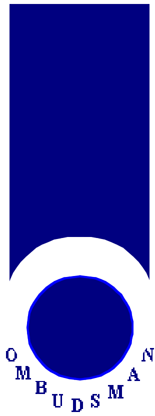


# SUBMISSION OF THE AUSTRALIAN BANKING INDUSTRY OMBUDSMAN TO THE REVIEW OF THE CODE OF BANKING PRACTICE

## JULY 2000

## SCOPE OF SUBMISSION

This submission discusses seven areas related to the current Code of Banking Practice ("the Code") where, in the view of the Ombudsman, there is scope for either clarification of existing provisions of the Code or additions to the Code. The areas are:

1. Definition of "customer";

2. Application of the Code to the resolution of disputes;

3. Disputed credit card transactions;

4. Maladministration in lending;

5. The interaction of the Code with legislation in relation to guarantees including issues relating to electronic lending;

6. Disclosure of variations to terms and conditions; and

7. Section 12.1(iii) of the Code and Privacy

## 1. DEFINITION OF "CUSTOMER"

The adoption in full of the Code of Banking Practice was timed to coincide with the coming into effect of the Uniform Consumer Credit Code (UCCC) (see Australian Payment System Council, Annual Report, 1995-1996). The definition of "customer" in the Code however, limits it's application to many customers who would otherwise be covered by the UCCC.

The definition of customer in the Code, clause 1.1 is an individual acquiring a banking service *"wholly **and exclusively**... for private or domestic use".*
It is desirable to align the definition with the Credit Code which applies to credit *"wholly **or predominantly** for personal, domestic or household purposes"*
(s 6). This would avoid gaps in coverage which might otherwise occur for customers who would not be covered by the Small Business Principles ("Banks and Small Business Working Together; ABA July 1998) but who have acquired banking services for a combination of purposes, predominantly but not exclusively personal.

## 2. APPLICATION OF THE CODE TO THE RESOLUTION OF DISPUTES

The Ombudsman has found member banks to be very responsive and well disposed towards resolution of complaints where the Ombudsman's office has identified a breach of the Code.

In addition, when this office has contacted member banks to obtain their views and responses to possible scenarios and the application and interpretation of the Code, member banks have been co-operative and informative.

Member banks have accepted the decision of their peers when interpreting the Code.

This process has worked quite well for the Ombudsman's office but it does raise problems where the industry may be disposed to interpret the Code in one way and the Ombudsman's office takes a different view to the majority.

It may be advisable to build into any redraft of the Code some mechanism for obtaining authoritative responses on industry practice and industry interpretation of the Code. It may be advisable to say that in any resolution of a dispute, which involves an alleged breach of the code, the decision maker's interpretation of the Code, following an analysis of the information provided by relevant banks, is binding.

## 3. DISPUTED CREDIT CARD TRANSACTIONS

### Contractual relationships

The Ombudsman recognises that credit card schemes such as Visa card and MasterCard comprise several separate contractual relationships between several parties.

### Nature of Contract with Cardholder

The contractual relationship between a cardholder and the bank is governed by the credit card conditions of use. The contract between the cardholder and the bank is essentially to the effect that the cardholder will be liable for the transactions he/she authorises by using the card.

Generally the conditions of use provide that the bank accepts no liability for the failure of a merchant to deliver goods paid for by credit card. The conditions of use also generally alert the cardholder to the need to report to the bank any irregularity or complaints about charges to the credit card within a specified time.

### Banks' contractual rights to chargeback

A separate arrangement exists between banks which issue credit cards and banks which have arrangements with merchants to honour credit card transactions. This relationship allows the cardholder's bank to make charge- backs to a merchant's bank in certain circumstances. These circumstances are outlined in international operating guidelines.

**Card scheme's operating guidelines**

Under the operating guidelines, card issuers are able to attempt to chargeback disputed transactions to the merchant's bank. The grounds for chargeback are detailed in the operating guidelines.

In response to a request for chargeback, the merchant's bank can reject the chargeback in accordance with the requirements of the operating guidelines.

**Relevance of operating guidelines to cardholders**

The operating guidelines have a high impact on the operation of the agreement between the cardholder and his/her bank, when a transaction is disputed because they identify:

- the grounds;
- the information required; and
- the time limits

for any attempt by the cardholder's bank to chargeback the transaction to the merchant.

The option to chargeback a disputed transaction is critical to consumers because:

- It is free;
- It overcomes some of the difficulties posed for consumers by national and international credit card use; and
- It avoids the double burden of the disputed debt and the legal cost of pursuing a merchant in respect of the error.

Notwithstanding the importance of access to the chargeback system for a cardholder, no information about these options or procedures is available to the cardholder because the cardholder is not a party to the card scheme contract.

Further, it appears likely that as between the bank and the cardholder, no contractual obligation exists at law to require a bank to take any action to attempt to chargeback a disputed transaction on behalf of its customer.

**Good banking practice**

Notwithstanding this absence of a contractual obligation on banks to attempt to chargeback disputed transactions on behalf of a customer, the Ombudsman's experience is that member banks will attempt to chargeback disputed transactions where they can.

As a result of this industry practice, the Ombudsman's view is that the objectives of the Code to:

- Describe standards of good practice and service;
- Promote disclosure of information relevant and useful to customers; and
- Promote informed and effective relationships between banks and customers,

would be well served by including in any new draft of the Code provisions reflecting good banking practice in relation to disputed credit card transactions.

As a related matter, it is advisable in the view of the Ombudsman to retain the current clause 1.4 of the Code which provides that the Code of Banking Practice is to be read subject to the Electronic Funds Transfer Code of Conduct (EFT Code) with appropriate amendments to reflect any change in the coverage of the EFT Code.

**Expansion of Code**

The Ombudsman suggests that the Code could be expanded to articulate and formalise practices, which are already widely adopted by member banks in relation to disputed credit card transactions.

The Ombudsman suggests the relevant criteria to consider for inclusion in the Code are that:

- An appropriate time frame for reporting a disputed transaction, should be appropriately identified and, preferably, highlighted, in the conditions of use for credit cards. The time frame should be as close as practicable to the actual time available to the bank to request the particular chargeback - in other words it should not be unreasonably short;

- The conditions of use should explain to the cardholder that the ability of the bank to dispute the transaction under the operating guidelines may be lost if they delay;

- Banks should process all disputed transactions as chargebacks where a chargeback right exists;

- Banks should use their best efforts, based on the information supplied by the cardholder, to use the most appropriate reason code for the charge back, so that the cardholder's reasons for disputing the transaction are properly represented;

- Banks should not accept a rejection of chargeback by the acquirer bank unless it is an appropriate response to the situation.

**Placing a Stop on an Account**

An issue, which has also arisen in the context of these cases, is whether a bank should place a stop on a credit card account when:

- A customer has disputed the transactions debited by a merchant;

- The credit limit of the card may have been exceeded; and

- That merchant is continuing to debit the account periodically.

The Ombudsman takes the view that it would improve and clarify the banker/customer relationship if the Code could be expanded to identify, as good banking practice, that in situations such as this, a customer would be offered the option of placing a stop on the

account, if the bank's system allows it, similar to the stop effected when a card is reported lost or stolen.

## 4. MALADMINISTRATION IN LENDING - A BANK'S UNDERTAKING TO ASSESS LOAN APPLICATIONS SO AS TO ENSURE THE LENDING IS APPROPRIATE

Attached to this submission, as appendix A, is a copy of the Ombudsman's Guidelines about assessing complaints of maladministration by a bank in its decision to lend to that customer.

The extract of the Guidelines is provided to suggest areas of good banking practice, which could be enshrined in an expanded Code to ensure that this vital area of banking activity has an appropriate code of practice.

## 5. GUARANTEES

A table comparing the provisions of the Code and the provisions of the Consumer Credit Code as they apply to guarantees is attached as Appendix B.

There are some differences between the requirements of the Code and the requirements of the Credit Code as they apply to guarantees. In some cases the Code imposes higher obligations, such as the requirement in cl 17.2 that a guarantee may only be accepted if the amount of the guarantor's liability is limited to a specific amount (compare s 55 of the Credit Code). In other cases, the requirements are less, such as those related to disclosure of information to guarantors. To the extent that the stated obligations in the Code are less, the Credit Code would apply because of cl 1.2 of the Code ("*This Code is to be read subject to any Commonwealth, State or Territory legislation*"). To the extent that the Code imposes higher obligations, these would apply and it is probably unnecessary/undesirable to make any amendments to them.

The current Code does not address a number of issues relating to guarantees which might be appropriate for consideration in the Review:

1. The absence of a right to receive information about a debtor's accounts before entering into the guarantee, and to know the reason why the guarantee is sought, which would better enable guarantors to assess the risk of providing the guarantee;

2. The desirability of many guarantors receiving financial advice, apart from any legal advice, before entering into a guarantee, so that they can assess the impact on them if the guarantee is called up in the future. This could be achieved by an appropriate amendment to cl 17.5; and

3. The effect of electronic commerce. The Code is readily translatable to e-commerce because, for example, it does not prescribe how information is to be provided. It might be desirable however to distinguish between transactions that can be conducted electronically and those that should not. Specifically it would seem to be undesirable that guarantees be taken electronically.

## 6. DISCLOSURE OF VARIATIONS TO TERMS AND CONDITIONS

ABIO principally relies on the Code of Banking Practice in applying standards of disclosure in relation to deposit accounts.

### Code

Clause 9.1 of the Code states that if the bank **introduces** a fee or charge or varies the method by which interest is calculated, the bank shall provide written notice to all affected customers 30 days before the change comes into effect.

Clause 9.3 of the Code states that a bank shall notify customers of a **variation** of standard fees and charges or of an interest rate by advertisement in the national or local media no later than the day on which the variation takes effect.

This office has encountered complaints from customers who say that in relation to variations to the terms and conditions of deposit accounts, the disclosure by notice in the national media is inadequate, this is particularly the case for bank customers living in remote areas.

The types of variation that are not covered by the Code include:

(a) Where there is an increase in the minimum balance to which an account keeping fee applies, for example, where the balance below which a monthly account keeping fee applies is increased from $1,000 to $2,000 and

(b) Where there is an increase in the balance to which the minimum interest rate applies, for example where the minimum interest rate of 0.3% is changed so that instead of applying to balances below $1,000 it is now applied to balances below $2,000.

**ABIO Approach**

In determining this issue, the Ombudsman's office takes into account the following:

1. The Code does not specifically cover the situation where the minimum balance to which a fee applies is raised;

2. The spirit of the Code is to inform customers of changes to the terms and conditions of their accounts so that they can make informed decisions about their financial affairs;

3. All customers would have been notified in writing that they had to maintain a minimum balance of $500, for example, to avoid the account keeping fee, when the fee was introduced;

4. For the group of customers with a balance of between $500 and $1,000, the account keeping fee which now applies, is in effect a new fee when there was not previously a fee; and

5. Unlike statement account holders, passbook account holders may not become aware of the new fee for quite some time if they do not update their passbook regularly.

**Suggested Clarification in Code**

The Ombudsman's view is that the spirit of the Code is to provide adequate disclosure so that bank customers are in a position to change their banking arrangements so as to avoid fees or to maximise their interest return should they wish to do so. On balance the Ombudsman's view is that good banking practice requires that written notice should be given to all affected customers 30 days before the change comes into effect of the change in the minimum balance to which an account keeping fee applies or a change in the interest rate tiers applying to a deposit account.

## 7. SECTION 12.1 (iii) OF THE CODE AND PRIVACY

**Duty of Confidentiality**

The duty of confidentiality owed by a bank to its customer is found in both the common law and in the Code of Banking Practice. Legislative obligations as to privacy, which have a slightly different context, are contained in the *Privacy Act 1988* (Cth) and, in a less formal sense in the National Privacy Principles.

As part of the development of the common law, the following statements (from the decisions of Bankes LJ and Aitkin LJ in *Tournier v National Provincial & Union Bank of England* [1924] 1 KB 461) have been accepted by the Australian courts as describing the banker's duty of secrecy or the duty of confidentiality:

- The duty arises as a matter of contract and is not absolute but qualified. The four exceptions accepted to apply are:

  - where disclosure is required by law;
  - where there is a duty to the public to disclose;
  - where the interests of the bank require disclosure; or
  - where the disclosure is made by the express or implied consent of the customer; and

- The nature of the information to which the duty extends includes the state of the account, the transactions which have gone through

the account and other information obtained from sources other than the account if that information was obtained as a result of the banking relations of the bank and its customer.

Section 12 of the Code reflects, in part, the common law position in relation to a bank's duty of confidentiality owed to its customers.

Section 12 says:

"*12.1 A Bank acknowledges that, in addition to a Bank's duties under legislation, it has a general duty of confidentiality towards a Customer except in the following circumstances:*

*(i) where disclosure is compelled by law;*
*(ii) where there is a duty to the public to disclose;*
*(iii) where the interests of the Bank require disclosure; or*
*(iv) where the disclosure is made with the express or implied consent of the Customer.*

12.2 *Subject to section 12.1, a Bank may not, without the consent of the Customer, disclose information concerning the Customer to another person but the Bank may disclose*

*(a) to a Related Entity, information necessary to enable an assessment to be made of the total liabilities (present and prospective) of the Customer to the Bank and the Related Entity, and*

*(b) to a Related Entity of the Bank which provides financial services which are related or ancillary to those provided by the Bank, information concerning the Customer unless the Customer instructs the Bank not to do so. A Bank shall advise those who become Customers after it adopts the Code that they have the right to give this instruction by the means referred to in section 6.1(ii).*"

Section 6.1(ii) provides that an instruction regarding a customer's confidential information may be given by marking a box in an application form.

**Relationship between the Common Law and the Code**

In Weaver & Craigie's *"The Law Relating to Banker and Customer in Australia"* (at page 2649) it is argued that, with the adoption of the Code by Australian banks, the practices embodied in it as a matter of contract will become binding upon both the bank and its customers.

This is supported by section 2.2 of the Code which says that any terms and conditions of an account shall include a statement to the effect that the relevant provisions of the Code apply to the provision of the relevant banking service.

This argument is accepted by this office in so far as the contents of the Code increase the protection of a customer's confidentiality provided by the common law.

**Section 12.1(iii) - Disclosure in the Interests of the Bank**

The exceptions in the common law and Code are largely self-explanatory, however, the third in each requires some specific comment.

The commentary contained in Weaver & Craigie (pages 2647 to 2649) indicates that this exception applied to circumstances where the bank is taking legal action or is otherwise required to disclose information to deal with a complaint.

The South African Acting Banking Ombudsman/Adjudicator commented on the application of the common law exception in his jurisdiction, saying that it is interpreted narrowly.

He also expressed the view that a bank may rely on the exception for a disclosure which would otherwise be in breach of the duty of confidentiality where it is essential to do so and "*. . . not merely when it is profitable, convenient or useful"* (Second Report of the Banking Ombudsman/Adjudicator for the period 1 May to 31 December 1999 at page 15). In other words, the "interests" of the bank, referred to in the exception, do not include commercial interests.

A survey of banks which are members of the Australian Banking Ombudsman Scheme was recently conducted as to those members' view of the meaning and intended application of the exception in section 12.1(iii) of the Code. The results of that survey indicated that member banks considered that disclosure in circumstances where the purpose was to obtain a commercial benefit, was not protected.

It is this office's view that a bank cannot rely on the common law or Code exception relating to disclosure in the interests of the bank to excuse a disclosure of information about a customer where it was not necessary for the protection of the bank's legal interests.

**Suggested Addition to Code**

We understand that the Code of Banking Practice applicable in South Africa contains a proviso on its equivalent of section 12.1(iii). The provision states:

> "*This will not be used as a reason for disclosing information about you or your accounts (including your name and address) to anyone else including other companies in our group for marketing purposes.*"

If such a proviso were added to the Code, it would have a dual beneficial effect, namely:

1. It would make it explicit that the disclosure of information about customers for purely marketing and/or commercial purposes cannot be excused by section 12.1(iii); and

2. It would ensure that, where there is disclosure to a related entity, that disclosure would be governed by section 12.2 and particularly section 12.2(b)

**Disclosure to a Related Entity**

Section 12.2 of the Code allows for disclosure without the consent of the customer by the bank to a "*Related Entity*" (as defined in section 9 of the Corporations Law).

The issue raised by section 12.2(b) is whether it allows for a bank to provide customer information to a related entity for the purpose of marketing a product of that related entity.

It is our view that it does so, unless the customer has effectively "opted out" (discussed below), for the following reasons:

- Section 12.2(a) deals with the provision of information to a related entity in circumstances where the related entity wishes to make an assessment of the customer's liabilities. It may be treated as intending to cover circumstances where a customer has made an application to the related entity for credit or some other product;

- Given that credit assessment is covered by section 12.2(a), section 12.2(b) appears to be directed at allowing a bank to provide information to a related entity so that entity can offer or market related or ancillary financial services to the bank's customer; and

- The requirement that a bank give a customer an opportunity to opt out of the process also supports a conclusion that the section is concerned with marketing rather than credit assessment.

**Provision to Opt Out**

In order for a bank to comply with the opt out requirement in section 12.2(b), it is our view that:

- If a box is to be ticked as foreshadowed by section 6.1(ii), the words used beside the box must be sufficiently explicit as to amount to an instruction to the bank that the customer's information is not to be provided to the bank's related entity/entities;

- A request that advertising or other similar material not be provided to the customer would not suffice; and

- A statement in account terms and conditions that the customer has authorised the bank to disclose information to a related entity would not suffice as no genuine opportunity is given for the customer to instruct the bank otherwise.

***Privacy Act 1988* (Cth)**

The *Privacy Act 1988* (Cth) ("Privacy Act") has limited application to banks. The information protected under the Privacy Act may be characterised as relating to information regarding an individual's credit worthiness, credit standing, credit history or credit capacity.

While there are limitations on how a bank, as a credit provider, may use or in what circumstances it may disclose information about customers, they do not apply to information such as name, address, telephone and account type details. Although such information is considered by customers to be of value, it cannot be said to fall within the above descriptors.

In these circumstances, issues regarding the disclosure of information outside the scope of the Privacy Act in its present form must be considered in the light of the common law and Code.

Colin Neave
Australian Banking Industry Ombudsman

31 July 2000

APPENDIX A

## – Extract from the Ombudsman's Guidelines on Maladministration and the decision to lend

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### The Decision to Lend

Complaints are often received from complainants alleging that a bank officer did not assess the complainant's loan application in a proper manner.

If the complaint is that a bank has refused to lend in circumstances where there was no pre existing obligation to lend, then the refusal to lend is an exercise of the bank's commercial judgement and not a matter in relation to which the Ombudsman will intervene.

If the complaint is that the bank's refusal to lend was because of discrimination which is based on race, gender, etc., then this is a matter which may be more appropriately dealt with by the Human Rights & Equal Opportunity Commission.

If the complaint is that a bank has made a loan which is wholly unsuitable given the complainant's circumstances, then this office will need to investigate whether the decision to lend was a proper exercise of the bank's commercial judgement or whether there was maladministration in the making of that decision and/or some other breach of the law or good banking practice.

## Commercial Judgement in Assessment of Loan Application

In such a situation, the Ombudsman will consider whether the complaint relates to the bank's exercise of its commercial judgement in assessing risk, character or financial or commercial matters in relation to the decision about lending and security. The following extract sets out the sorts of issues which fall within the category of commercial judgment:

> *"The ultimate lending decision should be made on an assessment of the ability of the applicant to repay the loan. This will be based on the figures provided by the applicant, supplemented by the banker's own research, and calculated*

*using the Bank's credit scoring tables, acceptable ratio limits or whatever other methods are appropriate.*

*However, it is likely that, to some extent, the decision will also be influenced by the "personal element", which is usually based on the banker's impression formed at the initial interview."*

*This may take into account the personal factors of the individual loan applicant or the business ability..., the technical ability of the loan applicant to properly perform his or her trade or profession, and their administrative skills, but it is important that the bank keeps a flexible view through the interview.*[1]

## Maladministration in the Decision to Lend

On the other hand, the Ombudsman will also consider whether there has been maladministration and in this context, the issue of ability to repay is a critical issue in determining whether or not there has been maladministration in the decision to lend.

*"The ability of a customer to repay the loan is obviously crucial to good lending practice. No banker should rely on realisation of assets held as security as the primary source of repayment and the banker must be satisfied that there is a clear repayment source. Preferably this should be under the control of the borrower and the banker should keep this in mind when examining the customer's commitments and assessing the loan amount and term."*[2]

## Criteria for Assessment

Where a loan is approved and it transpires that the customer had little or no hope of servicing the loan, it may be that such complaint will raise issues of maladministration. This issue is made explicitly relevant to loan transactions by the *Consumer Credit Code.*

In summary, the Ombudsman takes the view that when assessing whether or not to lend to the customer, a bank must act:

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[1] *Banking and Lending Practice* by PM Weaver & KM Shanahan (3rd edn) (1994) (Serendip Publications) at para 1120, page 225.

[2] *Banking and Lending Practice* by PM Weaver & KM Shanahan (3rd edn) (1994) (Serendip Publications) at para 1131, page 299.

1. As a prudent banker; and

2. In accordance with relevant standards of care

because if it does not do so, then it is clear that the customer may suffer financially (as may the bank).

**How do we assess what a prudent banker would have done and what the relevant standards of care are?**

1. Bank's Lending Guidelines

First we ask:

> *Was the loan made outside the bank's normal guidelines for lending?*

This is a relevant and appropriate standard by which to assess the bank's actions because we know that considerable thought and care has gone into the development of a bank's lending guidelines to enable the bank, by its officers, to properly analyse the risks associated with lending and so assess when it is prudent to lend.

If the loan has not been approved in accordance with the bank's own lending guidelines then this raises a serious question, to be answered by the bank, as to why the loan may nevertheless have been properly made in accordance with the standards of care expected in the banking industry.

2. Expressions of doubt by bank officers

## WE ASK:

> *Did the bank's own officers express doubt and concerns about the wisdom exercised in approving the loan?*

## THE USE OF THIS STANDARD RECOGNISES:

1. The hierarchy of loan approval within banks;

2. The expertise of bank officers; and

3. The subjective knowledge about customers of bank officers

which are relevant to an assessment of the risks associated with lending and when it is prudent to lend.

If doubts were expressed, then this raises a serious question, to be answered by the bank, as to whether the loan may nevertheless have been made in accordance with the standards of care expected in the banking industry.

## 3. Realisation of secu rity property

We ask:

> *Does the balance of information suggest that realisation of the security property provided was the only real prospect for repayment of the loan from the outset?*

The issue here is that put very simply it should be fundamental to a loan contract that loan repayments can be made by the borrower with the intention that when the loan is repaid the bank releases the security provided for the loan.

There may, of course, be borrowing arrangements which specifically envisage the realisation of security for repayment of all or part of the loan.

However, questions about the prudence of the lending decision necessarily arise if the customer cannot meet the loan repayments and cannot realistically hope to have the security released by the bank.

## 4. Further explanation

Each of the three standards of care applied by this office and identified above is an alternative which, if it cannot be satisfied by the bank, raises a real question as to whether the bank fulfilled its duty.

However, the loan circumstances must be looked at as a whole. An apparent failure to meet one of the standards may not establish a breach of the duty of care when all the circumstances relevant to the decision to lend are examined.

A simple example of this would be a loan for subdivision and sale of a property when the borrower's income would not support the loan on a principal and interest basis but the aim of the parties is to complete the subdivision, sell part of the land and either extinguish the debt or repay only the balance of the debt.

Clearly here realisation of the security property was the only way the debt could be wholly or partially repaid, but the granting of the loan would not amount to a breach of the law or good banking practice for this reason alone.

**Review of Complaint by Ombudsman's Office**

Frequently, a complaint that there has been maladministration in the decision to lend will need to be investigated because of the need to obtain the bank's lending file to fully assess the complaint.

The starting point in assessing a complaint is the bank's lending guidelines.

**Housing & Investment Loans**

For housing and investment loans, the usual criteria identified by a bank in its lending guidelines are:

1. The debt servicing ratio;

2. Uncommitted monthly income; and

3. The loan to valuation ratio.

To review whether these tests were properly applied and to satisfy the criteria identified in the Ombudsman's Guidelines, questions which may need to be asked by the Ombudsman's office include:

1. What was the valuation of the security property?

2. What did the bank do to verify the borrower's level of income?

3. Was the estimate for living expenses reasonable?

4. Were all commitments taken into account?

5. Did the bank assess the borrower's uncommitted monthly income against relevant standards?

6. Did the bank apply an average interest rate over the expected life of the loan for loans which offered honeymoon rates?

7. What information is there to confirm that the bank did the calculations required by its own lending guidelines?

**Small Business Loans**

For small business borrowing, additional matters which may need to be reviewed include:

1. Was the loan purpose consistent with and appropriate for the business of the borrower?

2. What was the relevant experience of the owner operators of the business?

3. Was the nature and locale of the business verified and assessed by the bank?

4. Were reasonable cash flow forecasts for the business provided by the borrower and reviewed by the bank?

5. Was a reasonable business plan for the business provided by the borrower and reviewed by the bank?

## Banks' Procedural Manuals

In many circumstances, a bank's procedural manual may outline the aspects of banking practice applicable to the assessment of risk or other aspects of a bank's commercial judgment.

Extracts from a bank's procedural manual:

1. Current at the relevant time for the purpose of the dispute; and

2. Any changes made to the procedural manual since that time,

will be relevant to the dispute and should be forwarded to the Ombudsman.

If a bank has concerns regarding the security and confidentiality of the procedural manual, then the bank may request that the extract remain confidential in accordance with paragraph 6 of the Terms of Reference.

The procedural manual may not necessarily be determinative. The circumstances surrounding the disputed transaction and banking custom may also be considered to determine whether good banking practice has been followed.

## Other Information

If the financial analysis indicates that the borrower did not meet the lending guidelines of the bank, then the case manager will need to determine what the bank did to satisfy itself that, although the lending was outside the lending guidelines, the loan may nevertheless have been properly made in accordance with the standards of care expected in the banking industry.

In this context, a case manager may look at:

1. The borrower's borrowing history;

2. The borrower's relationship with the bank;

3. Whether the loans officer had authority to approve a loan outside the bank's lending guidelines;

4. Whether there were any doubts expressed about the ability of the borrowers to service the loan;

5. Whether the bank relied on information provided by the borrower's accountant or financial counsellor;

6. Whether the borrower gave full disclosure of relevant financial information;

7. Whether the borrower had a real prospect of repaying the loan without undue hardship; and

8. If income consisted of government payments, whether these were likely to be on-going.

# APPENDIX B
# - COMPARATIVE TABLE: PROVISIONS OF THE CODE OF BANKING PRACTICE AND THE CONSUMER CREDIT CODE RELATING TO GUARANTEES

**Extracted from "Guarantees, the Consumer Credit Code and the Code of Banking Practice - Issues of Coverage, Risk and Reform";**
**Elisabeth Wentworth, June 2000.**

| | **Code of Banking Practice** | **Consumer Credit Code** |
|---|---|---|
| **Application** | Applies to Banks that adopt the Code (preamble) and thereby agree to observe the standards of disclosure and conduct when dealing with their customers.<br><br>"Bank" defined in clause 1.1<br><br>"Customer" defined in clause 1.1 as an individual acquiring a banking service "*wholly and exclusively for...private or domestic use*"<br>note excluded banking services<br><br>"Borrower" defined in clause 17.1<br><br>Applies to a guarantee or indemnity obtained from a 3rd party, who is an individual, as security for "*any financial accommodation or facility*" provided by a bank to "*any person*" other than:<br>• A public corporation or its related entities (cl 17.1(i))<br>• A corporation of which the guarantor is a director, secretary member or any of its related entities (cl 17.1(ii))<br>• A trustee of a trust of which the guarantor or a corporation of which the guarantor is a | Applies to provision of credit (section 6 requirements) by a credit provider (defined in schedule 1)<br><br>Requirements for application include that:<br>• Debtor is a natural person or a strata corporation (s6)<br>• Credit provided or intended to be provided "*wholly or predominantly for personal, domestic or household purposes*" (s 6)<br>• Guarantor is a natural person or a strata corporation(s 9)<br>• Guarantee is in relation to obligations under a credit contract within the meaning of the Code (s 9)<br>• Guarantee not an excluded guarantee under the regulations to s 9(3) |

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| | director etc or any of its related entities is a beneficiary (17.1(iii))<br>• A partner, co-owner, agent, consultant or associate of the guarantor, a corporation of which the guarantor is a director etc or any of its related entities or a trustee under (iii) (17.1(iv))<br><br>Provided the guarantor is an individual will apply to a loan for business purposes, unless the borrower is an excluded borrower under 17.1 | |
| **Disclosure** | Bank shall provide to the prospective guarantor:<br>• a written warning about the possibility of the prospective guarantor becoming liable instead of or as well as, the borrower; and<br>• if the borrower consents, a copy or summary of the transaction<br>(cl 17.4)<br><br>Before accepting a guarantee, a bank shall inform a prospective guarantor that:<br>• A copy or summary of the contract;<br>• A copy of any formal demand sent to the borrower;<br>• At the request of the borrower a copy of the latest relevant statement of account, if any, sent to the borrower<br>will be provided to the guarantor if the borrower consents<br>(cl 17.3) | Guarantee must contain a written warning in Form 4 (reg.20 - under s 50)<br><br>Credit Provider required to give prospective guarantor at least one copy of the credit contract "*before the obligations under a credit contract are secured by a guarantee*" (s51(1)(a); Amendment Act s24 clarifies timing to be "*before the guarantee is signed*"<br><br>Information statement must be given to a prospective guarantor (s51(1)(b)Form 5A from 1 Dec 1988; reg. 21) |
| **Post Guarantee provision of information** | If the borrower consents:<br>• A copy of any formal demand sent to the borrower;<br>• At the request of the guarantor, a copy of the latest relevant statement of account, if any, sent to the borrower<br>(cl 17.6) | Before enforcing credit contract against defaulting debtor, credit provider required to;<br>• provide to any guarantor a copy of the default notice given to the debtor;<br>Before commencing enforcement proceedings against a mortgagor, credit |

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| | | provider must give mortgagor a default notice (s 80)<br><br>At the request of the guarantor, a credit provider must provide information about the debtor's account (s 34) |
| **Limitation of Guarantor's liability** | Bank may only accept a guarantee if the amount of the guarantor's liability is limited to a specific amount<br>(cl 17.2) | Guarantor's liability may be limited by agreement but is otherwise co-extensive with debtor's (except for continuing credit contracts)<br>(s 55) |
| **Extension of Guarantee to future credit contracts** | Guarantee must be limited to a specific amount<br>(cl 17.2) | Allows for the extension of the guarantee to further credit contracts provided:<br>• Guarantee contains a provision that a future contract may be guaranteed (s 54(1);<br>• Credit provider gives the guarantor a copy of the future contract (s 54(2)(a);<br>• Credit provider obtains the guarantor's written acceptance (s 54(2)(b)) |
| **Form of documents** | No requirements as to form of guarantee | Guarantee must be:<br>• In writing(s 50);<br>• Signed by the guarantor (s 50);<br>• Easily legible (s 162);<br>• Clearly expressed (s 162);<br>• In printed type of not less than 10 points(reg.39) |
| **Legal and Financial Advice** | A bank shall recommend that a prospective guarantor obtain independent legal advice<br>(cl 17.5):<br><br>No reference to financial advice | The written warning prescribed by reg. 20 includes:<br>• " *You should obtain independent legal advice" before signing*"; |

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| | | and<br>• "*You should also consider obtaining independent financial advice*"<br><br>Note s 70 - absence of independent legal advice a factor which may be taken into account in determining whether a contract is unjust |
| **Withdrawal from Guarantee**<br><br><br><br><br><br><br><br><br><br><br><br><br><br>**Withdrawal from Guarantee (cont.)** | A guarantor may at any time extinguish the guarantor's liability by:<br>• Paying the then outstanding liability of the borrower (including any future or contingent liability); or<br>• Any lesser amount to which the guarantee is limited; or<br>• Making other arrangements satisfactory to the bank for the release of the guarantee<br>(cl 17.7) | A guarantor is entitled to pay out the credit contract at any time by paying:<br><br>The total of:<br>• The amount of credit<br>• Interest charges and other fees and charges payable by the debtor up to the date of termination;<br>• Reasonable enforcement expenses:<br>• Early termination charges if provided for under the contract;<br><br>less any payments made under the contract and any rebate of s.138 premium<br>(s 75) |