Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Submission regarding the Interim Report

Dr Rod Polkinghorne OAM 21st October, 2018

Dear Commissioner Haynes,

Thank you for the excellent work to date by yourself and your team. This submission relates to matters raised in your interim report and in particular to Agricultural Lending.

The matters I wish to address are:

1. **Unfair assertion of power**
   As succinctly noted in the Interim Report the gross imbalance of power between a major bank and a single primary producer with a distressed loan can, and does, invite behaviour that falls short of community expectations and also misconduct. From my experience with Rabobank the relatively unlimited power and resources of the bank are used to the full to intimidate, harass and persecute the borrower.

   To address this issue mechanisms are required to provide some counterbalance. These might include:
   - Compulsory mediation
   - Sufficient resourcing to allow Federal Government agencies, possibly the ACCC or Small Business Ombudsman, to act on the borrowers behalf
   - Limitations on actions that are allowed within banking loan contracts

2. **"Working out" of distressed loans**
   I strongly endorse the report (pp249) statement of "But the central ideas of treating working out as the best outcome and immediate winding up as worst, has evident application to the decisions that must be made when an asset management manager is considering how best to deal with a distressed loan to a farming business."The comparison to administration and deeds of company arrangement is also endorsed with the further observation that a joint endeavour by the borrower and lender is highly likely to result in a far more acceptable outcome for both.

3. **Compulsory Mediation.**
   I believe that compulsory mediation as raised by the report offers particular value at three potential points:
   - When a loan is first determined to be distressed
   - Prior to proceeding to appoint a receiver
   - Prior to a receiver or bank finalising a major asset sale

   Effective mediation at each of these points would offer far greater opportunity for options to be explored and in many instances vastly superior outcomes. From a borrowers

perspective it would also provide a desperately needed position of having an effective input into decisions that are far more personal and potentially catastrophic than they are for the bank. The personal trauma resulting from being deliberately kept in the dark, humiliated, persecuted and treated as unworthy of even base courtesies such as communication and advice of financial transactions is severe and potentially life threatening.

As also noted by the Commission "**arrangements that are proffered by lenders at mediation must be capable of practical implementation**". This is a critical observation that needs to be addressed through the Banking Code of Conduct or through law.

Consistent national legislation for compulsory mediation and associated conditions, together with clear principles to guide behaviour during mediation, would be a sensible outcome.

4. **Access to bank personnel**

The Interim Report notes the difficulty of establishing regular and effective contact with bank personnel, particularly where a loan has been passed to a special asset management unit.

In my experience this becomes impossible, not only due to physical distance, but by deliberate bank action to ensure no contact is possible; emails are not answered, phone calls are not taken and all communication comes at the borrowers high cost through an equally removed bank solicitor who is briefed purely to "enforce the action". The local manager who has had the predominant experience and understanding of the business is equally removed and prohibited from contact or involvement. As noted in the Interim Report "**without specialist knowledge and experience, managers in an asset management unit cannot make informed decisions about whether or how it may be possible for the agricultural business borrower to work its way out of the difficulties that have led to financial distress**".
In my opinion, and certainly in our situation, our local [redacted] manager had a solid understanding of the business at a detailed level arising from regular visits to the farm and other business units and could have provided useful input.

Arrangements, potentially within a mediation or post mediation structure where the local manager with detailed experience played a role in developing and overseeing agreed actions in conjunction with Special Asset Management and the borrower are highly desirable.
It is noteworthy that while all meetings with our local manager over many years were held at our Bairnsdale property or at our other business premises only one meeting with the credit manager was held and that was in Melbourne, and demanded.

Again this tactic acts to intimidate the borrower. There were no other meetings and the people calling the shots were cloistered in Sydney communicating through Piper Alderman. As noted correctly in the report "**The borrower will very likely see the negotiations as conducted with the lender holding a gun at the borrower's head**". In truth they are not negotiations, but simply meetings to demand an action predetermined by the bank.

5. **Appointment and direction of receivers**

The advice by Commissioner Haynes that the conduct of receivers falls outside the terms of reference is noted. However, the statement that "invariably, receivers and managers are appointed to act as agents of the borrower not the lender" (pp238) is far from the reality of how they view and execute their duties. The bank is the client, and a repeat client to be valued for understandable reasons.

While the receiver may be personally responsible, in my experience at least, they are directed in key actions by the bank and in ways which I believe amount to misconduct and fall way below community expectations. Again, in our case (my only direct experience), the bank directed actions that we had agreed with the receiver to be detrimental and against the interest of ourselves and, in our view, the bank. These were not trivial and included forced sale of the farm and our home $300,000 below a bank valuation obtained by the receiver and $1,000,000 below adjoining property sales in the same week. On several occasions we made recommendations to the receiver which were agreed as sensible but ignored/overridden after his consultation with Rabobank. The bank appeared to view the receiver appointment as a punishment with the only objective to "get things wrapped up" regardless of cost or return, and certainly in total disregard to any impact on the borrower.

Actions by the bank where they directly dictate actions by the receiver may warrant attention within the terms of reference. Might it also be worthwhile requesting an extension of the Commissions terms of reference to examine the actions of receivers given the extensive work already conducted and likely strong overlap of issues?

Our experience was a year prior to compulsory mediation being introduced in Victoria and certainly none was offered. The first notice was a phone call from the receiver to advise he had taken possession of the property, cattle and equipment. The introduction of compulsory mediation prior to appointment is again strongly endorsed.

6. **Limitation of recovery actions to asset recovery value**

As quoted in the interim report (pp240) "**The view from outside an appointing bank was accurately captured by the evidence of Mr Wheatcroft, a rural financial counsellor, when he said that 'the act of putting in a receiver never benefits a client [and] … in most cases it doesn't benefit the bank'.[1] As Mr Wheatcroft said, farmers see what happens in such a case as 'a massive destruction of value'.[2] And, judging from the great depth of feeling so obviously evident in farming circles, this view is widely held**" is pertinent and directly aligns with my experience.

Some changes to legislation, or to bank loan agreement conditions, might act to discourage the careless or deliberate destruction of value by a bank or their appointed receiver. In particular the current position of the bank being treated entirely different to all other

[1] Transcript, Chris Wheatcroft, 25 June 2018, 3105.

[2] Transcript, Chris Wheatcroft, 25 June 2018, 3105.

creditors on appointment of a receiver deserves consideration. When a receiver is appointed by the bank all non bank creditors are "frozen" with the amount owed remaining fixed. In contrast the bank continues to escalate its' debt, and at a rapid rate through penalty interest charges, fees and limitless expenditure for legal fees, including responding to any queries from the borrower and receiver costs. None of these are visible or contestable by the borrower, and in our case produced a never substantiated demand for over $500,000 (or 25%) beyond sale proceeds that exceeded the debt on appointment of the receiver. The net effect is that the bank is "in charge" and rapidly increases its' position as being the major creditor further facilitating aggressive and abusive bank behaviour. Furthermore the bank feels unconstrained in ruthlessly pursuing the borrower for any shortfall resulting from incompetent or deliberately rushed action that led to gross destruction of value.

Two options might reduce the incentive for the observed behaviour:

1. That the bank debt also be frozen on appointment of a receiver as for other parties providing an incentive to keep costs low and maximise returns through either a workout or more considered sale of assets.

2. That bank recovery be limited to receipts from sale of the mortgaged asset. The bank lends based on its' own or an agreed % of asset valuation and as a consequence should be an active partner in taking on risk limited to that able to be recovered by effective marketing of the asset in the case of farm property. If this was the case the incentive would be greater to maximise the return. The demonstrated alternative has been to trash the primary asset, ramp up excessive and unsubstantiated costs, and then seek to persecute the borrower by further legal action to recover an ever growing and unsubstantiated claim.

   The standard process of demanding every possible personal guarantee in addition to an agreed loan against the core farm asset is unprincipled and multiplies the intense pressure on a farm owner already dealing with the considerable trauma of having the farm seized. It is also unrealistic to expect a farm borrower to be able to effectively negotiate changes to bank loan agreements or to avoid personal guarantees given the associated extensive legal fees and imbalance of negotiating power when entering into a loan agreement.

7. Access to information

Aside from the debilitating experience of having to deal with bank appointed lawyers and often a receiver while simultaneously being stripped of all access to funds and consequent ability to engage professional assistance or council, further injustice and abuse of power occurs through withholding of critical information.

Crucial information includes property valuations and timely accounting of unidentified expenditure being charged to the borrower.

As a matter of principal any expenditure to be charged to the borrower should be openly disclosed in a timely manner together with associated instructions. Knowledge of property, stock and equipment valuations is core to establishing a position and if shared openly potentially useful as a base for discussion or mediation. Further there must be a right to challenge costs that appear excessive with potential to make these contestable.

Finally provision of detailed accounting records from a receivership or scheme of arrangement must be available to the borrower and provided prior to any attempt by the bank to take legal action to recover claimed shortfalls.

As an example, in my own case Rabobank solicitors issued a writ for $506,155.21 some five months after selling our property and without any accounting of how this amount was calculated. Prior to receiving the writ we could obtain no financial detail whatsoever, and no indication of a final position, despite repeated requests. As known asset sales from the property and livestock exceeded the original debt and some machinery assets still remained unsold to our knowledge this sum, and the immediate court action came as a severe and gut wrenching shock. The amount has never been detailed or substantiated.