

Banking & Finance - Bulletin 57 March 2008

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** On 1 July 2008, the Banking & Financial Services Ombudsman (BFSO), Financial Industry Complaints Service (FICS) and Insurance Ombudsman Service (IOS) merged to form the Financial Ombudsman Service (FOS).*

Credit Listings

In our Bulletin 34 (June 2002), we considered a number of issues relating to the listing of overdue accounts. We think it is timely to remind credit providers of the requirements of the *Privacy Act* in relation to the listing of overdue payments and the inter-relationship of credit listing with the requirements of the Uniform Consumer Credit Code ("UCCC").

Listings without prior warning

Some disputes received by this office have related to a listing made without warning, that is, the overdue payment may have been demanded, and be more than 60 days overdue, but the consumer has not been notified at the time that if the payment becomes overdue that failure to pay will result in the debt being listed.

The Privacy Commissioner's Explanatory note 54 states:

'Where an individual becomes overdue in respect of credit given by a credit provider, the credit provider may not report the overdue payment to a credit reporting agency unless the credit provider has first notified that individual that the credit provider may lodge a report about the overdue payment against the individual with a credit reporting agency.'

The view of this office is that, as a matter of good practice, a financial services provider must warn the consumer at the time of demand that failure to pay may result in a credit listing. It is not sufficient that notice about a possible listing is given at the time the credit was provided as such a warning may not be sufficiently proximate to the overdue payment.

Listing amounts less than 60 days overdue

For a listing to be made with a credit reference agency, the payment that is listed must be over due for 60 days or more. Section 18(1)(b)(vi) of the *Privacy Act* provides that the information held by a credit reporting agency should be a record of:

"credit provided by a credit provider to an individual, being credit in respect of which:

- A. *the individual is at least 60 days overdue in making a payment, including a payment that is wholly or partly a payment of interest; and*
- B. *the credit provider has taken steps to recover the whole or any part of the amount of credit (including any amounts of interest) outstanding;"*

If a debtor fails to pay an instalment due under a credit contract regulated by the UCCC, the creditor can only recover the total amount due if it has met the requirements under Section 85 of the UCCC. Section 85 provides that an acceleration clause is to operate only if the debtor is in default under the credit contract and:

- The credit provider has given to the debtor and any guarantor a default notice under Section 80;
- The default notice contains an additional statement of the manner in which the liabilities of the debtor under the contract would be affected by operation of the acceleration clause and also the amount required to pay out the contract (as accelerated); and
- The default has not been remedied within the period specified in the default notice (unless the credit provider believes on reasonable grounds that the default is not capable of being remedied).

For contracts to which these sections of the UCCC apply, a credit provider cannot enforce a credit contract unless it has provided the debtor with a notice that allows the debtor a period of at least 30 days from the date of the notice to remedy the default and the default has not been remedied. It is our view that it is appropriate for the credit provider to include in the Section 80 notice, a statement that the debt may be listed if it remains overdue for 60 days or more.

A notice under Section 80 is not required to be given if:

- The credit provider believes on reasonable grounds that the credit contract was induced by fraud on the part of the debtor;
- The credit provider has made reasonable attempts to locate the debtor but without success;
- The Court authorises the credit provider not to do so; or
- The credit provider believes on reasonable grounds that the debtor has or intends to remove or dispose of mortgaged goods under a mortgage related to the credit contract without the credit provider's permission or if urgent action is needed to protect the goods.

In most cases, a credit provider will be required to serve a notice under Section 80 before the full amount of the debt becomes due. This will not occur until at least 30 days from the date the notice is given. Under Section 173(1) of the UCCC a notice will be taken to be given:

- If it is given personally, on the date it bears or the date it is received by the addressee, whichever is the later;
- If it sent by post, on the date it bears or the date it would have been delivered in the ordinary course of post, whichever is the later;
- If sent by facsimile or electronic transmission, on the date it bears or the date on which the machine from which the transmission was sent produces a report indicating that the notice or other document was sent to the addressee, whichever is the latter.

Under Section 172(5) of the UCCC, if the notice is given by post, service may be affected by properly addressing, prepaying and posting the notice or other document as a letter. The UCCC does not require that the debtor actually receives or reads the notice. What is important is that the credit provider can show that it was sent in accordance with the provisions of the UCCC. Therefore a credit provider should have sufficient records to show exactly what was sent to the debtor and how and when it was sent. If, however, the notice was sent by post and returned to the credit provider, then service may not have been effected.

Assuming that the notice has been properly sent and has not been returned, then it is only upon the expiry of the Section 80 notice that the full amount becomes due and payable. If the credit provider wishes to list the full amount owing (as accelerated) then it must wait at least another 60 days before doing so. For example:

- | | |
|----------|--|
| 31 March | Section 80 Notice is given requiring rectification of the default (eg payment of the arrears) within 30 days of the notice being given. Please note, the date the notice was sent is not the first day of the 60 days for the purposes of credit listing. |
| 3 April | Section 80 Notice is deemed to be "given" in the ordinary course of post (this date may vary depending on the geographic locations of the creditor and debtor. In this example, three days have been allowed for the ordinary course of post, but it is best to allow up to five business days.) |
| 3 May | Section 80 Notice expires (if the expiry date is a weekend or non-business day, it is preferable to allow time for compliance on the next business day after expiry.) |
| 4 May | This is the first day when payment of the full amount is "over due". |
| 2 July | If the full amount (or any part thereof) remains over due, this is the earliest possible time that full amount of the debt could be listed. |

If the listing has been made too early it may be that it will have to be removed or amended. For example, if the credit provider, in error, started counting its 60 days from 31 March and listed the debt on 15 June, and the debtor repaid the debt in full on 20 June, then at no time did the debt become 60 days over due. In those circumstances the listing ought to be removed and compensation for non-financial loss may be considered having regard to the Ombudsman's guidelines.

If however, the debtor does not make payment within 60 days from the date of the expiry of the notice, then the listing ought to be amended, so that the correct date that the debt became overdue is listed. This ensures that the file held by the credit reporting agency is accurate and up to date.

Providing accurate information to customers

Where a credit provider notifies a customer of an overdue amount and demands payment, the credit provider must ensure that the customer is not given conflicting or

misleading advice about what to do to avoid falling into default, having the account cancelled or suspended, and/or a credit listing being made.

For example, if a customer is informed of an overdue debt and that payment is required by a stated date, or within a specified number of days to avoid the account being suspended and a listing made on his or her credit file, no action should be taken to suspend the account or list the debt until after the nominated date or the time period specified.

Care should also be taken not to mislead customers into believing that payment of a lesser amount is sufficient to avoid recovery action and a credit listing. In some cases we have seen, the debt has been properly accelerated having regard to Sections 80 and 85 of the UCCC, but the debtor continues to receive statements or letters requiring the payment of a lesser amount, often any past due payments and over limit amounts. If the customer pays the lesser amount stated in the subsequent notice, and continues to pay in accordance with those statements, it is our view that no recovery action or credit listing should be made even where the full amount is due but remains unpaid.

Any case where a customer found to have been misled by representations or instructions given in a letter or account statement seeking payment, may result in compensation being awarded and, where a debt is listed prior to the date indicated in the letter or in circumstances where payment of a lesser amount stated by the credit provider, it is very likely to result in a determination that the listing should be removed.

Recovery of Enforcement Costs

This office frequently receives complaints from customers about enforcement costs which have been incurred by the financial services provider and charged to their account. We will consider such a complaint insofar as we will investigate whether the costs were reasonably and properly incurred and accounted to the customer. This includes consideration of discounts or rebates to which the financial services provider was entitled and the impact of the GST component of such costs on a financial services provider's claim for reimbursement.

Entitlement to Reasonable Costs

A financial services provider's loan documentation or security documentation will invariably provide that, in the event that the customer defaults under the terms of their facility and the financial services provider incurs costs in enforcing its rights upon such default, the financial services provider will be entitled to seek reimbursement of those costs from its customer. The usual wording has the effect of making the customer responsible for the costs on an indemnity basis.

However, this contractual right is subject to the financial services provider's implied contractual duty to act as a reasonable and prudent banker. As noted by the NSW Supreme Court in *Elders Trustees & Executor Co Ltd v Eagle Star Nominees Ltd* (1986) 4 BPR 9205:

"...there is a necessarily implied qualification that the provision applies only to costs, charges and expenses or payment properly incurred...For this purpose, I consider that the "properly" means "reasonably and in good faith"... This is consistent with the view expressed by Street J in Re Shanahan (1941) 58 WN (NSW) 132 at 136 that a clause in a mortgage requiring the mortgagor to pay "all costs and expenses incurred by the mortgage" in various ways, would not cover "costs which had been unjustifiably or vexatiously incurred by the mortgagees so as to impose an unwarrantable burden on the mortgagors."

It is not the role of this office to scrutinize every item claimed by a supplier of services such as the financial services provider's lawyers or collection agents. However, we will investigate the costs a financial services provider has sought to recover from a disputant to determine whether the costs have, in the circumstances, been reasonably incurred.

Discounts and Rebates

A financial services provider is only entitled to seek recovery of the costs it incurred. Therefore, if the financial services provider receives a discount or rebate from its provider for the cost of services rendered, a financial services provider when seeking reimbursement from its customer must account for such benefits.

In *St George Bank Limited v Irani (No 2)* [2007] VSC 116, the Victorian Supreme Court considered an arrangement St George Bank Limited had with its panel firms by which the solicitors were "required to pay to the Bank a rebate of fees paid by the Bank, calculated on a sliding scale". Mr Justice Whelan concluded that:

"Nor, in my view, can guarantors be required to pay to the Bank by way of "indemnity" legal costs and expenses which have been repaid by the solicitors' firms. Accordingly, my conclusion is that the calculation of the amount outstanding must give appropriately calculated credits for the rebates."

This office similarly takes the view that, if a financial services provider is entitled to a rebate, the amount of that rebate, if not already remitted by the supplier, should be calculated and an adjustment made in the amount the financial services provider seeks to recover from its customer.

The Impact of GST

As everyone appreciates, the provisions of *A New Tax System (Goods and Services Tax) Act* ("the GST Legislation") introduced a goods and services tax ("GST"), currently 10%, to be levied on the supply of goods or services. A detailed analysis of the impact of GST on costs incurred for goods or services generally and by a financial services provider is provided further below.

It is the view of this office that a financial services provider is not entitled to recover any more than that which it is, or should reasonably be, out of pocket. Therefore, if the financial services provider is entitled to a credit from a third party, that credit should be accounted for in the financial service provider's claim for reimbursement from its customer.

Therefore, we will take into account any entitlement the financial services provider would have to claim a Reduced Input Tax Credit ("RITC") as allowed under the GST legislation on the costs incurred and passed on to its customer. This is because an entitlement to claim the RITC rests with the financial services provider as the entity which received the services eligible for a RITC; if the costs are passed on in total to the customer, the customer is not able to make a claim to the Australian Taxation Office ("ATO") as the customer did not contract for the services supplied.

It should be noted that, in our view, the name of a customer on a tax invoice is not determinative of the entitlement to RITC. The crucial question is who contracted for and received the supply of services. Therefore, a financial services provider may request its supplier to provide it with an invoice rendered to the name of its customer. However, as the financial services provider is still the party who has contracted for the services, the financial services provider will, on the face of it, be the entity entitled to claim the RITC on the invoice from the ATO, not its customer.

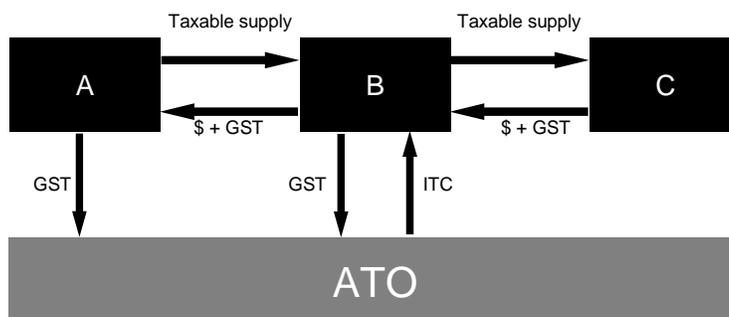
The Ombudsman will make no comment about a financial services provider's practice in accounting to the ATO for any RITC to which it is entitled. This is a matter for each financial services provider to decide taking into consideration accounting, taxation and compliance advice. However, even if a financial services provider elects not to claim a RITC to which it is entitled, this office expects the financial services provider acting reasonably and prudently to account to its customer for any RITC entitlement. The financial services provider should only seek to recover from its customer those costs that are net of any RITC entitlement.

Taxable supply

A business that makes a taxable supply and also receives a taxable supply from its suppliers must account to the Australian Taxation Office ("the ATO") for one-eleventh of the price of its supply by remitting GST. At the same time, it is entitled to an input tax credit ("ITC") for amounts in respect of GST it has paid on purchases made. Broadly speaking, the effect is that the business has to pay only a net amount (if the GST levied is greater than its ITC) or is entitled to a GST refund (if its ITC is greater than the GST it levied).

This is the position of B in the example below.

Taxable supply

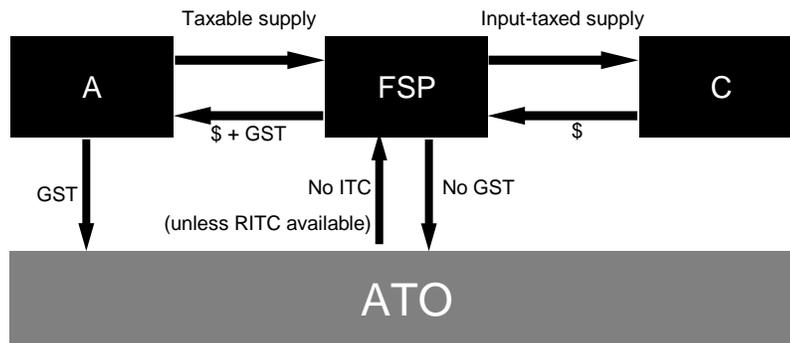


Input-taxed supply

However, the GST Legislation has identified certain transactions which are defined as an input-taxed supply. This means that the business does not need to remit GST on transactions with its customers. This also means that it does not have any ability to claim full input tax credits on acquisitions it makes in connection with the transactions with its customers. However, there may be an entitlement to a reduced input tax credit ("RITC") of 75% of the amounts in respect to GST paid to suppliers. The RITC is only in respect of some specifically identified acquisitions.

This is the position of FSP below, and applies to any business providing financial services. Thus, it is applicable to the members of the BFSO scheme insofar as any contract with a customer involves the provision of a financial service such as a loan.

Input-taxed supply



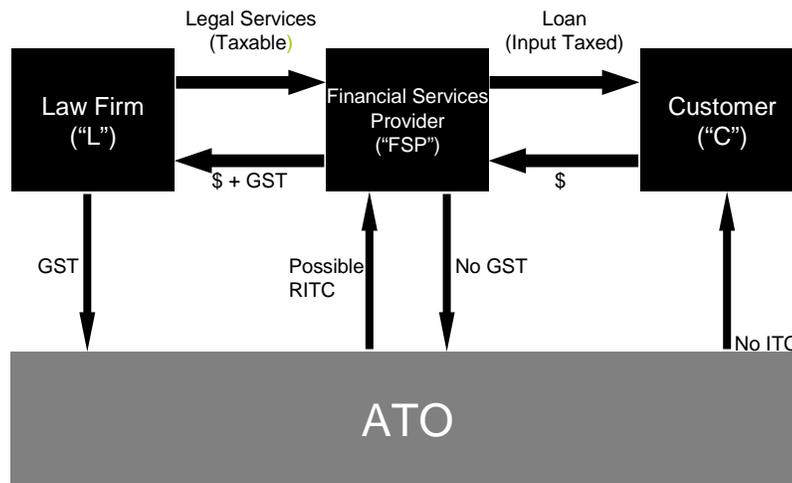
Services eligible for a Reduced Input Tax Credit

The regulations to the GST legislation set out the acquisitions of goods and services which are entitled to RITC (refer to Regulation 70-5.02). They include:

- lenders mortgage and title insurance;
- loan protection insurance;
- loan application, management and processing services, such as property title searches by credit reference assessment and credit scoring analysis, and valuations;
- debt recovery, litigation and lodgment of documents by a financial supply facilitator managing the recovery of sums due by borrowers (e.g., debt collection agencies, lawyers, receivers)

The services are provided to the financial services provider, who is therefore the entity entitled to claim the RITC. The RITC is 75% of the GST which has been paid by the financial services provider on invoices rendered by its own supplier for those services.

Therefore the usual position of a financial services provider regarding debt recovery costs is as set out in the example below. A qualification is made for the position of a financial services provider seeking to realise its security. In the realisation of assets, a financial services provider stands in the shoes of its customer and makes a supply of goods which is or is not a taxable supply depending on the goods. If the security comprises commercial or industrial property, the financial services provider may be entitled to 100% ITC. If the security involves residential property, the situation is more complex. Financial services providers should seek professional advice for further clarification of their liabilities to account to customers for the effects of GST in any particular circumstance.



- GST is driven largely off the contractual position.
- Who does "B" engage with contractually?

Update on proposed merger of EDR schemes

Background

As readers of these Bulletins are aware, the Board of the Banking and Financial Services Ombudsman ("BFSO") resolved in principle to merge BFSO's operations with those of the Insurance Ombudsman Service ("IOS") and the Financial Industry Complaints Service ("FICS") late last year.

The Board of BFSO believes that the consolidation of activities is a logical step, given the joint shared services work which has been going on for some years involving BFSO, IOS and FICS.

The Australian Securities & Investments Commission has been very supportive of the initiative.

There has been strong support too from the Australian Bankers' Association and other industry associations.

In short, for a whole range of reasons, including the simple fact that the services offered by a consolidated organisation will in time lead to more effective use of the resources available to BFSO, IOS and FICS, the decision to take the merger project to the implementation phase has been made.

The Effect of the Decision

It is intended from 1 July 2008, the dispute resolution function previously conducted by BFSO will be conducted by Financial Ombudsman Service Limited ("FOS") in the "Banking and Finance" Division of FOS.

FOS will be a new company formed if all goes to plan during April of this year. That company will have a transitional Board of nine Directors drawn from the existing Boards who will be:

- Peter E Daly AM – Chairman;
- Professor the Hon Michael Lavarch (BSFO Chairman);
- Fiona Guthrie (BFSO Board Member);
- Jenny Fagg (of ANZ and BFSO Board Member);
- David Squire (of MLC and FICS Board Member);
- Russell McKimm (Stockbroker and former President of the FPA and FICS Board Member);
- Jenni Mack (FICS Board Member);
- Kerrie Kelly (Insurance Council of Australia and IOS Board Member); and
- Elizabeth Lanyon (IOS Board Member).

Those Directors will hold office until June 2009. The Board will then consist of four representatives each of financial services providers and the consumer interest with an independent Chairman. The transitional Board will be eligible for reappointment.

Membership of the FOS service will be open to any financial services provider operating in Australia. Voting for FOS members in General Meetings will be based on the financial contribution by members to FOS. All members will have a vote.

The Board will establish Advisory Committees to deal with the different sectors of the financial services industry. There will be provision in the Constitution of FOS for establishing a complete range of Advisory Committees. These will include:

- Banks;
- Other deposit taking institutions;
- Finance & Mortgage brokers;
- Financial Planners;
- Stockbrokers;
- General Insurers;
- Funds Managers; and
- Life Insurers.

An Advisory Committee will also be set up to deal with issues of specific interest to small businesses, whether as providers or users of financial services.

These Committees, of course, will meet only as and when necessary, but at all times there will be significant involvement in the work of those Committees on the part of the relevant industry associations.

As indicated in previous correspondence, the present Terms of Reference, processes, procedures and guidelines at BFSO will continue to apply to disputes which come to FOS after 1 July 2008 and of course to disputes which are referred to BFSO in the meantime.

However, there will be a complete review of the Terms of Reference or Rules of all of BFSO, IOS and FICS. The review will be conducted over the next 15 months and involve extensive consultation with members, those representative of the consumer interest, regulators and other interested parties. Our objective is to have a standard set of Terms of Reference or Rules and associated procedures and policies for FOS in place by 1 January 2010 at the latest.

Next Steps

During April 2008, it is planned to provide information sessions on the new scheme in all States of Australia to which the members of BFSO, IOS and FICS will be invited. Regular bulletins on progress in relation to the establishment of the new scheme will also be issued.

We are also planning to advise those representative of the consumer interest of developments at various conferences over the period April to July 2008.

Enquiries by BFSO members or those representative of the consumer interest in relation to any of the issues referred to in this Bulletin can be directed to enquiries@bfsso.org.au.

BFSO is looking forward to our involvement in FOS which will, as mentioned above, build on the joint services programme which has existed now between IOS, FICS and BFSO for several years, as part of our objective to have in place the best possible dispute resolution mechanism for the financial services industry in Australia.

As is always the case, we welcome feedback on this Bulletin.



Colin Neave
Banking and Financial Services Ombudsman