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Banking and Financial Services Ombudsman Limited

With effect from 19 August 2003, the Australian Banking Ombudsman Limited changed its name to the "Banking and Financial Services Ombudsman Limited". The change was preceded by extensive consultation and discussion with all stakeholders. Changes were also made to the Constitution of the company to allow non-bank members to become part of the Scheme.

The name change reflects the fact that, whilst the descriptor "Banking" is exceptionally well recognised and understood, many of the Scheme's members are themselves promoting the notion that banks are either themselves or are closely associated with others active in the market supplying financial services products. The name change also reflects the changes that were made to the Scheme's Terms of Reference in March 2002.

New Code of Banking Practice

The Australian Bankers' Association ("ABA") on 1 August 2003 released the new Code of Banking Practice ("the new Code"). A number of member banks have already adopted the new Code and no doubt many more will do so in the coming months.

OMBUDSMAN

BULLETIN

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The new Code was written by the ABA based on the results of the review conducted by Mr Richard Viney. The process undertaken by Mr Viney involved seeking submissions and then consulting widely on those submissions. Recommendations were then made to the ABA and the new Code was drafted and launched by the ABA in August[1].

In this Bulletin we discuss how BFSO will approach the new Code generally and highlight some of the more significant changes. It is not a complete statement of our approach and we will be developing more detailed guidelines in due course.

BFSO Jurisdiction and Approach

The stated purpose of the new Code is to set standards of good banking practice for banks to follow when dealing with existing or potential individual or small business customers and guarantors.

Under the Terms of Reference, the Ombudsman makes decisions having regard to:

(a) The law;
(b) Applicable industry codes or guidelines;
(c) Good industry practice; and
(d) Fairness in all the circumstances[2].

The new Code will be approached by BFSO as an industry code and also as reference for good industry practice for member banks. For banks which adopt the new Code, there will also be a contractual obligation to comply with all of its provisions including obligations to comply with all applicable laws and to act fairly and reasonably towards customers in a consistent and ethical manner.

As always, if we determine that there has been a breach of the New Code, any award of compensation will turn on whether the breach resulted in loss or damage.

Significant Provisions

In the following pages we make some preliminary comments regarding the issues raised by some of the more significant provisions in the New Code and, where appropriate, our anticipated approach. As will become apparent, the subject matter of many of the provisions discussed have been considered by us in some way in earlier Bulletins or in our Guidelines or Policy documents.

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[1] More information about the history of the Code and the review process can be obtained from the ABA at www.bankers.asn.au. The website also has a useful Frequently Asked Questions page and a current list of all banks which have adopted the Code. As at 1 September 2003 the following banks had adopted the new Code: Adelaide Bank Limited, Australia and New Zealand Banking Group Limited, Bank SA (A division of St George Bank Limited), Commonwealth Bank of Australia, National Australia Bank Limited and St George Bank Limited

[2] Copies of the Terms of Reference are available from our office and also on our website www.abio.org.au . Other publications available on the website include all Bulletins, Guidelines to the Terms of Reference and our Policies and Procedures manual

Definitions

BFSO's jurisdiction to deal with disputes is determined by the Terms of Reference. The Ombudsman's capacity to investigate a possible breach of the new Code will turn on whether the dispute and/or the disputant is within the Terms of Reference. The latter may turn on the definitions contained in the new Code and therefore the eligibility of the individual or business to complain to the Ombudsman.

Individuals

The new Code applies to individual customers and prospective individual customers. Where a financial product is involved, retail clients (as defined in Chapter 7 of the *Corporations Act 2001* (Cth) ("Corporations Act")) are covered. All matters about which an individual could complain in relation to the new Code would be within the Ombudsman's jurisdiction.

Small businesses

The following small businesses are covered by the new Code:

(a) A business having less than 100 full time (or equivalent) people if the business is or includes the manufacture of goods; and

(b) In any other case, a business having less than 20 full time (or equivalent) people.

Where a banking service is provided to a small business for use in connection with a business that does not fall within (a) or (b) then the new Code will not apply – for example where a facility is provided to a subsidiary company to purchase equipment to be used by the parent.

The definition of small business is based on that contained in the Corporations Act which has also been the basis for the definition of the term in our Terms of Reference. However, the word "people" has been used instead of "employees". It is understood that the intention was to pick up persons classified as independent contractors as well as employees.

The result of this definitional variation between our Terms of Reference and the new Code is that disputes relating to some small businesses may fall within the Terms of Reference but issues could not be raised under the new Code. This is because with the inclusion of people in the new Code, a small business may exceed the maximum number of people before the Terms of Reference limit on employees is met.

It should be noted that the New Code has replaced *"Banks and Small Businesses Working Together – A Set of Principles"*.

Banking products and services

"*Banking service"* is defined as any financial service or product provided by a bank in Australia including any financial service or product supplied by the bank or through an

intermediary and, where a financial service or product is provided by another party but is distributed by the bank, the distribution or supply of that product - for example a life insurance policy provided by another unrelated entity distributed by the bank in conjunction with arrangements for a home loan.

Examples of the banking products and services covered include:

> Deposit and transaction accounts, personal and home loans, credit cards, debit cards, safe custody facilities, small business loans, investment loans and lease financing

These are services and products which fall within the Terms of Reference.

Acting fairly and reasonably

We and our stakeholders are familiar with assessing events and actions from the perspective of fairness. The fairness criteria has been a part of the Terms of Reference since the Scheme was established and we have developed a general approach and applications of that approach to certain situations[3].

With the inclusion of this requirement in the new Code, bankers and consumers alike will be required to consider on a day to day basis what, in particular circumstances, amounts to acting "*fairly and reasonably towards* [customers or prospective customers] *in a consistent and ethical manner*" taking into account the conduct of the bank and customer and their banking contract.

It is clear that guidance can be obtained from legal comment on equitable principles and statutory provisions which refer to and require a consideration of fairness[4]. One of the primary objects of the new Chapter 7 of the Corporations Act is to promote fairness, honesty and professionalism by those who provide financial services. Another is to promote fair, orderly and transparent markets for financial products[5]. We can expect some judicial comment and comment within the community about how these objects can be met and what amounts to fairness in the financial services industry. The commitment to fairness in the new Code can then be considered in the context of those comments.

Guidance can already be found in dictionaries as to the meaning of fairness and fair: "*the quality or condition of being fair*"; "*equitably, impartially*"[6]; "*just, unbiased, equitably; in accordance with the rules*"[7].

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[3] See pages 53 to 54 of the Guidelines to the Terms of Reference and Supplement to Bulletin 38 regarding fairness in debt collection

[4] For example principles relating to unfair pressure, unjust contracts, consumer protection legislation including the Trade Practices Act 1976 (Cth), the ASIC Act and state based Fair Trading legislation

[5] See section 760A

[6] See The Shorter Oxford English Dictionary

[7] See The Australian Concise Oxford Dictionary

In the case of *Story v NCSC* [8]Young J said in the context of an obligation to act efficiently, honestly and fairly:

> *"I do not think I need dwell on the meaning of the word 'honestly' except to remark that it is significant that it is used in conjunction with the word 'fairly'. Those words tend to give the flavour of a person who not only is not dishonest, but also a person who is ethically sound, indeed, the sort of person reflected in the words of Psalm 15."*

Psalm 15 refers to the following qualities: to walk uprightly, work righteousness and speak the truth, not backbite nor take up a reproach against a neighbour.

When assessing what amounts to acting consistently and ethically, good industry practice and advice from our Banking Adviser will be of great importance. It may be that a larger number of surveys of BFSO members, formal and informal, will be conducted to assist us when determining these standards in specific circumstances. We will also have regard to banks' prudential obligations as required by clause 2.3.

Compliance with laws

Adopting banks undertake to comply with all laws relating to banking services including those concerning consumer credit products, other financial products and services (for example laws concerning misleading conduct and unconscionable conduct), privacy and discrimination (clause 3). As the contents of the New Code become part of the contract (see clause 10.3) the undertaking in clause 3 creates a contractual obligation to comply with all laws and would also give rise to an entitlement to make a claim for loss or damage based on breach of contract. As some of the laws mentioned do not necessarily include an automatic entitlement to claim damages, this part of the new Code adds to the legal entitlements of existing and prospective customers.

Account combination & the Centrelink Code

The new Code requires information to be provided about account combination when an existing account is held and a new account is opened (clause 16.2).

Clause 17 imposes some further requirements. A bank is required to notify its customer promptly after any right to combine is exercised (clause 17.1). If a dispute arose about account combination we would first consider whether a contractual entitlement to combine accounts existed and then whether prompt notice was given taking into account industry practice.

In addition, banks undertake to comply with any applicable requirements under the Code of Operation for Centrelink Direct Credit Payments ("Centrelink Code") (clause 17.2). As a result of this clause, all banks which adopt the new Code will be contractually bound by the terms of the Centrelink Code, even where that bank has not formally adopted that

[8] 13 NSWLR 661 at 672

latter code. A revised version of the Centrelink Code came into operation from December 2002.

We receive telephone calls from Centrelink recipients on a daily basis. The callers often raise concerns about access to Centrelink payments particularly when the account has been overdrawn. As these complaints raise immediate and urgent problems which impact on the Centrelink recipients' capacity to live and meet basic needs, it is particularly important that banks are aware of their obligations under the Centrelink Code and act quickly to address concerns. Ordinarily we are not called on to investigate these disputes – usually because the immediate problems pass relatively quickly if not satisfactorily.

This Bulletin provides an opportunity to comment on the change in the Centrelink Code to the definition of "*unauthorised debt*".

The previous Centrelink Code stated that its provisions would not apply to fraudulent, dishonest or otherwise unlawful transactions, conduct or activity by or on behalf of a customer as a result of which an unauthorised debt was incurred to the financial institution. "*Unauthorised debt*" was defined as a debt for which there had been no prior authorisation by an officer of the institution.

The revised Centrelink Code now states that its provisions do not "*extend to cover unauthorised debt.*" A new definition of that term has been included:

> "*Unauthorised debt - means a debt that is incurred when a customer knowingly transacts on their account in order to gain funds from a financial institution that they are otherwise not entitled to and have no other sources of funds to cover the overdrawing.*"

Because of the inclusion in the new definition of the knowledge of the customer, arguably there is no substantive change to the circumstances which are excluded. We understand that the definition has been drafted to reflect elements of dishonesty or fraud or actual intention at the time of the transaction. To conclude that the Centrelink Code and its provisions regarding access to payments were not applicable, we would have to be satisfied (on the balance of probabilities) that the customer had the intention to gain funds knowing he or she had no entitlement to the funds and in circumstances where the customer had no capacity to repay. This reading appears to be supported by clause 11 which suggests steps a customer can take to "*limit the possibility of unintentionally overdrawing their account*".

In our view unintentional overdrawings or overdrawings which are approved by the bank, whether as a result of an automated system or by the making of a commercial decision, would not be treated as unauthorised debts, unless we are satisfied on the balance of probabilities that the customer acted dishonestly or fraudulently.

On this reading we would expect that there would be only a limited number of cases where a financial institution would rely on the unauthorised debt exclusion and that the facts of those cases would indicate the existence of actual intention at the time of the transaction, dishonesty or fraud. Therefore we would expect that banks will release to the majority of Centrelink recipients 90% of their payments when an account is overdrawn.

Direct debits

The new Code deals with direct debits on transaction accounts in two ways: clause 10.4 (j) states that terms and conditions will include details about how cancellations of direct debit requests will be processed and clause 19 contains undertakings to promptly process cancellation instructions and complaints about direct debits to transaction accounts. Both of these provisions are welcome.

The first will ensure that banks provide information to customers which will allow them to manage direct debits effectively. The undertaking to process cancellation instructions promptly will ensure that difficulties which arose in the past and which led to numerous unauthorised direct debits being processed should be avoided. The provisions reinforce the customer's entitlement to give instructions to his or her bank about the account and the bank's obligation to act on those instructions.

It is also appropriate that complaints regarding direct debits be addressed by the bank rather than being treated solely as an issue between the customer and the holder of the direct debit authority. The approach we will take to these cases has been detailed in Bulletins 24 and 29 issued in March and June 2000 respectively.

It should be noted that these provisions will not apply to direct debits on credit card accounts (clause 19.2). In those cases regard will be had to the terms and conditions of the credit card account and any chargeback rights.

Chargebacks

A chargeback is a right which may be exercised in certain situations by a cardholder's bank against a merchant's bank. It is a right to charge back responsibility for a credit card transaction from the cardholder's bank to the merchant's bank.

Chargebacks arise where a cardholder disputes a transaction and his or her bank raises a chargeback against the merchant's bank, for example because the cardholder did not participate in the transaction or receive the goods. The merchant's bank may then refer the transaction to the merchant and seek proof of authorisation, for example by production of a voucher carrying the cardholder's signature. Unless the merchant is able to produce a valid signed sales voucher or establish that the cardholder signed when receiving the goods, the liability of the transaction will fall on the merchant.

There are varying requirements and time limits within which a cardholder's bank must exercise its right. The chargeback rights and requirements are identified in the operating rules of the various card schemes.

While cardholders are not party to the chargeback agreements and are often largely unaware of the rules which apply, they may well benefit from their proper application.

As a result of clause 20 banks will be obliged to:

- Claim a chargeback right where one exists and where a transaction has been disputed within the time frame contained in the account terms and conditions;
- Claim the chargeback for the most appropriate reason;
- Not accept a refusal of a chargeback by a merchant's financial institution unless it is consistent with the relevant card scheme rules; and
- Include general information about chargebacks with credit card statements at least once every 12 months.

These provisions are consistent with the approach taken by us to credit card disputes – see further Bulletin 26, issued in September 2000 and updated earlier this year. The inclusion of these obligations in the account contract will mean that cardholders will have greater access to the benefits of the chargeback agreements.

Provision of credit

Our Terms of Reference have always given BFSO an ability to consider whether the provision of credit in particular circumstances was appropriate. While we refer to this as an aspect of maladministration, the new Code deals with it under the heading of provision of credit. Individuals or consumer borrowers are protected by provisions of the Uniform Consumer Credit Code ("UCCC"). The significance of the provision in the new Code is that it restates or confirms that the common law obligation to lend responsibly extends to small businesses.

Clause 25.1 requires a bank to exercise the care and skill of a diligent and prudent banker in selecting and applying its credit assessment methods and forming an opinion about the customer's ability to repay before making an offer of credit or before offering to increase existing credit.

The approach taken by us to whether lending was appropriate takes into account not only relevant credit assessment methods and the capacity to repay but also other available information. Other information which is considered may include:

- Whether bank officers expressed doubts or concerns about the credit application;
- Whether on balance it appears that the sale of the security property was the only real prospect for repayment (assuming that was not the original intention of the borrower);
- The customer's lending history;
- Whether all relevant financial information had been disclosed to the bank;
- Whether the customer could repay without hardship; and
- Where the income included government benefits or payments, whether these were likely to be ongoing[9].

The standard applied to our assessment of all issues regarding lending is that of the reasonable competent banker acting in accordance with accepted current practice[10] and we determine current practice having regard to banks' own internal policies and advice from the Ombudsman's Banking Adviser.

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[9] For further information on our approach to maladministration see our Policies and Procedures; Bulletin 26 regarding credit cards generally; Bulletin 33 regarding unsolicited credit card limit increases

[10] See *Selongor United Rubber Estates Ltd v Craddock (No 3)* [1968] 1 WLR 1555

While we make an assessment of information beyond that contained in clause 25 of the new Code, there is no doubt that central to the question of whether credit was offered appropriately is the issue of capacity to repay. The way capacity to repay is measured by banks is by their own credit assessment methods. Clause 25 will overlay this with the diligent and prudent banker test. A variety of assessment methods are used by banks but the test to be applied by BFSO will be whether the credit offered was credit which the customer had, at the time it was offered, the capacity to repay.

Joint debtors

In recent years it appears to have been common for non–bank lenders to establish loans in joint names where one party receives the benefit of the loan funds and the other provides the security. An illustration of the circumstances leading to joint loans of this type and the problems which can arise follows:

> A husband and wife wanted to borrow funds to purchase a property and consolidate several small loans into the one home loan. They approached a broker and told him that the husband's father had an unencumbered property.
>
> Applications for finance were submitted: one in the name of the father for a loan of $32,000 and another joint application for $190,000 in the names of the husband and wife and the father. The loans were granted and the funds were used to purchase the property and also to repay the smaller debts owed by the husband and wife.
>
> The bank took mortgages over the father's property and the new property. That property was to be held by the husband and wife as to a 99% share and by the father as to a 1% share.
>
> During the course of the investigation, the Ombudsman's banking adviser commented that the circumstances were unusual enough to have warranted some discussion between the bank and the father to ensure that he understood the implication of the arrangements he was entering into. The unusual circumstances included the fact that the father had a potential total liability for the loan despite the fact that he only had a 1% interest in the property and that funds were used to repay debts for which he had no prior liability.

Our experience indicates that loans are established in this way because they may be processed more quickly than when a guarantee is required and perhaps they are sometimes used to avoid the disclosure issues surrounding guarantees.

Clause 26 of the new Code will assist in ensuring that, where an offer of finance is in fact a loan and a guarantee, then it will be established in that way.

The clause says that the bank will not accept a person as a co-debtor where *'on the facts known"* to it, the person will not receive any direct benefit under the facility.

In addition, the clause will require banks to take all reasonable steps to ensure that the each co-debtor understands that he or she may be liable for the full amount of the loan and his or her rights to limit future liability. In relation to the latter, a co-debtor may terminate liability for future advances or financial accommodation on giving the bank written notice. This right will, however, only arise where the bank has a legal entitlement to terminate any obligation which it has to provide that future credit (clause 26.3).

Whether or not this provision will deal with all issues relating to joint debts and guarantees will depend on how much the bank knows about the circumstances leading to the request for credit, the loan purpose and the relationship of the loan applicants. The increasing use by loan applicants of mortgage brokers will add a further complicating dimension.

We make the following preliminary comments:

- When investigating a dispute about whether the Code obligation has been met and/or whether a loan ought to have been established as a joint one, we would look at the loan application form and interview notes to assist in determining the purpose of the loan, the relationship of the parties and the extent to which the disputant was to benefit. We would also seek this information from the disputant;
- Given that it is usual banking practice to obtain these types of details from loan applicants, we would expect this information to be held by a bank and it would be regarded as part of the information known by that bank;
- Where the circumstances indicate that other relevant information ought to have been sought, the fact that the bank did not seek that information would not necessarily mean a bank is excused. This is because good industry practice may require that further enquiries be made – as seen in the case study above; and
- If relevant information is known to a broker who is acting as an agent for the bank, that knowledge would be attributed to the bank – see further Bulletin No 36 issued in December 2002 regarding our approach to agency of brokers.

Joint accounts and subsidiary cards

We see many disputes regarding joint accounts and the use of subsidiary cards. It is often the case that these disputes arise when the personal or business relationship which gave rise to the account arrangements breaks down or changes.

In our view it is extremely important that all parties are aware of how these accounts work, how instructions may be changed and where liability for use of the accounts falls. The information required to be provided to joint account holders and primary cardholders by clause 27 ought to ensure that these matters are clearly stated and brought to the attention of all parties.

A common dispute concerns when a primary credit or debit cardholder attempts to cancel or stop a subsidiary card only to find that those efforts will not necessarily limit the subsidiary cardholder's spending or use of the card. Many account terms and conditions require not only notice to the bank but also the return of the subsidiary card itself. Where relationships have broken down, the retrieval of a subsidiary card may be almost impossible.

Clause 27.3 indicates that banks will not be entitled to require the return or destruction of the subsidiary card provided that a request for cancellation has been made and "*all reasonable steps*" to have the subsidiary card returned to the bank have been taken. If these requirements are met the primary cardholder will not be liable for any continuing use of the card.

Illustrations of actions which amount to all reasonable steps have not been included in the new Code. Our provisional expectations of what would amount to all reasonable steps in these types of cases would include information showing that the primary cardholder has asked for the return of the subsidiary card – for example a copy of a letter addressed to the subsidiary cardholder. It may be that in some cases there are no reasonable steps which could be taken because the primary cardholder has no way of contacting the subsidiary cardholder or is entitled to prefer not to do so. The use of an intermediary, for example the subsidiary cardholder's solicitor where there are family law proceedings on foot, may be considered to be a reasonable step.

Guarantees

When a dispute concerns a guarantee, there are a number of matters to consider including the law, procedures which are regarded by BFSO as representing good industry practice and, of course, the relevant facts as can be established.

The principal important change arising from the new Code concerning guarantees is that it requires a bank, before taking a guarantee, to provide meaningful financial information to the potential guarantor, which will assist them in assessing the level of risk involved in providing the particular guarantee. Importantly, the protection extends to guarantors of small business loans.

There is no doubt that the giving of a guarantee involves risk. Most guarantors, particularly those who have received independent legal advice, know that if the debtor defaults the security they provide will be at risk. But the principal difficulty for a guarantor is assessing the risk that the particular debtor will default.

Where guarantors are covered by the UCCC, under section 51 the lender is required to provide them with a copy of the credit contract before they enter into the guarantee. This alone may not tell them what led to the proposed borrowing, whether it is a re-financing of an existing debt or debts, what other obligations the debtor has or what will happen if the guarantee is not given.

The provisions of the new Code will significantly extend a bank's obligation to disclose information to potential guarantors, essentially limited at common law to disclose information only if the transaction has unusual features[11]. In the short term this will mean considerable compliance-related changes to bank practice and may well be seen by some lenders, borrowers and directors of borrowing companies as undesirable and unnecessarily expensive. In the long term, however, the changes will improve the position of guarantors and will also considerably reduce the risk to a bank of a guarantee being declared to be unenforceable. If the required information is provided to a guarantor it will be extremely difficult for the guarantor to claim that they were taken by surprise or were uninformed about the transaction.

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[11] For a succinct discussion of the common law position see '*Guaranteeing someone else's debts*', NSW Law Reform Commission Issues Paper 17, April 2000, at p 69. See also the discussion in Phillips & O'Donovan, *The Modern Contract of Guarantee*, p 122ff, LBC (3rd edition). See also a paper given by Elisabeth Wentworth, General Counsel, BFSO at the Law Council of Australia/Law Institute of Victoria Financial Services Committees Seminar 16 October 2002, "*The New Code of Banking Practice and Guarantees: What lawyers need to know*"

The following are comments on some aspects of the guarantee provisions. All stakeholders ought to conduct their own careful review and note in particular the application and transitional provisions in clause 39 which impact on the guarantee clauses.

Independent legal advice

The original Code required a recommendation be given that a prospective guarantor obtain independent legal advice and the written warning prescribed by regulation 20 of the Consumer Credit Regulation includes the statement 'You should obtain independent legal advice'.

The new Code does not require a bank to insist that a guarantor obtain independent legal advice but the combined effect of an express recommendation and the other information contained in clause 28.4 may give a greater emphasis to the desirability of independent legal advice being obtained. As has always been the case, a recommendation alone will not protect a bank against liability for unconscionable conduct or under the principles in *Garcia v National Australia Bank Ltd* [12] if in fact the transaction is unconscionable or if the guarantor did not in fact understand the nature of the transaction and no explanation was given. Where the guarantor declines to obtain independent legal advice or is unable to do so the bank will have to make the risk management decision as to whether to take the guarantee.

Demands, excesses, overdrawings etc must be disclosed

Lack of accurate information regarding the status of accounts and any arrears can be a concern for guarantors.

Sub clauses 28.4 (b) and (c) set out additional obligations to provide information subject to limited exclusions[13].

Clause 28.4 (b)(i) provides that before taking the guarantee, the bank must tell the guarantor about any notice of demand made by the bank on the debtor and/or any dishonour on any facility. Under 28.4(b)(ii) the bank must disclose any excess or overdrawing on any facility the debtor has, or has had, with the bank.

This will mean that a bank's system must be set up to search for, retrieve and report the relevant information as part of the guarantee process. The transitional provisions allow time for banks to set up the required systems.

In addition, by 28.4(c) the bank must tell the guarantor if any existing facility will be cancelled or if the facility will not be provided, if the guarantee is not given. This is important information for guarantors who may have been told by the debtor or a bank officer that the guarantee is 'just a formality'. It may well be a formal requirement of the bank's lending policy but it is important for the guarantor to know that it is an essential one and that the bank does not regard itself as adequately secured without the guarantee.

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[12] (1998) 194 CLR 395

[13] These provisions do not apply where the guarantee relates to a financing facility for a commercial asset (eg a lease, rental, hire purchase, bill or sale or chattel mortgage) or where the guarantee is being given by the sole director of the company which is the principal debtor.

Timing

The information required to be provided by clause 28.4 (notice, disclosure, copy documents and other requested information) must be provided at least the day before the guarantee is signed unless, after receiving the information and before signing the guarantee, the guarantor has received independent legal advice[14].

We will still have regard to whether in fact the potential guarantor had adequate time to consider the information and make the decision to sign. In doing so we will consider all the circumstances surrounding the execution of the guarantee. Accordingly, the fact that one day was available will not necessarily address all issues relating to understanding and opportunity to review or obtain independent advice.

Copies of certain documents must be provided

The provisions relating to documentation to be given to guarantors will be significant in the assessment of good industry practice.

Sub clause 28.4(d) requires the bank, before taking the guarantee, to provide copies of certain documents[15]. The requirements go well beyond a copy of the related credit or security contract and include copies of:

- The final letter of offer to the debtor (which will give information about any conditions on the offer);
- Any earlier conditions satisfied before the first letter of offer was issued;
- Any related credit report (which will give information about the debtor's credit history with other lenders);
- Any current related credit insurance contract;
- Any financial accounts or statements of financial position given to the bank within the previous two years in relation to the facility;
- The latest statement of account relating to the facility;
- Where there has been a demand, excess, overdrawing or dishonour of the sort referred to in 28.4(b) (i) (which must be disclosed), a copy of the statement of account for the relevant period; and/or
- Any notice given in relation to the facility within the previous two years with which the debtor has not complied.

Under 28.4(e) the bank must also give any other information which is reasonably requested, but not including internal opinions.

In addition, the effect of clause 28.4(a)(v) may be that a guarantor may request, and expect to be provided with, information about the facility at any time after the guarantee has been given. In any event, in BFSO's view a guarantor is entitled to information regarding the facility and particularly the amount owed at any time.

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[14] This obligation under clause 28.5 does not apply to commercial asset financing facility or sole director guarantees

[15] The commercial asset financing facility and sole director exclusions also apply to this sub clause and to 28.4(d)

Confidentiality of the debtor's financial information

It has been recognised that one of the difficulties in providing information to guarantors is the fact that a debtor's consent is normally required before information is provided to third parties, including guarantors, if a bank is not to be in breach of its common law duty of confidentiality and/or its obligations under the Privacy Act[16].

As a result of the disclosure requirements which will have to be met before a guarantee may be taken, banks will be required to obtain the consent of the debtor to meet its confidentiality and privacy obligations. If consent is not obtained then under the new Code, the guarantee cannot be taken. This may well result in the whole transaction not proceeding.

Signing

It is common for guarantors to say to us and to the courts that they signed documents which had been given to them by the party to benefit from the transaction or in their presence.

As a result of clause 28.6 (a) the bank must not give the guarantee to the debtor to arrange the signing and may not give the guarantee to someone acting on behalf of the debtor to do so, except a legal practitioner or financial adviser who is working for the guarantor. Of course issues may arise in the event that a legal practitioner acts for both the debtor and guarantor in the same transaction. If a bank were on notice that a legal practitioner had acted solely for the debtor in the past and could be regarded as a close adviser of the debtor, then it may be prudent to suggest that the guarantor seek advice from a different legal practitioner.

Where a bank officer attends the signing of the guarantee (the usual situation will be where it takes place at a branch or bank office), the bank must ensure that the guarantee is signed in the absence of the debtor (clause 28.6(b))[17]. Where the signing takes place in the offices of a legal practitioner, then he or she ought also ensure that the debtor is not present.

The new Code provision will be treated by BFSO as setting a clear industry standard for member banks.

Future credit contracts

The new Code contains provisions concerning the steps to be taken to ensure that a mortgage securing a guarantee will be enforceable where further credit is granted to the debtor. We have seen a number of cases where additional credit in the form of new facilities or extensions to existing facilities has been granted without first obtaining the consent of the guarantor or the third party security provider. As a result of clauses 28.12 and 28.13, the security for further credit granted in these circumstances would be unenforceable.

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[16] See the discussion in Phillips & O'Donovan, ibid.

[17] The obligations under clause 28.6 do not apply to commercial asset financing facility or sole director guarantees

Clause 28.12 deals with third party mortgages and says that the mortgage will be unenforceable in relation to a future credit contract or a future guarantee unless the bank has given the mortgagor a copy of the contract document for the future credit and then obtained the mortgagors written acceptance of the extension of the mortgage to cover that future credit.

Clause 28.13 deals with guarantees and is essentially the same as clause 28.12 but it carries a proviso. The proviso is that, if the future credit contract is within a limit previously agreed in writing by the guarantor and notice was given when the guarantee was taken that future credit could be included, then the disclosure and consent requirements do not have to be met.

This means that, if provision for future credit has been included in the original guarantee, a guarantee will be enforceable, so far as the New Code is concerned, in relation to future lending even if the guarantor does not know about it and has not agreed to the extension of the guarantee to it, and even, presumably if it considerably increases the risk for the guarantor or extends the period for which they will be liable.

The exception contains the potential for unexpected hazard for a guarantor, particularly one who has given a guarantee on the basis that the loan was one required to be reduced over time (as opposed to a line of continuing credit or an overdraft). The guarantor may reasonably expect that they will be 'on the hook' for a certain period of time for the stated amount but that within an ascertainable period the loan which they have guaranteed will be repaid. This provision on its face allows for a different kind of facility such as an overdraft to be substituted for, say, a term loan up to the limit of the guarantee, without the guarantor's knowledge or consent.

When considering the effect of this proviso, it should be kept in mind that the new Code does not reduce a bank's liability for unconscionable conduct. Also it may be that the Ombudsman would take the view that it is consistent with good industry practice to always obtain a guarantor's acknowledgment for additional lending, even if it is within an existing limit.

Enforcement of judgments

Banks and consumer representatives need to take specific note of clause 28.14. The clause contains a promise that a judgment against a guarantor will not be enforced unless:

- judgment against the debtor has remained unsatisfied for 30 days after written demand for enforcement of the judgment debt, or
- reasonable attempts to locate the debtor have been unsuccessful, or
- the debtor is insolvent

but the clause does not apply where the principal debtor is a small business[18].

[18] This clause is based on section 82 of the UCCC. Although the clause does not apply to small business debts, it would pick up individual investment loans which would not be covered by the UCCC

BFSO will carefully examine the circumstances leading to attempts to enforce guarantees to check the new Code requirements have been met in addition to any representations made or other circumstances which indicate it would be contrary to law, good industry practice or fairness for the guarantee to be enforced.

Family Law Proceedings

Clause 38 is a promise that by the date an individual bank announces its adoption of the new Code, it will publish guidelines setting out the manner in which it will deal with:

- Applications for transfers of mortgage and consents to transfer of title under Family Court determinations or approvals; and
- Otherwise enforce debts affected by a family law property settlement.

Published guidelines on these matters will be most welcome. BFSO's approach to Family Court matters[19] is based on an intention to deal with the dispute between the bank and the disputant to the degree possible having regard to sometimes completed, sometimes ongoing and sometimes proposed, Family Court proceedings. It is to be hoped that the guidelines issued by banks will assist in ensuring that to whatever degree possible, the banking issues can be resolved ahead of Family Court proceedings. In addition, those guidelines will assist in ensuring that parties to those proceedings and their representatives can frame orders in a way which is more likely to be acceptable to banks and which will result in orders which are able to be meaningfully implemented.

As always we welcome any comments and feedback on the contents of this Bulletin.

Colin Neave
Banking and Financial Services Ombudsman

[19] Set out in our Polices and Procedures pages 105 to 106