BULLETIN NO 36

DECEMBER 2002

In this Bulletin:

1. Agency of brokers – ABIO Revised Approach

Introduction

The December 2001 Bulletin (Bulletin 32) set out our approach to the question of when a bank will be liable as principal for misleading and deceptive conduct of a broker who is involved in the marketing, application for or establishment of a loan or other financial service.

We have recently reviewed our approach as a result of the following observations in the cases that have been considered by us:

- An increase in the use of brokers by banks for activities which go beyond merely providing information about available products and assisting in the completion of the loan application and extend to activities which would traditionally be the responsibility of the bank lending officer or back office of the bank;

- An apparent increase in the delegation to brokers by banks of the responsibility of explaining the loan offer or security documents or both, including an apparent refusal by banks in some cases to have direct contact with the borrower, instead referring all questions to the broker;

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BULLETIN

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- An increase in the sophistication of the contractual arrangements between banks and brokers, reflecting the broader range of activities undertaken by the brokers, and indicating, in our view, the giving of actual authority to the broker to carry out what would otherwise be regarded as aspects of the bank's role in the lending process.

Summary of revised approach

- It is more likely that we will conclude that a broker is an agent of the bank if the bank has no direct contact with the borrower and/or the borrower is referred by the bank to the broker for explanations about the loan offer, the product features or the security documents.

- We will place less weight on statements made to borrowers that the broker is not the agent of the bank and will place more weight on the actual arrangements in place between the bank and the broker.

- Similarly, we will place less weight on clauses in the agreement between the bank and the broker which seek to deem the broker not to be an agent of the bank and more weight on the agreement as a whole.

Discussion

It is becoming more common for banks to outsource to brokers the tasks traditionally carried out by an internal lending officer – explanation of product, taking of the loan application and notification of approval.

In such cases the bank will pay commission to the broker and will usually have in place a referral or broker agreement. The agreement will usually contain express statements such as 'The broker is not the agent of the bank', although it will also, usually, require the broker to indemnify the bank against any liability it may have as a result of misstatements by the broker – in the absence of agency the bank is unlikely to have any liability so the indemnity in that sense contradicts the express statement. The customer may also be asked to sign an acknowledgement that 'the broker is your agent not the bank's agent'.

The aim of such statements is undoubtedly to distance the bank so far as possible from any errors, omissions or misstatements that may be made by the broker. Nevertheless there will be cases where a bank will be liable for misleading or deceptive conduct by the broker.

Liability of a bank for misleading or deceptive conduct by a broker

A bank will be liable for misrepresentations or other misleading and deceptive conduct by a broker if at the relevant time the broker was acting as the agent of the bank. The agency may be a limited one and it is possible for a broker to be the agent of the customer for some purposes such as sourcing the finance but the agent of the bank for the purposes of taking the loan application and providing product information. Agency may be either actual or apparent.

Actual authority

Features that will, in our view, establish agency based on actual authority:

- Express authority to act as agent for the bank in one or more respects - such as in identifying the customer, completing the application form, taking the loan application to a certain stage or providing information with the express authority of the bank *and* under the control of the bank. For example:

    - the broker may be provided with information produced by the bank and be subject to the direction of the bank as to how that information is passed on to the customer;

    - the broker may be given express permission to use the bank's logo in documents produced by the broker;

    - the broker may be given express permission to access the bank's internal system to gain and communicate information about the progress of a loan application;

- Referring the borrower back to the broker when the borrower had specific queries about the loan product or offer, saying that the broker could answer all the borrower's questions to the bank or refusing to provide information except through the broker;

- A requirement to comply with internal bank policies such as a code of conduct when dealing with loan applications and to be trained in those policies and practices, particularly where there is any component of performance review.

The code may, for example, specifically authorise the broker to give applicants information about bank products, how they work and what are their terms and conditions. This is consistent with an intention that the broker will be carrying out some of the bank's own functions on behalf of the bank; or

- Payment of a commission - although our view is that this needs to be in combination with other factors.

Apparent or ostensible authority – examples of a sufficient holding out

- Referring the borrower back to the broker when the borrower had specific queries about the loan product, saying that the broker could answer all the borrower's questions to the bank or refusing to provide information except through the broker;

- Not correcting the understanding of the borrower that the broker was acting for the bank when the bank knows that the broker has been holding themselves as having authority to do so;

- Allowing the broker to use a title that would normally only be given to an agent;

- Allowing the broker to use or display the bank's logo in association with the broker's own promotional or contractual material;

- Allowing the broker, in the presence of the borrower, to access internal bank systems to establish the progress of an application; and/or

- Holding out the broker as having some authority without making it clear that the authority is limited;

- Payment of commission – in combination with other factors.

The relevance of express statements in documents

An acknowledgment signed by the borrower, that the broker is the borrower's agent and not the bank's will be taken into account in determining whether the broker was held out as having authority to act for the bank. But it may not protect the bank where clear representations to the contrary have been made and it will not assist the bank if it is contrary to the actual arrangements between the bank and the broker.

In other words, it may mean that there will be no holding out, but the bank will nevertheless be liable because the broker is actually the agent of the bank at the relevant time.

2. Native Title Claims and Bank Lending Policy

This office has recently considered a number of claims involving the provision of loans to customers who have purchased properties which are the subject of native title claims.

In one case, the dispute concerned whether the bank should have conducted its own native title search. The solicitors for the disputants did not include a native title search in their usual range of searches, and only carried one out at the insistence of the disputants. Once the existence of a native title claim became known, the bank withdrew its offer of funding. The disputants also had the right to rescind the purchase contract, which they did.

The offer of finance was later reinstated and the disputants made a lower offer to purchase the property, which was rejected by the vendor. In the course of investigation, we surveyed the banks to see if a native title search was undertaken where a bank was proposing to lend money to purchase land that may be the subject of a native title claim.

The response was that native title searches were not routinely undertaken in relation to land that may be the subject of a native title claim. This office is of the view that the existence of a native title claim is primarily a matter for the purchaser and their legal advisers, as are all other issues concerned with title. It is often the case that the existence of native title will not have any substantial affect on the ability of the bank customer to use the land, especially where there is a pre-existing pastoral lease.

However, where a bank has a policy of withdrawing approval for funding should a native title claim be discovered, it would be prudent in our view for that bank to undertake such a search for its own purposes at an early stage. Alternatively it would seem reasonable to ensure that the borrower is notified of that policy and so can ensure that any necessary searches are carried out.

Banks may wish to consider, if they have not done so already, developing policies for lending where the proposed security property may be subject to a native title claim, including policies regarding the undertaking of native title searches. We are happy to discuss this issue further with interested parties.

3. EFT Disputes and Financial Hardship

We have been advised by community legal services and Members of Parliament that a growing number of people with EFT disputes are experiencing financial hardship while they wait for banks to investigate their claims. The situation usually arises where, as a result of ATM shortpays, cardholders have no cash and little or no balance left in their accounts.

The same problem could also arise, however, in the context of unauthorised withdrawals from a cardholder's account.

The EFT Code of Conduct

The EFT Code of Conduct sets out the timeframes within which financial institutions should:

- Acknowledge receipt of an EFT dispute;
- Complete its investigation of a dispute; and
- Advise the cardholder in writing of the outcome of the investigation.

The EFT Code requires a response in writing within 21 days, but it does not require an investigation to be completed within 21 days. The response may be to advise the need for more time, in which case the Code allows 45 days to complete an investigation. In exceptional circumstances, an investigation may take longer than 45 days provided that the account institution gives reasons for the delay and provides monthly updates on progress.

It is our experience that most banks have adequate systems in place to ensure that they comply with these timeframes, and in many cases, disputes are resolved in a matter of days.

However, even if the timeframes set out in the EFT Code are complied with, there is a small number of cardholders who experience financial difficulty while the bank is conducting its investigation. This is particularly true in cases where the ATM in question is owned by a financial institution other than the bank that issued the card. In these cases, the cardholder's bank must wait for information from the other financial institution before reaching a view on the claim.

Survey of Banks

This office recently conducted a survey to ascertain whether banks had policies in place to assist cardholders while investigations are taking place. Some banks have a policy of advancing the amount of the disputed transaction to cardholders provided a Statutory Declaration concerning the circumstances of the loss is made. This procedural step is taken on the understanding that if the claim is ultimately denied, the bank will reverse the amount of the advance from the cardholder's account. Other banks have a similar policy but allow only a partial release of funds.

The majority of banks, however, have no formal policy about this issue and deal with requests for temporary credits or overdrafts on a case by case basis.

A few banks stated that there are no circumstances in which a request for a temporary credit or overdraft would be approved.

Good Industry Practice

This office is of the view that there is a need for some consistency of approach to this matter, and that all banks, if not already doing so, should develop policies for dealing with requests for assistance from cardholders.

We acknowledge that in some circumstances, claims for financial loss are not genuine, and banks could be exposed to risk if they were required to immediately place temporary credits to accounts upon receipt of all EFT disputes. Therefore, a degree of staff discretion could be retained in a bank's approach to these cases.

The following factors should be taken into account when banks are reviewing their approach:

- All requests for temporary credits or overdrafts pending the outcome of investigations should be given consideration by appropriate staff ;

- Staff should be given authority to exercise their discretion to approve requests for temporary relief in certain circumstances;

- Specific internal guidelines should be developed to assist staff to exercise their discretion in an informed manner; and

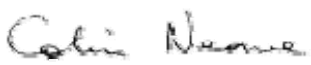
- Systems should be put in place to enable assistance to be given to cardholders promptly.

4. Issues featured in our Bulletins this year

Bulletin No.	Date	Subjects
33	MAR 2002	New Terms of Reference Unsolicited invitations for credit card limit increases Farm debt mediation and "exceptional circumstances"
34	JUNE 2002	Collection Issues: Sale of debts, Credit Reporting and Mortgagee sales Financial Services Consumer Helpline
35	SEPT 2002	Special Bulletin on Electronic Commerce: Operating authorities and electronic banking Online transfers to wrong account number Access to third party accounts Online impersonation Credit card fraud and chargeback issues Access to Internet Banking

Seasons Greetings

The office of the Banking Ombudsman takes this opportunity to wish all readers the compliments of the season



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