

COMMONWEALTH GOVERNMENT

RESPONSE TO THE

PARLIAMENTARY JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND SECURITIES (PJSC)

REPORT ON 'SHADOW LEDGERS'

AND THE PROVISION OF

BANK STATEMENTS TO CUSTOMERS

BANKING PRACTICES

The Government believes that it is important for the community and for all financial institutions that they adopt and maintain good banking practices and deliver high standards of customer service.

The conclusions and recommendations of the PJSC Report on *'Shadow Ledgers' and the Provision of Bank Statements to Customers*, address two areas of concern about banking practices:

- concerns about internal accounting practices related to writing-off customer debts for taxation purposes. The Government response to this aspect of the Report is at Part A.
- allegations relating to disclosure practices such as the issue of bank statements to customers in default on their loan obligations. Part B contains the Government's response to the PJSC's findings on this matter.

PART A: TAXATION CONCERNS

Conclusions and Recommendations

- 1.41 *The PJSC does not find that with regard to the instances before it and with regard to the material provided to it, either through written submissions or oral evidence, that a wrongful use of shadow ledgers occurred or that the failure to provide bank statements could have constituted unlawful behaviour.*
- 1.42 *The Committee notes that the Australian Tax Office covers the accounting practice of operating shadow ledgers in its TR 94/32. This tax ruling allows that when banks classify a loan as non accrual that any interest accruing thereafter will not be derived for income tax purposes until it is received. The Committee concludes that it is unlikely that a case could be made that the use of shadow ledgers by banks are not a proper accounting function.*
- 1.43 *The Committee notes the bank's advice that independent auditors Ernst & Young had specifically reviewed the shadow ledger accounts and confirmed that the activity on those accounts is in accordance with accounting and taxation requirements.*
- 1.44 *While the Committee is satisfied with the findings of Ernst & Young, to ensure that any outstanding public concern is addressed about the administrative errors admitted by the bank in relation to Tratzea's accounts, the Committee asks the CBA to confirm the taxation treatment of monies in respect to Tratzea were correct.*

The Government believes that financial institutions should deal with their customers in an open and transparent manner. It considers effective communication to be a key component of good banking practice. It is central to the maintenance of good customer relations, particularly where a customer is experiencing financial difficulties, and requires both parties to exchange relevant information. While appreciative that, for commercial reasons, financial institutions may not wish to reveal some aspects of their accounting and taxation affairs, it would nevertheless appear to be in their best interests to take all steps necessary for the effective resolution of customer concerns.

Initiatives arising from the Committee's inquiry are considered to be a beneficial step towards resolving customer concerns about internal accounting practices relating to their debts. However, the Government considers it regrettable that these concerns were permitted to arise and believes that they could have been avoided or resolved through more effective communication between financial institutions and their customers.

The Government and the Australian Taxation Office (ATO) take very seriously all issues relating to compliance with the taxation laws. The ATO does, and will continue to, take steps to ensure that taxpayers comply with the taxation laws.

To assist taxpayers in complying with those laws the ATO issues public rulings advising of the Commissioner's view on the application of those laws to particular circumstances. The Commissioner's views as to the taxation treatment of bad debts and non accrual loans has been publicly documented in Taxation Rulings TR 92/18 and TR 94/32 respectively.

The Government has been advised by the Australian Competition & Consumer Commission (ACCC) that it has investigated a number of complaints and while all investigations are not complete it is clear that proceedings cannot be instituted for breaches of the Trade Practices Act in every case. The ACCC has noted that the Commonwealth Bank has initiated a mediation process to deal with complaints and the ACCC is hopeful that process will deal with the individual complaints more thoroughly than any litigation it might initiate.

PART B: DISCLOSURE CONCERNS

Conclusions and Recommendations

- 1.45 *The Committee concludes that the Commonwealth Bank by not automatically issuing account statements to some customers who were in default on their loan obligations exacerbated an already difficult situation for the customers, making it difficult for them to budget, re-finance loans and submit taxation returns.*
- 1.46 *The Committee believes that the Commonwealth Bank's explanation that they did not provide bank statements to customers because they did not wish to 'inflame a dispute' is poor banking practice. Evidence presented to the Committee also demonstrated that the confusion customers faced about the bank's practices in respect to 'shadow ledgers' was unreasonable.*
- 1.47 *The PJSC therefore concludes that the management practices of the Commonwealth Bank in relation to non-provision of statements albeit to a small number of customers who had fallen behind with repayments, were seriously flawed in terms of best practice customer relations.*
- 1.48 *The Committee acknowledges the efforts that witnesses to the inquiry such as Mr Bruce Ford have made in order to have their issues properly considered. The Committee notes that the need to hold an inquiry into 'shadow ledger accounts' represents a failure of the Commonwealth Bank to resolve some customer relation disputes internally.*
- 1.53 *The PJSC also notes that members of the Committee believe that on the evidence presented it is not possible to determine how many Commonwealth Bank customers have been affected by the bank's decision not to issue bank statements when loans are in default. The PJSC recommends that mediation services be offered by the CBA to affected customers where appropriate.*

Labor and Democrat members believe that the Commonwealth Bank should appoint an independent mediator to resolve any outstanding disputes. Labor and Democrat members also believe that the appointment of the mediator should be advertised in the national press and the Commonwealth Bank asked to report back on progress in resolving disputes.

- 1.54 *The PJSC recommends that all banks if they do not do so already, clearly inform customers about the procedures and processes which result in the case of troubled loans.*

Adequate disclosure places customers in a position to make informed and timely decisions about the organisation of their financial affairs. Effective disclosure is also an important foundation for building good relations between financial

institutions and their customers. Good disclosure practices clarify the nature and extent of each party's rights and obligations and in so doing help to foster a mutually beneficial customer/bank relationship.

The Government therefore considers it poor banking practice for a financial institution to withhold from its customers relevant and timely information about their financial obligations. This is so irrespective of the fact that only a small number of customers may be affected by such practices.

The consequences of inadequate or inaccurate disclosure include customer confusion about banking procedures and a breakdown in the relationship between financial institution and customer. Appropriate disclosure is likely to assist in the process of resolving concerns and any confusion that may have arisen between financial institutions and their customers.

It is therefore reasonable to expect that financial institutions would endeavour to provide all necessary financial information to their customers. Where disputes do arise, it is important for financial institutions to advise their customers about the dispute resolution avenues available to them and the processes involved.

The Government encourages financial institutions to review regularly any internal practices that have a potential to impact adversely on customer relations, including their internal dispute resolution processes. The Government expects such reviews would aim to ensure the continued effectiveness of these processes and to address those measures necessary to resolve reasonable customer concerns.

1.49 The PJSC recognises that the commitment by the Commonwealth Bank to provide full statements to customers in default is a step forward. However, the Committee is disappointed that this commitment did not eventuate until this Parliamentary Inquiry was initiated.

1.50 While the Committee has investigated the practice of the Commonwealth Bank in respect to the treatment of bad debts and the creation of shadow ledger accounts it is evident that this practice is not limited to the Commonwealth Bank. Indeed in its evidence to the Committee the Commonwealth Bank stated that its practices are 'industry standards'. If this is indeed the case then it is appropriate that all banks commit to providing statements to customers who are in default on their loans when requested by the customer.

1.51 The PJSC believes that all financial institutions which do not already do so should adopt the announced intention of the Commonwealth Bank to provide full statements to all customers. Therefore the PJSC recommends that the automatic issuing of statements of account in all circumstances short of litigation be considered for inclusion in the banking code of practice.

1.52 *The PJSC believes that the statement should set out the total amount which the Bank believes that the customer owes in respect of the account in accordance with the terms and conditions on the account and should not reflect any write downs which the bank has made for internal accounting or taxation purposes. The Committee will refer the matter to the relevant parties undertaking the review of the banking code of practice.*

The Government would expect that financial institutions will review their banking practices in relation to troubled loans to ensure that their customers receive appropriate and timely information about their financial obligations. It encourages and supports this process.

In view of the central importance of adequate disclosure, the Government is pleased to note that the Commonwealth Bank has introduced, from 1 January 2001, new arrangements for the provision of full statements to customers in default on their loan obligations.

It notes that the current review of the Code of Banking Practice provides an appropriate forum for the banking industry as a whole to consider these matters. As part of the review, an issues paper canvassing possible changes to the Code was released on 5 March for public consultation. Presently, the Code includes some matters related to the provision of statements to customers. As the Code describes standards of good banking practice and is intended to promote the disclosure of information to customers, the review provides a timely opportunity for the banking industry to re-evaluate existing industry practices and to consider embedding any reforms in a revised Code.

The Government also welcomes initiatives taken by the Australian Banking Industry Ombudsman in December 2000, examining principles for good banking practice in this area. It views this as a positive step and encourages all financial institutions to adopt those banking practices necessary to deliver high standards of customer service.

