



# Code of Banking Practice

## Independent review

Financial Ombudsman Service Australia Submission

September 2016



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## Executive summary

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The Financial Ombudsman Service (FOS) Australia<sup>1</sup> is an ASIC-approved independent external dispute resolution (EDR) scheme that covers disputes across the financial sector.<sup>2</sup>

When deciding a dispute, FOS is required to do what is fair and reasonable in all the circumstances, having regard to factors including applicable industry codes and good industry practice. We consider that the Code of Banking Practice (Banking Code) represents good industry practice and generally reflects the common law obligations of financial services providers (FSPs). For this reason, we approach disputes on the basis that standards set by the code apply not only to its subscribers, but also to non-subscribing FSPs.

In addition to our role in dispute resolution, we have responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. We also provide secretariat services to the code monitoring and compliance committees for four industry codes of practice<sup>3</sup>.

We welcome the opportunity to contribute to the independent review of the Banking Code commissioned by the Australian Bankers' Association.

Key points in this submission<sup>4</sup> are outlined below.

### **Remedies for breaches of Banking Code**

We consider that, ideally, the Banking Code should specify the consequences of non-compliance with obligations that can result in very significant consumer detriment. As a first step, a provision could be added to the code stating that a breach of the provisions for guarantees causes the guarantee to be unenforceable.

### **Financial difficulty generally**

We suggest the review considers whether clause 28 of the Banking Code should be amended so that it:

- extends to guarantors
- prevents a bank from taking action, such as selling a debt, listing a default or enforcement action, for a specified period after a customer requests financial difficulty assistance.

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<sup>1</sup> Information about FOS is set out in full on our website at [www.fos.org.au](http://www.fos.org.au). The Appendix to this submission summarises key points.

<sup>2</sup> FOS is approved by ASIC under its [Regulatory Guide 139](#) *Approval and Oversight of External Dispute Resolution Schemes*.

<sup>3</sup> See Appendix for more detail.

<sup>4</sup> This submission does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessor schemes.

### **Financial difficulty and small business**

We suggest bank staff involved in small business collections receive enhanced training on the Banking Code.

Changes recommended by a recent inquiry could be made in relation to the Banking Code to:

- add requirements to give customers notice of expiry or variation of loans in certain situations
- address areas including loan impairment, revaluation and non-monetary defaults and
- make code subscription mandatory for certain financial services providers.

Clause 28 could be altered to ensure EDR information is given to a small business customer:

- in any default notice they receive
- when their request for financial difficulty assistance is declined and
- when they receive notice that a bank does not intend to renew a loan that is about to expire.

### **Intermediaries**

New disclosure requirements could be added to the Banking Code to improve communication between banks and customers who use brokers.

### **Joint debtors**

We suggest an amendment to clarify that the term 'benefit' in clause 29.1 means a direct and immediate gain. A distinction could be drawn between such a gain and an indirect benefit.

### **Direct debits**

We suggest further efforts be made to ensure that bank staff have a good knowledge of clause 21.

### **Requests for documents**

Clause 13.2 could be altered to enable customers to obtain copies of loan application documents, credit assessments and valuations.

### **Publication of information by Code Compliance Monitoring Committee**

We support amendments to confirm that the Code Compliance Monitoring Committee can proactively publish on its website de-identified determinations and information about breaches of the Banking Code.

## Provisions in Mutuals Code<sup>5</sup>

The review could consider whether aspects of the Mutuals Code should be incorporated in the Banking Code.

Please contact FOS if you would like us to clarify any of our comments or provide further information.

## 1 Banking disputes considered by FOS

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### 1.1 Dispute resolution and related work by FOS

FOS is Australia's principal EDR scheme for disputes between consumers and their banks. Continuing the work of our predecessors the Australian Banking Industry Ombudsman and the Banking and Financial Services Ombudsman, FOS draws on over 25 years of experience in resolving banking disputes.

Throughout that period, we have contributed to developments in banking legislation, policy and regulation, including regulatory guidance for EDR and internal dispute resolution<sup>6</sup>. We have also contributed to improvements in banking by handling systemic issues<sup>7</sup>.

Our [Annual Reviews](#) present detailed information about our work in resolving disputes, making submissions and addressing systemic issues relating to banking.

### 1.2 Bank members of FOS

FOS had some 5,540 licensees and 8,036 authorised credit representatives as members as at 30 June 2016. Our records for 2015-16 indicate that 46 of our members were banks.<sup>8</sup> Almost all of the Australian Bankers' Association's members are members of FOS.

### 1.3 Banking disputes accepted in 2015-16<sup>9</sup>

FOS accepted a total of 20,298 disputes across our whole jurisdiction in 2015-16. Banks were the sales and service channel in 44% of the disputes we accepted in 2015-16. In these disputes, the most common issues were financial difficulty and FSP decisions.

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<sup>5</sup> [Customer Owned Banking Code of Practice](#).

<sup>6</sup> For examples, see our submissions to the Senate [Inquiry into the Post GFC Banking Sector](#) and the Parliamentary Joint Committee [Inquiry into Impairment of Loans](#).

<sup>7</sup> Our online publication, [The FOS Circular](#), provides quarterly updates on our systemic issues work.

<sup>8</sup> This information is based on how the financial services providers have described their business to us.

<sup>9</sup> More detailed information is provided in our [Annual Review 2015-16](#).

## 2 Remedies for breaches of Banking Code

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The Banking Code does not specify the consequences of non-compliance. The most acute example of this issue relates to clause 31, which sets standards relating to guarantees. The code does not indicate whether a breach of the provisions for guarantees results in a guarantee being unenforceable (which is the FOS position) or consideration of whether the guarantor would have acted differently if the breach had not occurred.

The Banking Code provisions about taking guarantees are quite prescriptive. For example:

- clause 31.2 starts ‘We may only accept a guarantee if...’
- clause 31.4 starts ‘We will do the following things before we take a guarantee from you...’ and
- clause 31.5 starts ‘We will not ask you to sign a guarantee, or accept it, unless...’.

Given the wording of these provisions, non-compliance should mean that the guarantee is unenforceable. Not only does this outcome accord with the strong words used in the code. It also helps to ensure that bank staff comply with the provisions and keep records of their compliance, rather than taking the view that compliance is optional because the guarantee would have been signed anyway.

FOS adopts this approach in resolving disputes. We have determined that guarantees that breach the Banking Code are unenforceable.

We consider that, ideally, the Banking Code should specify the consequences of non-compliance with obligations that can result in very significant consumer detriment. As a first step, a provision could be added to the code stating that a breach of the provisions for guarantees causes the guarantee to be unenforceable.

We suggest that the aim should be to, over time, develop a tiered system of remedies and provide for them in the Banking Code. This would involve specifying substantial remedies for breaches regarded as particularly serious and less substantial remedies for other breaches.

## 3 Financial difficulty generally

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Clause 28 of the Banking Code deals with financial difficulty. We suggest consideration be given to amending clause 28 to address the matters noted below.

### 3.1 Applying provisions to guarantors

Clause 28 only applies to borrowers, not to guarantors. This means the Banking Code does not require FSPs to consider requests for financial difficulty assistance that relate to obligations to pay liabilities under guarantees. It may be appropriate to extend clause 28 so that it also applies to guarantors.

### 3.2 Preventing action by FSP

While a customer's request for financial difficulty assistance is being considered, the Banking Code does not prevent the bank from:

- recording a default listing against the customer or
- taking steps in debt recovery or collection action or a debt sale.

Paragraph 24.2 of the Mutuels Code, on the other hand, requires an FSP to put in place procedures to ensure (among other things) that it does not:

- list a customer's default on their credit reference file while the FSP considers an application or request from the customer, unless legally required to do so or
- sell a debt to a debt buy out business while the FSP considers an application or request in respect of the debt from the customer.

It is important that banks focus on giving real and genuine consideration to their customer's financial difficulties rather than continuing with collection activity. We are also concerned that the selling of a debt to a third party while a hardship application is being considered may mean that the bank effectively avoids its obligations under the Banking Code to assist their customer. This is of particular concern where the third party does not subscribe to the code.

If a financial services provider declines to give financial difficulty assistance, regulatory guidance issued by ASIC<sup>10</sup> prevents the financial services provider from taking enforcement action for at least 14 days. FOS is of the view that equivalent provisions should be incorporated into the Banking Code.

## 4 Financial difficulty and small business

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### 4.1 Enhanced training

FOS has been concerned for some time that bank staff operating small business collection departments are not aware of the Banking Code, particularly its provisions for financial difficulty. While there have been significant improvements by banks in dealing with individuals in financial difficulty, the same level of improvement has not occurred in areas of banks responsible for dealing with small business financial difficulties.

FOS considers that bank staff involved in small business collections should receive more extensive training about the Banking Code focussing on financial difficulty. Initiatives that have been implemented in hardship areas dealing with individual consumers, such as training from financial counsellors, could be replicated in the small business area.

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<sup>10</sup> ASIC's [Regulatory Guide 165](#) *Licensing: internal and external dispute resolution*. See 'IDR timeframes', especially paragraphs 109 to 111.

## 4.2 Recommendations of recent inquiry

The report on the recent Parliamentary inquiry into the impairment of loans included the following recommendation.<sup>11</sup>

### Recommendation 2

The committee recommends that the banking codes of practice administered by the Australian Bankers' Association or the Customer Owned Banking Association and other regulatory arrangements be revised to require that:

- Authorised deposit taking institutions must commence dialogue with a borrower at least six months prior to the expiry of a term loan. Further, where a monetary default has not occurred, they must provide a minimum of three months' notice if a decision is made to not roll over the loan, even if this means extending the expiration date to allow for the three months following the date of decision.
- If a customer is meeting all terms and conditions of the loan and an authorised deposit taking institution seeks to vary the terms of the loan, the authorised deposit taking institution should bear the cost associated with the change and provide six months' notice before the variation comes into effect.
- Customer protections relating to revaluation, non-monetary defaults and impairment should be explicitly included in the code.
- Subscription to a relevant code becomes mandatory for all authorised deposit taking institutions.

FOS supports implementation of the initiatives in Recommendation 2 in the review of the Banking Code. Making changes in relation to the code based on this recommendation could strengthen consumer protection, particularly for small business lending.

## 4.3 Information about EDR

If a request for financial difficulty assistance is declined, section 72 of the National Credit Code requires the creditor to inform the debtor of their rights to EDR and the contact details of the EDR scheme they could approach. This applies to individual, but not small business, consumers. Clause 28.8 of the Banking Code requires a bank to provide certain information after deciding whether to provide financial difficulty assistance, but does not refer to any information about EDR.

It may be appropriate to alter clause 28 to ensure EDR information is given to a small business customer:

- in any default notice they receive
- when their request for financial difficulty assistance is declined and
- when they receive notice that a bank does not intend to renew a loan that is about to expire.

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<sup>11</sup> [Inquiry](#) into the Impairment of Customer Loans conducted by the Parliamentary Joint Committee on Corporations and Financial Services. See Recommendation 2 in the inquiry's report released in May 2016.

## 5 Intermediaries

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A question that arises regularly in disputes - especially in the area of 'responsible lending' - is whether an intermediary in a transaction, such as a broker, was acting as the agent of the FSP or the customer. Often a customer who approaches a broker is not aware that the broker is their agent and believes the broker is a representative of the FSP. This can be crucial where the customer provides important information to the broker which is not communicated to the FSP.

If customers were better aware as to whether they were directly dealing with a representative of the FSP, they may take additional steps to confirm that information has been communicated to the FSP.

In this context improved disclosure to customers could prove effective. For example where a customer is applying for a loan through a broker who is their agent, the FSP might, as part of the loan approval process, be required to inform the customer that:

- the loan is being sourced by a broker
- the broker is the customer's representative
- the customer should carefully check that all information provided by the broker is accurate and
- if there are particular issues that are important to the customer, they should be communicated directly to the FSP.

## 6 Joint debtors

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Clause 29.1 of the Banking Code is designed to prevent a guarantor of a debt from being signed up as a co-debtor. It states:

We will not accept you as a co-debtor under a credit facility where it is clear, on the facts known to us, that you will not receive a benefit under the facility.

The equivalent provision in the previous version of the Banking Code (clause 26.1) said that the co-borrower must receive a 'direct benefit'.

Clause 29.1 is similar to paragraph 11.1 of the Mutuels Code. In a dispute recently considered by FOS, a subscriber to the Mutuels Code provided credit that benefitted one borrower by consolidating his credit card debts. His wife was not previously liable for the credit card debts and derived an indirect benefit through the reduction in household expenses.

FOS decided that, to amount to a 'benefit' for the purposes of paragraph 11.1, a benefit must be a direct and immediate gain. An indirect benefit is not sufficient. The approach taken by FOS in this case is consistent with case law.<sup>12</sup>

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<sup>12</sup> See for example: *State Bank of NSW v Chia* [2000] NSWSC at [213] and [214] and *Agripay Pty Ltd v Byrne* [2011] QCA 85 at [11] and [62].

We suggest an amendment to clarify that the term ‘benefit’ in clause 29.1 means a direct and immediate gain. A distinction could be drawn between such a gain and an indirect benefit.

## **7 Direct debits**

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Disputes concerning cancellations of direct debit authorities arise regularly in our experience. The Banking Code provides for direct debits in clause 21 and the FOS approach to direct debits is set out in Bulletin 29<sup>13</sup>.

We consider clause 21 to be effective. However, in our view, the provision is not widely known by bank staff and we suggest further efforts be made to ensure it is well known.

## **8 Requests for documents**

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Clause 13.2 of the Banking Code gives customers the right to request copies of documents retained in accordance with certain legislation. The documents include contracts, security documents, statements of account and notices.

With the introduction of responsible lending obligations, clause 13.2 could be altered to also enable customers to obtain copies of loan application documents and credit assessments made under section 116 of the *National Consumer Credit Protection Act 2009* (National Credit Act).

We also consider that copies of valuations obtained by the bank in the course of a loan application should be provided to the customer. The customer has paid for the valuation and we are of the view that it would reduce the number of disputes coming to FOS if the customer was provided with a copy of the valuation at the earliest available opportunity.

## **9 Publication of information by Code Compliance Monitoring Committee**

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The submission made to the review by the Code Compliance Monitoring Committee recommends amendments to confirm the committee’s ability to proactively publish on its website de-identified determinations and information about breaches of the Banking Code. FOS supports this recommendation.

We have been publishing our determinations for some years now and this allows users to obtain a better understanding of how cases are decided. In our view, similar reporting in relation to the investigation of code breaches would also help to increase the community’s understanding of the workings of the code and how compliance with it is monitored.

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<sup>13</sup> [Bulletin 29](#)

## 10 Provisions in Mutuals Code

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As discussed in our meeting with the reviewer on 4 August 2016, the Mutuals Code is a more recent example of a code of conduct in the financial services sector than the Banking Code. The Mutuals Code has endeavoured to expand some of the concepts originally stated in the Banking Code.

It may be useful for the review to consider whether certain aspects of the Mutuals Code should be incorporated in the Banking Code. Adopting aspects of the Mutuals Code would have an additional benefit of enhancing harmonisation of standards in the financial services sector.

The notes below refer to some of the more significant areas of difference between the two codes.

### **Responsible lending**

Paragraph 6.3 of the Mutuals Code adds to the responsible lending obligations by providing that the FSP will only lend amounts that the FSP believes, on the information available to it, the customer can reasonably afford to repay. This is perhaps a higher test than is in accordance with what a 'diligent and prudent banker' would believe. It is certainly higher than the test in the National Credit Act, which is whether the customer is unable to repay without substantial hardship.

Paragraph 6.3 of the Mutuals Code also states that different criteria will apply in the case of some products such as bridging loans and reverse mortgages.

### **Credit limit increases**

Paragraph 7.1 of the Mutuals Code provides that the FSP will act responsibly in setting and increasing the amount of credit available to the customer. It also provides that the FSP will not send an unsolicited offer to increase the credit limit where:

- the customer has a recent poor repayment history with the FSP or
- the FSP is aware of circumstances that make it imprudent for the FSP to extend further credit.

Paragraph 7.2 of the Mutuals Code provides that any unsolicited offer to increase the credit limit will include information on:

- the new minimum payment required
- options for lowering existing or new credit limits
- not accepting the offer if the customer cannot afford the credit, is having difficulties making payments, or their financial circumstances are likely to deteriorate and
- how to tell the FSP that they do not wish to receive offers to increase the credit limit in the future.

## **Reverse mortgages**

Paragraph 8.2 of the Mutuels Code provides that the FSP will:

- comply with the National Credit Act requirements regardless of the purpose for which the loan proceeds are used
- strongly encourage the borrower to seek financial advice from an independent qualified financial adviser and to consider seeking independent legal advice and
- ensure the reverse mortgage loan –
  - limits their repayment obligations to the market value of the property, except where permitted by the National Credit Act and
  - allows the borrower to discharge the loan at any time.

## **Guarantees**

Paragraph 12.12 of the Mutuels Code provides that an FSP cannot make a guarantor liable for a future loan using an all accounts guarantee provision unless:

- the guarantor has been provided with updated information available to the FSP on the financial position of the borrower and
- that is information that a careful and prudent guarantor may wish to consider before allowing a guarantee to be extended.

The Banking Code requires an FSP, before taking a guarantee, to give the guarantor information about the borrower. The only information the Banking Code requires a guarantor to be given when the guarantee is extended to a future loan is a copy of that loan.

## **Financial difficulty**

Paragraph 24 of the Mutuels Code deals with financial difficulty. Notably it contains provisions to prevent an FSP from default listing a customer or assigning their debt while the FSP considers a financial difficulty request from the customer.

## Appendix - About FOS

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FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector. Our service is free to consumers and is funded through a combination of levies and case fees paid by our members, which are financial services providers.

FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines. The original participants were:

- the Banking and Financial Services Ombudsman
- the Financial Industry Complaints Service, and
- the Insurance Ombudsman Service.

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre, and
- Insurance Brokers Disputes Ltd.

Our operations are governed by our Terms of Reference that form a contract with our members. The Terms of Reference are available on our website.

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector. FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as:

- banking
- credit
- loans
- general insurance
- life insurance
- financial planning
- investments
- stock broking
- managed funds, and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC.

FOS also provides code monitoring, administration and secretariat services to committees that monitor financial services providers' compliance with these industry codes of practice:

- the Code of Banking Practice
- the Customer Owned Banking Code of Practice

- the General Insurance Code of Practice and
- the Insurance Brokers Code of Practice.

FOS is governed by a board with an independent chair and:

- four 'industry directors' appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry, and
- four 'consumer directors' appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.