a special disadvantage in dealings with a bank on a guarantee. For one thing, the description presumably covers a great number of astute and capable Australians. Age itself does not raise a presumption of weakness. The same may be said of their ethnicity and fluency in English. Such factors may contribute to a relevant disadvantage in some people, and not in others."

It is more difficult to establish unconscionability where a broker is involved. This is because the lender typically deals with the broker and may not have any direct contact with the borrower. In these circumstances it is difficult to establish that the lender has sufficient knowledge of the borrower's special circumstances. As the courts generally view brokers as agents of the borrower, rather than the lender, the knowledge of a broker cannot necessarily be imputed to a lender.

While the effect of a loan being unconscionable is usually that the transaction be varied or set aside, it would be rare for a borrower to enjoy the benefit of a loan without any obligation to repay. See for example, in *Perpetual Trustees Victoria Ltd v Ford* (2008) 70 NSWLR.

Details of some actions taken by ASIC in relation to the unconscionable conduct provisions of the ASIC Act are outlined in our response to question 2.

Responsible Lending Obligations

From 1 July 2010 the *National Consumer Credit Protection Act 2009* (the National Credit Act) introduced a number of additional statutory requirements for both lenders and finance brokers, including licensing requirements (including the need to be a member of an ASIC approved external dispute resolution scheme) and responsible lending obligations.

The responsible lending obligations require finance brokers and credit providers to make reasonable enquiries into and verification of a consumer's financial position prior to the provision of credit. Before providing credit, or suggesting that a consumer apply for a loan, credit licensees must undertake an assessment as to whether the consumer will be able to comply with the financial obligations under the credit contract, or could only comply with substantial hardship. It is presumed that if a consumer will only be able to comply with their financial obligations under the credit contract by selling their principal place of residence, then the consumer could only comply with those obligations with substantial hardship, unless the contrary is established. Credit providers are prohibited from providing credit if it is likely that the consumer would be unable to comply with their financial obligations under the contract, or could only comply with financial hardship.

The responsible lending obligations in the National Credit Act provide a more explicit regulatory framework around what credit providers and intermediaries (including finance brokers) must do before providing credit, as compared to the general prohibition on unconscionable conduct in the ASIC Act. As such, these responsible lending obligations have significantly increased the level of protection for borrowers.

Residential Property Investment

To the extent that a consumer's inability to repay a loan arises from non-performance of an investment in residential property, it should be noted that advice on direct investment in residential property is not regulated as a financial product under the *Corporations Act 2001* or the *ASIC Act*.

The states and territories have primary responsibility for the regulation of real estate transactions. Although the National Credit Code has been extended to cover loans entered into from 1 July 2010 for investment in residential property, it does not regulate advice about direct investment in residential property.

Question 2 (Hansard Ref: pp. 55-56)

Senator CAMERON: What the constituent raised with me was they had been advised by a relationship manager, an assistant manager of the bank at Forster and the financial planner northern region on some financial transactions they were going to take out. To make a long story short, they borrowed $2 million on this advice. They are saying that there were bullying tactics, high-pressure tactics; they had their funds all go into debt reduction; they were asked to sign blank documents; they were told not to date documents; they were advised that they could not change any of the conditions they were not happy with, were told 'just sign them and the bank would fix them up'. The bank told them that if they did not sign the documents that the bank would bundle the file up and send it to Melbourne and then they could deal with Melbourne but would not get as good a result. The proposition is that it was common. The allegation from my constituent is that it was common for the ANZ Bank to send blank documents to them to sign and then they would be filled in later. I am not trying to justify people signing blank documents but this seems to me to be to be consistent with the type of behaviour that the consumers group, the Banking and Finance Consumer Support Association, described in their evidence. Does ASIC receive complaints of this type about the Australian banking system?

Mr Kell: Not in any significant numbers. ASIC does hear these types of allegations occasionally raised in public. It needs further information to pursue action than those sorts of general descriptions you have just provided. If ASIC is to take an action it needs specific evidence and that is not always forthcoming. No, ASIC does not have widespread evidence presented to it of some kind of systemic criminality of that sort, if that is how you characterise it, in the Australian banking system.

Senator CAMERON: No, I do not think I said systemic.

Mr Kell: In some ways I think that is what you are suggesting. Is ASIC getting a lot of complaints about that across different banks, across different areas of that sort of systemic behaviour? The answer to that is no.

Senator CAMERON: Whether it is systemic or not, the behaviour is not behaviour that ASIC would tolerate in one incident if it was correct, would it? What role would ASIC play in these types of allegations?

Mr Kell: It is difficult to comment without further information. ASIC does take action—and I can give you examples—against lenders and brokers that engage in unconscionable conduct. There was a case this year involving the Australian Lending Centre. I would be happy to run you through that. It demonstrates where ASIC does take action when brokers have sought to engage in actions that are significantly detrimental to their clients and that is exactly the sort of thing ASIC will take up if it comes across it.

Senator CAMERON: We would be happy to receive some documentation on that rather than spend much more time on that issue.

ASIC assesses all reports of misconduct from the public for potential breaches of legislation it administers.

ASIC's work before 1 July 2010

Before 1 July 2010, the States and Territories had primary responsibility for the regulation of consumer credit under the Uniform Consumer Credit Code (UCCC). At that time, ASIC had a more limited role in relation to the regulation of credit through the prohibitions on unconscionable conduct and misleading and deceptive conduct

contained in the ASIC Act. As noted in our response to question 1, there are also a number of legal complexities in cases concerning unconscionable conduct. Nevertheless ASIC was active in the industry during that period.

While not the primary regulator of consumer credit, ASIC identified risks related to low doc loans arranged by finance brokers on the fringe of the market in its 2008 Report *Protecting Wealth in the Family Home: An examination of refinancing in response to mortgage stress*. This report was referred to in the Government's 2008 green paper setting out options for Commonwealth regulation of consumer credit and subsequently informed the Government's development of the responsible lending requirements in the National Credit Act which commenced in July 2010.

In addition, ASIC did previously take enforcement action under the ASIC Act in relation to unconscionable conduct and misleading and deceptive conduct. Below are some examples of this enforcement activity.

Australian Lending Centre

In 2010, ASIC commenced proceedings in the Federal Court of Australia against Australian Lending Centre Pty Ltd (ALC), Sydney Lending Centre Pty Ltd (SLC), and Christopher John Riotto in relation to loans brokered to five clients between 2005 and 2008. ASIC also brought proceedings against a lending company also controlled by Riotto, AMR Investments Pty Ltd (AMR), alleging that it engaged in unconscionable conduct in relation to the loans.

On 3 February 2012, the Court found that in four of the five cases, the companies engaged in unconscionable conduct by having clients sign broking contracts for business loans when they knew that they wanted personal loans. The Court also found that on two occasions, the companies engaged in misleading or deceptive conduct by representing to lenders that the loans were for business purposes. The practical effect of this conduct was to remove important consumer protections provided by the Uniform Consumer Credit Code (UCCC) – which applied at that time.

The Court also found that the loan brokered for one of the clients was unconscionable because it was secured over his house and the relevant broker (ALC) knew that he could not afford to make the repayments. The Court also found that brokering such a loan was, in itself, unconscionable conduct.

In relation to the fifth client, while the Court found that the loan was accurately categorised for a business purpose, the Court nonetheless found that there had been unconscionable conduct because the client, a pensioner, suffered from a clearly identifiable mental disability which the companies exploited by having him sign a broking contract and loan with an interest rate of 5% per month secured over his only asset, his home. The Court also found that the company which made this loan (the related company, AMR) also engaged in unconscionable conduct, and that Riotto was knowingly involved in these contraventions.

The Court granted an injunction restraining future similar conduct and awarded compensation to one of the borrowers.

Shortly after the decision, the companies and Riotto appealed to the Full Federal Court. However, they have now discontinued the appeal pursuant to a settlement which involved:

- the imposition by ASIC of an additional condition on ALC's Australian credit licence, requiring ALC to appoint an independent compliance expert to conduct reviews of ALC's business over two years; and
- ALC appointing an additional responsible manager to its credit licence.

For more information see media releases 10-112AD, 12-19MR and 12-203MR.

Kelvin Skeers

An early example of ASIC's work in relation to low-doc loans is the action taken in 2006 against Canberra-based mortgage broker Tonadale Pty Ltd and its employee Mr Kelvin Skeers in relation to two low-doc loans Mr Skeers arranged for a client in August 2004 and November 2005. ASIC alleged that Tonadale and Mr Skeers misrepresented:

- to the lender the borrower's financial position in the application forms; and
- to the borrower what would be included in the borrower's loan application forms.

In October 2007 the Federal Court declared that Tonadale and Mr Skeers, had engaged in misleading and deceptive conduct and unconscionable conduct when the loans were arranged and ordered that Tonadale:

- pay compensation to the borrower; and
- establish compliance, education and training programs.

On 28 August 2008 ASIC commenced criminal proceedings against Mr Skeers, alleging that he knowingly used false accountants' letters with the intention of inducing a lender to approve low-doc loans for seven borrowers. Mr Skeers pleaded guilty and on 27 May 2009 was placed on a good behaviour bond for two years upon entering into a recognisance of $5,000, and was also ordered to perform 240 hours of community service over the next 12 months.

Following his failure to complete the 240 hours community service from his original sentencing, Mr Skeers was resentenced on 1 December 2010 to 15 months imprisonment, to be suspended after serving 5 months weekend detention and entering a 15-month good behaviour bond with a $2,000 surety.

See media releases 06-373, 08-36, 08-198 and 09-99AD for further information.

ASIC's current work

Since the commencement of the National Credit Act, ASIC has been very active in responding to consumer concerns and seeking to ensure industry compliance through guidance to industry, administration of the licensing framework, surveillance and enforcement action.

From 1 July 2010 to 30 June 2012 ASIC has refused seven applications for credit licences and 722 applications have been withdrawn.

In addition, since 1 July 2010 nine persons have been banned from engaging in credit activities, and 14 Australian credit licences have been cancelled. These enforcement actions have been taken for conduct both prior to and after 1 July 2010, including where persons were convicted of fraud. ASIC has 17 current investigations concerning alleged fraud or misconduct relating to information provided by finance brokers in loan applications. In the majority of cases, these matters concern loan applications to ADIs which have been identified and reported by industry.

As noted in our testimony ASIC has not identified widespread evidence of systemic misconduct in the banking sector along the lines suggested by Ms Brailey. In response to previous general allegations made by Ms Brailey ASIC has requested her on a number of occasions to provide ASIC with any additional information and specific evidence of falsification of documents in the banking sector. This evidence has not been forthcoming. Following her testimony to the Committee, ASIC has again requested Ms Brailey to provide any such evidence.

More recently, ASIC has received a number of letters from members of Ms Brailey's Banking and Finance Consumers Support Association, Inc (BFCSA), some of which raise general concerns about low doc loans and call for a Royal Commission, and others which raise concerns about their own loan transactions. However, these letters generally make broad allegations of misconduct and do not contain any specific evidence of the alleged misconduct. We are therefore encouraging these people to provide us with additional information and documents to assist us in assessing the matters.

We also understand that a number of BFCSA's members obtained loans from finance broker Mortgage Miracles. The Western Australian Police has charged Mortgage Miracles' director, Ms Kate Thompson, with fraud offences in relation to her conduct as a mortgage broker and it is understood that a hearing on whether Ms Thompson is fit to stand trial is scheduled to be held on 12 November 2012.

ASIC identified loans promoted as low doc as an area for review, following commencement of the responsible lending obligations, due to potential compliance risks. Our initial report from this review, Report 262 *Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans* was published in November 2011 and can be downloaded from our website. This report, which focused on practices in the first six months from the commencement of the National Credit Act, found that finance brokers were generally aware of the new responsible lending obligations, with ongoing enhancements made to their practices and procedures during this period as the industry sought to comply fully with the responsible lending obligations. The report did however identify areas for further improvement in industry practice and made a number of findings in this regard.

ASIC is currently reviewing how credit providers are complying with their responsible lending obligations on loans that are promoted as low doc, and how credit licensees with a large number of representatives are ensuring their compliance with the responsible lending obligations.

Initial data suggests that credit providers' current lending practices are generally tighter than those existing prior to the GFC and that the proportion of home loans which are promoted as low doc has decreased significantly since the introduction of the responsible lending obligations for authorised deposit-taking institutions in January

2011. Information from these reviews does not support Ms Brailey's claim that the broker channel only sells low doc and no doc loans. Rather, information from these reviews indicates that loans promoted as low doc are generally only a small proportion of loans written by finance brokers and that there is a low level of complaint by borrowers to credit providers alleging falsification of information on loan application forms.

Irrespective of whether loans are promoted as full doc or low doc, the responsible lending obligations under the National Credit Act apply, requiring both finance brokers and credit providers to make reasonable inquiries into and verification of a borrower's financial position. Although different types of inquiry and verification may be used based on a borrower's specific circumstances (eg self-employment), some of the practices common prior to the GFC would not likely satisfy the responsible lending requirements. In this respect *CP178 Advertising credit products and credit services* noted that credit licensees should consider whether claims about no doc type products may be misleading or reflect practices that do not comply with responsible lending obligations.

Question 3 (Hansard Ref: p. 56)
Senator WILLIAMS: When you say you carefully consider matters that come to ASIC in the way of complaints, I have a lot of problems with that. For four years, complaints went to your office about the infamous Stuart Ariff and the way he was robbing people. Now he is in jail where he belongs. The only reason you acted was because it went to the media. I know people send you emails and complaints. I have taken complaints to you myself. I want to take you through a couple. When a receiver is sent onto a farm—and this is post GFC—does that receiver have the right to sell the grain on that property if the bank does not have a lean on that grain?
Mr Kell: I cannot answer that question right now. I will take that on notice.

Whether a receiver has a right to sell specific property will depend on the specific provisions of the original charge/mortgage granted by a company and the specific circumstances of any one case.

Receivers generally are very careful to avoid selling property not covered by the security under which they are appointed.

A receiver exercising rights over property to which they have no rights would likely give rise to a civil claim against them personally for trespass and conversion.

If ASIC receives a complaint about the conduct of a receiver, then ASIC would assess the specific circumstances to determine whether to take enforcement action or whether it may be more effective to use other regulatory tools, such as inclusion in our ongoing pro-active practice review program to see if issues of competence or capacity need to be addressed.

Question 4 (Hansard Ref: p. 58)
Senator EGGLESTON: Have you met with any of the submitters who have been to this inquiry, or their representative groups such as the Unhappy Banking group, headed by Geoff Shannon?
Mr Kell: My understanding is that we have received complaints from some of those individuals. As to whether we have met with them directly, I would have to check. I would have to check as to the nature of our communication with them.
Senator EGGLESTON: It would help for the information of the committee if you could give a list of the names and the individuals and the numbers.

Geoff Shannon met two ASIC staff members in person at ASIC's Brisbane office on 3 April 2012. As far as is known, ASIC staff have not met with any of the other submitters to the inquiry, or any of their representative groups. ASIC's communication with reporters of misconduct is normally by mail, email, or telephone.

ASIC has received seven reports of misconduct from persons who have made submissions to the Inquiry that raise concerns similar to those raised by members of the Unhappy Banking group. This number is higher than the four matters previously reported to the Committee as it includes reports of misconduct by parties other than Bankwest, such as the external administrators of companies, as well as a report of misconduct by Bankwest which had not previously been identified as raising similar concerns.

Other questions raised at the hearing but not listed on the Committee's notification letter dated 17 August 2012

Question 5 (Hansard Ref: p. 56)
Senator WILLIAMS: On the Bankwest problems, a receiver was sent in to a hotel and sold up two hotels. The bank was paid in full, about $24 million, and a receiver was paid in full, and $1 million was left over. The bank would not give the million dollars back to the bloke who owned the pubs because that bloke was suing Bankwest. The bank said they are going to keep the million dollars to pay their legal fees in the situation with the bloke who is suing them. Is that acceptable practice? When someone is cleaned up and everyone has their money, shouldn't anything that is left over go back to the owner of the assets, when all creditors have been paid and the receiver has left the operation?

The answer to this question will depend on the application of the appropriate State or Territory law (examples being the Conveyancing Act, Transfer of Land Act or Real Property Act), general common law principles and on the individual circumstances of each case (including by reference to mortgage documents, the nature of the dispute and so forth).

Mortgagees and receivers ought to ensure that proceeds are properly distributed and if there is a dispute about the proper distribution of surplus funds, it may be appropriate to take steps to secure the money while the dispute is determined. For example, this could include putting the funds into a joint interest bearing account or paying them in to court.

Question 6 (Hansard Ref: p. 57)
Senator WILLIAMS: Section 428 of the Corporation Act—selling assets at around market value. When a receiver is sent by a bank in to a private home, a block of land with a house on it, it is not a company. Does the receiver still have to abide by the Corporations Act and section 428?

We assume that the section referred to is Section 420A rather than Section 428 of the Corporations Act 2001 (Cwlth).

In terms of corporate receiverships, the receiver will be subject to s420A when exercising the power of sale in respect of the property of a corporation over which the receiver has been appointed.

In terms of non-corporate receiverships, there is not an exact statutory equivalent to section 420A. However, some State and Territory legislation contain similar provisions with respect to the receiver's duties when exercising the power of sale and, depending on the circumstances of each case, these may be relevant.

An example is section 85(1) of the *Property Law Act 1974* (Qld) which provides that "It is the duty of a mortgagee…to take reasonable care to ensure that the property is sold at the market value."

It is also relevant to note that receivers are governed by common law and duties such as the obligation to exercise powers in good faith and for a proper purpose.

If ASIC receives a complaint about the conduct of a receiver, then ASIC would assess the specific circumstances to determine whether to take enforcement action or whether it may be more effective to use other regulatory tools, such as inclusion in our ongoing pro-active practice review program to see if issues of competence or capacity need to be addressed. However, ASIC is only empowered to regulate the conduct of registered liquidators. Receivers appointed to corporate entities must be registered liquidators but receivers appointed in a non-corporate context are not required to be registered liquidators.

Question 7 (Hansard Ref: p. 59)
Senator EGGLESTON: .... The last matter I want to raise with you is that a number of submitters referred to having to sign a deed of forbearance after running into problems with Bankwest. The deed included a large fee, an interest rate of up to 18 per cent and a confidentiality clause. Firstly, why are deeds of forbearance necessary and what restrictions exist on what may be included in a deed of forbearance? Secondly, in some cases the only way the negotiating position of a borrower can be strengthened is through public exposure of the situation, such as through the media. One must question whether a confidentiality clause is appropriate in these sorts of circumstances. Would you like to comment on those points?

A deed of forbearance between a bank and a borrower typically involves the bank making a promise not to sue for the payment of money that is due and owing by the borrower, provided the borrower gives some consideration, e.g. a sum of money, or security or additional security for the outstanding debt. Such a deed will often be entered into as an alternative to litigation.

A deed of forbearance will generally be in the nature of a private contract. Its terms must be agreed to by both parties. As with other contracts, entry into a deed of forbearance is subject to statutory and general law principles on unconscionability. A borrower cannot be compelled to agree to the terms of a deed; but a failure to do so may mean that the bank proceeds to litigation.

There may be legitimate reasons for both the bank and the borrower to have the terms of a deed of forbearance remain confidential. Normally confidentiality clauses are not framed in a way that precludes a borrower from seeking legal advice or taking legal action where they are of the view that the deed of forbearance or any of its terms may be contrary to law.