Chapter 9

Bankwest: Conclusions and recommendations

How the committee approached this part of the inquiry

9.1 Before outlining the committee's conclusions and recommendations, it is necessary to explain how the committee approached the evidence about the alleged mistreatment of a not insignificant number of certain small business customers by Bankwest. The most crucial point is that this committee is not a court. While the committee has questioned Bankwest about particular cases and has utilised evidence relating to specific disputes to support its findings, readers of this report should not expect to find the committee's judgment on individual cases. Disputes between parties to a contract that cannot be resolved through other means need to be dealt with through the judicial process. Further, the committee has been very mindful of the undesirability of examining these cases in detail when some of them are before a court. The committee has accordingly reviewed the evidence from a broader, systemic perspective. Additionally, general comments made by the committee should not be interpreted to fully apply to every case; the committee received a number of submissions and it is inevitable that comments made by the committee, while applying to some cases, may not be relevant to all.

9.2 The main role of the committee in this inquiry has been to ensure that the regulatory settings governing the financial sector are appropriate and that the government agencies charged with administering and enforcing these regulations are effectively performing their role. It is not automatically the case that a collection of disputes, even if they share certain characteristics, should trigger regulatory change that would impact entire groups of borrowers. While there are many sad and distressing stories now on the public record, the committee cannot help but observe that, in some cases, although the aggrieved borrower may have been able to operate successfully during periods when the business environment was relatively good, the more challenging times presented by the global financial crisis placed extra stress on less robust and more speculative projects. In many cases, loans were sought for ventures that were a considerable risk even during the more stable economic environment that existed prior to the global financial crisis; this is evidenced by the cases where banks other than Bankwest had refused to finance the initial loans. Following the crisis, the decisions of the other financial institutions have probably been justified.

9.3 This of course does not apply to every case, nor does it excuse Bankwest—under its previous owners Bankwest was willing to enter into these loans that other financial institutions, acting more prudently, chose not to. When its small business borrowers are experiencing difficulties, Bankwest has a duty to make genuine attempts to work with the borrower, to clearly explain what is happening and why, and to treat them with courtesy.

9.4 While Bankwest may have been acting prudently by reassessing the risks of having certain loans on its books in the wake of its acquisition by the CBA at the height of the global financial crisis, there are legitimate concerns about some of the approaches adopted by the bank as a result of the reassessment. In examining the Bankwest issue, some individuals put forward the terms of the purchase agreement entered into by the CBA to acquire Bankwest as an explanation for what occurred. The committee notes these concerns but believes other factors such as the deterioration of the property market and general anxiety about the business and economic environment seem more significant based on the evidence available. In any case, the committee does not consider that it is necessary for it to definitively determine which factors may have influenced Bankwest's actions. The possible reasons provide some context, however, the concerns about Bankwest's approach and the regulatory responses required can largely be considered independently of these issues. That multiple potential explanations have been put forward supports this reasoning. While it can be conceived that situations similar to those that faced Bankwest's borrowers could be experienced by future customers of any lender, they could be caused by any number of events. The recommendations made by the committee are accordingly directed towards changes that will support more equitable dealings generally between small businesses and banks and that can apply to a broad range of future situations.

A proportionate and balanced response

9.5 The committee wishes to ensure that the regulatory settings in the financial sector relating to business lending encourage entrepreneurial activity and allow sufficient flexibility for parties to enter into agreements that best suit the particular circumstances of the commercial operation. While most small business dealings with banks are not problematic from a regulatory perspective, the evidence received by this inquiry and previous inquiries indicate that there are still problems with current arrangements. Small business owners are busy individuals focused on the day-to-day operations of the business. They may not have the time or expertise needed to fully consider how certain actions, such as changes to facility terms, will impact them. Small business finance also shares many characteristics with consumer lending; for example, both small businesses and consumers face significant imbalances in negotiating power with large financial institutions. Yet while both small businesses and consumers receive some safeguards through the industry's Code of Banking Practice, consumer lending is also subject to the much stricter requirements of the statutory National Credit Code.

9.6 However, rather than recommend similar government intervention for small business finance, the committee considers it would be preferable for the industry to work on solving the evident problems. The committee has previously called for the Australian Bankers' Association (ABA) to meet with small business representatives to develop a code of practice specifically relating to lending to small businesses. The evidence received in this inquiry further confirms the need to give effect to this recommendation. Failure by the ABA and the banks to act on this recommendation may strengthen the case for more prescriptive government regulation in this area.

Given the arguments from the sector about the cost and burden of added regulation in general, the committee is of the view that if banks genuinely have these concerns, they have both the obligation and opportunity to demonstrate that the banking sector takes concerns about small business finance issues seriously and is willing to proactively develop a stronger self-regulated solution.

9.7 The committee does not consider the code of conduct for small business lending should interfere with the flexible nature of commercial agreements, but it envisages that it could set out some general principles for small business lending and address some of the particular conduct revealed by this inquiry. In particular, the committee recommends that the following issues be addressed:

- Changes to facility terms should be clearly explained to the borrower in writing, not simply issued. Small business owners may not have the capacity to review revisions to lengthy and complex loan documentation and identify what has changed. Documentation changing the terms of a loan should be accompanied with a cover letter clearly explaining what the changes are.
- Both borrowers and lenders take on obligations and responsibilities when they contract. Initial valuation reports provide security for lenders but changes to valuation reports pose serious threats to borrowers who are otherwise meeting all their obligations. In the absence of major economic shocks or unexpected events, small business owners should be entitled to expect that their dealings with the bank will be based on this initial assessment for a reasonable amount of time into the loan, such as for the first two years.
- It is generally the borrower that pays for costly revaluations that the bank requires. In many cases involving Bankwest valuation reports were used as a basis for placing businesses in receivership, yet borrowers were often denied access to the report and were left to speculate about the integrity of the valuation process. It is, therefore, difficult for the borrower to form a considered view as to whether the bank's instructions to the valuer and the valuer's actions were proper, or whether the receiver acted appropriately in exercising their power of sale according to the relevant requirements of the Corporations Act. Borrowers should, therefore, be automatically provided with copies of any valuation reports that they have paid for or which the bank intends to rely on to demonstrate that the borrower is in default. On request, borrowers should also receive copies of all instructions given by the bank to the valuer. This should apply even after a receiver has been appointed.
- Borrowers should also have the right to challenge a bank-ordered valuation by commissioning their own valuation. In the event that there is a disagreement about which valuation should be relied on, the disputed reports could be mediated by an industry body, such as the Australian Property Institute.
- The short period of time, such as 24 hours, between when notices of demand were received and when payment was required was another issue identified by the committee as inherently unfair. While there is some conflicting evidence regarding how aware (informally) the borrower was that a notice of demand

was going to be issued, it would be preferable that the formal notice include an added reasonable period of time for the borrower to seek refinance, such as 14 days. In addition to this 14 day period, further time should be available to allow for the finalisation of contracts if refinancing has been secured. This additional time should also be available to allow a borrower to continue negotiations for refinance if an offer appears reasonably likely. Banks and receivers should cooperate with any reasonable requests for information made by the borrower during this period that would assist the borrower reach an agreement for refinance.

- Given the substantial impact on the viability of the business that the imposition of default interest can have, how the default rates will be determined should always be clearly detailed in the facility terms provided to the borrower, rather than being linked to other documentation.

Recommendation 9.1

9.8 That a voluntary code of conduct for small business lending, developed by the Australian Bankers' Association, be established. The code should, at a minimum, require that:

- **changes to facility terms must be accompanied by a document that clearly explains the changes to the borrower;**
- **initial valuation reports associated with the purchase of a small business should be relied on by the bank for a reasonable amount of time, such as for the first two years of the loan, unless a major defined shock or event occurs;**
- **borrowers be automatically provided with copies of valuation reports that they have paid for or which the bank intends to rely on to demonstrate that the borrower is in default, and that all instructions given by banks to valuers be provided to the borrower on request;**
- **notices of demand include a minimum deadline of 14 days for repayment, but that a further reasonable period of time should also be available to allow for the finalisation of necessary contracts if refinancing has been secured, or to allow negotiations to continue if an offer of finance is reasonably likely;**
- **banks cooperate with any reasonable requests for information made by the borrower that would assist the borrower secure refinance; and**
- **how default interest rates will be determined should always be clearly specified in the facility terms, not linked to other documentation.**

Recommendation 9.2

9.9 That the Australian government takes any necessary action to facilitate the establishment of the code of conduct for small business lending referred to in recommendation 9.1.

Making dispute resolution schemes more relevant to small business

9.10 The committee is also concerned about the options available to small business owners to seek redress. The committee notes that FOS may consider small business disputes, but there are a number of limitations on FOS which limit its relevance and effectiveness for these disputes. Most significant is that FOS is unable to consider claims that exceed $500,000. While consumer lending disputes of this magnitude may be best dealt with by other means—although the committee has not made a judgment on this—the evidence received indicates that disputes relating to small businesses can easily reach this level as they deal with high-value assets. However, for these businesses there are many competing pressures on available funds and it is not likely that a reserve is available to finance the institution of court proceedings. In any event, the appointment of a receiver leads to the business's funds being out of the control of the business owner. The committee believes that small business owners should not be restricted from seeking review by FOS because of this.

Recommendation 9.3

9.11 That the terms of reference for the Financial Ombudsman Service (FOS) be amended so that:

- **FOS may consider disputes from small business applicants where the value of the claim is up to $2 million; and**
- **the cap on the maximum compensation that FOS can award be increased to $2 million when the dispute relates to a small business.**

Recommendation 9.4

9.12 That the terms of reference for the Financial Ombudsman Service (FOS) be amended so that FOS may consider disputes from small business applicants that relate to matters from 1 July 2008 onwards under the new caps outlined in recommendation 9.3. The staffing levels and funding of FOS should be reviewed to ensure it has sufficient resources available to perform this function.

9.13 The committee also considers that there is a flaw in the current external dispute resolution framework as when a receiver is appointed by a secured creditor, FOS cannot review their actions or require them to stop enforcement action such as selling the company's assets. The committee is not of the view that FOS's terms of reference should be extended to cover receivers as it is not well-placed to consider disputes about the receivers' actions (which are taken as an agent of the company that they are appointed to). However, in situations where a genuine dispute exists being a borrower and a financial service provider, and the appointment of a receiver seems inevitable, the borrower should have the opportunity to seek a review of the substantive matters of the dispute before such an appointment is made.

9.14 Further to the committee's recommendation that notices of demand should include a reasonable minimum deadline for repayment (recommendation 9.1), such a notice should also be required to include information about FOS. Recognising that this could potentially be misused in cases where lodging a dispute could have limited

merit (i.e. a last act of desperation by the borrower that could actually be disadvantageous for them if the dispute is prolonged and not resolved in their favour), the committee notes that under the existing terms of reference for FOS the financial services provider would still be able to seek FOS's consent to the proposed appointment of receivers or for the initiation of other enforcement action. That FOS would have to consider such a request would at least provide some external scrutiny of the decision.

Recommendation 9.5

9.15 That the code of conduct for small business lending referred to in recommendation 9.1 stipulates that lenders may not appoint receivers to a small business unless:

- **a notice of demand to the small business has been issued by the lender and the 14 day period of time outlined in recommendation 9.1 has elapsed; and**
- **if the lender is a member of the Financial Ombudsman Service (FOS), the notice of demand clearly states that the borrower may apply to have a dispute related to the lender considered by FOS, but that FOS would be unable to review claims related to the actions of a validly appointed receiver. Disputes lodged under such circumstances should be treated as urgent and the dispute handling process expedited by FOS.**

Recommendation 9.6

9.16 That receivers be required to cooperate with all requests from the Financial Ombudsman Service (FOS) that relate to a dispute between the bank and the borrower that FOS is considering.

The role of receivers

9.17 The committee is also concerned about some outcomes that arise once a receiver is appointed. The committee notes that both the borrower and bank are subject to risk once a business is in trouble, however, there appears to be limited risk for receivers or accountability for the fees they charge. From the evidence received, banks do not seem inclined to challenge the receivers' actions or their fees, and there is little ability for the borrower to do so once their assets have been sold. While section 420A of the *Corporations Act 2001* imposes an obligation on receivers to take all reasonable care that property of a company is sold at a price not less than its market value if it has a market value at the time of sale (or otherwise the best price that is reasonably obtainable), it is inherently difficult for borrowers to scrutinise the receiver's actions. Therefore, if the borrower can produce sufficient evidence that indicates that the sale process may not have been in accordance with section 420A of the Corporations Act, the receiver should bear the burden of proof for demonstrating that they fulfilled their obligations.

9.18 The committee is also aware that, on occasion, inaction by receivers can also frustrate attempts by the borrower to seek refinance.

Recommendation 9.7

9.19 That when a business is placed in receivership, the receiver is required to demonstrate to the borrower that they have considered every unconditional offer when exercising a power of sale in respect of a property.

9.20 If the borrower can demonstrate that an unconditional offer has been made by a party interested in purchasing a property and the receiver instead sells the property by a process that achieves a price that is less than that offer, the burden of proof should be on the receiver to demonstrate that their actions were in accordance with section 420A of the *Corporations Act 2001*.

Recommendation 9.8

9.21 That receivers be required to cooperate with any reasonable requests for information made by the borrower that would assist the borrower secure refinance.

Recommendation 9.9

9.22 That the code of conduct for small business lending referred to in recommendation 9.1 requires that if a bank has appointed a receiver to the small business, then the bank must regularly inform the borrower about the costs and fees associated with the receivership. The bank must also take all reasonable care to ensure the costs and fees are reasonable.

Small finance issues more generally

9.23 The committee also considers that further investigation of the challenges that small businesses face in pursuing review of actions taken by banks, receivers and other bodies is warranted. This is a complex issue not well-placed within this inquiry's terms of reference. The committee does not have a firm view as to which body should conduct such an investigation, although it notes that the Australian Small Business Commissioner who is due to take office on 2 January 2013 may be the appropriate office.

Recommendation 9.10

9.24 An early priority of the Australian Small Business Commissioner should be to examine burdens for small businesses in pursuing litigation against banks and receivers and to report their findings and recommendations to the Australian government.

Recommendation 9.11

9.25 That, following the Australian Small Business Commissioner's appointment becoming effective, the Small Business Commissioner provide an annual report to the Senate on small business finance issues. In preparing this report, the Small Business Commissioner should receive any necessary support from relevant government departments and agencies.