Shadow Ledgers and the Default Process in the Australian Banking Sector

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Abstract

Media publicity regarding perennial conflict between small business/farmer borrowers and their bank lenders has in the last fifteen years brought forth an added dimension of that conflict – the phenomenon of a 'shadow ledger' system. Shadow ledger records have the peculiar status of denoting the authoritative debt claimed by the bank to be owing by a defaulted customer, readily acceded to by the judiciary in court litigation, but being unrecognised within the auditing and regulatory apparatus. The relevant regulatory agencies have declined to acknowledge the shadow ledger system and to confront its implications. Three case studies are outlined, as well as reference to other cases. The shadow ledger record forms one component in a parallel accounting system involving two sets of books by which the banks engineer default and foreclosure of borrowers following the establishment of the borrower as 'non-accrual'. At worst, that system has facilitated unconscionable practices against presumed failing customers being represented as legitimate practices before the courts. In the context of an impasse in regulatory oversight of financial sector unconscionability and fraud, the non-accrual accounting system of the banking sector deserves urgent attention.

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Shadow Ledgers and the Default Process in the Australian Banking Sector

Bank customers have perennially been in conflict with their lenders. Reportage has noted 'Evidence of the harsh treatment of customers by banks, including the inability of farmers and small-business people to get their statements, was given to the 1991 Martin banking inquiry and the 1997 Federal inquiry into fair trading conditions for small business' (O'Loughlin & Lampe 2000).[1]

From the mid-1990s, disgruntled former customers of the Commonwealth Bank of Australia ultimately achieved sympathetic press coverage (Cumming 2000; Lampe & O'Loughlin 2000). The phenomenon of 'shadow ledger' records and the (non)provision of bank statements to customers became the subject of an inquiry in August 2000 and report by the federal Parliamentary Joint Statutory Committee on Corporations and Securities (Chapman Committee 2000). The press continued its coverage (O'Loughlin 2000; Lampe 2000), ensuring atypical exposure of a minor inquiry and its hitherto marginalised subject matter.

The 'shadow ledger' terminology originates from the Commonwealth Bank of Australia (CBA); it is employed below as a generic label. The remaining three major Australian banks have their own descriptive names, with the National Australia Bank (NAB) describing this record originally as a Red Ink Memorandum Account, now a Bad Debt Memorandum Account.

The accounting system employed by banks subsequent to the default of small business customers is complex, secretive, and the source of distress that compounds the suffering associated with the former customer's loss of a business. The system has been neglected by the accounting profession, banking sector academics and regulators. Given that default accounting procedures are steeped in lack of transparency, the relevant professions' emphasis on the importance of transparency should make an examination of this issue desirable. Given that these procedures appear to have facilitated dubious practices by bank lenders, the relevant professions' emphasis on the importance of ethical standards in business practices should make an examination of this issue imperative.

This paper outlines the authors' understanding of the business customer default process by Australia's major banks, and the role of the shadow ledger record in that process. It then addresses the sale of customer assets as a key manifestation of the default process in operation. The lack of transparency of the default accounting procedures facilitates, as evidence by the documentary trail, potentially unconscionable or fraudulent practices in the disposal of customer assets – practices ultimately condoned in the courts. General coverage is complemented by three case studies, highlighting in detail the character of the default process and the role of the shadow ledger. The Parliamentary Inquiry into shadow ledgers and its implications is summarised, including coverage of

[1] The Committees produced the reports Martin (1991) & Reid (1997), respectively.

the rare bank defense of its usage. The three regulatory authorities are examined whose formal responsibilities include dimensions of the bank default process, highlighting that none of the authorities takes an active interest in bank default procedures and their possible abuse. Finally, a conclusion summarises the paper's findings, with a prognostication that current unsatisfactory elements of the bank default mechanism, in terms of process and outcomes, are likely to be replicated in the indefinite future.

The distinguishing character of the shadow ledger system

A shadow ledger record is brought into existence when a bank defaults a customer, of substantial import for small business borrowers.[2] During the period from default to closure of a customer's accounts through realisation of customer assets and disposition of net returns, the customer is subject to two parallel sets of records for each credit facility. Until about the late 1980s, these records in the NAB were drawn up manually, but the bank (as did others) subsequently computerised its bad debt processing.

All interest claimed by the bank would henceforth be recorded in the shadow ledger, at rates (typically penalty rates) determined unilaterally by the bank. Other debit entries include sums determined on a discretionary basis (asset sales; 'service' fees).

Conventional bank-customer accounts may be characterised as mainframe 'for value' accounts. Conventional accounts are updated on (and related statements issued from) the mainframe computer system. Such accounts involve monetary consideration – tangible payments and receipts are involved. Once the shadow ledger record is established, there are two sets of books running parallel in complementary fashion to record designated figures deemed necessary to finalise the default process.

All information recorded on mainframe accounts is subject to periodic reporting to the Reserve Bank of Australia, and of bank impaired assets accounts to the Australian Prudential Regulation Authority, but the shadow ledger system exists outside any external system of audit or regulation. However, figures produced within this parallel register are perennially accepted as authoritative within the courts.

Following the creation of the shadow ledger record, the bank will place a 'stop' indicator on mainframe accounts. Given that future interest payments will be entered on the shadow ledger statements, the mainframe accounts will no longer reflect the debt owing as determined by the bank.

The 'stop' indicator also means that the bank would no longer make available to the customer bank statements relating to 'for value' accounts. These statements have traditionally been marked, 'DO NOT POST - REFER MANAGER'. Such statements would normally be held on the customer's file.

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[2] The NAB default procedure is apparent from a discovered document in the Walter case (discussed below) from the Victorian State Credit Bureau to the Wodonga branch, 18 December 2000 (penciled label '492'). Titled 'Action Plan', the document simultaneously establishes non-accrual status, recording of the 'Z' label on account records, commencement of the bad debt memorandum account card (the shadow ledger), and a tentative bad debt provision.

The rubric printed at the bottom of the conventional ‘for value’ statement typically continues to be reproduced on the statements to be kept from the customers. The CBA version includes (the NAB version is comparable):

1. Please verify the correctness of the entries and notify bank of any errors. …
4. Please retain this statement for taxation purposes if required.

The practice of non-issue to the customer has also been followed for the shadow ledger statements. The instruction on a NAB Bad Debt – Memorandum Account record reads ‘Care: Do not issue statement without approval of Manager or Accountant. Maintain in alphabetical order in back of branch manual.’

The form of the shadow ledger statements itself has been variable and often deceptive. Some shadow ledger statements have as background a plain sheet; others are doctored bank stationery. Some have the character of a mainframe account statement. This last type will also reproduce the conventional rubric found on ‘for value’ statements.

Bank customers facing default who have managed to obtain either a ‘for value’ statement or a shadow ledger statement with this rubric affixed would naturally take the latter statements for normal bank statements. Customers have thus faced a conundrum – two statements for the same account and displaying different entries and thus residuals. Which is the accurate accounting? A reasonable answer is neither. Fees charged are discretionary; asset sales figures may be the product of manipulation; debit interest entries to the shadow ledger record are notional only.

The appended claim of relevance of statement content to ‘taxation purposes’ is illusory. The customer has no means of discerning what figures are relevant for purposes of submission of annual taxation returns. Having lost his/her business, the customer faces the added crisis of having no definitive figures to submit to the taxation authorities.

Sale of customer assets (and possible bankruptcy) as culmination of the shadow ledger system

Although many defaults no doubt would proceed smoothly, the parallel accounting system appears to have been a vehicle for arguably unconscionable practices against the borrower. An important component of such practices involves the manner of sale of customer assets, much of which have previously been taken as bank security.

The shadow ledger record is the immediate location for the crediting of the residual sum resulting from the sale of a former borrower’s assets, pending ultimate transfer to a mainframe account. Legal costs associated with the wind-up process have been arbitrarily handled. They would normally be debited directly to the realisation account; in some cases they may be debited initially to the stopped ‘for value’ account (as in the Walter case below). In rare instances (due to bank staff error) wind-up legal costs might be debited to the shadow ledger record.

Banks have consistently declined customer access to realisation accounts, the most important record for the ultimate lodging of a customer's constructed net residual debt.[3] Indeed, most litigants have no idea of their existence. Courts have either declined to demand or have ruled that there is no need for a bank to discover[4] its foreclosed customer's realisation account (c/f National Australia Bank v Freeman 2001).

The current default process can be utilised as a vehicle for sale 'under value' of a borrower's (or third party guarantor's) assets – a perennial practice. In the NAB foreclosure of the McMinn Gold Coast family childcare centre (Jones 2004: 11ff.), a 1996 registered valuer valuation put the expected value of the childcare complex (subject to completion of an addition) at over $2 million. After foreclosure, the McMinns obtained a contract of sale for $1.7 million which the receivers, acting for the NAB, refused to accept. The NAB sold the complex by closed tender for $1,180,000 in 2000. In the case of a mid-1990s Commonwealth Bank foreclosure of businesses owned by Dr Robert John Cooke[5], the CBA sold the borrower's assets for between $720-730,000, yet Cooke had obtained a registered valuer's appraisal which placed value on the business of $10.8 million.[6]

With NAB credit, the Somersets bought a strawberry farm outside Toowoomba in 1984 (discussed below) and were defaulted a year later. Successive valuations were corruptly inflated for purposes of the loan, and give no indication of the worth of the property. The 2-acre property was sold in 1989 for $165,000. The sale price was significantly under value – not for farming purposes, but for the ensuing close subdivision as the property was brought within the expanding Toowoomba boundaries.

The NAB foreclosed on the Walter restaurant/brewery family business at Albury-Wodonga in 2000 (discussed below), established at an approximate cost of $3.5 million. In 1998 the NAB placed a market value (for lending purposes) on the assets of $2.5 million. With the business not performing up to expectations, the NAB revalued the Walter security down to $2 million approximately 12 months later, recording that this lower figure was arrived at on a 'fire sale' basis. Subsequently the NAB's appointed receiver/manager, D'Aloia Handberg, sold the land and improvements and restaurant infrastructure in March 2001 for $1,061,000.[7] [8]

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[3] C/f. Malleson Stephen Jaques, NAB solicitors, to Rod Suthers, Troiani solicitor, 7 February 2001: 'Any "realisation" account that may be run by our client is an internal accounting procedure and is not relevant to the issues in dispute and as such, is not required to be disclosed.'

[4] 'Discovery' is used here in the legal sense – involving a litigating party's attempt to obtain documentary information relevant to the matter before the forthcoming trial.

[5] Medical Practitioner Cooke created and operated three emergency medical centres attached to hospitals in Cairns, Brisbane and Sydney.

[6] Report of David McGrane & David Harland, FINH, 22 December 2003.

[7] The receiver declined to attempt the best outcome for the Walters by selling the complex as an ongoing business. The brewery equipment, costing $750,000, was discarded. An NAB file note, dated 18 January 2001, records discussion between a bank officer and a D'Aloia Handberg principal as to the implications of sale of the Walter assets at $1.5 million. The note acknowledges that sale at this price would result in a net surplus to the Walter account.

[8] The purchaser at auction subsequently leased the property to another party (on 10-year terms for $1 million), who in turn exchanged the lease for one on a Queensland grazing property. The purchaser's lease sum was not significantly different to the price paid at auction. The sale price has allowed another party to henceforth enjoy rental income on a property in which he has no capital invested.

The NAB foreclosed on the Troiani brickworks at Bundaberg in 1999 (discussed below). The brickworks and related properties were sold in March 2000 for $3.132 million.[9] [10] It appears that the brickworks itself, on a 13.67 hectare site, comprised a mere $400,000 of that aggregated sale figure. Yet the 1996-97 financial accounts (the last audited accounts) have ‘property, plant and equipment’ of the brickworks valued at just under $27.5 million.

The lender can also facilitate sale under value by arbitrarily devaluing its customer securities prior to sale and providing a veneer of legitimacy to the ultimate sale. Of course, security valuation involves an element of discretion, subject to variation according to market conditions, but some devaluation cases lack rational explanation. In the 1998 NAB foreclosure of the Lynton Freeman Queensland grazing property (Jones 2004: 12ff.), NAB records indicate an initial 1992 market value for lending purposes on its sole broadacre security at $2,000,000; in the space of four years from 1996, the bank decreased the market value to $1,750,000, then to $1,500,000, to $1,400,000, to $1,260,000, then to $850,000, eventually selling its security for $770,000 after claiming $30,000 for selling costs.[11]

The process can further be used to appropriate and hive off part of sale proceeds. In the Cooke case, the bulk of the (under value) sale proceeds were not conveyed to the Cooke accounts. Given that Cooke equipment assets were sold at net $704,000,[12] an amount of only $34,452.26, representing roughly 5% of those proceeds, appears on the borrower’s shadow ledger record (labeled ‘Receiver’s Distribution’).[13]

Driving a former customer into bankruptcy prevents that customer from taking legal action against the lender (for the critical subsequent 3-year period). Following the NAB’s sale of the Somerset property in September 1989, the Somersets served a writ against the bank (and the former owner) on 22 December. Immediately in the new year, on 17 January, the NAB petitioned for bankruptcy of the Somersets, which was successful and which vitiated the Somerset writ. Bankruptcy status can be readily pursued if the customer is left with a residual debt after sale and realisation of assets. Sale of assets under value (or recording of less than sale value) is a ready vehicle for ensuring that a residual debt appears on the shadow ledger record.[14]

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[9] Malleson Stephen Jaques, NAB solicitors, to Redchip Lawyers, 4 April 2000.

[10] The Troiani brickworks was purchased by a consortium of individuals intimately associated with the brickworks itself, the ownership devolving to the firm’s solicitor and one of the brickwork’s regional agents.

[11] The valuations for $1.5 million (December 1997), $1.26 million (July 2000) and $850,000 (March 2001) were performed by Herron Todd White. Discovered NAB document (annotated D1-48, dated 14 April 1998) provides strong evidence that the devaluation process was contrived. The finance newsletter *The Sheet*, dated 18 February 2008, included a segment titled ‘Property valuers pressured into inflating prices’. The author noted: ‘Full valuation property valuers are routinely pressured by lenders to inflate the value of the property to aid in the bank approving the loan. … Brendon Hulcombe, CEO of Herron Todd & White, agrees “Yes there are, of course”, when asked if any of his valuers are pressured. “Valuers are pressured quite routinely”.’ An inference that the reverse process occurs when a bank wishes to realise on a customer’s assets is not implausible.

[12] Letters from receiver I R Hall of Coopers & Lybrand to CBA personnel, dated 7 August, 2 October & 16 October 1996.

[13] Ref: Cooke Mantle Pty Ltd, Bills Matured Account, page 12, date of issue 1 May 1999.

[14] See n.7 regarding the sale of the Walter family brewery/restaurant.

The operation is wholly under the control of the bank. The receiver/manager, regardless of who instigated the appointment, works in conjunction with the bank and not the customer. The bank's leverage is ironically enhanced because the courts hold to the risible fiction that the receiver/manager is an agent of the borrower while acknowledging de facto mortgagee control (c/f Muirhead v Commonwealth Bank of Australia 1996; National Australia Bank v Freeman 2001). Any discretionary or unconscionable process undertaken by the receiver/manager will be supported or condoned by the bank, yet held to be the ultimate responsibility of the borrower.[15]

The character of the shadow ledger system can be better understood in application. Three case studies are offered below, with a sample shadow ledger statement for each case reproduced as appendices.

Three case studies

The Somerset/Kabwand case

Edward and Joy Somerset moved in semi-retirement to near Toowoomba, Queensland, following success with broadacre farming begun on a soldier settlement (Jones 2004: 18ff.). In late 1984, they were inveigled to purchase a worthless strawberry farm of 2 hectares at an inflated price by the NAB branch manager and then owner who deceived them on the farm's productivity and returns.[16]

In the space of fifteen months from September 1984, the manager placed a series of market values on bank security for lending purposes of $260,000 (up from the previous $210,000) to $475,000 to $575,000 (the valuation necessary for the proposal to fall within the regional manager's delegated lending authority and on which the Somerset loan was approved) to $350,000 (subsequent to instructions to the manager to create a bad and doubtful debt return).[17] The Somersets walked off the property within a year in December 1985, and were defaulted soon after.

Shortly after retirement from the NAB, Salmon was employed as a consultant by the Somersets' legal advisers in the Somersets' dispute with the NAB (Kabwand/Somerset v National Australia Bank 1986; 1989)[18], thus acquiring intimate knowledge of the case. In court, counsel cross-examined the bank officer who perfected the security valuations. His Honour interjected, stating: 'a bank manager can place any value he

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[15] That the receiver/manager is de facto the agent of the mortgagee and not the mortgagor, contra to legal convention, is confirmed in the Walter family Bad & Doubtful Debt Report, dated 14 September 2001 (discovered document, annotated '651'), in which the bank's Asset Structuring unit confirms that the bank has given the receiver/manager a general indemnity in the face of litigation from the Walters.

[16] It transpired that the manager was a friend of the owner, who faced foreclosure of the property by the NAB. Vide Jeffrey Robert Cardell Senior in cross-examination by the Somersets' counsel: 'Was not most of your discussion with the bank manager in the terms of dollars? – No, not terribly. We were good friends.' (Kabwand/EJR Pastoral Co v Cardell & Ors 1986).

[17] With the $475,000 revaluation the manager also doubled the size of the property from 2 to 4 hectares. With the $350,000 devaluation the manager returned the property to its rightful size of 2 hectares.

[18] The Somersets, following legal advice, sued under s 52 of the Trade Practices Act. On appeal, they attempted to amend their plea to fraud, their original intentions, but were denied with the refusal of the bank's counsel to countenance the plea amendment.

likes on a bank security', or words to that effect.[19] This dictum cemented the Somersets' defeat in the courts.

The incomplete Somersets' shadow ledger records that became available (in those days manually updated, often sloppily rejigged, and partially unreadable) are in themselves unremarkable (Appendix 1). They show (notional) interest charges entered monthly (roughly $4-6,000 per month for the Instalment Loan and $2,500-3,500 per month for the Overdraft in Reduction account), along with 'service' charges. The records show the bank totting up up to $10,000 charges per month on a debt which the Somersets claim was engineered through fraud, now leveraged on an idle acreage. This 'running meter' record obscures the essential means, character and dimension of the process by which the Somersets lost the assets which they brought to the bank (net assets of over $1 million) and subsequently reduced to penury.

Significant dimensions of the Somerset shadow ledger record are as follows. First, the court was presented via affidavit with a debt balance taken from the shadow ledger record, and before customer properties were sold and bank securities realised. This balance was accepted as authoritative by the court. Second, the deceptive advice and manipulation of bank security values was the core of the problem and preceded default. The shadow ledger record merely crystallises the outcome of such practices.

The Walter case

A rare instance in which the bank shadow ledger process is exposed during litigation is that of the National Australia Bank v Walter (2004) trial hearing during May to July 2003.[20] The Walter family's Albury-Wodonga brewing and restaurant business had been foreclosed by the NAB in 2000 (Jones 2004: 7ff.; 2007).[21]

Ms Carmen Walter had been apprised by the authors of the existence of the shadow ledger record. Thus the NAB produced an 'expert witness' to explain to the court the bank's version of the system. NAB's legal services manager Athol James Aldous spoke to a signed 'Certificate Pursuant to Section 55B of the Evidence Act 1958'.[22] [23] Aldous stated in this Certificate that the amounts owing by the plaintiffs were identified from the Bad Debt - Memorandum Account (i.e. the shadow ledger).

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[19] Salmon was present in the courtroom as note-taker for the plaintiffs when this witness/judge interchange took place. The transcript of the proceedings does not include this significant interchange, indicating that the transcript had been doctored.

[20] Judge Dodds-Streeton disclosed belatedly in the hearing that she was the beneficiary of 8,000 shares in the NAB. At the then price of $30 a share, that holding would have been worth a not inconsiderable quarter of a million dollars. Her Honour also claimed a personal bank-customer relationship with the NAB. Her Honour declaimed that 'a fair-minded observer with knowledge of the material facts would not reasonably apprehend that I might not bring an impartial mind to the resolution of the questions to be decided in the proceedings' (National Australia Bank v Walter, 2004: par.199).

[21] The Walter family had been induced to migrate to Australia following advertising by the Victorian Government in Germany promising an ideal business environment. Initial NAB facilities were established indifferently by the then Wodonga branch manager; subsequently the bank imposed in December 1998, contra borrower requests, two facilities – an interest only loan of $1 million, and a principal & interest loan of $380,000 (drawing in family home mortgage as security for the business venture). The Walter accounts were immediately put on watch without the customers' knowledge.

[22] Bank discovered document labeled D35, dated 12 June 2003.

[23] National Australia Bank v Walter (2004), transcript pp.1330-85 (12 June 2003) & pp.1400-53, 1457-80 (17 June 2003).

Aldous' explanations regarding the NAB'S default procedure, distilled from the court transcript, follow:

> (i) When a borrower's account is determined as 'non-accrual', the 'DO NOT MAIL' notation appears on the statement and from that moment on, and the statement is not issued to the customer. No interest and fees are henceforth charged on that account. The account is frozen [to the customer]. Nobody sees these bank documents except for bank internal purposes.[24]
>
> (ii) Once the account ceases to attract interest and fees, the account would then be given a 'Z' indicator which confirms these actions.
>
> (iii) If a customer wanted a statement, detail would be taken from the shadow ledger, created from the bad and doubtful debt record. That account would show ongoing (claimed) interest and fees, etc.[25]
>
> (iv) The memorandum account card is not a statement. It is a record of what the borrower would owe if interest and fees were to be calculated.
>
> (v) The transcript records that the shadow ledger is a record only and that no real money is put into the account. It's a book entry. It is also confirmed that write-offs have nothing to do with the shadow ledger.
>
> (vi) The shadow ledger was previously compiled in manual fashion and generally it is now compiled on an Excel program. The interest is automatically calculated by the system. The program will key in the last business day of the month so that interest can be calculated.
>
> (vii) The Certificate of Debt has been calculated and arrived at from detail on the shadow ledger. The certificate is amplified by the statement to the effect that the amount is accurate to the best of his knowledge and belief.

In general, the outline given by Aldous confirms the understanding of the shadow ledger system as outlined above. Aldous merely states the character of the system without offering a defense.

The facility of the shadow ledger record to hide a dubious asset sale process is in evidence in the Walter case. The NAB's receiver/manager, D'Aloia Handberg, sold the land and improvements and restaurant infrastructure on 2 March 2001 for $1,061,000 (as noted above). The sum of only $600,000 was remitted by the receivers to the bank. Proceeds were distributed in the two shadow ledger records associated with the 'interest only' account and 'principal & interest' account, respectively, at roughly $303,000 and $297,000, which left both accounts in deficit.

The Walter 'interest only' shadow ledger is instructive (Appendix 2). Virtual interest owed is accruing at draconian penalty rates; draconian administrative charges are

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[24] Aldous is here referring to the 'for value' accounts.

[25] Aldous refers generally to 'accounts'. However, the shadow ledger incorporates notional figures and is not an account.

applied; and there is a set-off in June 2001 from the partial proceeds from the restaurant sale three and a half months previously.

The receiver/manager claimed 'payments and expenses' associated with 'running' the business and engineering its sale (over 3 months) for the sum of $719,476.[26] Moreover, the NAB's witness (Aldous) informed the court that the NAB had also deducted a $250,000 fee, representing a 'discharge and document preparation fee'.[27]

In her judgement, Dodds-Streeton J deferred to the claims of the NAB's legal services manager. She claimed that the allegations of the Walters concerning the shadow ledger 'are without foundation' (National Australia Bank v Walter 2004: par.264). Her Honour claimed that the shadow ledger processes 'are explicable by legitimate internal record keeping and accounting requirements' of the NAB. Dodds-Streeton further states: 'The differences identified by the Walters do not constitute evidence of absence of consideration, inaccuracy, deception or other legal impropriety. There is no basis for the allegation that the NAB was "deliberately misleading to conceal a wilful deceit of the real transactions to the detriment of the Walter Family and their associated Trust or Company".' The judge offers no argument nor precedents for her refusal to consider the plaintiff's claims.[28]

The NAB controlled the sale of the Walter family assets. We infer from the evidence that the sale took place on terms that generated a residual debt, recorded on the shadow ledgers (in turn legitimised by the court), so that bankruptcy proceedings could take place in due course - which they did.

The Troiani case

Sante Troiani was Managing Director and with his wife, Rita, majority owner of their Bundaberg-based company, Wide Bay Brickworks Pty Ltd (WBB). Troiani had reconstructed a defunct brickworks from the mid 1970s, turning it into a successful and innovative enterprise by the early 1990s.[29] The business was foreclosed in 1999. We have inferred from the documentary evidence that the Troianis have been the victim of an engineered defalcation of their business from the outset of their banking relationship with the National Australia Bank in 1993.

Document discovery for this case was derisory. The NAB sought Summary Judgment against Sante & Rita Troiani as Third Party Guarantors in the Supreme Court of

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[26] The figures are extracted from a 2-page statement, lacking identification notation and date, presumably from D'Aloia Handberg to the NAB (annotated 'D44'). The significant sum representing the receiver's 'payments and expenses' is not broken down or defended. This sum exceeded the gap of some $461,000 between the sale revenue and the allocation to the Walter accounts.

[27] National Australia Bank v Walter (2004), transcript pp.1428-29. There is no record of this fee on Walter customer account statements in the authors' possession.

[28] Apart from Walter, only two cases have had the issue of the legitimacy of the shadow ledger record mounted in the court (Heinrich v Commonwealth Bank of Australia 2003; Timms v Commonwealth Bank of Australia 2004). In both cases, the plaintiffs were belatedly apprised of the shadow ledger phenomenon by external consultants. In all three cases, Heinrich, Timms and Walter, the judge decided for the bank on the presumed legitimacy of the bank-certificated quantum of debt. The character of the bank default accounting system is ignored and is rendered, de facto, irrelevant.

[29] At the time of the move to the NAB in 1993, WBB had a turnover of $12 million, employed 130 people and was recognised as a major industrial concern in Queensland.

Queensland. The NAB was awarded a decision in its favour on 19 March 2001, formalised on 22 March, without the NAB being compelled to discover its WBB file documents. The WBB records were in the hands of the receivers, unavailable to the Troianis. Even the transcript of the hearings was subsequently destroyed. The NAB had the Troianis declared bankrupt in 2002.

This case is distinctive in that the NAB implemented a de facto default structure in February 1996, unbeknown to Troiani as managing director. Formal demand was not issued until August 1999, 42 months later. During that time the NAB ran parallel mainframe accounts and shadow ledger records for WBB's two main facilities, unprecedented in bank default cases.

Sante Troiani moved his business to the NAB in 1993 after much importuning by the NAB's Bundaberg manager (and an inducement in the form of a small business award from the NAB itself). In November, the NAB approved a welter of facilities for WBB, the two main ones being a 'multi option facility' at $7,450,000, and a 10-year leasing facility at $8,400,000 (grossed up to $13,500,000 with interest). The leasing facility was to finance a 'state of the art' kiln that Troiani was importing from Italy. The multi option facility was a minefield of complexity, and was the key means by which Troiani was defaulted and defrauded.

This complex facility began life as a bill facility, commencing immediately in November 1993 and becoming fully drawn by May 1995 at $7,450,000. The bank subsequently converted the bill into two 30 day bills, for $3,450,000 and $4,000,000. The bank declined to roll over the two bills in early 1996. Instead, the sums were debited in February and March 1996 to a new account labeled 'Wide Bay Brickworks Pty Ltd No 2 Account'. This change meant that previous contractual arrangements had been voided unilaterally by the bank.[30] One infers from this documentation that the bank had determined before February 1996 to foreclose on WBB, a little over two years into a long term lending commitment by the NAB. WBB's accounts subsequently become chaotic. The chaos appears to be due to the fact that the NAB had put WBB into default de facto while maintaining a façade of business as usual. The accounts are structured as if the customer has been defaulted, but the business remains in operation and is paying interest (for a time) and reducing debt.

Much of the character of No 2 account indicates that the customer has been determined as non-accrual. The space intended for direction of dispatch indicates 'DO NOT MAIL REFER MANAGER'. Statements also record a 'Z' indicator in the top right hand corner, which conventionally means that the account ceases to attract interest and fees.

However, contrary to the 'Z' indicator, interest was charged and drawn from the WBB operating account from March 1996 to June 1997.[31] As per non-accrual convention, the interest paid is not recorded on the No 2 account statements. The account's

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[30] The character of the account bears no relation to any standard bank facility. The ambiguous character of this account is reflected in its chameleonic titling – in correspondence, variously labeled 'Overdraft No 2 and/or Bills', 'Bank Bills', and, upon final demand, an 'Overdraft in Reduction Account'. The fundamental divergence between a bill facility and an overdraft in reduction account implies that, if the mislabeling is due to incompetence, it is incompetence on a substantial scale.

[31] There is a curious non-rational round robin process by which the Cash Management Account, itself funded by the operating account, then reimburses the operating account for the interest payments.

principal function was to log transfers from the company's Cash Management Account for the reduction of the No 2 account's principal (pending the formal issue of default). The bank had required the company to set up the Cash Management Account, with regular deposits from its operating account, as a pool from which bank officers could draw irregular transfer sums at their discretion.[32]

Simultaneously a parallel shadow ledger record was created for the No 2 account (confirming de facto default). Several overlapping statement pages bearing no formal identification, with entries from February 1996 to February 1999, were made available to Troiani's solicitor in early 2000. The earliest page is merely a blank sheet (Appendix 3). Because the pages were faxed (to a WBB staffer), the pages bear the fax imprint 'FROM NAB BUNDABERG BBC' or 'Bundaberg BBC 4-368'. The last two pages are of a standard NAB format, typically used for issue of emergency statements.

Formally, a shadow ledger record logs virtual interest (interest foregone) on a debt incurred by a business no longer generating revenue. But WBB in operation was paying real interest on the No 2 account debt; 'appropriately' the real interest payments for the first 13 months of interest payments are not recorded on the shadow ledger statement. Thus neither of the parallel records for the No 2 account records these interest payments on the debt. Three months of real interest payments are recorded on the shadow ledger statement for April to June 1997. This phase was possibly due to a mistake by a bank officer not apprised of the inconsistent status of the WBB account.

From July 1997 until foreclosure, 'interest' (amounts ranging over $38,000-42,000 per month) continue to be debited to the shadow ledger record, but no corresponding withdrawals from a mainframe account exist. Thus, interest payments are real for 16 months (with the last three recorded 'inappropriately' on the shadow ledger statement), but from July 1997 until foreclosure, interest is notional, as is appropriate for a business subject to non-accrual status. WBB, however, remained in operation.

On 9 April 1997 the shadow ledger statement is credited with a sum of almost $645,000 (coupled with a later $20,000 deposit) arising from the forced sale of a WBB property. However, the 1.4 hectare property (WBB's engineering shop on Enterprise Street across the road from the brickworks) sold for $760,000 on 4 March. The remaining $95,000 is formally unaccounted for. Moreover, the certified valuation of the property was $1,100,000.[33]

The same statement page shows a debit on 24 April 1997 of $28,704, described as a 'KPMG fee', yet KPMG delivered no services to the company.[34] The same entries are also made on the parallel No 2 statement itself, albeit merely as 'transfer' and 'miscellaneous debit' respectively. The shadow ledger is taken as the defining record for discretionary entries.

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[32] C/f Barry T Byrne, Bundaberg manager, NAB, to Troiani and others, 16 October 1996.

[33] The property is one of 13 subject to certified valuations by either Maddern Valuation Services or Herron Todd White (Hancock Sawyer Corpe to Ernst & Young, acting for WBB, dated 22 April 1996), with a market valuation of $1,100,000 and 'forced sale valuation' of $1,000,000.

[34] A letter from the NAB, dated 16 October 1996, demanded that KPMG be hired to process the sale of non-core assets, and that WBB will 'continue to pay $10,000 per week to KPMG until such time as the debt owing to [the bank] is paid in full'. Troiani resisted this demand.

Again, contrary to convention, the No 2 account shadow ledger displays a series of credit entries, labeled ‘Repayment’. The irregular transfers from the company’s Cash Management Account to the No 2 account, to reduce its principal (as noted above), have also been credited to the shadow ledger record.

The NAB issued its Formal Demand Notice dated 4th August 1999 for the sum claimed due on the No 2 account, $6,278,936.40, formally transposed from the shadow ledger record (the final shadow ledger statement was never discovered). However, the balance recorded on the final statement of the No 2 account as at 4 August 1999 is $3,160,673.76, some $3,118,000 less than that shown on the Formal Demand Notice. A discretionary partial bad debt write-off of $2 million was credited to the No 2 account on 29 March 1999, which leaves $1,118,000 unaccounted for.

The mainframe leasing statements were included in an affidavit filed on 2 March 2001 by the NAB Asset Structuring Manager for the Troiani Summary Judgment hearing. The most striking disclosure was that the NAB had credited the WBB leasing account on 22 May 1996 with $3,984,550.90, marked as a ‘Rebate’. This credit reduced the balance from $11,759,320.04 to $7,774,769.14. The bank reversed the ‘Rebate’ three years later on 28 May 1999 (‘RVSL Rebate’), with foreclosure imminent (Appendix 4). This reversal increased the balance outstanding from $4,060,425.79 to $8,044,976.69.

When Salmon brought the rebate to Troiani’s notice in late 2004, he surmised that the sum possibly represented the proceeds from a federal government development grant associated with the ultra-modern kiln. Troiani had given the paperwork to his auditor for completion and submission and had heard nothing further. In June 2005, Troiani made a formal complaint to the Queensland Police alleging that the NAB had misappropriated the rebate sum (as above). The bank replied to the Police as follows:[35]

> By May 1996 the lease facility was classified as “non-performing”. As a result the bank would normally apply an internal entry to the facility representing the future net income we expected to forgo if the realisation of the facility was to occur. … It is important to note that the customer has no entitlement to any such reduction in the facility balance and it represents a purely internal entry in the financial accounts of the bank. … By 28 May 1999, after extensive negotiations, the facility had been receiving regular payments. The entry on 28 May 1999 simply reversed the early entry …

The bank had also brought a parallel shadow ledger record into play for the leasing contract. On 1st April 1999, the NAB faxed (to a WBB staffer) a one page statement with respect to the leasing facility from commencement to 31 March 1999. There is no identification (save for the NAB fax imprint). This page constitutes the shadow ledger statement for the leasing facility (Appendix 5).

The leasing shadow ledger statement has no entries pertaining to the rebate and rebate reversal. The balances on the mainframe leasing statements and the shadow ledger statement thus diverge by almost $4 million over a three year period. The ‘Current Arrears’ column is instructive. It indicates that an expanding arrears was rectified by

[35] Arthur Stalley, Major Fraud Investigation Group, Queensland Police Service, to Troiani, n.d. (August 2005).

April 1996, and that regular repayments (with one exception) were made from that time. The bank's explanation of the rebate and rebate reversal is curious; moreover, the timing of these two entries is incompatible with the explanation.

The mainframe statement pages also highlight that the bank brought the account to a 'zero' balance by recording a write-off amounting to $4,775,540.30 on 15 August 2000.[36] [37] The write-off, as per banking convention, does not appear on the shadow ledger statement. Which is the 'true' record?

WBB's assets relevant to brick manufacturing comprised at least six properties in Bundaberg; moreover the Troianis were the registered proprietors of at least eighteen other properties (comprising 40 individual lots) throughout Queensland. Troiani was forced to sell these properties on an ongoing basis (albeit most property disposal was engineered by the receiver/manager). The parallel accounting system at its most flexible has facilitated the loss by the Troianis of their considerable assets, both business and personal.

The Parliamentary Inquiry and Report

As noted, customer pressure and media publicity elicited a Parliamentary inquiry, albeit narrowly delineated. The inquiry was a cursory one day affair (16 August 2000), and its report, *Report on 'Shadow Ledgers' and the Provision of Bank Statements to customers*, a mere 11 substantive pages (Chapman Committee, 2000). The inquiry heard and received complaints from those claiming to be (or representing) victims of the Commonwealth Bank, and heard and received explanations from CBA spokespersons defending their practices.[38]

The key complainants were the couple Bruce Ford and Wendy Murray and the then Financial Services Consumer Policy Centre. The FSCPC had surveyed rural borrowers in particular, with responses highlighting a systemic problem. Ford and Murray were themselves the victims of the CBA's dismantling of the Commonwealth Development Bank in the mid-1990s, and their frustration in attempting to understand the limited and inconsistent information disclosed by the CBA led to them becoming advocates for small business maltreatment by banks in general. Ford and Murray have been instrumental in putting the 'shadow ledger' phenomenon onto the investigative agenda.

The complaint particulars were neatly summarised in one FSCPC submission (FSCPC, 2000: 2). A typical dispute results in the following. Bank statements were not received and their issue refused by bank officers. Those statements that had been received accidentally were inconsistent – customers received a mixture of mainframe and shadow ledger statements with the customers in ignorance that a dual accounting system existed. As a consequence, the customers reported difficulties: the reigning

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[36] The effected write-off is some $60,000 in excess of the (contrived) final debit balance of $4,715,000.
[37] Two entries arising during the period of receiver/manager control after August 1999 conclude the statement – an unexplained credit of over $1,900,000 labeled 'termination' appears in April 2000, and a credit arising from asset sales of almost $1 million appears in July 2000. No detail of receiver/manager activity, in disposing of the Wide Bay Bricks business and assets and the bulk of the Troianis' other properties, was ever advised to the former Managing Director.
[38] In a submission to the Inquiry (Salmon 2000), Salmon recommended that the inquiry be widened, particularly to cover all four major banks. The recommendation was not taken up.

interest rate was not known and unjustified; fees and charges were not known and unjustified; budgeting was difficult, and the completion of tax returns was impossible.

The Inquiry is the only occasion on which any bank has offered a defense of the shadow ledger system. The bank variously claimed that non-disclosure was standard commercial practice; that its practices were dictated by external standards and regulatory bodies; that the complainants had broken their contract and thus had no rights; and that, in any case, the issues were relevant to only a very small number of customers. The bank's approach is encapsulated in the specious response to the claims of non-issue of statements (cited in Chapman Committee, 2000: 5):

> … when dealing with an impaired loan, the relationship between the bank and the borrower may be vexatious. The Borrower may dispute the amount owed and the Commonwealth Bank may cease to issue statements as in the past there had been little purpose in providing information that the customer may perceive as incorrect and may further inflame the dispute that may be in place between the customer and the bank.

To take the bank's claims in order. The claim that non-disclosure is standard commercial practice is correct, but indefensible. The claim that the practices are dictated by external standards/regulations is incorrect. That customers who break their contracts have no rights is of dubious legality; moreover, it is evident that many customers are defaulted on bank initiative. Finally, the claim that only a very small number of customers is involved is incorrect. The inference is that the bank deliberately misled Committee members.

The Committee's report is desultory. The Committee decided that the CBA's use of shadow ledgers was not wrongful or unlawful (Chapman Committee 2000: 9ff.). However, the Committee did claim that the bank's non-provision of statements to customers was 'seriously flawed in terms of best practice customer relations'. The Committee majority recommended that the bank offer mediation to affected customers 'where appropriate'. No mechanisms were proposed that would ensure that the CBA altered its behaviour. In particular, the Committee declined to put the shadow ledger phenomenon in its larger context, in spite of the evidence inviting it to do so.

The Commonwealth Bank gave its word that it would send out statements from 1 January 2001. Twelve months after the Parliamentary Committee hearing, journalist Anne Lampe wrote (Lampe 2001a): 'But none of those who appeared has had his or her problem resolved. None has been offered compensation. None has received back statements.' Foreclosed South Australian farmer Stephen Heinrich wrote to Senator Chapman in July 2001, claiming that he had received no statements from the CBA, that correspondence with the CBA's Mr Ullmer had not been answered, and that previous correspondence with Chapman himself had not been answered.[39]

In July 2001 ABC Radio interviewed key protagonists of the Chapman Committee inquiry (Australian Broadcasting Corporation 2001). The CBA's Michael Ullmer claimed that 'the inquiry reached a unanimous view that the bank had done nothing

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[39] Stephen G. Heinrich to Senator Grant Chapman, 31 July 2001.

improper. It is important to have that clearly understood'. The bank had evidently determined that it was to be business as usual.

Shadow ledgers were again in the news in mid-2007 when a long-aggrieved CBA customer gained intercession with the bank via her local Member, the Treasurer Peter Costello (Gluyas 2007a). Melbourne businesswoman Lana McLean claimed that the CBA failed to provide her with statements in her failed case against the bank in early 2001, only months after the Parliamentary Inquiry. The issue was revisited by the Parliamentary Committee, implicating the Australian Securities and Investments Commission, and it is to the relevant regulatory authorities that we now turn.

A permissive political and regulatory framework

The formal briefs of various regulatory authorities should facilitate awareness and critical examination of the banking sector's non-accrual accounting system. However, none of the relevant authorities has displayed concern for this issue in their regulatory involvement in banking practices.

The Australian Prudential Regulation Authority

A formal regulatory framework exists for the treatment of bank secured assets designated as non-accrual, centred on the Australian Prudential Regulatory Authority. The structure is elaborate, but ultimately permissive of bank discretion.

The newly created APRA assumed the statutory role of overseeing the viability of 'deposit-taking institutions' from the Reserve Bank of Australia in July 1998. It is APRA's duty to establish and enforce a uniform regulatory regime for bank oversight of asset quality, credit risk and treatment of impaired assets.[40]

The APRA credit risk management guidelines are elaborate but their conception suffers from two key weaknesses. First, the spirit of the guidelines presumes a banking practice culture rooted in rationality, competence, diligence and integrity. Yet these elements are perennially missing from bank lending practices. The RBA/APRA guidelines were developed to prevent recurrence of the irresponsible lending practices of the late 1980s (culminating in massive bad debts for the banking sector), but regulatory personnel have not sought to inquire to what extent a culture conducive to such practices persists as a natural element of financial deregulation.

APRA's brief is oriented to institutional stability and viability; in pursuing this goal it prefers an arms' length stance. APRA could possibly claim that this stance has been validated, given the long-term decline in the impaired assets ratio.[41] But an incautious

[40] The Australian Prudential Regulation Authority issues preferred guidelines for the recognition and measurement of and provisioning for assets to be designated 'impaired' (Australian Prudential Regulation Authority 2006a). The guidelines are the product of a succession of revisions to a code originally formulated in 1993 by the Reserve Bank (Reserve Bank of Australia 1993). The RBA guidelines promulgated a quarterly statistical collection and reporting, to be put into practice by the banks beginning financial year 1994-95. These figures are available on the RBA website under Statistical Tables: Assets and Liabilities: Banks – Consolidated Group Impaired Assets – B5.

[41] Impaired assets as a percentage of total assets declined dramatically from 6.91 per cent in March quarter 1992, following the early 1990s recession (RBA figures, personal communication) to 2.54 per cent in September quarter 2004 (the beginning of the reported series), then steadily to roughly 0.19 per

drive for market share has remained, increasingly coupled with an uncritical imperative for staff reductions and/or staff rotations, especially at the 'coal face' of customer interaction. Credit risk control will be neglected at the front end (loan facilitation, quantum and terms) and loaded onto the back end when problems arise, and at the customer's expense. The domestic reflection of the global financial crisis of 2008 embodies the adverse consequences of these practices. It is salutary to note that APRA directs that (Australian Prudential Regulation Authority 2006a: par.33):

> Reliance on collateral must not:
> (a) be a substitute for an appropriate assessment of a party to a facility, in particular, the party's ability to meet its contractual obligations; or
> (b) compensate for insufficient information about a party.

Given that asset security is the *sine qua non* of bank lending, this directive would be contravened by banks on a systematic basis.

The second weakness is that APRA is formally concerned with the quantum of impaired assets but apparently indifferent to how banks account for this quantum. APRA guidelines note (Australian Prudential Regulation Authority 2006a: par.29):

> … Whenever estimates of future income flows on a facility are set to zero, or an ADI [authorised deposit-taking institution] otherwise suspends interest or other income from facilities, the facilities must be reported as non-accrual facilities, for the purposes of the Prudential Standard.

However, APRA declines interest in how the banks record procedures relating to non-accrual facilities. There is no acknowledgement of nor interest in the parallel 'shadow ledger' system by which banks 'administer' bank-designated impaired assets.[42]

APRA's impaired asset guidelines have become more elaborate with each revision since their initial formulation in 1993. Yet embedded in successive guidelines is the admission that objectivity is an elusive goal. For example (Australian Prudential Regulation Authority 2006b: par.5):

> Recognition and measurement of impairment in practice cannot be based totally on formulas or rules. … The scope for exercise of discretion in assessing impairment must be prudently limited and documentation should be in place to enable an understanding of the procedures and judgements which are exercised by management.

An earlier version is more explicit (Reserve Bank of Australia 1995: par.9):

> the key element of the definition [non-accrual items] requires that banks place on a non-accrual basis any facility where there is reasonable doubt about the collectability of principal and/or interest, irrespective of whether the customer concerned is currently in arrears or not. This element of the definition

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cent during 2006-07. However, the financial crisis has resulted in the ratio rising to 1.18 per cent in December quarter 2009 (see previous n.).

[42] Replies by APRA staff to letter inquiries by Salmon, 19 April & 14 July 2006.

> acknowledges the reality that recognition of impaired assets will always have a high degree of subjectivity attached to it.

Tellingly, one factor allowing a facility to be 'regarded as impaired' reads: 'a write-off has been taken on a facility even if the facility is not in breach of contractual requirements.' (Australian Prudential Regulation Authority 2006a: par.24).

Thus a bank has absolute discretion to decide to place a facility on a non-accrual status. APRA guidelines do not envisage that banks may be 'trigger-happy' in the declaration of non-accrual status on facilities of viable or potentially viable businesses. The cases outlined here support the latter prospect.

The Australian Taxation Office

The tax treatment of revenue associated with bank impaired assets is shrouded in mystery. No light was shone in the Australian Taxation Office's submission (a nugatory three pages) to and cursory appearance before the Chapman Parliamentary 'Shadow Ledgers' inquiry, some of which was *in camera*. The ATO eschewed acknowledgement of the shadow ledger phenomenon, and its taxation implications.[43] For the ATO, as with APRA, a bank's decision to put a borrower onto a non-accrual status is its own business – a 'commercial consideration'.

The opportunity for banks to make partial bad debt write-offs has enhanced dramatically the taxation dimension in the banking sector's discretionary default and foreclosure process.

Until February 1992, banks could claim a deduction for bad debt write-off only after they had realised all assets held as security against their foreclosed borrower. Banks might make a partial bad debt write-off, but no tax deduction could be claimed. The omnibus Taxation Laws Amendment Act (No 3) 1992 passed the House of Representatives on 28 May and the Senate on 17 June. The amendment enabled banks to effect a partial debt write-off and to claim an income tax deduction on that amount.

The amendment had its origins amongst a grab bag of policy offerings in the document *One Nation*, presented by the new Prime Minister Paul Keating as a pragmatic vehicle to pull the Australian economy out of recession. The Labor Government defended the proposal thus (Keating 1992: p.77):

> … uncertainty in the [taxation law in relation to bad debts] may give creditors [banks] a tax incentive to resort to complete foreclosures … in order to obtain recognition of losses from bad debts for tax purposes. That is, businesses may be forced into liquidation because of taxation considerations, with consequent lay-off of employees, rather than being allowed to trade their way out of difficulty. The Government will legislate to ensure taxpayers [banks] who can claim deductions when they write off bad debts will be able to claim deductions for partial debt write-offs …

43 The submission appended several Tax Rulings of potential but unexplained relevance – that interest accruing on loans deemed non-accrual is not treated as assessable income (TR94/32); and a bad debt write-off is considered eligible as a tax deduction under certain (indiscernible) conditions (TR92/18) (Australian Taxation Office 2000).

This peculiar amendment passed through both Houses of Parliament without debate, save for a comment from Democrat Senator Kernot: 'The bad debts provision is not opposed by the Democrats, although there is no evidence that it has achieved the avoidance of bankruptcies and foreclosures as was claimed at the time of One Nation.'[44] Senator Kernot's impression is apt – the Government's explanation is misleading. The amendment appears to have been a sop to the banks (Westpac was close to bankruptcy) rather than a concession to at-risk businesses. No subsequent reference has been made to this concession by any regulatory authority. The revolutionary impact of the change on non-accrual status decisions (APRA's concern) and on taxation liability (the ATO's concern) has gone undocumented and un-analysed.

The size and timing of a partial bad debt write-off is at the bank's discretion. The amount will be 'credited' to the defaulted customer's 'for value' loan account. The write-off is never recorded as a credit transaction on the bank's shadow ledger record, providing one key reason for the divergence of the balances entered in each system.

In the Troiani case, the NAB made a partial bad debt write-off of $2 million on a $7,450,000 facility (then standing at $5,200,000 debit) on 29 March 1999. This timing compares with a time line of the informal determination of non-accrual in February 1996, the issue of formal demand in August 1999, and the finalisation of the process in January 2005. The size and timing of this write-off appears arbitrary.

The use of partial bad debt write-offs is not to the mutual benefit of lender and borrower, but entirely to the benefit of the lender. Moreover, the relationship between partial 'bad debt' write-offs and the final write-off (known only to the bank) following finalisation of the foreclosure process remains obscure.

Only the Australian Taxation Office has the capacity to pursue the tax implications of bank bad debt write-offs, and partial write-offs in particular. There is, in principle, no reason why the ATO cannot mount an audit of the major banks with respect to the tax experience of bad debt write-offs, indeed with respect to the taxation implications of the entire process of banking default and foreclosure of customers.

The political sphere has condoned the laxity. At the request of advocates Ford and Murray, the then Independent MP Peter Andren gave notice in March 2004 regarding five questions on the taxation implications of the shadow ledger system.[45] The responsible Minister, the Treasurer Peter Costello, replied on 15 June. Costello's answer to the first question (on the tax deductibility of claimed interest following non-accrual determination) contained no substance. The Treasurer replied to the other four questions as follows: 'Section 16 of the *Income Tax Assessment Act 1936* prevents the Commissioner of Taxation from discussing the affairs of individual taxpayers with others except when expressly empowered to do so under the Act.' This diversionary response constitutes a disdainful treatment of those bank customers whose plight with respect to their bank debt liability and related tax obligations had been publicised, and an abrogation of the responsibility of the Treasurer's office for the taxation portfolio.

The Australian Securities and Investments Commission

[44] Senate Hansard, 17 June 1992, p.3831.
[45] House of Representatives, Question No 3249, 3 March 2004.

In July 1998 the Australian Securities and Investments Commission was recreated out of the Australian Securities Commission with an added brief for consumer protection. An August 2001 amendment to the ASIC Act, operative in March 2002, gave ASIC full responsibility (acquired from the ACCC) for unconscionable conduct / misrepresentation in the arena of financial services. Formally, small business had joined retail finance consumers under ASIC's umbrella.

ASIC's expanded responsibilities occurred as the shadow ledger phenomenon continued to fester, and ASIC became the key arena for attempts to persuade those in authority that there was a problem needing attention. The longtime advocates for this cause, Bruce Ford and Wendy Murray, directed considerable efforts to this arena. Ford/Murray position papers questioning the legality of the shadow ledger record, written in 2002 and 2004, were addressed to ASIC personnel. This effort appears to have come to nought.

In 2007, ASIC was put in the spotlight when allegations of bank malpractice, including the shadow ledger dimension, appeared in the media (Gluyas 2007a; Australian Broadcasting Corporation 2007a; 2007b). The Parliamentary Joint Committee on Corporations and Financial Services (still then chaired by Liberal Senator Grant Chapman) was approached by alleged victims, and intervened publicly. Chapman mentioned the possibility of a sequel to the 2000 inquiry, but passed responsibility to ASIC. He is reported as claiming that '… it was the general view of the committee that ASIC should first investigate and take "whatever action is required. Another hearing is unlikely, but it depends what comes back from ASIC."' (Gluyas 2007b).

Appearing before the Parliamentary Committee on 29 June, ASIC Deputy Chairman Jeremy Cooper claimed that 'We are not a core regulator of loans, so the ordinary failure to provide bank statements is outside our jurisdiction, unless there's misleading or unconscionable conduct.' (Gluyas 2007c)

The Committee pressed the referral, which included 11 separate complaints, onto ASIC. Senator Chapman requested of ASIC, '… to investigate each of the cases and let us know if there is a systemic problem' (Gluyas 2007b). Other complaints directly to ASIC were subsequently added to the list. However, the reporter Richard Gluyas noted six months later, 'The corporate watchdog has all but drawn the curtain on the regulatory soap opera involving off-balance-sheet or "shadow" bank ledgers …' (Gluyas 2007d). ASIC has made no public reference to the outcome of the referral.[46]

The state of play is encapsulated in the Parliamentary Joint Committee's subsequent bi-annual report on its oversight of ASIC (Parliamentary Joint Committee on Corporations and Financial Services 2007). ASIC was demonstrably complacent (ibid.: 2.26-27):

> When consumers are not getting what they want from internal dispute resolution, there is the external process and there is complaining to us, and our data is not showing over-the-odds levels of complaints about internal dispute resolution procedures, particularly with the majors. It is a key part of our surveillance, it is a key part of having a licence from us, but it is not flashing a

[46] As a prominent complainant, Lana McLean expressed thorough dissatisfaction with both the bank and ASIC, having had no satisfaction from either. Personal communication to Jones, 19 March 2008.

> red light, particularly because the next step from internal dispute resolution is generally to external. … in financial services where you have a very large brand to protect there is a pretty strong correlation between having that brand and wanting to resolve complaints. That is a pretty broad generalisation, but I think the data bears that out.

These claims are contrary to the evidence. The Committee also noted (ibid.: 2.30):

> Given these regulatory dead ends for business loan customers seeking external resolution to their banking disputes, the role of ASIC in enforcing the unconscionability provisions of the Corporations Act seems to be an important one. However, ASIC indicated that it had decided to focus on system problems rather than individual cases: 'If ASIC got involved in every civil dispute that it was invited to get into, it simply would run out of resources'.

ASIC has declined to 'focus on system problems' regarding bank malpractice against small business. As previously for s 51AC of the Trade Practices Act with respect to financial institutions, s 12CC of the ASIC Act remains dormant.[47] Individual complainants are perennially told that ASIC cannot help them.[48]

Successive annual reports highlight that ASIC considers the 'financial services reform' process (which brought the coverage of misleading and unconscionable conduct into ASIC) to have been of relevance to its mandate only with respect to the licensing and re-licensing of institutions.

In general, consideration of the shadow ledger phenomenon has been neglected by the relevant regulatory institutions – APRA, the ATO and ASIC. It follows that the larger context of bank default procedures, of which the shadow ledger system is a component, has also been treated as out of bounds for these institutions.

Conclusion

The conventional process by which banks default their small business customers is an un-audited process, one pervaded by discretionary procedures. In particular, the shadow ledger dimension is merely the most opaque face of a multi-faceted system by which a lender maximises its advantage against a borrower that the bank elects to default. De facto, this murky process has the imprimatur of the relevant regulatory bodies and of the Australian courts.

The Chapman report effectively legitimised the banking sector's shadow ledger system without bothering to delve into its character or context.

The CBA's claim to the Chapman Committee that the shadow ledger process is both legitimate and inevitable is inconsistent with banks' practices in withholding information regarding ongoing charges from the defaulted customer. Is non-disclosure *prima facie* evidence that such banks are engaging in practices that they wish to hide?

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[47] Save for the curious (and failed) attempt to hobble the controversial Mr David Tweed in his ongoing offers to unsophisticated minor shareholders to purchase shares at prices significantly below market prices (ASIC v National Exchange Pty Ltd 2005).

48 Jones holds copies of samples of such correspondence.

Non-disclosure facilitates discretion and inaccuracy in the post-default entries in the mainframe accounts and the shadow ledger record. How is the veracity of bank costs (legal, receiver/manager, etc.) and disposition of asset sales to be ascertained? Administrative incompetence or conscious deceit may not be corrected.

The CBA's claim that the shadow ledger process is both legitimate and inevitable also appears inconsistent with the fact that the shadow ledger records are absent from regular auditing and reporting requirements.

During the Chapman Committee inquiry, CBA spokesman Michael Ullmer claimed that the sometime CBA customers, having failed in their businesses and having subsequently broken their undertakings with the bank, were hardly worth the attention and certainly not deserving of commiseration. If one confronts that customers may be channeled into default/foreclosure status either through bank officer incompetence or through conscious deceit, the issue of post non-accrual accounting procedures becomes of dramatic significance, not merely for the customer but for broader concerns of the efficacy and morality of the banking sector in fulfilling its basic public functions.

Looking behind the opacity of the shadow ledger face is an important step, but an investigation into the entire default accounting process demands to be pursued to its logical conclusion.

The Parliamentary Joint Committee concluded its August 2007 ASIC oversight summary of 'Bank conduct and dispute resolution procedures' with the following (Parliamentary Joint Committee on Corporations and Financial Services 2007: 2.31):

> In the light of ASIC's evidence and subsequent complaints to the committee alleging malpractice involving by (sic) the major banks, the committee has requested that ASIC further investigate and report to it on a number of these complaints. The committee has asked ASIC to give particular regard to the non-provision of bank statements and the internal dispute resolution processes banks follow. Any further action by the committee in this area, including an inquiry into possible systemic malpractice in the banking sector, will largely depend on the response it receives from ASIC.

ASIC has declined to act. In February 2009 the Committee launched an 'Inquiry into Financial Products and Services', product of the collapse of Storm Financial Limited; but the terms of reference were constrained from investigating 'possible systemic malpractice in the banking sector'. In its report, the Committee rejected claims by the CBA (and other banks) that their involvement was at arm's length, but dissolved bank culpability in the Storm crisis with mild reproof.[49] It appears that the accounting system utilised by banks following default of business borrowers will remain opaque into the indefinite future.

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[49] The report noted: '3.52 The committee is concerned that close relationships and integrated systems, at least at the branch level, and perhaps in combination with bank sales and lending targets discussed at paragraph 3.54, may have caused some bank staff to lose sight of who their true customer was and to fail in their obligations under the Code of Banking Practice to exercise prudence and diligence in their lending decisions.' (Ripoll Committee 2009: 32)

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