AUSTRALIAN BANKERS' ASSOCIATION

# Family Law Amendment Bill 2003

## Submission by Australian Bankers' Association

## to the

## Senate Legal and Constitutional Legislation Committee

**14 July 2003**

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## Introduction and Summary

The Australian Banker's Association welcomes the opportunity to inform the Committee of concerns member banks have with respect to this Bill.

These concerns arise from Schedule 6 to the Bill and in particular the proposed power to be conferred on the court to make orders that bind third parties.

The Explanatory Memorandum (EM) to the Bill indicates that the court's exercise of this power can apply to any creditor including a financial institution. It is noted that the Productivity Commission had advised that a Regulatory Impact Statement was not required.

The regulatory impact on business is stated in the EM to be minimal and to the extent it does have impact that impact on business is not expected to be significant.

The Consultation Statement in the EM does not indicate consultation with the finance sector in the development of the Bill.

The ABA is concerned that there appears to have been no consultation with the financial services sector. The Bill is expected by the ABA to have potentially significant impacts on banks.

The ABA does not support the proposed extension of the Court's power to bind banks because of the potential for increased credit risk exposure by banks.

Further consultation is needed with the banking industry and the ABA submits that either Schedule 6 of the Bill should be withdrawn to allow this consultation to take place or the Bill should provide for a bank's consent as a pre-condition to the exercise of the courts' power to make an order binding the bank in respect of a debt or other liability, actual or contingent, owed to the bank.

## Substantive Comments

Banks are the major providers of personal and home finance to Australian families. This finance can be secured or unsecured. Banks are also the principal providers of finance to Australia's 1 million or so small businesses.

Every bank lending decision is preceded by a credit risk assessment in order to satisfy the bank that the borrower will able to repay the loan. Lending decisions are made on the basis of cash flow rather than on the value of security. Many lending decisions are made without the borrower having to provide security, for example in credit card lending.

Credit risk includes an assessment of regulatory risk. This is the risk of regulatory change or intervention that could interfere with a bank's ability to recover its loan or rely on its contract with the customer.

The price and availability of credit is influenced by the bank's assessment of credit risk. The higher the credit risk the higher the price of the credit and the lower the amount or availability of the credit in particular cases.

Proposed section 90AE of the Bill provides for the court to direct a bank in regard to a debt owed to the bank by a party involved in a matrimonial cause creates a potential intervention in the bank's decision as to whom it should lend money and from whom it may recover that money.

Exercise of this power by the court would substitute the court's view on a person's credit worthiness for the bank's. The court would be, in effect, exercising a commercial judgment instead of the bank and directing the bank accordingly.

The potential exercise of this power creates regulatory risk.

The level of marriage failure and the extent of family or household debt are of significant dimensions to create an increase in credit risk for banks and other lenders if the proposed power is conferred on the court.

Extending the court's power to bind banks under the Bill means:

1. that altering the liability of parties or the proportion of their liability for a debt reduces the ability of the bank to recoup the debt from the parties whom the bank had originally determined were credit worthy;

2. that the bank is deprived of recourse to one of the parties either fully or proportionally (i.e. debts being joint and several); and

3. that substituting one party's liability with another's increases the exposure of the bank to credit risk especially where that party was not an original party to the contract.

The extension of the court's power to bind banks in relation to debts owed to them by family court litigants is a potentially significant erosion of the value of a bank's substantive right of property in a debt. This is because one of the debtors can be absolved from further liability for the debt. This is not simply a procedural matter. It goes to the certainty of the contractual promises to repay the debt or to meet the liability.

Also, clauses 90 AE (2) and 90 AF (1) and (2) of the Bill give the court even wider power to intervene in the legitimate exercise by a bank of its contractual and security rights against the parties. This intervention could extend to:

a) restraining the exercise of the power of sale or the recovery of possession of security property that could involve not simply the matrimonial home but other property ;

b) restraining the recovery of debts through legal proceedings even where those debts are not in dispute;

c) directing the bank to change the terms of its contract with one or both parties;

d) relieving one of the parties from liability under a guarantee of the other party's debt to the bank; and

e) the court exercising a wide discretion in the interests of dividing property between the parties that could extend to an effective re-opening of a credit contract and altering its terms and conditions.

Proposed section 90 AE (3) is intended to provide a creditor with protection against loss of its ability to recover a debt or enforce a liability. The ABA submits that proposed section 90AE(3) fails to adequately protect a bank. It fails because:

a) it puts the court in the position of judging the bank's own assessment of credit risk and empowers the court to substitute its judgment for that of the bank;

b) the exercise of the court's power could deprive the bank of a possible future avenue of recourse against one of the original debtors. For example if there was a shortfall under a mortgagee's sale the bank could not have recourse to both the original parties to the mortgage if the court had relieved one of them from the debt;

c) the foreseeability test takes no account of subjecting a borrower to undue hardship or of the borrower's cash flow;

d) the foreseeability test might assume that the party taking over the debt is to be maintained by the other party and that party fails to meet those commitments.

e) the foreseeability test could be interpreted by a court to mean that if the asset security value at the time of the settlement is equal to or greater than the debt the test is satisfied; this does not account for prudential loan to value ratio requirements and possible future accumulation of interest, selling expenses, enforcement expenses and costs;

f) the power would extend to contingent debts where the parties to the marriage are guarantors of a corporate business debt;

g) the exercise of the power could interfere with the rights of other debtors or guarantors who are jointly and severally liable with the married parties where their proportionate liability is increased and their rights of contribution or subrogation are affected because of the release of one of them; for example if one party is effectively discharged from the liability this could leave a third and fourth joint debtor who pays out the debt without recourse by way of subrogation to the bank's security or to contribution from the party who has been released;

h) the exercise of the power could mean that under a loan contract where the bank has a continuing contractual obligation to lend either in the form of progress payments or because the facility is a revolving credit facility such as an overdraft, the bank may be compelled to continue to lend to a person to whom the bank is unwilling to continue to do so; and

i) it is unclear what "procedural fairness" would entail other than a right for the bank to make submissions to the Court. There is no requirement for the court to give priority or similar weight to the bank's submission.

## Lending Implications

Possible lending implications arising from the increased regulatory risk include:

1. a higher price for credit based on increased risk;

2. the setting of a more conservative loan-to-value ratio;

3. the setting of a higher debt servicing ratio that could restrict the amount of credit available;

4. shortening the term of the loan; or

5. borrowers needing to procure lender's mortgage insurance.

## Other Implications

As with lending there are other banking services that could be adversely affected by the extension of the court's power to bind banks.

For example, investors and small business operators often enter into exchange traded or even over-the-counter (OTC) derivatives to hedge their exposure to a variable market condition such as foreign currency or commodity prices.

If the court were to direct that the bank's counterparty to a derivative contract is to be replaced with a party whom the bank has not undertaken a credit risk assessment, this would expose the bank to risk.

This risk is unique because derivative contracts are created through a master agreement that is, in effect, a master netting contract. Each derivative contract amends the master netting contract. The Payments Systems and Netting Act (PSN Act) allows for the master netting contract to operate in the case of insolvency of a counterparty with effect that all obligations are netted off and settled accordingly.

The PSN Act stops an insolvency administrator from cherry picking solvent counterparty transactions and disclaiming obligations owed by the insolvent party.

A power in the court to make orders transferring individual transactions to third parties has the potential to leave the original counterparty with all the liability and none of the gains.

Exchange traded and OTC products can be extremely complex. If a court were to direct a substitution of one party for another under a derivative contract this could mean that the incoming party may not have the benefit of the information given when the product was first acquired. This would undermine the financial services reform legislation that has been developed to ensure there is adequate pre-contractual information before retail customers take up financial products. Furthermore, security is often taken for exposures under these products, provided either directly to the issuer or via bank guarantee. So the taker of the security will have a concern if the risk of loss is increased through a different party doing the trading.

Also, a transfer of liability to party whose identity the bank has not verified under the Financial Transactions Reports Act could place the bank at risk.

## Commencement

If the Bill is to go ahead in its present form there would be considerable compliance arrangements that banks would have to put in place including:

1. Staff training
2. Instruction manuals
3. Development of lending policies and procedures
4. Changes to loan contract terms and conditions to make provision for the event of a court order.

There should be at least six months allowed for these arrangements to be made before the legislation commences.

## Conclusion

The ABA submits that the Bill present serious credit risks for banks and potential customer disadvantages.

Banks have generally endeavoured to co-operate and work with family law litigants to achieve their family law settlements and agreements.

Nothing has been put to suggest that banks have not been co-operative in seeking to accommodate the parties' objectives.

The ABA submits that further consultation is needed with the banking and financial services industry. The ABA submits that either Schedule 6 of the Bill should be withdrawn to allow this consultation to take place or the Bill should provide that the court must not make an order binding a bank in respect of a liability owed to the bank unless the bank has first consented to the terms of that order. A bank would not unreasonably withhold its consent.

***Australian Bankers' Association***
***Sydney***
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