

Parliament of the Commonwealth of Australia

The House of Representatives Standing Committee
on Banking, Finance and Public Administration

CHECKING THE CHANGES

**Review of Certain Recommendations of the
Banking Inquiry Report**

October 1992

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Foreword

The Committee's previous report on the banking industry has resulted in the most significant changes to the industry since deregulation in the early 1980s. Recommendations from that inquiry which have been implemented by the Government have changed the competitive, supervisory and consumer protection environment in ways which will significantly benefit bank customers.

Among the major changes which resulted from the Committee's report are the opening up of entry to foreign banks which will be able to operate as branches of their parent banks, development of a Code of Banking Practice, the appointment of a second Deputy Governor of the Reserve Bank to be the supervisor of banks and a Prices Surveillance Inquiry into the profitability and pricing of credit cards.

In this review, the Committee's task was to assess the progress of banks in implementing the recommendations from the previous inquiry which were specifically their responsibility to implement. The Committee's expectation was that banks' implementation of recommendations would complement the Government's response and reinforce the benefits to flow to bank customers over time.

When the review commenced it was clear some banks' implementation of some recommendations was unsatisfactory. The process of the review has been beneficial in maintaining pressure on banks to put in place changes which the Committee considers will result in better banking practice.

As a result of the Committee's focus on the industry for the last two years and the changing economic environment, the industry has faced a period of upheaval and self-reflection. This followed the rapid change brought about by deregulation.

The Committee considers a period of consolidation is now appropriate. However, with the learning experience of the 1980s and the soul searching that has occurred since then behind them, banks face the period of consolidation with a more appropriate framework and set of ethics in place.

The challenge for banks is to demonstrate how they have learned from experience in responding to the challenges of the 1980s. Customer focus will be one key to success by banks. Also in re-focussing their businesses and seeking to revive their lending, banks must be mindful of the low inflationary economic environment and the need to see the economy growing. Banks which respond best to this environment will succeed in the 1990s.



PAUL ELLIOTT, MP
CHAIRMAN

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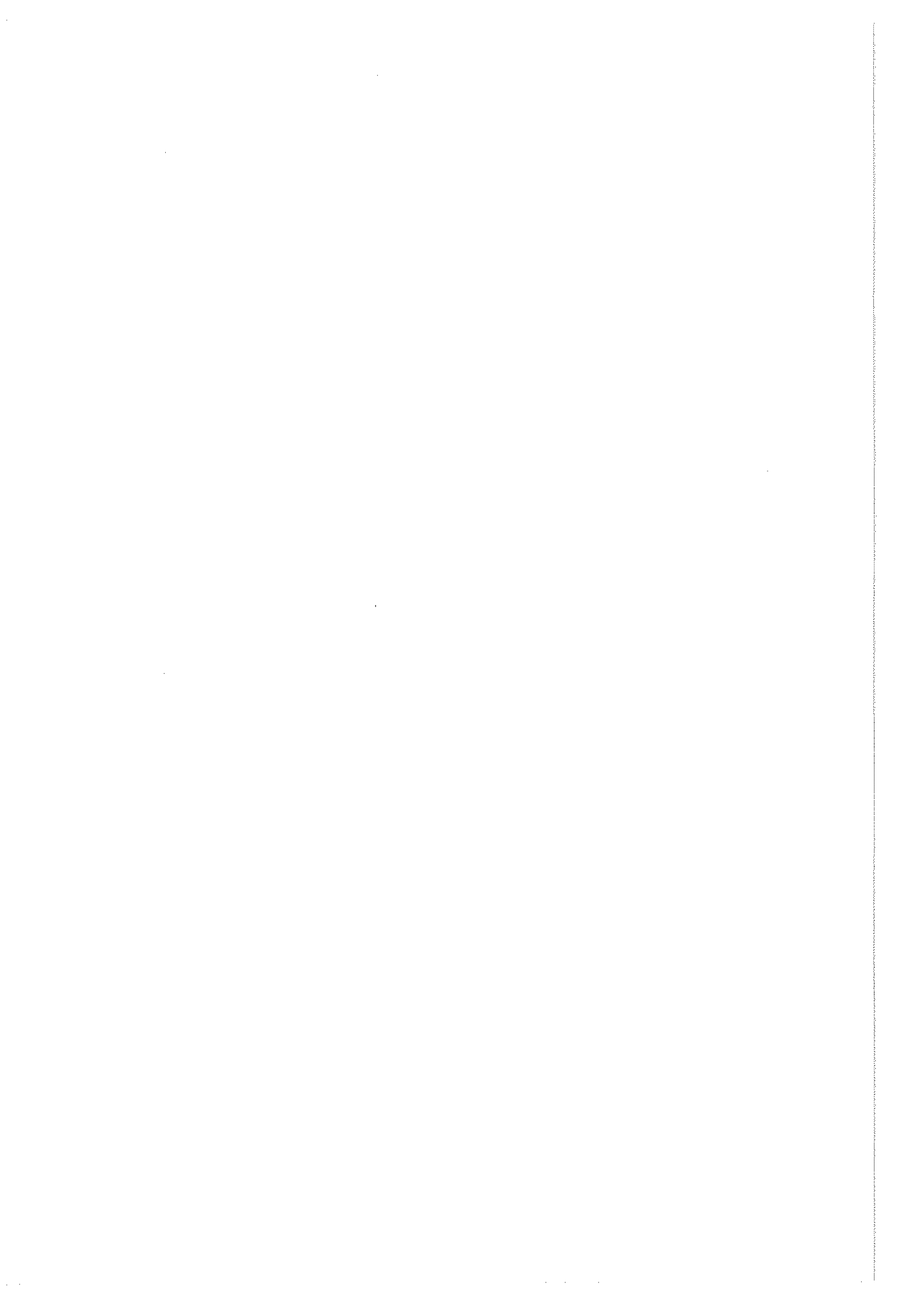
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Members of the Committee

Chairman: Mr R P Elliott, MP (from 5 March 1992)

Deputy Chairman: Hon I B C Wilson, MP

Members: Mr J N Andrew, MP
Mr R A Braithwaite, MP
Dr R I Charlesworth, MP
Mr B W Courtice, MP
Mr A J Downer, MP (to 6 May 1992)
Mr S C Dubois, MP
Mr R F Edwards, MP
Mr G Gear, MP
Mr R S Hall, MP
Mr S P Martin, MP (Chairman to 2 January 1992)
Mr L J Scott, MP (from 3 March 1992)

Secretary: Mr D R Elder

Advisers: Mr R Drake

Inquiry Staff: Ms L J Gillies

Terms of Reference of the Committee

The Standing Committee on Banking, Finance and Public Administration is empowered to inquire into and report on any matters referred to it by either the House or a Minister including any pre-legislation proposal, bill, motion, petition, vote or expenditure, other financial matter, report or paper.

Terms of Reference of the Inquiry

The Committee has been requested by the Treasurer to inquire into and report to the Parliament by 30 October 1992 on:

the implementation of those recommendations in the Banking Inquiry Report which were directed specifically to banks and which are the responsibility of banks to implement, specifically recommendations numbers -

40, 42, 43, 44, 45, 46, 47, 48, 51, 57, 58, 59, 60, 62, 64, 65,
67, 68, 70, 71, 72, 73, 74, 78, 79

Abbreviations

ABA	Australian Bankers' Association
ABARE	Australian Bureau of Agricultural and Resource Economics
ACA	Australian Consumers' Association
ADR	Alternative dispute resolution
AFIC	Australian Financial Institutions Commission
ANZ	Australian and New Zealand Banking Group Limited
ASC	Australian Securities Commission
CBA	Commonwealth Bank of Australia
FAS	Farm Assessment Scheme
FCBA	Foreign Currency Borrowers' Association
FHS	Farm Household Support
FID	Financial Institution Duty
ISC	Insurance and Superannuation Commission
MMB	Minimum Monthly Balance
MOU	Memorandum of Understanding
NAB	National Australia Bank
NCACC	National Consumer Affairs Consultative Council
NFF	National Farmers' Association
PSA	Prices Surveillance Authority
RAS	Rural Adjustment Scheme
RBA	Reserve Bank of Australia
SBNSW	State Bank of New South Wales
TPC	Trade Practices Commission

List of Recommendations

Chapter Two - Small Business

Product development and advice

The Committee recommends that:

1. banks and the Australian Bankers' Association develop a strategic direction to their approach to the development of resources and advisory services to assist small business' understanding of banks financial reporting and assessment requirements;
2. Federal and State Ministers for small business discuss with peak accounting bodies and small business associations ways of ensuring small businesses are provided with better financial management and planning advice by their accountants and other advisers; and
3. banks develop packages for other industry sectors similar to that being developed for the tourism industry. (paragraph 2.11)
4. banks look to further develop products for small business which pay interest on credit balances in working accounts. (paragraph 2.20)

Availability of finance

The Committee recommends that:

5. banks develop strong initiatives to provide lending to the small business sector;
6. senior management of banks re-enforce the message to staff to take a positive approach to lending in line with the low inflationary which emphasises cash flow as the critical criterion in lending decisions; and

7. the Reserve Bank of Australia monitor developments in, and report regularly on, credit availability and credit growth as it affects differing sectors of the community with a particular focus on the access to credit of small business and farmers. In doing so the Reserve Bank should, in consultation with banks, small business organisations and governmental bodies, enhance its information base in relation to these sectors. (paragraph 2.48)

Lending practices and margins

The Committee recommends that:

8. banks strengthen their methods for monitoring the implementation at a local level of policies and guidelines relating to small business lending to ensure compliance with the formal policies of the bank and report on such compliance to the Reserve Bank; and
9. banks consult with small business organisations as part of their assessment of compliance of staff with bank policies to encourage lending. (paragraph 2.53)
10. the Reserve Bank of Australia monitor and report publicly on movements in bank interest rate margins, with particular attention being given to margins applying to small business and farmers. (paragraph 2.63)

Disclosure

The Committee recommends that:

11. banks disclose to business customers the differential between market reference rates on bill facilities and the rate charged by banks to customers. (paragraph 2.69)
12. as part of the development of a Code of Banking Practice a formula for a single comparison rate of the total cost of loan and deposit products be implemented. The rate should be available to consumers, small business and farmers. (paragraph 2.76)

Code of Banking Practice

The Committee recommends that:

13. the banking practice and disclosure requirements relating to small business customers contained in recommendations numbers 43-48 of 'A Pocket Full of Change' and in this report be included in the proposed Code of Banking Practice, or in a future enhancement of the Code. (paragraph 2.80)

Chapter Three - The Rural Sector

Financial difficulties

The Committee recommends:

14. the capacity of farmers to assess the long term prospects of their farming business should be enhanced by providing them with greater access to expert independent advice on farm assessment and management and financial planning. (paragraph 3.27)
15. banks should make use of the provisions in the 'One Nation' statement for the partial write off of debts to assist farmers who are experiencing short term difficulties during this period of rural sector downturn. If there are limitations in the provisions, banks should approach the Government or the Australian Taxation Office with suggested changes; and
16. the availability of the arrangements should be promoted actively by banks amongst rural customers. (paragraph 3.33)
17. the Government keep the rural counsellors program under review to ensure sufficient funding is available to enable assistance to be provided to farmers facing financial difficulties. (paragraph 3.35)

Expertise within banks

The Committee recommends that:

18. banks increase their capacity to provide expert assistance to the farming sector by expanding the quality of their resources in rural branches. Emphasis should be given to enhancing the financial knowledge and farm risk management skills of rural staff. (paragraph 3.53)

Code of Practice for Banker/Farmer relationships

The Committee recommends that:

19. the relationship between financial institutions and farmers be addressed as a matter of priority as part of a proposed Code of Banking Practice. It may be necessary to develop a supplementary section to incorporate the particular aspects of the relationship which cannot be included in a general code. Farming organisations should be consulted closely in the development of the Code. (paragraph 3.65)

Chapter Four - Dispute Resolution and Mediation

Complaints statistics

The Committee recommends that:

20. the Banking Industry Ombudsman publish in his annual report detailed information and statistics regarding complaints against individual banks raised with his Office. (paragraph 4.31)

The Banking Industry Ombudsman Scheme

The Committee recommends that:

21. an increase to \$200,000 in the monetary limit applied to the Banking Ombudsman Scheme be implemented immediately;

22. the scope of the Banking Industry Ombudsman Scheme be extended within a further two years of operation to include the complaints of small incorporated bodies and farmers;
23. the essential criterion of fairness under which the Ombudsman makes his determinations should be retained;
24. any changes to the terms of reference of method of operation of the Banking Industry Ombudsman Scheme only be implemented by the Board of the Scheme after full consultation with the Council of the Scheme, the Banking Industry Ombudsman and the wider community which has an interest in the Scheme; and
25. all banks be urged to maintain membership of the Scheme. (paragraph 4.57)

Alternative means of resolving disputes

. Foreign currency loan disputes

The Committee recommends that:

26. Westpac and Commonwealth Banks given high priority to resolving outstanding foreign currency loan cases on a fair basis and without reliance on legal or other technicalities;
27. the Committee have a continuing role in monitoring implementation of recommendation no 60 in relation to the resolution of outstanding disputes; and
28. all banks consider alternative dispute resolution mechanisms as means of settling outstanding foreign currency loan disputes. (paragraph 4.97)

. The Commonwealth Bank and the Nyngan Situation

The Committee recommends that:

29. the Commonwealth Bank act without further delay to resolve outstanding Nyngan cases on fair and reasonable terms and without resort to legal technicalities or tactics; and
30. the Committee have a continuing role in monitoring implementation of recommendation no 57 of the Banking Inquiry Report. (paragraph 4.110)

. General mediatory recommendation

The Committee recommends that:

31. a requirement for mediation or alternative dispute resolution in the event of a dispute should be included in contractual arrangements between banks and small commercial customers. (paragraph 4.114)

Chapter Five - Competition in the Market Place

Deposit accounts

. Minimum monthly balance

The Committee recommends:

32. All banks immediately convert minimum monthly balance accounts to a daily formula, unless consumers opt for a minimum monthly balance in exchange for a higher interest rate. The Code of Banking Practice should contain a requirement on this issue. (paragraph 5.30)

. Interest rate not applied to the whole balance

The Committee recommends that:

33. banks should not apply different interest rates to different parts of an account balance. Where a customer qualifies for a higher interest rate, that rate should be applied to the whole balance. The Code of Banking Practice should contain a requirement on this issue. (paragraph 5.35)

. Zero interest accounts

1. Cheque accounts

The Committee recommends that:

34. banks pay interest on all positive balances in cheque accounts. Where a low interest cheque account is retained as the cheapest option for some customers, banks should advise account holders of the availability of the alternatives paying higher interest. (paragraph 5.42)

2. Accounts with no interest below a certain balance

The Committee recommends that:

35. banks pay some interest on all positive balances, even where the account is aimed at balances above a certain amount. (paragraph 5.48)

5. Trust accounts

The Committee recommends that:

36. interest be paid on all trust accounts in banks and be used to benefit the persons on whose behalf the money is being held. (paragraph 5.55)

. **Superseded accounts**

The Committee recommends that:

37. all banks should promptly upgrade all superseded accounts to the most appropriate new account. The Committee recommends that the Code of Banking Practice should contain a requirement on this issue. (paragraph 5.61)

Independent information to bank customers

. **How independent information could be increased**

The Committee recommends that:

38. the Treasurer, in consultation with the Minister for Consumer Affairs, examine ways of increasing the availability in the market place of independent comparative information about bank products. (paragraph 5.87)

Early repayment of fixed rate loans

The Committee recommends that:

39. consideration be given to the inclusion in the Code of Banking Practice of a limitation on the early repayment charges on fixed interest rate loans of no more than the cost to a bank of unwinding the facility; and

40. banks ensure their literature on fixed rate loan products contains adequate warnings of the implications of borrowing at fixed interest rates. (paragraph 5.100)

Chapter Six - Other Issues

Fraud reporting

The Committee recommends that:

41. those banks which have not already done so, develop a code of ethics or conduct for staff which will:
 - . require the reporting by staff of instances of suspected fraud, corruption or illegal behaviour; and
 - . require staff to deal in a fair and proper way with customers. (paragraph 6.11)

Disclosure in foreign currency transactions

The Committee recommends that:

42. banks investigate appropriate procedures to ensure greater disclosure of margins applying to foreign currency transactions; and
43. concerns of foreign currency borrowers about excessive margins charged on foreign currency transactions be raised in the context of negotiation or mediation of foreign currency loan cases. (paragraph 6.26)

Chapter Seven - Conclusion

Continuing parliamentary role

The Committee recommends that:

44. the Committee undertake a further review within 12 months of implementation of those recommendations of the Banking Inquiry Report which were directed at banks for their implementation. (paragraph 7.31)

CHAPTER ONE

THE IMPACT OF THE BANKING INQUIRY REPORT

The Banking Inquiry Report

1.1 On 28 November 1991 the Committee tabled its report on the Australian banking industry - *'A Pocket Full of Change - Banking and Deregulation'*. The report was recognised widely as one of the most significant reviews of the banking industry for many years. Its recommendations were broad ranging covering competition in banking, the purpose and methods of prudential supervision of banks, banks' role in supporting particular sectoral areas and the relationship between banks and consumers. Recommendations were directed both to governments and to banks for implementation.

Response by government

1.2 The Commonwealth Government responded quickly to the Committee's report implementing some of the recommendations as part of the 'One Nation' statement by the Prime Minister on 26 February 1992. To enhance competition, the Government decided to allow open foreign bank entry and branch banking for foreign banks within a suitable prudential and supervisory framework. It was noted in the Prime Minister's statement that:

These measures, to allow the entry of additional foreign banks and to allow foreign banks to operate as wholesale branches and to acquire second tier banks, should lead to further improvement in the international competitiveness of the Australian financial sector, while not putting at risk the deposits of ordinary Australians.¹

1.3 Some concerns have been raised by foreign banks about the tax regime under which foreign banks will be able to operate as branches in Australia. The Committee has referred these concerns to the Treasurer for consideration. The issues are being addressed in discussions between governmental officials and industry bodies.

¹ 'One Nation' Statement by the Prime Minister, Hon P J Keating, MP, 26 February 1992, AGPS, p.69.

1.4 Following Cabinet consideration of the report, the Treasurer announced the implementation of further major recommendations. In a letter to the Chairman the Treasurer advised of the Government's decision to:

enhance financial system supervision:

- by closer and more regular coordination between the supervisory agencies (Reserve Bank of Australia (RBA), Insurance and Superannuation Commission (ISC), Australian Securities Commission (ASC) and the Australian Financial Institutions Commission (AFIC)) in the form of a Council of Financial Supervisors under the Chairmanship of the Reserve Bank of Australia; and
- by creating a second Deputy Governor of the RBA with duties related largely to prudential supervision.

develop a non-legislative, comprehensive code to cover best banking practices in respect of relations between banks and their customers, with that code being monitored by a re-constituted Australian Payments System Council.

ask the Price Surveillance Authority to examine the profitability of credit cards and merchant's pricing of credit card sales and cash sales.²

1.5 These announcements gave effect to the central recommendations of the report. The Government's full response to the report, tabled in the House of Representatives on 25 June 1992, indicated the Government's agreement to most of the other recommendations, and certainly to the most significant remaining ones.

1.6 Finally, the Government recently has agreed to the application of the more restrictive 'substantial lessening of competition' test to mergers or acquisitions in all industries. The Committee had recommended this more restrictive test should apply to the banking and financial services industries. The implementation of this test should assist, over time, in maintaining competition within banking and financial services markets.

1.7 Taken together, the Committee's recommendations constituted a very significant framework for enhancement of the competitiveness, supervision and customer orientation of the Australian banking industry. The Government's implementation of most of the recommendations will see that framework put in place for the benefit of the Australian community.

²

Letter to Chairman from Treasurer, Hon J Dawkins, MP, dated 5 June 1992.

The current review

1.8 As noted earlier, recommendations in the Banking Inquiry Report were directed both to governments and to banks.

1.9 On 31 March 1992 the Treasurer, Hon John Dawkins, MP, referred to the Committee a review of the implementation by banks of the 25 report recommendations specifically directed towards banks. The Committee prepared a paper on the recommendations being reviewed and a copy of the paper is at Appendix 1.

1.10 The purpose of the review was to complement the Government's comprehensive response to the recommendations by assessing the action banks have taken to implement the recommendations specifically directed to them.

1.11 In conducting the review, the Committee sought responses from banks to their implementation of the recommendations. Submissions or comments also were sought from a range of interest groups and organisations including consumer, small business, farming and foreign currency borrower organisations. A list of submissions received to the review is at Appendix 2. Other documentation taken by the Committee was incorporated in the records as exhibits and these are listed at Appendix 3.

1.12 A series of public hearings were conducted at which many organisations which had made written submissions were invited to give oral evidence. In addition, the Chairman had a day of informal discussions in Dubbo regarding the difficulties being experienced by farmers. A program of activities undertaken by the Committee is at Appendix 4. A list of persons and organisations who gave evidence at public hearings is at Appendix 5.

1.13 The approach the Committee took in its recommendations directed towards banks was to define a view of best banking practice. The recommendations were not meant to be a set of rigid restrictions that would bind all banks to a single approach. The Committee had not recommended that the measures be implemented by legislation or regulation. It was of the view that legislation in these areas may restrict banks activities unnecessarily and possibly lead to unintended outcomes.

1.14 However, the Committee did not consider the market would always drive banks towards best practice. Pressure would need to be maintained on banks to get them to implement recommendations that would lead to a better and fairer banking system for customers. The review provided the means for the Committee to maintain this pressure.

1.15 In reviewing the recommendations the Committee did not wish to re-visit in detail issues that already had been determined in the earlier report. The focus was on banks' progress in implementation. However, where necessary, the Committee has assessed the adequacy of its recommendations and has suggested refinements or further recommendations to ensure the intention of the original recommendations is achieved.

1.16 The report is structured according to the major areas covered by the recommendations being reviewed. Recommendations will be addressed under the following chapter headings:

- . small business
- . farmers
- . dispute resolution and mediation
- . competition and consumer issues
- . other matters

CHAPTER TWO

SMALL BUSINESS

2.1 In this chapter the Committee reviews a number of recommendations from 'A Pocket Full of Change' which were directed to improving the relationship between banks and small business customers.

2.2 In its chapter on business in the previous report the Committee concluded that larger business had received significant advantages from deregulation. Finance for large business was more readily available at a better price and banks had been innovative in product development for large business.

2.3 There also had been benefits to small business from deregulation such as more readily available finance. However, the Committee recognised that small business had to pay a market price for the finance it obtained and this was in general greater than the price paid by small business in the regulated era. More recently there have been concerns banks may be restricting the availability of finance. This issue was addressed in the previous report, but in this chapter the Committee reviews the latest evidence on the issue.

2.4 The Committee also identified significant problems in the relationship between small business and banks. Many of the recommendations currently under review relate to these problems. The recommendations were directed towards improved product development and advice, lending practices of banks and disclosure of information to small business customers.

Product development and advice

2.5 The Committee's previous report concluded product innovation had been one of the major benefits to business flowing from deregulation. However, the Committee considered small business would benefit from further development by banks of product packages and advisory services specifically to assist improving small business' financial management and planning (Recommendation No. 40).

2.6 The Australian Bankers' Association (ABA) and individual banks outlined the initiatives that have been undertaken in recent years to assist small business in this area. The initiatives include:

- . development of information packages and resources for use by small business;
- . making available trained staff who have expertise and experience in dealing with small business;

- . working with industry and governmental bodies involved in small business development; and
- . participating in seminars, meetings, conferences and educational programs directed towards meeting small business needs.

2.7 The Minister for Small Business, Construction and Customs, Hon David Beddall, MP, expressed reservations about whether banks should be encouraged actively to develop packages and advisory services to assist small business to improve financial management. He considered the cost of doing so could be reflected in higher charges to small business and may lead to a conflict of interest. He noted some banks already are involved in running seminars and developing packages for small business, but considered the approach to be haphazard and probably ineffectual. The Minister's preference was for the capacity of third parties such as accountants to be enhanced to assist small business clients with financial management and planning. As the Minister noted:

... the ideal situation would be for the small business loan applicant to demonstrate a sound business plan and management skills before approaching a lending institution.¹

2.8 The Committee agrees with the Minister's comments about the importance of small business clients obtaining independent advice on financial management and planning. These issues should be discussed with small business organisations and the accounting profession.

2.9 Recommendation No. 40 was not proposed as an alternative to the independent, expert advice which small businesses should seek about their financial management and planning. Rather it was directed to banks' development of resources and advisory services that would assist small business to understand, and more easily meet, banks' requirements for information to assess and review lending proposals. Products and services developed by banks in this area appear to be directed towards improving this understanding. For example, the ABA has developed a package of resource materials and an information base to assist businesses in the tourism industry in their dealings with banks. This approach has been highly regarded within the industry. Consequently, the Minister's concerns about possible conflict of interest should not arise if banks maintain their existing focus.

¹ Evidence, p. S602.

2.10 The Committee considers banks' efforts generally in implementing this recommendation to be satisfactory. However, the Minister for Small Business' comments that the approach taken by banks lacks a strategic direction has some validity, The Committee considers banks and the ABA, as part of their assessment and review of small business facilities, should continue their development of resources and advisory services which will assist small business to be aware of banks' requirements for financial information and reporting. Banks and the ABA should develop a strategic direction for the industry in the development of their approaches in this area.

2.11 The Committee recommends that:

1. banks and the Australian Bankers' Association develop a strategic direction to their approach to the development of resources and advisory services to assist small business' understanding of banks financial reporting and assessment requirements;
2. Federal and State Ministers for small business discuss with peak accounting bodies and small business associations ways of ensuring small businesses are provided with better financial management and planning advice by their accountants and other advisers; and
3. banks develop packages for other industry sectors similar to that being developed for the tourism industry.

2.12 Specifically in the area of product development the Committee made a recommendation that banks offer to small business a product which allows payment of interest on working capital accounts when the balance is in credit. (Recommendation No 42) In making this recommendation the Committee was conscious of the monthly billing cycle of small businesses which sees accounts fluctuate between credit and debit during the course of the month. While small businesses face charges for overdraft facilities when their accounts fall into debit, they should receive interest on accounts when they are in credit during the monthly cycle. More broadly, the Committee wished to see flexible products available to small business which recognised the monthly cycle of debit and credit and enabled small business to get the best use of its total relationship with banks.

2.13 Sweep facilities were considered one method of providing flexibility. A number of banks indicated they offered sweep facilities to selected small business customers. ANZ Bank described why sweep facilities were provided only to some customers and indicated some of the shortcomings of such facilities:

Sweep facilities generally are complex, expensive to develop and run, and limited in their application. By their nature, they require double the processing of an ordinary account, and will therefore not be a mass market product. Any extra interest earned would be more than offset by the increased cost of providing the facility.

Government duties and charges have always had a serious impact on the viability of these products, and the recent increases in FID have reduced their viability for individual and corporate users.²

2.14 Banks have endeavoured to offer some of the advantages of sweep facilities but overcome the drawbacks by providing a single credit/debit account for small business customers on which interest is charged when the account is in debit but interest is paid when in credit. National Australia Bank (NAB) noted the advantages of its Business Management and Cheque accounts:

Currently, the transfer of funds between transaction and interest-bearing accounts is common practice. It is a practice which incurs costs to both customer and bank. The new account will encourage small business customers to consolidate their accounts so as to earn cash management rates of interest [on amounts above \$5000 in the cheque account], while at the same time minimising government charges relating to their inter-account transactions.³

2.15 State Bank of New South Wales (SBNSW) offers a similar product through its State Business Account.⁴

2.16 Some banks pay interest on credit balances in business cheque accounts. However, not all of these products have an overdraft facility. Some banks also are offering offset accounts to business. These have less attraction than mortgage offset accounts because of the tax deductions already available to business.

2.17 Other banks indicated that interest was only paid on credit balances on business cheque accounts where 'a commercial case exists for such payment'⁵ or for a 'particular connection'.⁶

2 Evidence, p. S201.

3 Evidence, p. S238.

4 Evidence, pp. S109-110.

5 R & I Bank, Evidence, p. S30.

6 Commonwealth Bank, Evidence, p. S171.

2.18 The Commonwealth Bank (CBA) noted interest payment on current accounts and the conditions operating on such accounts will be 'the product of competition'.⁷ Similarly ANZ Bank stated deregulation and heightened competition for depositors would see banks which did not offer attractive facilities lose customers.⁸

2.19 The Committee endorses these comments. It notes some banks have moved to provide flexible products to small business which increase the efficiency of small business banking operations, reduce the cost of conducting a banking relationship and pay and charge market interest rates on credits and debits in accounts. It could be expected that such products or other innovations will become more widely available across institutions as small business customers appreciate their advantages and respond accordingly. The Committee wishes to re-enforce its recommendation made in the previous report.

2.20 The Committee recommends that:

4. banks look to further develop products for small business which pay interest on credit balances in working accounts.

Availability of finance

2.21 In its previous report, the Committee noted one of the benefits of deregulation was the greater availability of finance, at a market price, to all sections of business. The removal of interest rate regulation also removed the constraints on bank lending which were a feature of the regulated era, enabling banks to raise funds and lend at market rates. In fact many would argue lending was too freely available immediately following deregulation and gave rise to some of the excesses of the 1980s and a subsequent overreaction by banks.

2.22 During the previous inquiry concern was expressed that banks had reacted to the excesses of the 1980s and the economic downturn of the early 1990s by imposing a supply side 'credit crunch' or 'credit squeeze'. While the Committee had anecdotal evidence which presented a picture of some restriction on the availability of finance to small business, the wider picture did not show conclusive evidence of a credit squeeze.⁹ In the Committee's view restrictions on credit were likely to flow more from the tighter lending criteria which had been adopted by many banks and by the more cautious approach of some bank lending staff than from restrictions to the supply of credit. As a result the Committee recommended banks reassess their procedures for lending to small business to ensure sound proposals were supported. (Recommendation No. 43)

⁷ Evidence, p. S171.

⁸ Evidence, p. S202.

⁹ House of Representatives Standing Committee on Finance and Public Administration report, *A Pocket Full of Change - Banking and Deregulation*, AGPS, Canberra, November 1991, pp. 249-250.

2.23 In reviewing this recommendation, the Committee again was presented with assertions banks were imposing a credit squeeze and unnecessarily restricting the availability of finance, particularly to the small business sector. The Committee received submissions from banks on this issue. It sought contributions from small business and farming organisations. It reviewed recent literature on the issue and sought a paper from the Reserve Bank on the information available to it on lending to the rural and small business sectors.

2.24 Banks strongly denied they were applying supply side restrictions on credit availability. They stated the problem was a lack of demand. The ABA pointed to the lack of increase in the ratio of the use of existing facilities to limits as evidence that demand remained weak. If a credit squeeze was being imposed it could be expected existing facilities would be more heavily utilised as excessive demand that was not being met by new facilities relied more heavily on existing facilities.¹⁰ Individual banks pointed to similar evidence.¹¹ The ABA also noted growth in bank lending to the private sector continued to be above both overall economic activity and non-bank lending.¹²

2.25 ANZ Bank pointed to the balance of evidence suggesting demand factors have been the driving force behind the recent falls in business credit.¹³ According to ANZ Bank this slow-down could be attributed to:

- . active debt reduction in businesses;
- . lower new lending/borrowing, in line with the weak economy; and
- . higher bad debt write-offs.¹⁴

2.26 The view of banks is supported by published information from both Treasury and the Reserve Bank. In a paper on commercial lending and business credit, Treasury stated:

The decline in business credit growth is a composite of both supply and demand influences. Demand factors such as voluntary debt repayments to strengthen balance sheets and a slight reduction in the rate of usage of revolving credit limits suggest that demand-side influences have been significant.¹⁵

10 Evidence, p. S1.

11 Commonwealth Bank, Evidence, pp. S165-170 and Westpac, Evidence p. S283.

12 Evidence, p. S1.

13 Evidence, p. S196.

14 Evidence, p. S197.

15 'Commercial New Lending and Business Credit', *Economic Round-up*, Treasury, Autumn 1992, p. 41.

2.27 In its paper to the Committee on rural and small business lending, the Reserve Bank drew some indicative conclusions on the basis of the somewhat limited information available to it.

2.28 In relation to lending to the rural sector on which the RBA had reasonably good information, it was stated banks have maintained their lending over the past year or so.¹⁶

2.29 In relation to small business, the RBA stated there were few statistics as banks follow different practices when classifying business lending. From the information it was able to obtain from the four major banks the RBA stated:

it appears that lending to small businesses has followed a pattern similar to banks' total business lending. The latter has fallen over the past year or so but this does not necessarily indicate any restriction on the supply of credit by banks; it is also consistent with a reduction in demand for credit.¹⁷

2.30 Even some of the critics of banks acknowledged the lack of demand for finance. A representative of the National Farmers' Association (NFF) stated about the farm sector 'there is not a lot of demand out there for new finance'.¹⁸ A small business representative considered unquestionably the main problems were on the demand side. He stated 'there is no problem with a good business properly presenting figures getting bank accommodation'.¹⁹

2.31 While much evidence points to problems on the demand side, there also remain problems on the supply side.

2.32 Some associated with small business pointed to continuing problems for small business in obtaining bank finance. A letter from Commonwealth, State and Territory Ministers for Small Business stated:

Judging by the amount of correspondence and representations received by Ministers on this issue, we find it difficult to accept that there has been a significant improvement in the banks' preparedness to provide capital for the small business sector.²⁰

16 Evidence, p. S873.

17 Evidence, p. S872.

18 Evidence, p. 210.

19 Evidence, p. 221.

20 Letter to Chairman from Commonwealth, State and Territory Ministers for Small Business dated 28 August 1992.

2.33 Other supply problems identified primarily centre on the continuing cautious approach adopted by lenders as a response to the lending difficulties of the 1980s.

2.34 Some banks acknowledged these problems. ANZ Bank referred to the pressures on managers as a result of the difficult economic conditions and stated the danger was that:

... under such pressures, there will be little time or inclination to culture new loan business from competitors or bank managers might shun proposals that come the bank's way.²¹

2.35 The fact that senior management in many banks continues to see a need to exhort branch management and lending staff to revive lending and finance new sound lending proposals seems to indicate a continuing caution among some bank lending staff.

2.36 The Governor of the Reserve Bank, Bernie Fraser, recently referred to anecdotal evidence of continuing concerns in this area:

Anecdotal reports suggest that many banks have reacted to recent experiences by adopting an excessively cautious approach to both existing borrowers and prospective new lending propositions. ... When particular cases are investigated by the banks concerned, it often emerges that there is another side to stories of harsh treatment by banks. Yet the weight of anecdotes is such that they cannot be dismissed out of hand.²²

Mr Fraser stated the excessive caution continued despite Head Office directives to branch staff.

2.37 There is still strong anecdotal evidence on small business facing supply side problems. This includes severe security requirements as a pre-requisite to obtaining finance. The Chairman of the Council of Small Business Organisations advised that, where small businesses had received finance, it often was difficult and expensive to obtain. Quite often finance was not forthcoming at all.²³

21 Evidence, p. S193.

22 RBA Bulletin, July 1992, p. 20.

23 Evidence, pp. 349-50.

2.38 Apart from directives to staff to adopt a less cautious approach, banks have responded to the recession by offering new lending packages to small business. National Australia Bank has announced a 'recession buster' package of \$1 billion of additional lending to small business at a two per cent discount on the assessed interest rate for the first twelve months. Approvals of loans within National Australia Bank have been significant highlighting the value of such initiatives. Other banks have responded to the package by offering similar discounts to small business customers.

2.39 These packages are welcome and should result in making additional credit available to small business. According to the Reserve Bank, there has been a significant level of interest in these special offers and some approvals, although the amounts remain small relative to banks' total lending.²⁴

2.40 One small business representative claimed the packages would only benefit customers from other banks not the 'hard core of small business which has an on going relationship ... with its existing bank; and the cost of moving makes it impossible to move'.²⁵ The packages largely would attract customers from other banks rather than generating significant new lending to small businesses unable to obtain finance.

2.41 Finally, the Reserve Bank referred to a CAI-Westpac survey of finance availability to the manufacturing sector which shows an increase in the proportion of respondents reporting finance as easier to obtain and few identifying lack of finance as the main factor constraining their business growth. However, as the Reserve Bank notes the index has been rising since interest rates commenced falling making it unclear whether the index is measuring the availability of credit or its cost. Movements in the index therefore say nothing definitive about the existence or absence of credit rationing by banks. The Bank noted the trough in the index in the most recent recession was well above the troughs in recessions prior to deregulation indicating the availability of credit to business is less subject to cyclical swings in the economy in a deregulated environment.²⁶ This would suggest, as a generalisation, old fashioned 'credit squeezes' are unlikely to eventuate in a deregulated market where credit will be restricted largely on price rather than by global limits being placed on lending.

2.42 As with the previous inquiry it is very difficult to reach firm conclusions on whether the availability of credit, particularly to small business, is being unnecessarily restricted.

24 Evidence, p. S875.

25 Evidence, pp. 347-48.

26 Evidence, p. S876.

2.43 On the basis of overall statistical information available to it, the Committee considers there are problems on the demand side which explain to a significant extent why credit growth remains stagnant. These statistics do not point to evidence of a bank imposed credit squeeze.

2.44 However, it also is clear significant problems remain on the supply side. There continue to be complaints to the Committee from small business of an overly cautious approach to lending by banks at the local level. The efforts of senior management of banks to counter this caution are recognised. However, these efforts must be maintained. There is a need for banks to develop strong small business initiatives and to encourage lending staff to focus on a revival of lending.

2.45 The provision of additional lending for small business also is recognised as a useful development. This lending should be directed to fostering new business proposals rather than being used as a means to attract the best of other banks' customers.

2.46 In the current low inflationary environment, banks emphasised the importance of cash flow rather than capital appreciation as the focus of lending.²⁷ Banks claimed this reinforced existing lending practices which had a strong focus on cash flow rather than security. The anecdotal evidence pointing to excessive security requirements being demanded for additional or new facilities appears to belie the changed focus which banks say they have developed.

2.47 The Committee considers levels of bank lending and the relative influence of demand and supply factors should continue to be monitored, particularly as the economy moves out of recession and growth in credit could be expected. It is clear existing data in this area is inadequate to provide clear indications on trends in bank lending to small business and, to a lesser extent, the rural sector. The Reserve Bank would be the appropriate body to monitor and report on developments in this area because of its access to information, its interest in trends in the macro economy and its involvement with banks. To do so effectively, the RBA will need to *enhance its information base*. The Committee suggests this be done in consultation with banks, small business organisations and governmental authorities such as small business departments and the Australian Bureau of Statistics. The results of the RBA's monitoring could be reported regularly in its Bulletin.

2.48 The Committee recommends that:

5. banks develop strong initiatives to provide lending to the small business sector;

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Evidence, p. 170.

6. senior management of banks re-enforce the message to staff to take a positive approach to lending in line with the low inflationary which emphasises cash flow as the critical criterion in lending decisions; and
7. the Reserve Bank of Australia monitor developments in, and report regularly on, credit availability and credit growth as it affects differing sectors of the community with a particular focus on the access to credit of small business and farmers. In doing so the Reserve Bank should, in consultation with banks, small business organisations and governmental bodies, enhance its information base in relation to these sectors.

Lending practices and margins

2.49 The extreme caution of some bank staff also has had its impact on lending practices. In the previous report the Committee recognised a tightening of bank credit assessment and review procedures was necessary following the sloppiness of procedures which had characterised some lending during the 1980s. However, there was anecdotal evidence to the previous inquiry which pointed to banks 're-visiting' many small business loans and changing conditions and margins, or cancelling facilities, without consultation or notice and without any appeal mechanism available. The Committee recommended that, as part of a review of facilities, consultation with customers should occur, advice should be given of any changes, an appeal mechanism should exist and banks should provide opportunities for businesses to manage themselves out of difficulty (Recommendation No. 44).

2.50 The overall response by banks to this recommendation is summed up in the ABA's submission:

... the general approach of banks is to advise business customers in writing of changes that may result from reviews of facilities, with written advice provided usually prior to those changes taking effect. Also ... banks have a range of processes in place to ensure that the decisions of lending officers are appropriately reviewed, including reviews of proposals approved and rejected and oversight by more senior staff.²⁸

2.51 The Committee considers individual banks' responses to this recommendation indicate banks' formal policies and guidelines accord with the recommendation. However, formal bank policies and guidelines and actual practices at a local level can diverge. The Committee saw some examples where action by bank staff at a local level was at complete variance from what senior management of banks was telling the Committee about its bank's overall policies. When these divergences were drawn to the attention of individual banks, they were corrected quickly and comment was made that these anomalies were not formal bank policy.

2.52 *The potential for such divergences at a local level points to the need for banks continually to monitor the implementation of their policies in this area and regularly remind staff of policies.*

2.53 **The Committee recommends that:**

8. **banks strengthen their methods for monitoring the implementation at a local level of policies and guidelines relating to small business lending to ensure compliance with the formal policies of the bank and report on such compliance to the Reserve Bank; and**
9. **banks consult with small business organisations as part of their assessment of compliance of staff with bank policies to encourage lending.**

2.54 Small businesses and farmers were concerned about the margins they were charged by banks. In its earlier report the Committee found small business margins to be higher since deregulation than those charged to large business. A number of explanations for why this was the case were reported including the removal of cross-subsidies which had favoured small business; banks pricing for risk with small business generally being considered more risky; and banks beginning to lend to more risky businesses which previously would have relied on funds from other financial intermediaries such as finance companies. In view of small business concerns about margins the Committee recommended banks review their margins to small business taking account of the differences between the relative riskiness of lending to this sector and the extent and nature of security usually taken on small business loans (Recommendation No 45).

2.55 There remain concerns about the size of risk margins banks apply to loans to small business and farmers. The New South Wales Farmers Association claimed the margins of its members had 'blown out quite significantly over the last few years' reflecting a failing in competition in the banking sector.²⁹

29

Evidence, p. 336.

2.56 Banks responded that small business and farmers' margins were treated on a case-by-case basis with margins varying significantly for individual small businesses. Recently the RBA has indicated margins for small business customers are wider than those for large business reflecting the fact that, on average, the risks are greater. The RBA stated:

Generally, the range is up to 4 percentage points [above the bank's reference rate], with an average of about 2 percentage points. Higher rates are usually charged on unapproved borrowings (where, for example, a customer has exceeded the maximum limit on an overdraft) and on loans where the customer is in default.³⁰

2.57 The RBA noted, while risk margins on business lending have been reassessed recently by many banks, the suggestions of large and widespread increases in business customer's margins were not well founded. Between August 1990 and September 1991 there was only a relatively small increase in the number of loans subject to larger margins. According to the Reserve Bank, the proportion of small and medium-sized business loans on which the customer margin exceeded two percentage points rose from 27 per cent to 31 per cent in the year to September 1991.³¹

2.58 According to banks, security is one of the factors taken into account in establishing the appropriate risk margin for small businesses. However, a number of banks emphasised that security was primarily the banks protection in case of default and did not, in itself, affect the riskiness of the business proposal. Furthermore, as the Commonwealth Bank stated:

... the notion that property security automatically insulates the lender against business risk is flawed, as the recent experiences in property values have shown.³²

2.59 A representative of National Australia Bank indicated the low inflation rate and consequent fall in asset prices had served to reinforce an existing focus on cash flow as the major criterion in lending assessment policies. Security was 'very much a second rung consideration'.³³

³⁰ 'Bank Interest Rate Margins', RBA Bulletin, May 1992, p. 6.

³¹ op. cit. p. 6.

³² Evidence, pp. S172-173.

³³ Evidence, p. 170.

2.60 The Committee considers banks' reassessment of lending procedures and criteria to have been appropriate in light of the lending excesses of the 1980s. Again the Committee cautions banks against overreacting to these excesses and choking off economic recovery. There is a delicate balance to be achieved between prudent lending and overcaution. Banks should be responding to the current low inflationary environment by emphasising cash flow rather than security as the central criterion in lending. A re-focussing in this way should ensure that growth is not inhibited.

2.61 The margins charged by banks to small business and farmers should be subject to continued monitoring and reporting. The Reserve Bank would appear to be the appropriate body to undertake this task, reporting regularly its findings generally on interest rate margins, and particularly on those applying to small business and farmers.

2.62 It also is essential that small business customers shop around to obtain the best deal in what is a competitive banking market. In doing so, they should obtain sound advice about their business and the best means of financing it. Banks should be encouraging small business customers to search for the best deal and to seek advice.

2.63 The Committee recommends that:

10. the Reserve Bank of Australia monitor and report publicly on movements in bank interest rate margins, with particular attention being given to margins applying to small business and farmers.

Disclosure

2.64 The Committee considered there were requirements of disclosure which should be met by all banks in relation to small business customers and made recommendations accordingly in the earlier report. These requirements were:

- . that margins above the appropriate bank indicator interest rate, fees and charges be disclosed as part of agreements between banks and small business (Recommendation No. 46);
- . any changes made to margins above the bank indicator rate, fees and charges during the course of a loan be implemented only following advice to, and in appropriate circumstances, consultation with customers (Recommendation No. 47); and

that a rate for comparison incorporating all costs associated with small business loans be disclosed by banks to customers. The Standards Australia comparative interest rate for consumer credit should be used (Recommendation No. 48).³⁴

2.65 In relation to recommendations 46 and 47, banks stated all risk margins, fees and charges were disclosed as part of original loan agreements with small business customers. A number of banks provided copies of Letters of Offer/Approval demonstrating they met the disclosure requirements made in the Committee's report. Advice is provided to customers of any changes in risk margins or conditions applying to a facility and usually follows a formal review which would involve consultation with the customers. Some banks also include interest rate information on all bank statements and the Committee considers this to be good practice which will assist customers.

2.66 While banks meet these formal disclosure requirements in loan documentation, evidence was given there was an undisclosed differential or margin between market reference rates on bill facilities and what individual small business customers were charged as their rate before the addition of the risk margin. As one small business representative told the Committee:

The interest rates at which my company's bill lines are negotiated always seem to be far higher on the day than the rates published in the newspaper.³⁵

2.67 When the issue was raised with his bank a shading was given on the rate but the differential was not removed entirely.

2.68 As the differential is not disclosed it is likely many small business customers would not be aware that their rate differs from the market reference rate on bill facilities. The Committee considers these margins should be disclosed to customers.

2.69 The Committee recommends that:

11. **banks disclose to business customers the differential between market reference rates on bill facilities and the rate charged by banks to customers.**

³⁴ House of Representatives Standing Committee on Finance and Public Administration Report, *A Pocket Full of Change - Banking and Deregulation*, pp. 252-63, AGPS, Canberra, November 1991.

³⁵ Evidence, p. 218.

2.70 One of the major requirements which small business and the farming sector have asked for in relation to disclosure has been the provision of a single rate which incorporates the total cost of finance including fees, charges and interest rates. It is argued the provision of such a single rate will enable simple comparisons to be made between differing products and different banks leading to a more efficient market.³⁶ The Committee agreed with this view and recommended in the previous report a comparative rate incorporating all costs associated with small business loans be disclosed to customers (Recommendation No. 48).

2.71 A similar recommendation was made with respect to consumer loans (Recommendation No. 98), in this case with the Committee recommending legislation be enacted to require banks to use a single comparative rate of the cost of finance.

2.72 Banks argued there were problems with the development and use of a single comparison rate. It did not enable accurate comparison between some products such as fixed term and open-ended credit facilities. A single rate built in assumptions about how consumers use products but consumers might use products differently from the assumptions making the single rate inaccurate for their particular usage. As a result the ABA:

... strongly prefers disclosure of all the price components rather than summary statistics so that comparisons can relate to particular borrower's usage. Consequently, the ABA has been exploring approaches whereby customers can calculate comparison rates themselves, allowing for their patterns of usage.³⁷

2.73 The ABA has developed a brochure 'Understanding the Costs of Farm Finance' which enables farming customers to calculate their own comparison rates based on personal usage of a facility. The ABA states the rates which result, while approximations, 'are sufficiently robust that consumers will not be misled'.³⁸ The brochure also can be used by small business customers.

2.74 While the Committee appreciates the problems raised by banks in relation to a comparison rate, it does not consider they negate the potential usefulness of such a rate. The problems of different usage of facilities can be overcome by having simultaneous disclosure of all fees and charges enabling customers to compare, not just the single overall rate, but likely effects of fees and charges according to patterns of usage. The Committee also emphasises the disclosed single reference rate would be **additional to**, and not replace, the disclosure of other information about the loan.

36 Evidence, p. 335.

37 Evidence, p. S9.

38 Evidence, p. 59.

2.75 The Government's response to recommendation 98 indicated further consideration would be given to the development and use of a single comparison rate on loan and deposit products as part of the Code of Banking Practice. Within that process, consideration should be given to the disclosure of such a rate to small business and farmers.

2.76 The Committee recommends that:

12. as part of the development of a Code of Banking Practice a formula for a single comparison rate of the total cost of loan and deposit products be implemented. The rate should be available to consumers, small business and farmers.

Code of Banking Practice

2.77 The good banking practices and disclosure requirements in relation to small business which were recommended in the previous report and which have been reviewed in this chapter should be incorporated into a Code of Banking Practice covering the relationships between banks and small business. This will ensure banks continue to adhere to best banking practice and may eliminate some discrepancies which arise between banks' policies and their actions.

2.78 The Chairman of the Trade Practices Commission, Professor A Fels, informed the Committee the extent to which the Code currently being developed should address explicitly the relationship between financial institutions and small businesses and farmers had yet to be decided. He noted the general principles of the Code, such as those dealing with information disclosure, would appear to apply as a matter of course.³⁹ Small business and farming organisations are being consulted in the Code's development.⁴⁰

2.79 The Committee considers the Code must cover the specific relationships between financial institutions and small business customers. In developing the current Code, or in future enhancements to the Code, there should be coverage of all aspects of the relationship between financial institutions and small business. In developing the Code to cover all aspects of the relationship between financial institutions and small business the best practice approaches to the relationship embodied in the Committee's recommendations in the previous report and this report should be included.

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Letter from Prof A Fels to the Secretary dated 11 September 1992.

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Evidence, pp. 229-230.

2.80 **The Committee recommends that:**

13. **the banking practice and disclosure requirements relating to small business customers contained in recommendations numbers 43-48 of 'A Pocket Full of Change' and in this report be included in the proposed Code of Banking Practice, or in a future enhancement of the Code.**

Dispute resolution

2.81 The earlier report reflected the concern of small business about the adequacy of their means to resolve disputes with banks. Small business lacked cheap, quick and effective means of resolving disputes. Small businesses also emphasised their lack of bargaining power and financial resources in dealing with disputes with banks. The Committee considers banks should develop measures for more effective ways of dealing with disputes involving small business customers than the current reliance on expensive and cumbersome court processes. These issues are considered in detail in Chapter 4.

CHAPTER THREE

THE RURAL SECTOR

3.1 The Committee made a number of recommendations relating to the rural sector in its earlier report. Only some of these were among the recommendations subject to the current review. Prior to reviewing those recommendations the Committee discusses generally the difficulties being experienced in many rural areas and the impact these difficulties have had on the relationship between banks and farmers. These difficulties were highlighted in individual representations by farmers to the Committee and during a day of informal discussions in Dubbo which the Chairman had with farmers.

3.2 Later in the chapter the Committee assesses implementation of its recommendations including the availability of expertise within banks to advise rural customers on bank products (Recommendation No. 52). It also examines a Code of Practice for rural customers (Recommendation No.s 50 and 56). While the recommendations to give effect to the Code were not among those to be reviewed, the Committee considers any examination of the difficulties of the rural sector must address the development of an appropriate Code of Practice to govern bank/farmer relationships. The recommendation for specific mediation of the disputes the Commonwealth Bank has in the Nyngan region (Recommendation No. 57) is dealt with in the next chapter.

Prospects for the rural sector

3.3 The rural sector has been through one of its most difficult periods for many years. The Australian Bureau of Agricultural and Resource Economics (ABARE) reported recently:

The Australian rural economy has experienced a severe decline over the past eighteen months. This has been caused largely by weak commodity prices ... and was exacerbated by severe drought in northern New South Wales and south east Queensland which reduced production in these areas.¹

3.4 As a result, ABARE stated farm incomes in 1991-92 were expected to have fallen to their lowest values, in real terms, for 30 years.²

¹ ABARE, Farm Surveys Report 1992, p. 11.
² op. cit.

3.5 The severe downturn in the rural economy coincided with a period of very high interest rates exacerbating the difficulties for some farmers. According to the New South Wales Farmers' Association, these factors and the problems being experienced by some farmers have combined to make the relationship between some sections of the rural sector and banks 'extremely tense'.³ The NFF noted the one third of farmers who had no, or no significant, debt had maintained reasonably harmonious relationships with banks. However, for the one third who had a very high level of debt the relationship had been 'pretty acrimonious over the past couple of years'.⁴

3.6 The Chairman's discussions in Dubbo gave a clear indication of the way in which the relationship has deteriorated. While most individual farmers who spoke with the Chairman were in severe financial difficulties and consequently could be expected to have problems with their banks, the Coonamble District Council of the New South Wales Farmers' Association was able to indicate the widespread nature of the concerns about banks which exists in the rural sector. According to a submission from the Chairman of the Council, over the last few years the Council:

has been continually bombarded by its members through its meetings, and privately by both its members and other community people, as to the unethical practices, and totally difficult and unamicable business relationship being experienced, in conducting their banking business.⁵

3.7 Fortunately the outlook generally for the rural sector is a little brighter. A representative of the National Farmers' Federation noted there were some tentative signs of an upturn in rural Australia with a recovery in commodity prices and a reasonable start to the season. However, the recovery is from a very low base and it will take some years for there to be a secure recovery.⁶ This picture is reinforced by ABARE which is forecasting a modest recovery in farm incomes for 1992-93.⁷

3.8 An improvement in the general picture will not mean an improvement in circumstances for individual farmers nor even an improvement in all regions. Drought in some regions will have a significant impact and many farmers will continue to experience severe hardship. Consequently it can be expected the relationship between banks and some farming customers will remain under pressure.

3 Evidence, p. 340.

4 Evidence, pp. 211-212.

5 Evidence, pp. S891-92.

6 Evidence, p. 205.

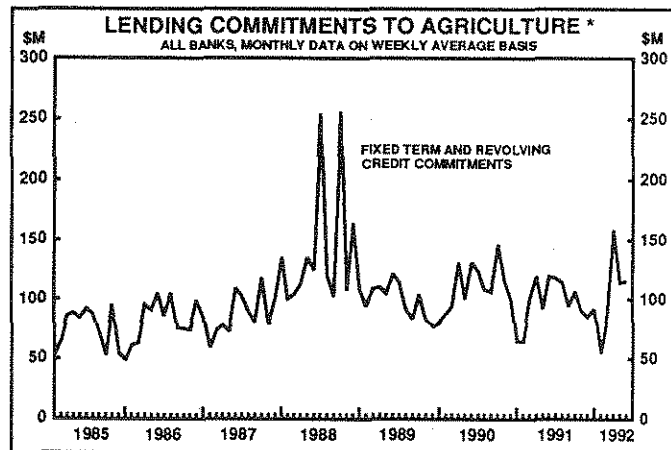
7 ABARE, Farm Surveys Report 1992, p. 20 and Agriculture and Resources Quarterly, 4(2), June 1992, pp. 144-45.

Finance availability

3.9 Despite the difficult circumstances facing farmers in a number of areas, the NFF noted banks had been providing carry on finance to farmers including for the 1992 winter planting. This was supported by the New South Wales Farmers' Association.⁸

3.10 As noted in the previous chapter, information available to the Reserve Bank also confirms banks have maintained their lending to the rural sector over the past year or so. Figure 1 shows new bank lending commitments to agriculture. While these are subject to fluctuation, new lending appears to have been maintained over the last year or so. The Committee recommended in the previous chapter that the Reserve Bank monitor, and report regularly on, credit availability and credit growth as it affects particular sectors including the rural sector.

FIGURE 1



* Source is *Reserve Bank of Australia Bulletin*, Table B.13, monthly.

3.11 Several rural borrowers advised the Committee some banks were requiring them to sign 'Deeds of Arrangement' as a condition of re-financing. These deeds allegedly require borrowers to agree to sell their properties within three months if they miss one monthly repayment.⁹ The Committee considers such action by banks, if occurring without opportunity for reasonable discussion, to be extreme.

⁸ Evidence, p. 341.

⁹ Evidence, p. S904.

Risk margins

3.12 As in the previous inquiry, farming organisations and individual farmers expressed a number of concerns about risk margins charged to them by banks. These are the margins added to the bank's reference rate to take into account the riskiness of a particular lending proposition and are distinct from the bank interest 'margins' which are the differential between the interest paid and received by banks.

3.13 The NFF stated interest rate falls had been slow to be passed on to rural customers.¹⁰ According to the New South Wales Farmers' Association banks had increased their risk margins to rural borrowers. Margins averaged between 1.5 to 3 per cent for farmers with even the top end of the industry having margins increased from 0 to 2 per cent.¹¹

3.14 A number of issues relating to margins were raised by the Coonamble District Council of the New South Wales Farmers' Association:

- . the margins between wholesale and retail interest rates were very large;
- . there was no equitable reason in many cases for the variation in *additional risk margins between clients and there appears to be no standard method of calculating risk factors;*
- . banks are varying their additional margins, often without notice;
- . interest rates are not being shown on bank statements; and
- . the method of calculation of total interest rates is not disclosed.¹²

These concerns were echoed in submissions from the Parkes and Castlereagh Action Groups.¹³

¹⁰ Evidence, p. 208.

¹¹ Evidence, p. 342.

¹² Evidence, p. S892.

¹³ Evidence, pp. S895-908.

3.15 As noted in the previous chapter, banks now are paying closer attention to pricing for risk and consequently margins for small business customers and farmers have been reviewed and in some cases increased. The Committee considers risk margins charged to farmers should be subject to continued monitoring and reporting. There is a recommendation made in the previous chapter for the Reserve Bank to monitor and report on margins charged to small business and the farming sector.

3.16 In relation to banks' practices in the charging and variation of margins and the disclosure requirements banks should have, these matters should be covered in an effective Code of Banking Practice covering farmers. This is discussed later in the chapter.

Financial difficulties

3.17 As a result of the range of factors outlined earlier, a number of farmers now are facing desperate financial problems with many of them confronting the possibility of having to leave their properties. ABARE statistics indicate around four to five per cent of farmers are in severe financial difficulties and may have to leave farming in the next two to three years. A further three to four per cent are experiencing financial hardship but have prospects of returning to profitability if conditions improve.¹⁴ These statistics underline the extensive process of adjustment facing a number of rural areas and point to the traumatic period ahead for many farming families who may have to leave properties which have been in their families' hands for generations.

3.18 While this pressure exists on farmers to consider their future, the NFF stated there had been few foreclosures or forced sales.¹⁵ This was confirmed by individual banks which stated foreclosure was a last resort which was rarely implemented. Banks stated they preferred to ensure an orderly exit from farm properties where no other alternatives appeared available.

3.19 Although there may have been few foreclosures, many farmers have left their properties in the last few years as a result of financial difficulties. In some cases farmers face significant pressure to leave, including pressure which is imposed by banks. The NFF warned that much of the pressure of adjustment to cyclical difficulties tended to take place in the upturn rather than in the trough and consequently:

¹⁴ Briefing material attached with press release from Hon S Crean MP, Minister for Primary Industries and Energy, dated 21 September 1992 announcing new farm adjustment measures.

¹⁵ Evidence, p. 207.

If we see a continual recovery in the farm sector, then we would expect to see a number of farms coming on the market either under pressure from the bank or simply because the proprietor has reached the realisation that there is no opportunity for recovery and has made their own decision.¹⁶

3.20 The critical factor in decisions about the future of a farmer centres on the farmer's 'long term viability'. This term is used extensively by banks, farming organisations and rural counsellors but was treated with scepticism by some farmers.

3.21 The solution to the current difficulties proposed by rural action groups was for a moratorium on all foreclosures, evictions and bankruptcies on farms and the use of long term low interest loans issued through the Commonwealth Bank, Commonwealth Development Bank and the Primary Industry Bank of Australia. In relation to the second proposal, any attempt to fix interest rates at an artificially low level would see the availability of funds severely rationed as occurred in the days of regulated interest rates. Alternatively, the Commonwealth taxpayer would have to heavily subsidise market interest rates to ensure funds were still available. The Committee considers that neither of these is an appropriate solution to the difficulties of farmers in the longer term.

3.22 In relation to a moratorium on foreclosures/bankruptcies etc, the Committee considers banks should avoid foreclosure if at all possible. Banks also should not take precipitate action against individual farmers to force them to leave their properties before a full assessment has been done of that farmer's future prospects. What is required is that decisions about the future of a farmer must be made on the basis of the likely long term capacity of the farmer to make a successful business of the farm.

3.23 The NFF argued banks did not have a sound capacity to assess the management ability of farmers. According to the NFF:

... it would be worthwhile for banks and governments, and perhaps even for research corporations, to look at ways in which to develop tools to assess future viability, other than the sorts of cash flow budgets which the farmer might have put together by the local accountant, and simply looking at the equity position of the farm.¹⁷

¹⁶ Evidence, p. 208.

¹⁷ Evidence, p. 210.

3.24 Advice is available to farmers facing financial difficulties under the ABA/NFF Farm Assessment Scheme (FAS). The Scheme has been used mainly to determine independently the options available for farm clients facing financial difficulties. It has been used both for mediation of disputes and for provision of expert consultancy advice. Utilisation of FAS has been highest in Western Australia, Victoria and New South Wales. A recent joint review by the ABA and NFF highlighted the need to increase the awareness of the Scheme among farmers and place emphasis on attempting to address problems before they became severe.

3.25 The Committee considers there is a need to increase the availability of expert advice to farmers facing difficulties. The concept of 'long term viability', used to assess farmers' circumstances, should be developed in a broader way, taking into consideration not only the financial position of the farmer, but also farm management expertise. If this occurs, 'long term viability' will be seen by farmers as a valuable tool for ongoing farm management rather than simply as an instrument for banks to remove them from their properties.

3.26 It also is essential for farmers generally to have greater access to expert independent advice to assist them in realistically assessing their farm's prospects and to put in place better systems of farm and financial management.

3.27 The Committee recommends:

14. the capacity of farmers to assess the long term prospects of their farming business should be enhanced by providing them with greater access to expert independent advice on farm assessment and management and financial planning.

3.28 The implementation of this recommendation will assist in the longer term but will not address the current difficulties of farmers in some areas. Inevitably some farmers will have to leave their properties as part of the process of structural adjustment occurring in some areas and this will require sensitive handling by banks and appropriate support from government. Also where farmers stay on the land, support will need to come from banks and government. This will involve both banks and governments developing long term proposals for the future for structural adjustment in the rural sector.

3.29 The Government's 'One Nation' statement made provisions for banks to claim deductions for partial write offs and for losses incurred in debt for equity swaps for debts written off after 26 February 1992.

3.30 It was considered this arrangement would allow farmers and rural businesses in financial difficulty to reconstruct their debt and trade their way out of trouble rather than have premature foreclosures forced on them by banks purely for taxation reasons. The provisions were described by the Executive Director of the ABA as an 'active tool' to be used by banks on a case by case basis to write off some debt while leaving the farmer with an ongoing viable enterprise.¹⁸ The comment was made that there was a need for the Australian Taxation Office still to do some things before 'it can be fully implemented'.¹⁹

3.31 The Committee has seen no evidence of banks making use of these provisions to assist in dealing with the current situation despite the significant interest in the arrangements which has been shown by many farmers. Many farmers have sought to discuss such arrangements with their banks and have been rejected.

3.32 The Committee considers banks should examine these provisions closely to see whether they can be used to assist farmers in the current situation. The Committee sees the provisions potentially as very useful and banks negative reaction so far as unacceptable. If there are practical difficulties in using the provisions, banks should discuss these with the Government or the Australian Taxation Office.

3.33 The Committee recommends that:

15. banks should make use of the provisions in the 'One Nation' statement for the partial write off of debts to assist farmers who are experiencing short term difficulties during this period of rural sector downturn. If there are limitations in the provisions, banks should approach the Government or the Australian Taxation Office with suggested changes; and
16. the availability of the arrangements should be promoted actively by banks amongst rural customers.

3.34 In addition to the specialist farm assessment and management advice which should be available to farmers, rural counsellors play an important role in assisting farmers to deal with the financial and other stresses associated with the rural downturn. In the 'One Nation' statement the Government increased the funding for rural counselling. The Committee considers the government should keep this program under review to ensure it is receiving sufficient funding to enable assistance to be provided to farmers facing financial difficulties.

18 Evidence, p. 19.

19 Evidence, p. 19.

3.35 The Committee recommends that:

17. the Government keep the rural counsellors program under review to ensure sufficient funding is available to enable assistance to be provided to farmers facing financial difficulties.

Governmental assistance

3.36 The major form of governmental assistance to farmers facing difficulties is the Rural Assistance Scheme (RAS). The Commonwealth Government recently announced significant changes to the Scheme as well as the introduction of a new Farm Household Support Scheme.

3.37 The changes were in response to criticism of the focus, effectiveness and administration of RAS and followed a comprehensive review of the Scheme by independent consultants and extensive consultations with the States and rural industries.

3.38 The key features of the new RAS are:

- . a focus on farm productivity, profitability and sustainability, rather than the emphasis on assistance and debt reconstruction under the old scheme;
- . concentration on a single program, to be administered flexibly by State Rural Adjustment authorities, to replace the existing Parts A, B and C under the old scheme;
- . provision for interest subsidies on commercial finance;
- . grants for farming training, farm planning and appraisal;
- . a re-establishment grant of \$45,000 for those meeting financial tests and electing to leave the farm;
- . special interest subsidies up to 100 per cent, under a Commonwealth and State shared funding arrangement, to provide additional support for farmers experiencing exceptional circumstances;
- . strong Commonwealth administration and arrangements for improved accountability of the Scheme, and the establishment of a Rural Adjustment Scheme Advisory Council to provide strategic oversight of the Scheme; and
- . a comprehensive review of the Scheme in four years, with an eight year sunset clause on the Scheme in its new form.

3.39 The new **Farm Household Support (FHS)** Scheme, to be introduced in March 1993, will be established under a new Act within the Primary Industries and Energy portfolio, but the service will be delivered by the Department of Social Security on an agency basis. Key elements are:

- . support for farmers unable to access commercial 'carry on' finance to meeting daily family requirements;
- . a two year period during which FHS will be available at the equivalent of the Job Search Allowance while the farmer is free to choose whether he sells or remains on the farm
 - any FHS received by farmers who choose to remain on the farm will be on the basis of a loan;
 - farmers who sell within the two year period will receive the first nine months of FHS as a grant and the balance as a loan.
- . the capacity to cash out the balance of the nine months FHS grant as a lump sum if the sale occurs within the nine month period; and
- . a total potential benefit under the FHS and the RAS re-establishment grant to individual farmers of \$55,000.

3.40 The Committee notes the assurances given to the Minister for Primary Industry and Energy from banks about their commitment to the farm sector. It is expected that banks will respond to the new package of measures by demonstrating flexibility in adjusting loan conditions for individual farmers. Successive changes to the RAS away from assistance with debt re-construction have meant the responsibility for debt re-construction rests very much with banks and the Committee expects to see banks responding positively.

3.41 The Committee supports the emphasis to be given in the new Scheme to long term productivity and profitability and to the enhancement of the financial and risk management skills of farmers.

3.42 The proposed increase in the re-establishment grants and other assistance to farmers wishing to leave their properties also is welcome. The increase in the level of assistance will aid farming families who face a very difficult period of adjustment.

3.43 In addition to the proposed changes to the RAS, the Government recently announced a new drought policy. The policy will treat drought as a normal feature of Australian agriculture. Its focus is on farm management which takes account of the risk of drought and plans and manages the uncertainty associated with such environmental conditions. As well as this long term focus, the policy included additional assistance of \$14 million to deal with the exceptional drought being experienced in New South Wales and Queensland. The assistance, in combination with flexibility by banks, is designed to meet what farmers say they need in times of severe drought - access to long term finance with no repayments required during the drought. The Committee urges banks to co-operate with the program to adjust loan conditions to suit the circumstances of individual farmers.

Expertise within banks

3.44 Banks referred to the expertise which they have available to assist in meeting the specific needs of farmers.

3.45 National Australia Bank has established rural finance teams ('briefcase bankers ') consisting of an experienced rural banker, an agricultural graduate and support staff equipped with portable PCs to analyse a farmer 's financial position. These teams endeavour to tailor a farmer 's financial arrangements to the particular characteristics of a farm. Rural managers attend both internal and external courses to increase their skills. In addition, information on rural developments is sent regularly to all rural branches.²⁰

3.46 The Commonwealth Bank conducts rural training courses throughout Australia. Professional assistance is utilised in presenting those courses and their content is tailored to the rural pursuits in particular geographical areas. Training is complemented by visits by lending staff to farms in their district.²¹

3.47 ANZ Bank is in the process of developing a Rural Information Kit which will provide details of all ANZ products relevant to rural customers. Training on rural finance is provided to rural managers and some attend external training courses run by Marcus Oldham Agricultural College.²²

3.48 Both R&I Bank and the State Bank of New South Wales employ agricultural graduates as rural consultants or valuers. SBNSW also has Agribusiness Managers in four locations in New South Wales to manage its rural portfolio in a regional area.²³

20 Evidence, pp. S244-245.

21 Evidence, p. S174.

22 Evidence, pp. S204-205.

23 Evidence, pp. S33 and 104-105.

3.49 Farming organisations acknowledged the improvement in expertise within banks to deal with rural customers, but considered the overall picture was still variable with some banks doing better than others while even the best banks could do more. The value of banks adopting differing approaches was recognised.

3.50 The NFF considered one of the problems to be that rural branches were used as a 'training ground' for aspiring managers. There appeared to be no tendency towards specialist rural managers who developed and maintained a relationship with the rural sector. The high turnover of staff in rural branches also created problems for farmers.²⁴

3.51 The Committee recognises the efforts made by banks to increase the expertise of rural bank staff available to service farming customers and to ensure bank management in rural areas has greater direct contact with customers. These efforts must continue to overcome problems of variability in the quality of rural staff.

3.52 Differing approaches by banks to servicing the needs of farmers are to be encouraged as they will provide farmers with choice. However, there also should be a capacity for banks to learn from the best practice of other banks. Problems of high turnover of staff in rural areas and the inexperience of branch management should be addressed by banks adopting structures which will allow greater permanency and encourage greater specialisation.

3.53 The Committee recommends that:

18. banks increase their capacity to provide expert assistance to the farming sector by expanding the quality of their resources in rural branches. Emphasis should be given to enhancing the financial knowledge and farm risk management skills of rural staff.

Code of Practice for Banker/Farmer relationships

3.54 Banks have responded to the difficulties in their relationships with farmers by developing a voluntary code of practice to govern the relationship. The Code, known as the ABA Farm Code, was formally launched at a conference of the NFF in November 1991. However, the NFF said the Code received a scathing reception from delegates.

3.55 While farming organisations have given some credit to banks for endeavouring to address the concerns in the relationship, they consider there are significant shortcomings in the Code which has been developed. These concerns are:

the process to develop the code was deficient;

²⁴

Evidence, pp. 210, 211 and 213.

the code defines rights rather than stating how rights should be exercised; and

the code does not provide for the use of a single comparison rate of the overall cost of finance.

3.56 The ABA consulted with farming organisations in developing the Code. A number of drafts were produced and farming organisations provided comments on the drafts. Some of these suggestions were taken up but, according to the NFF, 'the majority and the more important suggestions were not taken up'.²⁵ The NFF considered the process of developing the code was frustrated by significant disagreement between individual banks with the result that the final code 'was the lowest common denominator, rather than something that really went to the heart of the relationship'.²⁶

3.57 The New South Wales Farmers' Association also noted individual banks protracted the process of completing the code.²⁷

3.58 A second concern was that, while the Code defined the rights of both parties, it did not spell out how those rights would be exercised. Mention was made by both the NFF and NSW Farmers' Association of dispute resolution procedures which should be defined clearly in any Code.

3.59 Under the ABA Code, mediation of a farmer's situation is available within the ABA/NFF Farm Assessment Scheme. A number of farmers have been assisted under the Scheme, but a recent review pointed to the relative lack of farmers' awareness of the Scheme. It is understood the other method of dispute resolution available under the ABA Code, the appointment of an independent arbitrator, has not been utilised.

3.60 At the Chairman's discussions in Dubbo farmers made it clear that the dispute resolution mechanisms delineated in the ABA Farm Code are not working adequately. Farmers had major disputes with banks but had no idea where to turn to have their concerns addressed. If, as discussed in the next chapter, banks will not permit farming disputes to be adjudicated by the Banking Industry Ombudsman, farmers need cheaper, more speedy and more effective dispute resolution procedures incorporated in a Code which farmers can enforce.

3.61 As a voluntary agreement, the ABA Farm Code cannot be enforced legally nor is any body monitoring banks' adherence to its provisions. This weakness reinforces the problem of the Code's lack of definition of how rights would be exercised under the Code.

25 Evidence, p. 214.

26 Evidence, p. 214.

27 Evidence, p. 339.

3.62 Farming organisations considered a code should provide for a single comparison rate to enable overall costs of finance to be compared more easily. This issue was discussed in the previous chapter and a recommendation made that a comparison rate formula be developed as part of a Code of Banking Practice and be applied to consumer, small business and farming customers.

3.63 Finally, there seemed to be a lack of awareness in the rural sector of the existence of the ABA Code. This is despite an extensive distribution by the ABA of copies of the Code to banks for distribution to branches, directly to many rural branches throughout Australia and to rural counsellors, departments of agriculture and farm newspapers.

3.64 The Committee considers the concerns raised by farmers about the ABA Farm Code can be resolved by the relationship between farmers and banks being subject to a formal Code of Banking Practice which is developed as a result of consultation involving banks and farming organisations. The Government's response to the Committee's report foreshadowed this when it stated the ABA Farm Code 'may be subsumed into the proposed general code'.²⁸ The most recent information available to the Committee is that it has yet to decided whether the Code currently being developed should explicitly address the relationship between financial institutions and farmers.²⁹ The Committee considers the Code should then be extended to cover relationships between financial institutions and farmers as a matter of priority.

3.65 The Committee recommends that:

19. the relationship between financial institutions and farmers be addressed as a matter of priority as part of a proposed Code of Banking Practice. It may be necessary to develop a supplementary section to incorporate the particular aspects of the relationship which cannot be included in a general code. Farming organisations should be consulted closely in the development of the Code.

²⁸ Government's Consolidated Response to the Parliamentary Inquiry into Banking and the Industry Commission Inquiry into the Availability of Capital, p. 13.

²⁹ Letter from Prof A Fels to Secretary dated 11 September 1992.

CHAPTER FOUR

DISPUTE RESOLUTION AND MEDIATION

4.1 In the Banking Inquiry Report, the Committee noted dispute resolution as one of the important issues raised by consumers, small businesses and farmers. While only a small proportion of the large number of transactions in which banks engage each year give rise to disputes, the disputes can result in acrimony between banks and customers if they are not resolved satisfactorily.

4.2 The imbalance in power between banks and many customers tends to weight the settlement of disputes in banks' favour. In its report, the Committee saw a need for cheap, speedy, fair and accessible mechanisms for both consumers and small commercial customers such as small businesses and farmers to resolve disputes with banks.

4.3 The recommendations reviewed in this chapter fall into four categories:

- mechanisms to prevent disputes, internal dispute resolution systems within banks and the use and publication of complaint statistics (Recommendations Nos 70, 71, 72, 73 and 78);
- the extension of the Banking Industry Ombudsman Scheme (Recommendation No 79);
- mediation of disputes involving Commonwealth Bank borrowers in the Nyngan region and foreign currency loan borrowers (Recommendations Nos 57 and 60); and
- alternative dispute resolution generally for small commercial customers (Recommendation No 58).

The Committee also comments more generally on alternative forms of dispute resolution for commercial customers of banks.

Internal dispute resolution

4.4 The Committee's recommendations in relation to internal dispute resolution advocated a pro-active approach by banks which may prevent disputes from arising. The Committee recommended banks improve their training of staff and provision of information to customers to overcome poor communication which is one of the major causes of disputes. (Recommendation No 70.) The Committee also considered the quality of service delivery should be subject to regular audit. (Recommendation No 78.)

4.5 Once disputes had arisen the Committee recommended banks should have effective internal dispute resolution systems to settle those disputes (Recommendation No 71). Further recommendations recognised complaint statistics were a useful indicator of banks' performance in customer relations and should be used by banks to identify problems and design better procedures (Recommendation No 72) and should be disclosed publicly to allow customers to assess banks' relative performance and individual bank's performance over time. (Recommendation No 73.)

Improving service quality

4.6 Information provided by banks on their training of staff in customer relations tended to be general. Most banks noted the significant amounts which were spent on staff training and indicated improved customer relations and service quality were important areas of training. Only two banks, State Bank of New South Wales and National Australia Bank, provided detailed information about relevant training courses.

4.7 The general nature of banks' responses to this recommendation makes it difficult for the Committee to reach conclusions on implementation. As the quality of customer service remains a significant concern of bank customers the Committee intends to keep this area under continuing review.

4.8 While staff training should enhance the quality of customer service delivery and decrease the number of disputes, the Committee considered the quality of service delivery should be subject to regular audit to check the availability of information to customers, the ability of staff to answer questions about bank products and practices and the courtesy of staff. As the Commonwealth Bank noted, the recommendation was based on no more than good business practice.¹

4.9 Most banks indicated they conducted checks of quality of information provision and service delivery. These checks ranged from internal checks and reviews to external mechanisms for assessing service quality. Among the external mechanisms used were:

- . an annual survey by R&I Bank directed to a sample of branch customers which provides measures on courtesy, accuracy, queue lengths etc²;
- . the use by Advance Bank of 'shadow shopping' audits not only of its own network but also that of its competitors to ensure service quality is maintained and enhanced³;

1 Evidence, p. S164.

2 Evidence, p. S38.

3 Evidence, p. S67.

the 'Mystery Customer' Program of State Bank of New South Wales which involves external consultants visiting and telephoning branch offices inquiring about a product or service⁴;

the employment by ANZ of external consultants to give branches a report card on aspects of customer service, including phone etiquette, branch and personal presentation, queue waiting times, availability of information etc⁵; and

the use by National Australia Bank of independent researchers to undertake monthly reports to ensure service standards in branches are maintained. 'Phantom shoppers' also are utilised to check on service quality.⁶

4.10 The use of independent consultants, in addition to internal checks, to undertake surveys of service delivery and availability of customer information should provide banks an indication of the accuracy of findings from internal surveys. The random and anonymous checking of the 'shadow shopping' surveys in particular should make bank staff aware at all times of the importance of good service delivery. As the overall performance of a bank can be enhanced by service quality there is an incentive for banks to ensure their reviews of service delivery provide a reliable guide to the standard being achieved by their staff.

4.11 The Australian Consumers' Association (ACA) emphasised the importance of this recommendation from the customer's rather than the bank's perspective. The Association stated where a service was a legal or contractual obligation, bank audits should be conducted formally and reported to the Reserve Bank or Trade Practices Commission. According to the Association, banks at times have been in breach of credit laws for many years without being aware of the breach.⁷

4.12 While consumers should feel confident that bank products and services are provided within the legal obligations of banks, the Committee's recommendation was directed to service quality and information which would enhance customer satisfaction by increasing competition between banks to provide quality service. It was not directed towards the compliance of banks with legal obligations. The auditing and reporting requirements suggested by the ACA appear excessive and it is questionable whether the Reserve Bank or Trade Practices Commission would be appropriate bodies to monitor such compliance.

4 Evidence, p. S108.

5 Evidence, p. S211.

6 Evidence, p. S255.

7 Evidence, pp. S615-16.

4.13 Most relevant credit legislation is State legislation which should be monitored and enforced by State consumer affairs bodies. Adherence to the proposed Code of Banking Practice, which will be legally enforceable, will be monitored by the Australian Payments System Council under guidelines which are still to be developed.

Complaint handling procedures

4.14 Once disputes with banks arise, customers should feel confident their complaints can be addressed quickly and effectively within the bank in the first instance. Consequently, the Committee recommended banks speed up their implementation of effective complaint handling schemes and make known their schemes' existence through brochures available in all branches (Recommendation No 71).

4.15 A summary of information about banks complaint handling schemes or procedures is at Figure 2.

4.16 It will be noted that most banks have some form of internal complaints handling procedure or scheme and a brochure advertising its availability. Consequently, most banks formally comply with the Committee's recommendation. Those banks which do not should do so as a matter of urgency. Where banks are small a separate complaints department or customer service line may not be necessary. However, a formal procedure for dealing with complaints (even if it involves only referral to a senior officer in the bank) and a brochure advising customers of the procedure should be available in even the smallest institution.

4.17 While having a formal internal dispute handling procedure and advertising it is welcome, the procedure must be effective and meet customers needs. The National Consumer Affairs Advisory Council has suggested:

... there is a need to develop minimum criteria for internal dispute resolution procedures for all financial institutions. This would ensure greater attention to efficiency, the application of natural justice and due process, and the reasons or justifications for decisions. The Office of the Banking Ombudsman may be the appropriate body to develop such criteria in consultation with industry, government and consumer organisations.⁸

8

NCAAC, *Your money ... a new deal for consumer financial services in the 1990s*, A report on the National Consumer Affairs Advisory Council Forum, 'New Directions in Consumer Financial Services', Canberra, 7-8 November 1990, pp. 17-18.

FIGURE 2

Banks' Internal Dispute Resolution Systems

Advance Bank	The Bank has a complaints handling system, a brochure advertising it and a 9-5 phonenumber.
ANZ Bank	The Bank has a complaints procedure, a brochure and an enquiry centre for taking complaints.
Bank of Queensland	Senior management of the Bank is involved in resolving disputes.
Citibank	There is a specific area in customer service to handle complaints to defined standards. The Bank has a brochure on its system.
Commonwealth Bank	The Bank has a formal complaint handling scheme and a brochure advertising it.
Metway	The Bank has a 'Consumer Ombudsman' reporting to the Managing Director to handle complaints. There is a brochure advertising the procedure.
National Australia Bank	The Bank has a complaints handling procedure and policy, a brochure advertising the procedure and a toll free telephone service to deal with inquiries and complaints.
R&I Bank	Complaints handling procedures are recorded in the Bank's 'Book of Instructions'. There is no complaints department and unresolved complaints are referred 'up the line'.
State Bank of NSW	The Bank has a complaints handling system and a brochure advertising it.
State Bank of SA	Complaints are handled by the Bank's Customer Relations Department. There is a brochure advertising the procedure.
St George Bank	The Bank has a Customer Relations Department to handle complaints and a brochure advertising the procedure.
Westpac	The Bank's complaints procedure is outlined in 'You and Your Bank'. The Bank also has a phone service line.

4.18 Advocating a similar approach, the Australian Consumers' Association suggested that, as the Banking Ombudsman Scheme could only work effectively if banks' internal complaints procedures also were effective, then the Ombudsman should be given the role of monitoring the adequacy of banks' procedures.⁹

4.19 The Committee agrees there is a need for banks' internal dispute handling procedures to meet some basic standards or minimum criteria. In its previous report the Committee identified a number of minimum criteria which internal complaints systems should meet. These included:

- . the need for all complaints to be recorded;
- . a clear point of entry for a complainant seeking to have a dispute considered;
- . clear steps in the procedure which are readily accessible;
- . clearly defined lines of responsibility, with each level of staff knowing their bounds of discretion in resolving disputes;
- . timeliness in resolving disputes;
- . the need for customers to have access to all relevant information; and
- . the need for a brochure about the bank's internal dispute resolution procedure.¹⁰

4.20 The Committee recommended in the previous report that the development of comprehensive procedures for resolving complaints and disputes be considered in the development of the Code of Banking Practice and that the criteria identified in the last paragraph should be included in the development of banks' procedures (Recommendation No 81). The Government's response indicated these issues would be covered by the Code and the Committee considers this is a more appropriate way to proceed than to involve the Banking Ombudsman in banks' internal procedures. Inclusion in the Code would see the adequacy of banks' procedures monitored by the Australian Payments System Council, as the body which will monitor compliance with the Code.

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¹⁰

Evidence, p. S613.
A Pocket Full of Change, op. cit., pp. 404-05.

Complaints statistics

4.21 The Committee recognised complaints statistics and information provided at least one important indicator of banks' performance in relating to customers. Consequently, it recommended banks make greater use of information obtained through complaints to improve performance (Recommendation No. 72) and publish complaint statistics in their annual reports (Recommendation No. 73).

4.22 Most banks indicated complaints information was used by management as a tool to improve procedures, products, staff training and practices and customer services. This would be expected from the best banks which would wish to ensure such information was utilised to improve performance.

4.23 Some banks indicated procedures and products which had changed as a result of information from complaints. The Commonwealth Bank changed its method of rounding up of interest on particular loan products following a customer complaint.¹¹ Another bank indicated a number of changes which had resulted from analysis of customer complaints including:

- the introduction of cheques to cater for left-handed customers and to make record keeping easier;

- an increase in the age limit to 21 years for exemption from fees on accounts; and

- a record of changes to interest rates on statements of accounts.

4.24 The ACA considered banks should be aware not only of their own problems identified by complaints, but also of problems affecting other banks. It recommended the Banking Ombudsman regularly publish case reports of complaints which may have industry wide implications.

4.25 The Banking Ombudsman already publishes case reports in his Annual Report and this is supported by the Committee. There is no need for a recommendation to extend the publication given to case studies by the Ombudsman.

4.26 Only one bank (R&I Bank) has published complaint statistics in its Annual Report. It stated the continued publication of statistics was a matter for its discretion.¹² Other banks' comments ranged from the view that such publication served 'no useful purpose',¹³ or was of 'no particular benefit to customers',¹⁴ to concerns about the lack of comparability of complaint statistics.¹⁵

11 Evidence, p. S156.

12 Evidence, p. S37.

13 Advance Bank, Evidence, p. S67.

14 CBA, Evidence, p. S156.

15 NAB, Evidence, p. S250, State Bank of New South Wales, Evidence, p. S108.

4.27 Many banks noted the Banking Industry Ombudsman already collects and publishes complaint statistics and considered this was a superior approach as comparability and consistency could be assured. In view of the reluctance of banks to publish their complaint statistics, consumer organisations also recommended the Banking Ombudsman publish comprehensive complaint statistics for each bank, including both complaints resolved within banks and complaints referred to the Ombudsman.¹⁶

4.28 While the Ombudsman would have statistics on complaints which are referred to him, the only information he has published regarding complaints against individual banks has been a chart showing the major problem areas for each bank as indicated by complaints.¹⁷ This chart did not provide any indication of the extent of complaints against individual banks, nor of their approach to resolving complaints.

4.29 The Ombudsman stated in his report:

For the purposes of this year's annual report, the current individual bank base is too small to draw any meaningful conclusions about individual banks.¹⁸

4.30 The Committee supports the publication by the Banking Ombudsman of a more detailed break down of complaints statistics and information relating to individual banks. The publication of this information by the Ombudsman should overcome problems of comparability. However, the publication of complaints information by the Ombudsman would have to be confined to complaints received by the Ombudsman's Office. It could not include, as suggested by the ACA, banks' internal complaint statistics. The responsibility for publication of these remains with individual banks. The Committee reinforces its recommendation for banks to publish this information in their annual report.

4.31 The Committee recommends that:

20. the Banking Industry Ombudsman publish in his annual report detailed information and statistics regarding complaints against individual banks raised with his Office.

¹⁶ Evidence, p. S614.

¹⁷ Australian Banking Industry Ombudsman Ltd, Annual Report, 1990-1991, p. 59.

¹⁸ Ombudsman, Annual Report, op cit, p. 55.

The Banking Industry Ombudsman Scheme

4.32 In its earlier report, the Committee found the Banking Industry Ombudsman Scheme to be working effectively. However, the Committee recommended the terms of reference for the Scheme should be extended to cover small propriety companies and to raise the monetary threshold to \$200,000 (Recommendation No 79). This recommendation was made because of concerns raised by small business and farmers in obtaining access to cheap, speedy and fair means of resolving disputes with banks.

4.33 Banks opposed an extension to the Scheme citing the effect an extension to cover more complex small business disputes would have on retail customers' access and speed of dispute resolution. The concerns of banks are adequately summed up by ANZ Bank:

The Ombudsman is at present having difficulty in coping with the number of complaints received. Any expansion of the scope would result in less attention being devoted to the small consumer, ie the very segment which the scheme is designed to assist.¹⁹

4.34 Consumer organisations supported the extension of the monetary limit of the Scheme to \$200,000 to bring it up near to the jurisdiction of the UK Banking Ombudsman. However, the extension to cover small business was opposed and coverage of building societies and credit unions was seen as a higher priority.²⁰

4.35 Given the concerns about the Ombudsman's office being flooded with additional and more complex complaints if there was an extension of the Scheme the Committee sought from the Ombudsman an indication of the number of additional complaints which would be covered. The Ombudsman indicated that one third of written complaints made to his office to 30 June last year were rejected as being outside of the terms of reference. The majority of these (26 per cent of total complaints) related to the fact of incorporation. Less than one per cent of written complaints were rejected as exceeding the monetary limit. However, the Ombudsman explained the monetary limit was an easily conveyed limitation while the restriction on coverage of incorporated bodies was more difficult to convey.²¹

19 Evidence, p. S211.

20 Evidence, p. S616.

21 Evidence, pp. 190-191.

4.36 The inclusion of incorporated bodies in the Ombudsman's coverage clearly would have significant implications for the Scheme in terms of numbers of complaints alone. Already, the Ombudsman pointed out, the time taken to settle disputes exceeds 90 days while the aim is to achieve a turnaround time of 60 days. In the absence of provision of additional resources, this time could be expected to increase if incorporated bodies were included. An increase in the monetary threshold would have less impact on turnaround time.

4.37 In view of these problems the Ombudsman and the Ombudsman's Council, as represented by its Chairman Sir Ninian Stephen, thought proposals for extension of the Scheme should be considered after the Scheme had been given more time to establish itself. Also detailed administrative work should be undertaken prior to any change and an appropriate lead period set before any change took effect.²²

4.38 Given the discussions which occurred about this recommendation for extension and the views put by banks about the need to allow the Scheme to 'bed down' before extensions to it were considered, the Committee was amazed and angered to learn accidentally of proposals by the Board of the Scheme to wind back the Scheme's coverage.

4.39 By mistake the Committee was sent draft agenda papers produced for a meeting of the Board of the Scheme which was to consider amendments to the Scheme's terms of reference. The amendments arose as the response from the Board to proposals put by the Council for some changes to the terms of reference. Sir Ninian Stephen had advised the Committee of proposals for amendments to the terms of reference which had been agreed by the Council and sent to the Board.²³

4.40 The agenda papers indicated the Board's agreement to some of the changes proposed by the Council. However, the Board proposed its own changes which in some areas would have limited significantly the Ombudsman's jurisdiction and powers as he had interpreted them.

4.41 The first area was in relation to whether the Ombudsman could deal with the question of third party cheques. Under Clause 20(a) of the terms of reference the Ombudsman can consider only a complaint if he is satisfied that:

The complaint is made to him by or on behalf of the individual to whom and for whom the banking services in question were provided, or the personal representatives of that individual.

22 Evidence, p. 201.

23 Evidence, p. 201.

4.42 The Board argued the Ombudsman could not consider matters of third party cheques as the 'secondary nature of a bank's involvement in the third party processing of cheques, does not make the third party a customer of that bank for whom it is providing a banking service and thereby have standing in a complaint to the Ombudsman'. To clarify the position in relation to coverage of third party cheques, the Board proposed to alter Clause 20(a) by inserting the word 'directly' into the clause as follows:

The complaint is made to him by or on behalf of the individual to whom or for whom the banking services in question were directly provided, or the personal representatives of that individual.

4.43 The other major, and more serious, change proposed by the Board was to Clause 15 which contains the criteria against which the Ombudsman must decide disputes. Clause 15 states:

15. In making any recommendations or award under these Terms of Reference the Ombudsman shall do so by reference to what is, in his opinion, fair in all the circumstances, and: -

(a) shall observe any applicable rule of law or relevant judicial authority (including but not limited to any such rule or authority concerning the legal effect of the express or implied terms of any contract between the applicant and any Bank named in the complaint); and

(b) shall have regard to general principles of good banking practice and any relevant code of practice applicable to the subject matter of the complaint.

The Ombudsman shall not be bound by any previous decision made by him or by any predecessor in his office. In determining what are the principles of good banking practice he shall, where he considers it appropriate, consult within the industry.

4.44 The Ombudsman has interpreted the criterion of 'fair in all circumstances' as being the foremost of the three criteria he has to take into account.

4.45 However, the Board considered the provisions in sub-paragraphs (a) and (b) were mandatory so that the criterion 'fair in all the circumstances' was qualified by these two paragraphs. The Board proposed to change Clause 15 to:

15. In making any recommendation or award under these Terms of Reference, the Ombudsman shall observe any applicable rule of law or any judicial authority (including but not limited to any such rule or authority concerning the legal effect of the express or implied terms of any contract between the applicant and any bank named in the complaint). The Ombudsman shall apply general principles of good banking practice and any relevant code of practice applicable to the subject matter of the complaint. The Ombudsman shall make any recommendation or award under these Terms of Reference by reference to what is fair in all the circumstances but he shall not make an award which is inconsistent with law or judicial authority or contrary to general principles of good banking practice and any relevant code of practice applicable to the subject matter of the complaint.

The Ombudsman shall not be bound by any previous decision made by him or by any predecessor in his office. In determining what are the principles of good banking practice he shall, where he considers it appropriate, consult within the industry.

4.46 The effect of the proposed change would have been to weaken significantly the application of the 'fair in all circumstances' criterion. As the Committee noted in its previous report 'The inclusion of reference to good banking practice and fairness are significant steps in recognising the quality of service to bank users'.²⁴

4.47 As a result of significant pressure brought by the Committee and others, the Board decided to proceed with only limited changes to the Scheme. The Board accepted most of the changes which the Council had proposed as well as making other decisions. The Board reaffirmed the criteria under which the Ombudsman makes determinations, that is by reference to what is fair in all the circumstances, observing the law and having regard to general principles of good banking practice. The Board also decided to exclude complaints regarding third party cheques from the Ombudsman's determination. This change was not retrospective.

24

A Pocket Full of Change, op. cit., p. 397.

4.48 Setting aside the substance of these changes, the controversy created by the way the Board went about considering changes highlights a difficulty of perception under which the Scheme operates. The Scheme is funded by the banks, and they, through the Board, have final say on the terms of reference under which the Scheme operates and the funding provided to the Ombudsman to deal with complaints.

4.49 As the Committee noted in its previous report, it would be deeply concerned if there was any attempt by banks to limit the Scheme because it has been 'too successful'. If it was clear the Scheme was being curtailed then options other than self-regulation may need to be considered.

4.50 Despite the latest controversy, the Committee still considers a self-regulatory approach is preferable to governmental involvement in a dispute resolution process. However, for self-regulation to work effectively there must be wider consultation about any changes proposed to the operation of the Scheme. If changes take place behind closed doors it encourages a view of underhanded dealings. If banks wish to make changes to the Scheme they should feel confident enough about their substance to sustain them in public debate.

4.51 In the end, of course, banks, through the Board, have the power of final decision-making and should do so in relation to a self-regulatory Scheme. However, consultation with the Council of the Scheme and the wider community must be undertaken prior to any decisions being taken about changes to the scope and powers of the Scheme to ensure continued public confidence in the impartiality of the Scheme's operation.

4.52 The Banking Industry Ombudsman Scheme is a bank initiative for which banks deserve credit. It can be seen as a model for other industries. All banks need to recognise there is value in the Scheme and give it their full support.

4.53 The Ombudsman Scheme provides an essential feedback mechanism to banks on complaints being made against them. It also reinforces for banks what are good banking practices and gives their customers confidence in the dispute handling mechanisms available if a complaint arises. There would be concern if *individual banks considered the Scheme was one they could opt out of freely without regard to the consequences for their customers.*

4.54 Feedback to banks from the complaint resolution processes of the Ombudsman should see the numbers of complaints handled by the Scheme diminish as banks address concerns internally. This should, in time, reduce the demands made on the Scheme and on the financial resources of individual banks to support it.

4.55 Although banks strongly opposed an extension to the Scheme in terms of the recommendation made in the earlier report, the Committee remains convinced these extensions are highly desirable. There seems to be no reason to delay implementation of that part of the recommendation which advocated lifting of the monetary limit to \$200,000. This would bring the Scheme broadly into line with the United Kingdom Scheme which has a limit of £100,000. This proposal was supported by consumer organisations and is unlikely to significantly increase the workload of the Ombudsman.

4.56 The extension of the Scheme to cover small incorporated bodies and farmers should be undertaken within two years when the Scheme should have had sufficient time to bed down. The Committee considers the implementation of this extension will be of significant benefit to banks. There should be cost savings from small commercial complaints being handled by informal dispute resolution procedures through the Ombudsman's Office, rather than having to resort to expensive court procedures. Also the speedy resolution of these complaints will greatly benefit the image of banks.

4.57 **The Committee recommends that:**

21. an increase to \$200,000 in the monetary limit applied to the Banking Ombudsman Scheme be implemented immediately;
22. the scope of the Banking Industry Ombudsman Scheme be extended within a further two years of operation to include the complaints of small incorporated bodies and farmers;
23. the essential criterion of fairness under which the Ombudsman makes his determinations should be retained;
24. any changes to the terms of reference of method of operation of the Banking Industry Ombudsman Scheme only be implemented by the Board of the Scheme after full consultation with the Council of the Scheme, the Banking Industry Ombudsman and the wider community which has an interest in the Scheme; and
25. all banks be urged to maintain membership of the Scheme.

Alternative means of resolving disputes

4.58 In view of the difficulties which face small commercial customers (such as small businesses and farmers) in resolving disputes with banks, the Committee considered mechanisms other than the Banking Ombudsman for dealing with disputes. Three recommendations (No.s 57, 58 and 60) were made in the previous report for mediatory mechanisms to assist in resolving a range of commercial disputes:

- it was recommended banks fund independent mediation of outstanding foreign currency loan disputes (Recommendation No 60);
- it was recommended the Commonwealth Bank establish an independent mediation mechanism to resolve outstanding rural disputes in the Nyngan region (Recommendation No 57); and
- a general mediatory mechanism should be available in relation to disputes between farmers and banks (Recommendation No 58). By extension this recommendation also could apply in relation to disputes between banks and small business customers.

4.59 Alternative dispute resolution (ADR) has received prominence recently as a process of resolving problems as an alternative to formal Court procedures. Among the advantages over the Court system which have been cited for ADR are:

- increased probability of achieving a satisfactory outcome for both parties;
- less costly and more speedy resolution of disputes;
- greater confidentiality and privacy;
- greater flexibility in techniques for resolving disputes and solutions which can be adopted;
- direct lines remain open between parties to the dispute; and
- a greater possibility of an ongoing commercial relationship between the parties following resolution.²⁵

4.60 The advantages were highlighted in recent evidence by the Law Society of NSW to the Senate Legal and Constitutional Affairs Committee in relation to its inquiry into the costs of justice:

²⁵

Warren Pengilly 'Mediation and Alternative Dispute Resolution: Some Australian Observations', *New Zealand Law Journal*, January 1992, pp. 11-15 at p. 13.

The primary avenue open for reducing the cost of legal services depends upon greater resort being had to the various modes of alternative dispute resolution (ADR) now winning wide acceptance throughout the world and the encouragement of lawyers and their clients to the view that in the pursuit of justice and equity, peaceful and non-litigious resolution of conflict is a viable alternative to a confrontation in Court.²⁶

4.61 While the advantages of ADR are clear, it is not suitable for all cases²⁷ nor should its advantages be overstated.²⁸ Also it must be recognised as being additional to, rather than alternative to, the court system. As Sir Laurence Street stated in his submission to the Committee, ADR:

... is not in competition with the established judicial system. It is an *Additional* range of mechanisms within the overall aggregated mechanisms for the resolution of disputes. Nothing can be alternative to the sovereign authority of the court system.²⁹

4.62 There are a variety of methods of ADR.

Adjudication - the process where parties to a dispute present their case for formal determination within the court system.

Arbitration - the submission of a dispute to a third party who, after considering evidence and arguments from both parties, to the dispute, makes a decision.

Mediation and conciliation - a process whereby the mediator (a neutral third party) acts as a catalyst to help the parties identify mutually compatible interests and reach settlement.

Unassisted negotiation - the bargaining process whereby parties seek to resolve a dispute among themselves - no neutral third party is involved.

²⁶ Cited in Senate Standing Committee on Legal and Constitutional Affairs, Cost of Legal Services and Litigation, Discussion Paper No. 4, 'Methods of Dispute Resolution', September 1992, p. 5.

²⁷ See Pengilly, op. cit., pp. 13-14.

²⁸ See Senate Legal and Constitutional Affairs Committee, op. cit., Chapter 6.

²⁹ Evidence, p. S909.

Counselling - the provision of advice to one or both parties to a dispute, recommending changes and assisting the parties to cope with the circumstances.

4.63 Sir Laurence Street provided a document comparing the elements of four forms of commercial dispute resolution - litigation, arbitration, expert determination and mediation (copy at Figure 3). It will be noted that the methods of dispute resolution other than litigation have significant advantages. Sir Laurence emphasised flexibility as one of the most attractive features of mediation which gave it advantages even over other forms of alternative dispute resolution.³⁰

4.64 Banks have used most if not all these methods in endeavouring to resolve commercial disputes. However, the Committee considers they should be used more extensively as an alternative to the courts.

4.65 In achieving the full benefits of the use of alternative forms of dispute resolution such as mediation, two important factors need to be kept in mind.

4.66 Although ADR is less expensive than litigation, it still can be costly to individuals to undertake. Pressure can be placed on individuals to resolve matters quickly to avoid the cost escalating. Legal aid should be available to cover costs of alternative dispute resolution mechanisms just as it is for litigation.

4.67 While alternative dispute resolution methods such as mediation are not like court proceedings, it is essential that each side have a base of knowledge before entering the process. Therefore there should be adequate discovery before mediation to 'level the playing field'. This was emphasised by Sir Laurence Street who stated 'It is essential that there be discovery before the mediation process can function effectively'.³¹

4.68 Clearly all the options need to be available but primarily banks and customers should maintain a dialogue as the most effective means of resolving issues in dispute rather than resorting to legal processes.

30 Evidence, p. 456.

31 Evidence, p. 460.

FIGURE 3

DISPUTE RESOLUTION IN COMMERCIAL MATTERS

<i>ELEMENT</i>	<i>LITIGATION</i>	<i>ARBITRATION</i>	<i>EXPERT DETERMINATION</i>	<i>MEDIATION</i>
1 Confidentiality	No	Yes	Yes	Yes
2 Choice of Adjudicator or Appointee	No	Yes	Yes	Yes
3 Range of Issues	As Plead	As Particularised	As Stated	Open Ended
4 Flexibility of Procedure	Moderate	High	Very High	Very High
5 Delay Potential	Moderate	Low	None	Very Low
6 Control by Parties	Low	Moderate	Very High	Very High
7 Susceptibility to Tactics	Moderate	Low-Moderate	None	Very Low
8 Control Over Parties	High	Moderate	None	None
9 Control Over Witnesses	High	Moderate	None	Not Applicable
10 Power to Compel Consolidation	Yes	No	No	No
11 Width of Remedies	Wide	Restricted	Not Applicable	Not Applicable
12 Binding Decision	Yes	Yes	Yes	No
13 Enforceability of Outcome	Direct	Almost Direct	Contractually Binding	Contractually Binding
14 Susceptibility to Appeal	Open	Restricted	None	Not Applicable
15 Liability for Opponent's Costs	As ordered	As awarded	None	None
16 Cost of Tribunal	Free	Parties as Awarded	Parties as Agreed	Parties as Agreed
17 Level of Costliness	Relative to Length	Relative to Length	Low	Low
18 Level of Time Required of Parties	Relative to Length	Relative to Length	Very Low	Very Low
19 Preservation of Business Relationship	Doubtful	Doubtful	High	Very High

Source: Evidence, p. S914

Foreign currency loan disputes

4.69 Foreign currency loans were sold to small business people in the early to mid 1980s. As a result of the dramatic fall in the value of the Australian dollar, many foreign currency borrowers lost heavily on their loans. Evidence to the earlier inquiry indicated banks' advice to borrowers about the risks of such loans was variable and that measures taken by banks to assist borrowers with their difficulties were inadequate.

4.70 The Committee noted the value of the conciliatory approach adopted by some banks to settling foreign currency loan disputes. A mediatory system, available either prior to, or as an alternative to, litigation was favoured as the approach to resolving outstanding foreign currency loan disputes.

4.71 The Committee considered either a single mediation system could be established to resolve outstanding disputes involving all banks or each bank could establish its own system for resolving its disputes. The ABA argued a single mediator was not appropriate as there were differences of approach, product and circumstances across banks. Each bank also would have its own approach to resolving the disputes.³²

4.72 The Committee agrees each bank should adopt its own measures to resolve its outstanding disputes. Nevertheless there is merit in banks considering the successful approaches which other banks have adopted.

4.73 Prior to the hearings on this review commencing, the Committee had seen little evidence that banks were responding to the spirit of the foreign currency loan dispute resolution recommendation. The Foreign Currency Borrowers' Association (FCBA) advised it had no record of any bank initiating mediation in terms of the recommendation.³³ Further, some borrowers who initiated action towards mediation were rebuffed by their banks.³⁴

4.74 At the first hearings, the Committee made it clear to banks, and particularly to Commonwealth and Westpac Banks as the two banks with the most number of outstanding cases, that it expected them to respond to the spirit of the recommendation and put in place an appropriate strategy to resolve outstanding claims. The Committee considered this to be in the interests both of those banks and of borrowers. Regular updates on progress in resolving disputes were requested of both banks with the latest of these being provided in late August-early September 1992. ANZ and National Australia Banks were asked for updates in July 1992 on their outstanding disputes. Other banks with little or no exposure to foreign currency loan cases provided information in their original submissions.

³² Evidence, p. S10.

³³ Evidence, p. S43.

³⁴ Evidence, p. S43.

4.75 Westpac provided two updates on its efforts to resolve outstanding foreign currency loan disputes as required in recommendation no. 60, the latest being on 28 August 1992. Tables 1-2 show the history of Westpac's settlement of foreign currency loan disputes since 1985. A summary of the current position in relation to outstanding Westpac foreign currency loan disputes is at Table 3.

4.76 Of an original 850 foreign currency loans, 45 matters remained in dispute, with a further nine cases being dormant. Since May 1991, 27 cases have been settled.

4.77 Of the outstanding cases, 20 are under negotiation while 25 are being litigated. The litigated cases include a number where negotiated settlements have been attempted but where a solution has not been found and litigation has followed. Westpac has written to 11 of those with outstanding claims which were considered amenable to solution through mediation. Of these four have agreed in principle to mediation, one has agreed to consider mediation but wishes to seek a negotiated settlement first and four others have acknowledged the offer but have yet to respond substantively. Westpac indicated it would review its outstanding foreign currency loan matters to determine whether a further round of letters should be sent.³⁵

4.78 In addition, Westpac has signed a memorandum of understanding with the FCBA for the establishment of a system of arbitration to resolve foreign currency loan disputes. A copy of the memorandum is at Appendix 6. Arbitration will be available in instances where a dispute has not progressed through the court system to a full trial and beyond, has not been resolved by negotiation or mediation or a clearly defined issue would represent legal grounds for overturning a pre-existing court decision or negotiated settlement. Westpac now is developing a draft arbitration agreement to give effect to the memorandum.

4.79 Westpac cited its preparedness to negotiate the agreement with the FCBA as indication of its commitment to resolving foreign currency loan cases.

4.80 The Committee welcomes the agreement of the Memorandum of Understanding (MOU) and considers it provides a mechanism for resolving outstanding cases. Westpac should interpret the agreement broadly and flexibly in bringing to conclusion outstanding cases.

35

Evidence, p. S772.

TABLE 1

History of Westpac Foreign Currency Loans since October 1985*		
1.	Approximate number of foreign currency loans outstanding as at October 1985.	850
2.	Approximate number of FCL borrowers who have made no claim against the Bank or who have entered into arrangements for which deeds or letters of release were not entered signed (pre - 1987.)	537
BALANCE		313
3.	Approximate number of deeds or letters of release entered into since 1987, including past litigants (see Table (3))	
	.. includes 8 cases where a court hearing commenced but where the matter was ultimately resolved by negotiation	256
BALANCE		57
4.	Number of matters that have finally been determined by a court.	3
5.	Dormant cases.	10
6.	Continuing action see Table (4)	44

* The PPL cases are not included in this table: 18 PPL cases have been settled, 6 remain outstanding

Source: Evidence, p. S431

TABLE 2**SETTLED WESTPAC AND PPL FOREIGN CURRENCY LOANS**

	Westpac	PPL*	Totals
Jan - June 1987	10		10
July - December 1987	18		18
Jan - June 1988	36		36
July - December 1988	50		50
Jan - June 1989	59		59
July - December 1989	26		26
Jan - June 1990	21		21
July - December 1990	5		5
Jan - June 1991	5	1	6
July - December 1991	11	15	26
Jan - June 1992	14	2	16
July 1992	1	-	1
Total	256	18	274

* Details of PPL loans are provided in respect of Westpac's open letter of March, 1991, and do not include settlements reached beforehand.

Source: Evidence, p. S432

TABLE 3**WESTPAC AND PPL FOREIGN CURRENCY LOANS AS AT 25 AUGUST 1992**

<i>Since May, 1991 Settled</i>	Westpac	PPL	Total
Settled by Negotiation	27 (3)	17 (4)	44 (7)
Settled by Mediation	2	1	3
Concluded by Litigation	1	0	1
Total Settled	30 (3)	18 (4)	48 (7)
<i>Status of Outstanding Cases</i>			
Under Negotiation	20 (5)	3 (1)	23 (6)
Litigation Continuing	25 (7)	3	28* (7)
Total Outstanding	45 (12)	6 (1)	51 (13)
Dormant **			
	9	0	9
<i>Likely Future of Cases in Litigation</i>			
Mediation/Negotiation Possible	22	3	25
Mediation/Negotiation Difficult/Unlikely	3	0	3

(Numbers in brackets represent approximate numbers of cases where borrowers have reopened settled matters. As indicated, some of these have since been resettled, some remain outstanding. The numbers are included in the totals.)

(* This number includes 10 cases where negotiated settlements have been attempted but where a solution has not yet been found and the litigation path has been followed. A negotiated settlement is expected to be reached in most cases.)

(** Dormant cases are those where no action has been taken by the claimant for a period of six months or more.)

Source: Evidence, p. S774

4.81 For example, the Committee has been made aware of a case, and there may be similar cases, which may not be considered to fall within the ambit of the MOU as it could be seen as a case which has been 'progressed through the court system to a full trial'. However, having had a successful court decision on the major questions of negligence, other matters flowing from that determination were in the process of appeal to the High Court on the questions of the quantum of damages. The appeal to the High Court was withdrawn in favour of pursuing mediation or arbitration. In the Committee's view this case, and other similar cases, can be seen as ones where there is a 'concisely and clearly defined issue' which would 'represent grounds for overturning any pre-existing court decision' and consequently, the Committee believes, should be subject to arbitration under the MOU.

4.82 The Commonwealth Bank has not put in place a formal dispute resolution or arbitration mechanism. Instead it has adopted a range of approaches in attempts to resolve disputes. The Bank stated:

... all executive and management levels within the Bank responsible for Foreign Currency Loan litigation matters are open to 'all and any' dispute-solving mediums/mechanisms, including the use of independent mediators where deemed appropriate.³⁶

4.83 As at 11 September 1992, the Commonwealth Bank had 41 cases outstanding, broken up into the following categories:

- . eight proceeding to formal mediation;
- . two awaiting response to offer of formal mediation;
- . six under written offer of settlement from the Bank;
- . four judgements which have been given in the Bank's favour, are in various stages of appeal; and
- . 21 in various stages of legal process but could move to mediation at an appropriate time.

4.84 The Bank indicated 14 matters had been settled since the Committee commenced its first hearings on the current review. The Bank stated it seeks settlement using direct negotiation with borrowers then, if necessary, formal mediation and, only where these methods fail, resorts to legal action.

36

Evidence, p. S162.

4.85 The Committee is aware of the efforts the Bank has made to resolve outstanding matters and understands the reasons for the range of approaches to settlement which have been taken. The Committee urges the Bank to endeavour to settle the outstanding claims in a responsive and flexible way without resort to legal technicalities.

4.86 National Australia Bank advised that it had resolved 26 claims involving foreign currency loan borrowers since May 1991. About a dozen formal claims currently were outstanding against the Bank. The Bank considered mediation was not an appropriate dispute resolution mechanism where the issue of liability remained open as the claims of both sides could not be tested by the mediator. Also the Bank referred to the small number of cases against it and considered the enforcement of a mediation process on it 'would disadvantage it in the comparatively few cases brought against the Bank and the small number of matters outstanding'.³⁷

4.87 It appears National Australia Bank shares the sort of misunderstanding of mediation referred to in evidence from Sir Laurence Street. Sir Laurence referred to a particular arbitration of which he was aware and which he considered was more appropriate for mediation. While one party was prepared to mediate the other was not. One of the Queen's Counsel appearing for the party which was not prepared to mediate told Sir Laurence later:

I am sorry that my clients would not go along with your recommendation for mediation, but I did not see how you could make any findings of fact without hearing the witnesses cross-examined.³⁸

As Sir Laurence noted, this was a misconception of the process of mediation as the 'mediator's role essentially is holding the ring for a party and party disclosures' not making findings of fact or attributing blame.³⁹

4.88 ANZ Bank has 26 outstanding claims of which 22 are being pursued by borrowers with action in the courts. The number of current outstanding claims compares with 39 claims as at 11 June 1991 of which 18 were being pursued by borrowers in the courts. While the number of outstanding cases has fallen significantly over the period, the number of cases being pursued in the courts has increased.

37 Evidence, p. S748.

38 Evidence, p. 455.

39 Evidence, p. 455.

4.89 ANZ Bank commented on the use of mediation to resolve outstanding claims:

The Bank does not support the appointment of an independent mediator or mediators in such matters given the different approach adopted by individual banks. We have considerable doubts that this form of mediation finally settles disputes. The Bank's approach has been to investigate disputes thoroughly and, based on the merits of the individual claims, settle it without resort to the legal process.⁴⁰

4.90 The settlement of matters by ANZ Bank is welcome, but the Committee notes a number of cases are outstanding and that most of these involve legal action. ANZ Bank may have avoided the opprobrium which some other banks have suffered as a result of the foreign currency loans saga and consequently not feel under the same pressure to resolve its remaining cases. However, the Committee considers the Bank should move to resolve its outstanding matters as a priority and consider all possible dispute resolution methods in seeking to settle cases.

4.91 Of other banks which responded to the Committee's review, only one indicated it had foreign currency loan matters which were in dispute and in this case there was only one matter unresolved.

4.92 Since the first hearings on the review, the two major banks involved in foreign currency loan disputes, Westpac and the Commonwealth Bank, have made a more concerted and sincere effort to resolve the disputes. This action is welcome. However, much of the adverse publicity surrounding foreign currency activities of banks could have been avoided had decisive action been taken at an early stage.

4.93 Some matters have been settled and others are in active negotiation. Westpac has developed a process through its MOU with the FCBA which should assist in resolving additional outstanding disputes. Some disputes remain in litigation. While the Committee generally would favour the use of the alternative dispute resolution mechanisms discussed earlier in this chapter to resolve these disputes, it is recognised that some matters will not be resolved in this way. The Committee considers those banks which have not looked closely at alternative dispute resolution mechanisms as a way of settling outstanding disputes should do so.

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Evidence, p. S245.

4.94 In relation to Westpac and the Commonwealth Bank, the Committee considers they should give high priority to resolving their outstanding disputes. Banks often complain about 'bank bashing' in media reports of such issues as foreign currency loans. The only adequate response by banks is to resolve the outstanding disputes and thus remove the source of criticism. While these matters remain unresolved, banks will be held in disrepute.

4.95 The Committee is aware of the difficulties created for some borrowers by the way in which some banks have conducted court cases. There was reference in the previous report to allegations from small businesses and foreign currency borrowers of banks abusing court processes by unnecessarily protracting proceedings and failing to ensure adequate discovery.⁴¹ The Committee viewed these allegations seriously. There was further evidence to this inquiry about the concerns of foreign currency borrowers regarding alleged abuses of court processes by some banks. These concerns emphasise the value of alternative dispute resolution mechanisms as means of settling outstanding foreign currency loan disputes.

4.96 As it appears largely to have been pressure from the Committee which has seen some banks adopt a more sensitive approach to settlement, the Committee considers its role in monitoring the implementation of this recommendation should continue. It would anticipate performing this monitoring role by seeking three monthly progress reports from relevant banks.

4.97 The Committee recommends that:

26. Westpac and Commonwealth Banks given high priority to resolving outstanding foreign currency loan cases on a fair basis and without reliance on legal or other technicalities;
27. the Committee have a continuing role in monitoring implementation of recommendation no 60 in relation to the resolution of outstanding disputes; and
28. all banks consider alternative dispute resolution mechanisms as means of settling outstanding foreign currency loan disputes.

41

A Pocket Full of Change, op. cit., pp. 264-65 and 330-33.

The Commonwealth Bank and the Nyngan Situation

4.98 During its initial inquiry the Committee received a large number of complaints about the lending practices in the 1980s of a manager, Mr Littlehales, in the Commonwealth Bank's branch in the town of Nyngan. It was alleged that Mr Littlehales' unorthodox lending practices were responsible for many rural borrowers overcommitting themselves and now facing massive debts as the consequences of the original lending has flowed through.

4.99 In its earlier report, the Committee concluded the lending practices of the previous manager were questionable, and that the Commonwealth Bank, as his employer and the body which approved the loans, had an obligation to address in a fair manner the problems which had resulted. The Committee recommended:

the Commonwealth Bank establish an independent mediator or panel acceptable to both the bank and the borrowers to mediate the disputes arising in the Nyngan region. This mechanism should include rural counsellors and should not affect recourse under the law which either party may wish to pursue. (Recommendation No. 59)

4.100 In its initial evidence, the Commonwealth Bank indicated of all customers who had transacted with the former Nyngan manager over the period 1982-6, 53 had been classified as having been or continuing to be in difficulty. Of the 53, 35 had been resolved since 1985. Eighteen cases remained outstanding. The majority of these were using the services of a rural counsellor or a Farm Assessment Scheme mediator.

4.101 CBA indicated that it endorsed the use of formal mediation for farm borrowers who found themselves in difficulty. It considered that some cases would benefit from a formal mediation process and use of the process would be encouraged where appropriate. CBA stated:

The Bank's experience is that numbers of customers find the presence of a third party can assist their development and evaluation of options, and assist in the presentation of proposals and their negotiation with the Bank.⁴²

4.102 In its most recent update, the Bank noted two of the 18 outstanding cases had been settled, one by mediation and one by direct negotiation following a failed mediation. In two cases mediation had been declined and a further case, which had been mediated, had not been resolved. Of the remaining 13 cases, 12 remained in active negotiation, the majority being assisted by a rural counsellor.

42

Evidence p. S160.

4.103 The Commonwealth Bank also defended itself against the Committee's criticism that it failed to take responsibility for the lending practices of its manager in Nyngan. Emphasising that the CBA accepted responsibility for the actions of its staff and with reference to evidence given by its representatives in Dubbo, the bank stated:

CBA's representatives had been discussing the adversity brought about by seasonal factors, falling commodity prices and high interest rates. The response by our representatives reflects that point in denying that the Bank was responsible for - to quote the Chairman, - 'the particular plight of Nyngan'. It was not intended as a denial of the Bank's responsibility for the actions of its staff.⁴³

4.104 During the course of the review, a number of Nyngan borrowers expressed dissatisfaction with the Commonwealth Bank's attitude to settlement of their disputes. It was alleged that the Bank did not want to involve itself in the mediation process unless it was made to do so.⁴⁴ In particular, it was stated in some submissions that the Bank had only sought mediation during April 1992 and not prior to that. CBA rejected this claim.⁴⁵

4.105 It was suggested by borrowers that the mediation process should be made obligatory on the Bank and that Sir Laurence Street or a panel headed by a person of similar expertise be appointed to undertake the mediation.⁴⁶ Borrowers considered rural counsellors should act only in an advisory capacity to the borrowers and not be appointed as mediators.

4.106 The Chairman of the Nyngan branch of the New South Wales Farmers' Association recommended the Federal government and not the Commonwealth Bank should establish an independent mediator or panel. The person or persons needed to be appointed from an outside source so as to ensure that they were independent of the parties involved.

4.107 In discussions with the Chairman in Dubbo in August 1992, borrowers claimed the Commonwealth Bank was considering debt write-off proposals only where borrowers agreed to leave their properties. By contrast some pastoral companies had agreed to debt write-off for borrowers.

43 Evidence p. S160.

44 Evidence p. S50.

45 Evidence p. 80.

46 Evidence p. S50.

4.108 While the Commonwealth Bank has made some progress in resolving outstanding disputes arising from the activities of its former manager in Nyngan, the Committee considers the special factors associated with the Nyngan cases require the Bank to adopt a sensitive and generous approach to these customers. It is clear much of the lending by the Commonwealth Bank at Nyngan was irresponsible and based on unrealistic expectations of the agricultural potential for the region. Based on evidence, the Committee recognises it was an aberration far beyond normal rural conditions. In view of these circumstances, the Committee wishes to keep the resolution of the outstanding Nyngan cases under continuing review.

4.109 In adopting a sensitive and fair approach the Committee would not expect the Bank to rely on legal tactics such as use of the statute of limitations. Also full discovery would be necessary as a pre-requisite to mediation or negotiation of disputes.

4.110 The Committee recommends that:

29. the Commonwealth Bank act without further delay to resolve outstanding Nyngan cases on fair and reasonable terms and without resort to legal technicalities or tactics; and
30. the Committee have a continuing role in monitoring implementation of recommendation no 57 of the Banking Inquiry Report.

General mediatory recommendation

4.111 The Committee made a general recommendation for mediation processes to be used more frequently in situations where disputes arose in a particular region or in relation to a particular issue (recommendation no 58). While this recommendation was made in the chapter on the rural sector, it could apply equally to disputes involving small business customers. As noted earlier in this chapter, small commercial customers currently do not have access to the Banking Industry Ombudsman Scheme and litigation is an expensive and frustrating avenue to follow to obtain redress.

4.112 In earlier chapters, the Committee has argued dispute resolution procedures for small business and farming customers should be incorporated in provisions of a Code of Banking Practice to cover these customers. This is considered a preferable approach to the establishment of an alternative institutionalised system for the mediation of small commercial disputes. Sir Laurence Street warned the creation of a standing tribunal to mediate commercial disputes was not in the interest of the negotiated consensus concepts embodied in mediation.⁴⁷

⁴⁷

Evidence, p. 457.

4.113 In addition to the dispute resolution mechanisms which will be available under the Code of Banking Practice to cover small business and farming customers, the Committee considers banks should use alternative dispute resolution methods, such as mediation, where appropriate. With this in mind the Committee would advocate a requirement for mediation or alternative dispute resolution to be included in contractual arrangements between banks and small commercial customers. As part of any dispute resolution there would need to be a full discovery of relevant documentation.

4.114 The Committee recommends that:

31. a requirement for mediation or alternative dispute resolution in the event of a dispute should be included in contractual arrangements between banks and small commercial customers.

