Code Compliance Monitoring Committee

INQUIRY REPORT:

PRE-CONTRACTUAL OBLIGATIONS IN RELATION TO GUARANTEES

UNDER THE 2004 CODE OF BANKING PRACTICE

June 2013
ABOUT THE CCMC

The Code Compliance Monitoring Committee (the CCMC) is an independent compliance monitoring body established under clause 36 of the 2013 Code of Banking Practice.

The Code of Banking Practice (the Code) is a voluntary code of conduct which sets standards of good banking practice for subscribing banks to follow when dealing with persons who are, or who may become, an individual or small business customer of a Code subscribing bank or a guarantor.

The CCMC’s vision is to promote compliance with the Code and thereby contribute to the improvement of standards of practice and service by the banks. The CCMC adopts a collaborative approach to working with banks in order to achieve compliant outcomes and continuously improve industry standards.

The CCMC conducts a compliance program that reflects the objectives of the Code and comprises three core activities namely: monitoring, investigating and engaging. The CCMC’s monitoring role includes conducting inquiries for the purposes of monitoring compliance with a particular requirement or requirements of the Code.

The CCMC is able to use a range of investigative and monitoring techniques when conducting these inquiries including:

- requests for information from subscribing banks;
- compliance visits to the premises of subscribing banks;
- consultation and feedback with consumer advocates;
- market research activities such as mystery or shadow shopping, surveys and forums; and
- engaging external experts.

The findings of these inquiries are provided to all participating banks, so as to influence and encourage positive change in code compliance monitoring frameworks and to share experience of good industry practice and areas requiring improvement.

CCMC reports contain de-identified data. Accordingly, only aggregated results are shown. After a period of consultation, CCMC Reports are published on the CCMC website at www.ccmc.org.au

Important note: This report gives information of a general nature only and does not constitute advice. Readers should contact their own advisers if they require advice in respect of the subject matter of this report.
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EXECUTIVE SUMMARY

This Report has been prepared by the CCMC following the completion of an own motion Inquiry into the Guarantees provisions in clauses 28.3 to 28.6 of the 2004 Code of Banking Practice (the 2004 Code). The data gathering and assessment phases of the Inquiry were undertaken in September and October 2012.

The CCMC appreciates the genuine and constructive engagement we have had with the Code subscribing banks (the banks), consumer advocates and the Financial Ombudsman Service (FOS) during the conduct of this review.

It should be noted that on 31 January 2013 the ABA published the 2013 version of the Code of Banking Practice (the 2013 Code), which will become effective on 1 February 2014. Unless otherwise noted in this report, reference to ‘the Code’ in this report means the 2004 Code. The Code clauses relevant to this report are largely the same in the 2013 Code as the 2004 Code.

WHY DID THE CCMC UNDERTAKE THE INQUIRY

During 2011-2012, the CCMC received a number of concerns and enquiries about alleged breaches of the Code by banks in this area.

The high number of credit facilities currently supported by a Guarantee indicates that these play an important part in the provision of credit, both to individuals and to businesses. Issues can and do arise however when banks do not comply with their own procedures. While the number of cases where issues have arisen in respect of Guarantees is comparatively small, the impact on individuals in these circumstances can be considerable. The current economic environment also suggests that this may continue to be an important issue over the short to medium term. This is a view shared by the consumer advocates interviewed by the CCMC as part of this Inquiry.

Details of the reasons for this Inquiry, its scope and purpose are described in section B of this Report.

THE BANKS’ CODE OBLIGATIONS

Diagram 2, on page 9, provides a ‘road map’ to these Code obligations. Banks must comply with these obligations before accepting a Guarantee from a person to secure a credit facility for another individual or small business.

Compliance with these clauses must also be considered through the lens of the Code’s Key Commitments to promote better informed decisions about banking services (clause 2.1(b)), to act ‘fairly and reasonably in a consistent and ethical manner’ in their dealings with prospective guarantors (clause 2.2) and to comply with other laws (clause 3).

Some of the obligations in clauses 28.3 to 28.6 do not apply to Guarantees provided by a sole director of a borrowing company for a small business loan.
HOW THE INQUIRY WAS CONDUCTED

In summary, this Inquiry reviewed how well the banks comply with their pre-contractual Code obligations to a prospective guarantor of a credit facility outlined in clauses 28.3 to 28.6 of the Code. The CCMC also considers any potential breach of these provisions by reference to the Code’s Key Commitments in clause 2.

The Inquiry was conducted in eight non sequential stages during 2012, as outlined in Section C of this Report. It included significant consultation with key stakeholders in developing the scope and timing of the Inquiry, research into emerging issues with the pre-contractual disclosure obligations associated with Guarantees and the development and conduct of both quantitative and qualitative surveys with the banks and consumer advocates.

The survey provided to the banks requested information about how effectively the Code obligations operated within their organisations during the month of June 2012. This allowed a point in time assessment of data and a frame of reference for the banks’ responses to the survey, given the sheer number of credit facilities entered into over the course of any one year. Consumer advocates were asked in a qualitative interview to share their case work experience associated with consumer dealings with banks in the pre-contractual phases before executing a Guarantee.

In all, 13 subscribing banks and six consumer advocacy organisations responded to the Inquiry’s data collection phase during September/October 2012.

In this Report we refer directly and indirectly to circumstances that have been identified in the case law, previous CCMC matters, cases raised by consumer advocates and those discussed in past research. It is important to note that some of these guarantees were entered into a number of years ago. It is often the case - and quite understandable - that allegations of breaches of the law or the Code in relation to the formation of a guarantee are not first raised until the guarantee is called on some time after the borrower is in default; by the time they are considered by a dispute resolution body some time will have passed.

There is no doubt that bank practice has been evolving under the influence of various developments including the common law, the Code and the important changes to the law introduced by the National Consumer Credit Protection Act 2009.

Accordingly the scenarios described in the report are not necessarily indicative of current bank practice. They do however highlight the types of compliance risks that banks may encounter when accepting Guarantees from individuals and in discharging their Code obligations. They were also instructive in the development of the survey instruments used during the review.

THE CCMC’S FINDINGS

Full details of the CCMC’s findings and recommendations can be found in Section E of this report. Diagram 1 below outlines a summary of the key findings, areas of good industry practice and areas for improvement identified by the CCMC.
The purpose of clauses 28.3 to 28.6 is to promote better informed decision making by prospective guarantors. The CCMC recognises that the banks have an important role in ensuring relevant information is both provided and considered by prospective guarantors prior to the execution of the Guarantee. The Code sets out the minimum standards banks have agreed to follow when dealing with personal and small business customers. Banks should, therefore, consider how they satisfy themselves that informed decision making is taking place, particularly where they identify that a prospective guarantor might be vulnerable, whether due to their relationship with the borrower or where they have limited capacity to understand the credit contact, such as where English is a second language.

The CCMC also considers that the more complex the Guarantee and the loan documentation, the greater is the obligation on the bank to ensure the potential guarantor engages in informed decision making.

The CCMC accepts, however, that there is a duty on the individual to consider carefully the information provided by banks before agreeing to become a guarantor.
**RECOMMENDATIONS**

The disclosure requirements of the revised Code of Banking Practice, which was recently published by the ABA, are very similar to the 2004 Code. The recommendations made in this report therefore will remain relevant to banks as they transition to the 2013 Code by 1 February 2014.

**Table of Recommendations**

<table>
<thead>
<tr>
<th>No</th>
<th>Recommendation</th>
<th>Rationale</th>
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<tbody>
<tr>
<td>1</td>
<td>Each Bank should carefully consider and review its potential risk of non compliance with clauses 28.3 to 28.6 in the areas identified in this report and assess its Code compliance framework against these risks when transitioning to the 2013 Code.</td>
<td>Banks should consider the potential for non compliance and mitigate this risk though effective disclosure of information and warnings.</td>
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<tr>
<td>2</td>
<td>Banks should consider reviewing their Code compliance and monitoring procedures in transitioning to the 2013 Code to ensure assessment is made of prominence and effectiveness of their disclosure of information and warnings under clause 28.4.</td>
<td>The provision of effective disclosure of information and warnings will allow the prospective guarantor to make an informed decision about becoming a guarantor.</td>
</tr>
<tr>
<td>3</td>
<td>Banks should ensure that information and notices are provided to the prospective guarantor in a timely manner to ensure they have sufficient time to consider their position and the risks associated with the Guarantee prior to execution.</td>
<td>This will ensure that the prospective guarantor has sufficient time to consider the risks and financial liabilities of becoming a guarantor before entering into the agreement.</td>
</tr>
<tr>
<td>4</td>
<td>Good industry practice suggests that even a prospective guarantor who has received independent advice, should be given at least 24 hours to consider the Guarantee documents prior to signing.</td>
<td>This will increase the prospective guarantor’s opportunity to consider the risks and financial liabilities of becoming a guarantor in the context of the independent advice given, before entering into the agreement.</td>
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<tr>
<td>5</td>
<td>The CCMC encourages banks to consider the vulnerability of a prospective guarantor. Banks which have effective processes to identify classes of prospective guarantors and take additional steps to ensure they receive information about their rights and responsibilities and the financial position of the borrower, are better placed to comply with their Code obligations.</td>
<td>This enhances banks’ compliance with the key obligation clause 2.2 to act fairly and reasonably towards a customer in a consistent and ethical manner.</td>
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The purpose of the recommendations is to:

- assist banks when reviewing their Code compliance monitoring frameworks in this area;
• raise awareness of possible risk areas associated with the pre-contractual disclosure provisions associated with Guarantees; and
• highlight possible areas for increased vigilance as banks transition to the 2013 Code.

The CCMC encourages banks to consider and adopt the good industry practice outlined in this report.

NEXT STEPS

The CCMC will follow up this Inquiry in the 2013/14 Annual Compliance Statement, to determine what changes, if any, banks have implemented to systems and procedures in response to the findings of this Inquiry and how effectively they have transitioned to the 2013 Code in this area.
Diagram 2: Pre-Contractual Obligations under the 2004 Code in respect of Guarantees

This diagram illustrates the Code obligations from left to right of a bank in discerning information, assessing information, and executing the Guarantee. This diagram forms a check map of Code obligations for the reader.

Diagram headings:
- Provision of Information by banks
- Consideration of information by the potential Guarantor
- Execution of the Guarantee
- Bank accepts the Guarantee

Subheadings:
- Notices
- Supporting information and documentation

- Seek independent legal and financial advice
- You can refuse to enter into the Guarantee
- You have the right to limit your liability as allowed by the law
- You can request information about the transaction
- Warning notice to be above the signature
- There are financial risks involved
- Whether the facility will be cancelled if the guarantee is not provided
- Explaining the rights and obligations of Guarantors (NSC)

- Notices of demand made by the bank on the borrower
- Any related credit contracts
- The final letter of offer made to the debtor
- Any related Credit Reports
- Any current credit related insurance contracts
- The latest statements of accounts
- Any unsatisfied notice of demand within the last 2 years
- Any other information about the facility

- Provide the information and allow to the next day to consider
- Unless Legal advice has been obtained
- Guarantee to include statement that Code obligations apply

- Bank does not give the Guarantee to the Debtor
- Ensure the debtor is not present at the signing where the bank attends

- May be provided with the Guarantee document
B INTRODUCTION

BACKGROUND

A Guarantee is used to manage credit risk. Under a Guarantee contract, the guarantor may be required to satisfy a debt of a borrower in a credit contract, where the borrower has defaulted on that debt.

The 2004 Code sets out a range of obligations that subscribing banks have to prospective guarantors prior to the execution of a Guarantee. These obligations are found in clause 28 of the Code. This clause deals with Guarantees and Indemnities provided by an individual for the purpose of securing a credit facility for an individual or small business.

Clauses 28.3 to 28.6 of the Code outline a range of obligations associated with pre-contractual disclosure by the bank to the prospective guarantor of a credit facility. These obligations fall into four distinct areas:

1. the provision of information, notices and warnings about the rights and responsibilities of potential guarantors and the risks associated with guarantees;
2. the provision of information and relevant documentation regarding the financial position of the borrower;
3. the consideration of this information by the prospective guarantor; and
4. the execution or signing of the Guarantee.

These obligations are illustrated in Diagram 2 on page 9 of this Report. The obligations illustrated in Diagram 2 remain unchanged in the 2013 Code. The findings of this Inquiry therefore will be relevant to banks as they transition to adopting the 2013 Code by 1 February 2014.

Some of the obligations in clauses 28.3 to 28.6 do not apply to Guarantees provided by a sole director of a borrowing company for a small business loan. This recognises the responsibility of the sole director, who is operating a corporate business, to be duly cognisant of his or her company’s financial performance. There are some other Guarantees to which the Code does not apply. These include Guarantees for credit facilities to companies which fall outside the definition of a small business.

The purpose of the clause 28 obligations is to provide protection to prospective guarantors and to facilitate informed decision making. This is done by ensuring prospective guarantors have access to relevant information and advice about their rights, obligations and transaction risks, prior to making a decision to enter a Guarantee. The banks must also provide information about the debtor that helps the prospective guarantor understand the risk they may take on.

The obligations of clauses 28.3 to 28.6 of the Code:

1. give notice to the prospective guarantor:
   - to seek independent legal and financial advice on the effect of the Guarantee;
   - that they can request information about the transaction;
   - that there are financial risks involved;
   - that they have the right to seek to limit their liability;
   - that they can request additional information about the facility they are being asked to Guarantee; and
that they can refuse to enter into the Guarantee.

2. place the prospective guarantor in an informed position about the borrower’s financial position by providing supporting documents;

3. ensure there is sufficient opportunity for the prospective guarantor to give proper consideration to documents prior to signing; and

4. ensure that the prospective guarantor has an opportunity to act without undue influence by the borrower at the time of signing.

Compliance with these clauses must be considered through the lens of the Code’s Key Commitments to promote better informed decisions about banking services by providing effective disclosure of information (clause 2.1(b)), to act fairly and reasonably in a consistent and ethical manner in their dealings with prospective guarantors (clauses 2.2) and to comply with other laws that may relate to their Guarantees obligations (clause 3).

REASONS FOR THE INQUIRY

The CCMC considered that an Own Motion Inquiry into this area of the Code was important for a number of reasons.

During 2011-2012, the CCMC received a number of concerns and enquiries about alleged breaches of the Code by banks in this area. Whilst these allegations usually arose in the context of a bank calling on a guarantee that had been executed by the guarantor a number of years ago, they also revealed some patterns concerning the failure of the guarantor to have received independent legal and financial advice prior to entering the guarantee; allegations that guarantors did not understand the risks associated with the transactions, their rights and responsibilities under the contract; or the debtor’s true financial position at the time the guarantee was executed. These matters are all relevant to the obligations found under clauses 28.3 to 28.6 of the Code.

Every year the CCMC sends out an Annual Compliance Statement (ACS) to each Code subscribing bank to gather information to assess how effectively they complied with their obligations under the Code. Whilst the volume of self reported breaches recorded by each bank in the 2011 ACS in this area of Code obligation was low and FOS reported low complaint numbers (90)\(^1\) in its 2010-2011 Annual Review\(^2\), the CCMC also had anecdotal evidence from consumer advocates suggesting the levels of understanding held by guarantors about their potential liabilities under a guarantee was at times insufficient.

The academic research and case law reviewed by the CCMC suggested that spouses, elderly parents or those from a non English speaking background may be more vulnerable to inadequate practice in this area of banking. In 2011 there were a number of Australian court cases concerning the obligations of banks in relation to Guarantees, which supported this concern.

In addition, the economic forecasts for 2012/13 and beyond suggested the likelihood of increased activity by the banks to call on guarantors to repay outstanding loan debt, particularly in relation to small business credit facilities. At the same time there had also

\(^1\) It is interesting to note that in its 2011/12 Annual Review, FOS reported that it had received an increase number of complaints about Guarantees (146), 127 (87%) of which were in respect of banks

\(^2\) FOS 2010-2011 Annual Review, at p.35
been increased media coverage about the use of Guarantees by financial institutions and credit activities in general.

**AIMS OF THE INQUIRY**

The aims of the Inquiry were to establish:

1. Current levels of bank compliance with the clauses 28.3 to 28.6 obligations.
2. How effectively banks monitor their compliance with these pre-contractual obligations in respect of Guarantees.
3. Any areas of non compliance with the Code, or emerging risks in relation to the operation of clauses 28.3 to 28.6.
4. Evidence of good industry practice in relation to a bank’s dealings or communications with prospective guarantors about pre-contractual matters.
5. How banks engage with prospective guarantors who may be at special risk, such as spouses, elderly parents or from non-English speaking backgrounds.

**SCOPE OF THE INQUIRY**

In order to define the scope of this Inquiry, and to ensure that the scope addressed areas of concern, the CCMC consulted with both subscribing banks and consumer advocates in early 2012 with regard to issues experienced in respect of Guarantees. We also reviewed allegations of Code breaches received by the CCMC and Court cases relating to this subject matter.

The CCMC consulted with subscribing banks regarding the timing of the Inquiry. This ensured that the Inquiry did not conflict with other regulatory reporting obligations. The Inquiry was limited to an examination of the operation of clauses 28.3 to 28.6 of the Code. These clauses are outlined in summary in Table 1 below. This Inquiry did not assess bank compliance with obligations related to withdrawing from or enforcing a Guarantee under clauses 28.10 to 28.14 of the Code, nor whether banks were meeting their responsible lending responsibilities under clause 25.1.

As previously mentioned, in assessing compliance with these provisions the CCMC referred to the banks’ Key Code commitments under clauses 2.1, 2.2 and 3 of the Code.

In addition, the quantitative survey provided to the banks requested information about how effectively the banks complied with their Code obligations, using June 2012 as a point in time reference for responses. Limiting the request for some data to June 2012 acknowledged the significant number of Guarantees handled by the banks in any given period. Other questions in the survey sought information from the banks about complaint

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3 These Code clauses are outlined in full in Appendix 3.
numbers and hardship applications received by them over a broader time frame, from January 2012 to June 2012. This was to ensure that sufficient data would be collected if, for example, complaint numbers were small.

To ensure the CCMC could establish a clear picture of the monitoring activities undertaken by each bank in relation to these obligations, the survey requested that the banks provide details of activities undertaken over the course of the financial year 2011-12. Questions concerning the Guarantees obligations were not included in the 2011-12 Annual Compliance Statement.

The case law and consumer data that was assessed by the CCMC both before and during this Inquiry assisted in identifying the types of compliance risks that banks may face in discharging their obligations under these Code clauses and were of assistance in designing the questionnaires used in the Inquiry. Decisions of courts and tribunals were also a point of reference for the CCMC when determining what constitutes fair and reasonable conduct by banks when dealing with prospective guarantors under clause 2.2 of the Code or compliance with other laws, as required by clause 3.

In conducting this review, the CCMC has not focussed on the obligations banks have under section 28.4 to provide notice to prospective guarantors that they should seek independent financial advice. This is because enquiries and complaints made to the CCMC have arisen in terms of the independent legal advice obligations. The CCMC however draws attention of the banks to this important obligation and encourages them to review their practices to ensure compliance with the Code's obligations when transitioning to the revised Code.

OTHER LEGISLATION AND REGULATION THAT MAY APPLY

Whilst this Inquiry dealt with the requirements of clause 28 of the Code, the CCMC notes that the subscribing banks have other legal and regulatory obligations in relation to Guarantees. These obligations were considered by the CCMC during the Inquiry. Clause 3 of the 2004 Code states that banks must “comply with all relevant laws relating to banking services”. This obligation continues in the 2013 Code under clause 4.

Some of the specific national legislative provisions that relate to Guarantees are outlined in summary below and are documented in greater detail in Appendix 4, but include the following:

**National Consumer Credit Protection Act 2009**

At the time of the Inquiry, Part 3, Division 2 of the National Credit Code applied to Guarantees. The requirements of this section of the National Consumer Code include:

- the need for the Guarantee to be in writing; and
- the provision of relevant documents related to the credit contract to the guarantor before and after the Guarantee is signed.

**Privacy Act**

Section 18N of the Commonwealth Privacy Act regulates disclosure by credit providers of personal information in reports related to credit worthiness. Sections 18N(1)(ba) and (bh) specifically relate to disclosures associated with Guarantees. This means, for example, that a bank can only disclose financial information about a debtor to a prospective guarantor, if the debtor has consented.
C METHODOLOGY

This Inquiry was undertaken in eight phases (non-sequential) as outlined in table 2 below.

Table 1: Methodology

<table>
<thead>
<tr>
<th>Stage</th>
<th>Description</th>
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<tbody>
<tr>
<td>1</td>
<td>Consultation with stakeholders in respect of the scope and timing of the Inquiry.</td>
</tr>
<tr>
<td>2</td>
<td>Development of the Inquiry documentation and approval to conduct the Inquiry.</td>
</tr>
<tr>
<td>3</td>
<td>Review of recent literature, legislation, regulation and case law to identify relevant issues in pre-contractual disclosure obligations outlined in clauses 28.3 to 28.6.</td>
</tr>
<tr>
<td>4</td>
<td>Collection of data and information on subscribing Banks’ processes and procedures in relation to clauses 28.3 to 28.6 (refer to Appendix 1).</td>
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<tr>
<td>5</td>
<td>Collection of data and information from Consumer Advocates in relation to the consumer experience of Guarantees.</td>
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<tr>
<td>6</td>
<td>Review of CCMC complaints data and External Disputes Resolution data.</td>
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<tr>
<td>7</td>
<td>Assessment and analysis of the data.</td>
</tr>
<tr>
<td>8</td>
<td>Publication of this report.</td>
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In stage 4 of the Inquiry, the CCMC distributed a quantitative questionnaire to subscribing banks seeking information, amongst other things, about:

- the number of loans written for individuals and small businesses (under the Code) in June 2012, and the number of these loans for which Guarantees were taken;
- the relationship between the borrower and the guarantor (particularly whether a spouse, or parent) and the guarantor’s type of background (particularly if an elderly parent or from a non-English speaking background);
- the disclosure documents provided to prospective guarantors in respect of Guarantees;
- how the bank ensured that notices were prominently disclosed;
- any additional steps taken by banks to ensure a prospective guarantor was aware of their potential liabilities, rights and obligations;
- the compliance monitoring undertaken by the bank in relation to pre-contract disclosure in the last 12 months;
- the number and nature of complaints about Guarantees made by consumers during the period 1 January 2012 to 30 June 2012; and
- how compliance with pre-contractual obligations under clauses 28.3 to 28.6 is monitored.

The responses sought by the questionnaire related only to Guarantees to which the Code applies. These include credit facilities to individuals and small businesses but do not include facilities to companies which fall outside the definition of a small business. A copy of the questionnaire is attached at Appendix 1 to this document.
The CCMC interviewed a number of consumer advocates, who also shared information and experiences concerning Guarantees. Their qualitative responses covered such topics as:

- the number of complaints received by these organisations regarding Guarantees;
- the nature of these complaints, including information about when the Guarantee was signed;
- the nature of the relationship between the borrower and the guarantor (in particular, spouses and parents), and the guarantor’s type of background (in particular; guarantors who are from non-English speaking backgrounds or elderly parents);
- the instances of legal and financial advice obtained by the prospective guarantors prior to signing the Guarantee; and
- any anticipated change of case load related to Guarantees due to the prevailing global economic conditions.

The engagement of the consumer advocates into this Inquiry has enhanced the CCMC’s understanding of the context in which individuals sign a Guarantee and the code compliance risks which may arise as a result.

We appreciate the genuine and constructive engagement we have had with all the Code participants, consumer advocates and with the Financial Ombudsman Service during this review.

D CURRENT ISSUES ASSOCIATED WITH GUARANTEES

CCMC RESEARCH

Whilst clause 28 only requires a bank to disclose information to prospective guarantors, the purpose of effective disclosure is to promote “better informed decisions about our banking services” (see clause 2.1(b)).

In order to understand the application of the Code obligations in practice and identify any issues associated with them, the CCMC reviewed recent legal cases and academic research concerning banks and Guarantees. Two research studies by The NSW Law Reform Commission in particular were insightful: Lovric and Millibank (2003) and a study undertaken in 2006 concerning the law relating to the Guarantee by one person of a loan to another person.

The studies identified that the vast majority of guarantors were people who are traditionally considered vulnerable: the elderly, women, migrants, members of minority groups and those who find it difficult to understand legal documents and transactions. The NSW Law reform study noted that “Because of their personal relationship with the borrower, guarantors generally enter Guarantees for emotional rather than financial reasons. There is, therefore, a need for the law to give special protection to guarantors to make sure they are treated fairly.” The studies had found that some guarantors did not have a full understanding of the documents that they signed, nor did they seek individual legal or financial advice prior to entering into the contract.

Our review of some of the major Australian decisions in this area is highlighted in Appendix 2 of this Report under the heading “CCMC Summary of Recent Case Law”.

These cases identify some areas of potential risk with pre-contract disclosure to prospective guarantors. We encourage banks to remain vigilant, when transitioning to the 2013 Code in relation to these risks, particularly given their obligations to act fairly in a consistent and
ethical manner in their dealings with prospective Guarantors and to comply with other laws. These risks include:

- guarantors may not always have had knowledge of, or have been informed of, the financial situation of the borrower;
- some guarantors may not fully understand their level of financial exposure until the Guarantee is called upon;
- Guarantees should not be signed in the presence of the borrower when bank staff attend the signing; and
- guarantors with a personal relationship to the borrower are more likely not to receive independent legal or financial advice prior to signing the documentation.

Whilst these cases concern matters between banks and guarantors in the past, the areas of potential risk remain relevant as illustrated by the anecdotal information received by the CCMC from consumer advocates during this Inquiry.

**RECENT CCMC EXPERIENCE**

Since 2011 the CCMC has received formal allegations from three guarantors that Code subscribing banks have breached their obligations in relation to Guarantees. All three cases have been complex and involved guarantors who may have been classified as vulnerable, with a personal relationship with the borrower. The Guarantees related to these allegations were signed by the respective guarantors between 2006 and 2009.

All three matters involved transactions entered into by banks where it was primarily alleged that:

- the bank had called on the Guarantee;
- the level of debt secured by the Guarantee was significant;
- the guarantor has not appreciated the extent of the financial liability under the Guarantee;
- the bank had failed to properly assess the financial capacity of both the borrower and the associated guarantor when entering into the loan and Guarantee; and
- the bank had failed to ensure that the guarantor had received independent legal advice on the Guarantee or had capacity to enter into the Guarantee.

Each matter also raised the question of whether the pre-contract disclosure obligations had been complied with. To date, the CCMC has not issued a Determination on these matters as they are all before the Courts or other jurisdiction, or were lodged with the CCMC outside the 12 month time limit.

In addition to the above, a concurrent allegation of a Code breach regarding a Guarantee was raised with the CCMC and FOS. The allegation again involved an assertion that the pre contractual disclosure obligations had not been met. FOS subsequently found that the bank involved had breached the Code by not providing the guarantors with at least 24 hours to consider the information (clause 28.5(b)) prior to executing the Guarantee. In his determination, the Banking Ombudsman noted:

"While there is no information to suggest the FSP’s (Financial Service Provider’s) breach of clause 28 was intentional, in my view clause 28 of the Code requires strict compliance, with any failure to comply rendering a Guarantee unenforceable….

In breaching clause 28 of the Code, I am also of the view that the FSP’s conduct breached clause 2.2 which requires the FSP act fairly and reasonably towards the Applicants. In my
view the FSP cannot be said to have acted fairly and reasonably to the Directors when the FSP denied them the protections of clause 28 of the Code.”

In a separate referral, FOS brought to the attention of the CCMC a Guarantee used by a subscribing bank in relation to merchant agreement facilities. This Guarantee, for use by small business directors or sole traders, did not meet any of the requirements of clauses 28.2, 28.3 and 28.4. The bank has now ceased issuing Guarantees of this nature and advised the CCMC that it will not enforce the Guarantee in any debt collection proceedings in relation to a credit facility where a Guarantee of this nature has been accepted. This will effectively place each guarantor in the position they would have been in had they not signed the Guarantee.

These two cases highlight the need for banks to ensure that all documents, processes and procedures comply with the pre contractual requirements of the Code in all cases.

**EXTERNAL DISPUTE RESOLUTION**

The 2011/12 FOS Annual Review noted that it had received a total of 146 complaints about Guarantees, of which 127 (87%) were in respect of banks. This compares to 90 cases in respect of Guarantees received in 2010/11.

A total of 34% of the 2011/12 complaints were in respect of “Decisions by FSP’s”. Most alleged that the lender should not have approved the original loan or credit facility that was guaranteed. Approximately 11% of these complaints related to a failure to meet disclosure obligations.

Financial Hardship complaints accounted for 27% of these complaints. For banks, this represents around 34 cases where a request for hardship assistance from a guarantor had resulted in a complaint being referred to FOS.

**E INQUIRY FINDINGS & RECOMMENDATIONS**

The data provided by banks to the Inquiry demonstrates that, while the nature of the Guarantee differs between banks due to different business mixes, Guarantees play a significant role in the provision of credit, both for personal and business purposes.

Banks identified over 16,000 loans that were supported by a Guarantee in the sample month of June 2012, with approximately 75% in respect of business loans.

Two banks advised that approximately 7% of their respective home loans were supported by Guarantees and most banks did not accept Guarantees in respect of personal credit (excluding home loans).

In transitioning to the 2013 Code, the CCMC suggests banks reflect on their Code compliance frameworks and assess:

- what constitutes “prominent” notice under clause 28.4(a) so as to ensure effective disclosure has taken place to a prospective guarantor, that they may limit their liability; should seek independent legal and financial advice and should understand that Guarantees have financial risks; and
- how they identify whether the prospective guarantor may be vulnerable, such as a spouse or elderly parent and/or has a non English speaking background.
PROVISION OF INFORMATION TO PROSPECTIVE GUARANTORS

Diagram 3: Code obligations associated with clause 28.4

Recommendation 1

Each Bank should carefully consider and review its potential risk of non compliance with clauses 28.3 to 28.6 in the areas identified in this report and assess its Code compliance framework against these risks when transitioning to the 2013 Code.

Rationale

Banks should consider the potential for non compliance and mitigate this risk though effective disclosure of information and warnings.

PROVISION OF INFORMATION TO PROSPECTIVE GUARANTORS

Diagram 3: Code obligations associated with clause 28.4

Clause 28.4 of the 2004 Code, detailed in Diagram 3 above, identifies the notices and information which must be provided to prospective guarantors before a Guarantee is accepted. (See Appendix 3 for full details of the Code obligations). The purpose of these clauses is to disclose relevant information to prospective guarantors so as to facilitate informed decision making and to protect prospective guarantors. The banks are required to give a prominent notice that a prospective guarantor:

- should seek independent legal and financial advice;
- can refuse to enter into the Guarantee;
- that there are financial risks involved
- has the right to limit their liability; and
- can request further information about the transaction.
The banks’ responses to this Inquiry have demonstrated to the CCMC’s satisfaction that, as at June 2012, they have adequate policies and procedures in place which, if appropriately applied, would meet the Code obligations in respect of clause 28.4. This assessment is based on the following:

- each bank could demonstrate they had processes in place to ensure that documentation is provided to prospective guarantors before the Guarantee is executed;
- documents provided indicate the templates used by banks in pre contractual disclosure contain the required notices under clause 28.4(a);
- each bank could demonstrate that processes were in place to provide the prospective guarantor with details of any notices of demands issued by the bank to the debtor and whether the facility would be cancelled if the Guarantee was not provided, as required by clause 28.4(b) & (c). This includes the use of checklists to ensure that all information regarding the debtor’s financial position are sent to the prospective guarantor; and
- each bank could demonstrate that it had processes in place to provide the information required by clause 28.4(d).

In addition, some banks advised that they undertake additional actions to comply with their legal and Code obligations in this area, including:

- providing warnings regarding the requirement to seek legal advice throughout a bank’s documentation, not solely in the Guarantee acceptance document. The CCMC believes that this action helps to ensure that the notice is prominent and effectively disclosed;
- providing separate information brochures that prominently displaying the notices required by clause 28.4(a) to prospective guarantors. The CCMC believes this would assist in bringing the notice to the attention of a prospective guarantor who may be unfamiliar with complex loan and Guarantee documentation; and
- conducting interviews with prospective guarantors to explain liabilities and reinforce the need for independent legal advice. This goes beyond the requirement to provide disclosure of relevant information under clause 28.4(a), but appears consistent with a bank’s legal obligations and relevant case law.

The CCMC considers that the initiatives detailed above are examples of good industry practice and assist in meeting the objective of informed decision making by the prospective guarantor. This should reduce the risk that a prospective guarantor will enter into a contract without the relevant understanding.

The obligations of the clause 28.4 (a) represent important rights and responsibilities of the prospective guarantor. The CCMC notes that some banks include the wording required by clause 28.4(a) in the Guarantee documentation only, which may result in this wording being obscured. The clause requires that the notice be “prominent” so that it is easily brought to the attention of the prospective guarantor. Disclosure of the notice in a prominent position in a number of documents assists in achieving this objective and is consistent with a bank’s obligations under the Unfair Contract Terms Act and in common law.

In particular, anecdotal information received from consumer advocates as part of the qualitative interviews conducted in stage 5 of this Inquiry indicated that many of their clients are unaware of the need for independent legal financial advice or do not fully appreciate the extent of their liabilities when providing a Guarantee. One consumer advocate advised that,

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4 “Prominent” is defined in the Merriam-Webster dictionary as standing out, readily noticeable or conspicuous.
in the ten Guarantee cases recently dealt with, none had sought independent legal or financial advice and relied solely on the representations of the borrower or the lender.

The CCMC suggests that this is an area that banks should reflect upon when transitioning to the 2013 Code.

In relation to clause 28.4(d), the matter of _Fast Fix Loans Pty Ltd vs. Samardzic (2011) NSWCA 260_, while not involving a Code subscribing bank, illustrates the need for lenders to fully disclose relevant financial information to the prospective guarantors, in order that they may make an informed decision regarding whether to become a guarantor.

The responses from consumer advocates and the review of the case law indicate vigilance is required to ensure that consumers are made fully aware of their liabilities, the need for independent advice and are provided with relevant information regarding the credit position of the borrower. The CCMC considers that prominent and effective disclosure is essential in providing prospective guarantors with sufficient information to make informed decisions about becoming a guarantor.

**Recommendation 2**

Banks should consider reviewing their Code compliance and monitoring procedures in transitioning to the 2013 Code to ensure assessment is made of prominence and effectiveness of their disclosure of information and warnings under clause 28.4.

**Rationale**

The provision of effective disclosure of information and warnings will allow the prospective guarantor to make an informed decision about becoming a guarantor.
CONSIDERATION OF INFORMATION BY PROSPECTIVE GUARANTORS

Diagram 4: Code obligations associated with clause 28.5

The CCMC considers that the Code obligations in clause 28.5 are important as they prevent banks from accepting an executed Guarantee without a prospective guarantor having sufficient time to consider all the information.

Based on the banks’ responses to this Inquiry, the CCMC is satisfied that, as at June 2012, the banks have procedures in place to allow at least 24 hours from the time the prospective guarantor receives the Guarantee document to consider the information provided prior to signing. The CCMC has also identified from a review of the same documentation received from the banks that the Guarantee documentation advises the prospective guarantor that the Code of Banking Practice applies.

Anecdotal evidence from consumer advocates has, however, highlighted historical instances where banks are alleged to have accepted the Guarantee less than 24 hours after the prospective guarantor has received the documentation and without the guarantor having received independent legal advice. Banks need to remain vigilant that procedures are applied in practice in this area.

Recommendation 3

Banks should ensure that information and notices are provided to the prospective guarantor in a timely manner to ensure they have sufficient time to consider their position and the risks associated with the Guarantee prior to execution.

Rationale

This will ensure that the prospective guarantor has sufficient time to consider the risks and financial liabilities of becoming a guarantor before entering into the agreement.
Recommendation 4

Good industry practice suggests that even a prospective guarantor who has received independent advice, should be given at least 24 hours to consider the Guarantee documents prior to signing.

Rationale

This will increase the prospective guarantor’s opportunity to consider the risks and financial liabilities of becoming a guarantor in the context of the independent advice given, before entering into the agreement.

Execution of Guarantee

Diagram 5: Code obligations associated with clause 28.6

Clause 28.6(a) of the Code (see Appendix 3) requires that bank not give the Guarantee to the borrower or to someone acting on behalf of the borrower, to arrange the signing of the document by the prospective guarantor. In addition, under clause 28.6(b) banks must ensure that the borrower is not present at the signing of the Guarantee if a bank representative is attending. One of the purposes of this clause is to prevent undue influence being exerted on the guarantor by the borrower.

While undue influence on prospective guarantors was a common concern of the consumer advocates interviewed as part of this Inquiry, the execution of Guarantees was not identified as an issue in our discussions with them.

Responses from banks to the Inquiry questionnaire indicate that that there are two common approaches taken by banks when providing documents directly to the prospective guarantor for signature. These are:

- the Guarantee documents are produced centrally by the banks and posted to the prospective guarantor; and/or
- bank staff personally present the documents to the prospective guarantor.
Banks have indicated that it is not their preferred procedure to have a member of staff present at the signing of the Guarantee.

Several banks commented that their procedures require that bank staff should not witness the guarantor’s signature unless legal advice has been obtained by the guarantor. One bank’s procedure, however, is for a member of staff, who has completed the appropriate training, to explain the Guarantee and witness the signature even where independent legal advice has not been obtained.

It is desirable for banks to provide additional information about the rights of prospective guarantors irrespective of whether or not they have received independent legal advice. It is the CCMC’s view however that the focus should remain on encouraging prospective guarantors to receive both legal and financial advice which is independent of the bank. Banks should also ensure they have rigorous compliance processes in place when allowing bank staff to witness and sign Guarantees, including documenting when a prospective guarantor has chosen not to receive independent legal advice.

**CATEGORIES OF GUARANTOR**

While clause 28 of the Code does not require banks to identify those prospective guarantors that might be vulnerable, the obligations of clause 2.2 require banks to act fairly and reasonably towards a prospective guarantor in a consistent and ethical manner. In doing so banks will consider the prospective guarantor’s conduct, the bank’s conduct and the contract between them.

In addition determining whether a bank has complied with its obligations under clause 28, the CCMC will also consider the common law and statutory obligations in accordance with clauses 2.1 and 3 of the Code (see Appendix 3).

The court case of Fast Fix Loans Pty Ltd vs. Samardzic, noted in this report, highlights the potential consequences, for both guarantors and banks, of not identifying prospective guarantors who may be classed as vulnerable.

Responses by banks to our Inquiry demonstrate that the following criteria are used by banks to assess the vulnerability of prospective guarantors:

- Do they play an active role in the management of the business for which they are providing the Guarantee?
- Are they fluent in English?
- Do they have a visual or aural impairment?
- Are they older than 65 or younger than 21 years of age?
- Are they offering the family home as collateral for the Guarantee (excludes directors/shareholders of the borrower, where the borrower is a business)?
- Do they appear to be subject to undue influence (from the borrower or any other party) to execute the Guarantee?
- Does the lender suspect, for any reason, a guarantor may not fully comprehend the prospective effects and consequences of providing a Guarantee?

Eleven of the banks responding to the Inquiry advised the CCMC that they have in place procedures for dealing with prospective guarantors who have been identified as vulnerable or at high risk if a default on the loan should occur. These procedures include:
• not providing the credit facility where undue influence is suspected, or the guarantor will derive no benefit from the facility;
• not providing the credit facility where the guarantor’s only method of repayment is the sale of the family home;
• requiring legal advice to be obtained before approving the credit facility;
• requiring the Guarantee, to be signed in the presence of an independent lawyer who can speak the guarantors first language;
• calling upon staff who are fluent in the guarantor’s first language to explain the Guarantee and the need for independent legal and financial advice; and
• referring prospective guarantors to third party organisations for translation services.

One bank responded that it did not have in place additional procedures, over and above those required by the Code, to identify and deal with categories of guarantors who may be classed as vulnerable. As a result of this Inquiry, however, the bank has indicated that it is reviewing its procedures in this respect.

Consumer advocates interviewed by the CCMC observed that elderly parents made up the highest proportion of cases dealt with by them in respect of Guarantees. In a number of cases dealt with by the advocates, there was evidence of undue influence exerted on the elderly parent by the borrower, the parent had acted as guarantors of business loans where they played no part in the management of business or would receive any benefit from the loan.

Issues in respect of Guarantees provided by spouses were not cited as a major issue by consumer advocates during this Inquiry. However, the court cases of Bank of Western Australia vs. Abdul 2011 and Agripay vs. Byrne 2011, illustrate the compliance risks associated with this class of guarantor. The CCMC has also received a number of enquiries from spouses lodging concerns regarding the absence of legal advice before executing a Guarantee.

In the full context of common and statutory law and Code obligations, the CCMC suggests that it is prudent for banks to consider the vulnerability of a prospective guarantor with regard to their ability to understand the risks and liabilities of becoming a guarantor. Spouses, elderly parents and people with a non English speaking background may, to varying degrees, be assessed as vulnerable.

**Recommendation 5**
The CCMC encourages banks to consider the vulnerability of a prospective guarantor. Banks which have effective processes to identify classes of prospective guarantors and take additional steps to ensure they receive information about their rights and responsibilities and the financial position of the borrower, are better placed to comply with their Code obligations.

**Rationale**
This enhances banks’ compliance with the key obligation clause 2.2 to act fairly and reasonably towards a customer in a consistent and ethical manner.
AFFORDABILITY

Whilst this Inquiry did not specifically review whether banks consider the ability of prospective guarantors to repay a Guarantee during the pre-contractual phases, the responses to our questionnaire suggest that banks have systems and procedures in place to assess the financial position of a prospective guarantor before accepting the Guarantee. This includes assessing income, expenses and assets. Several banks indicated that where they assess that calling upon the Guarantee would result in Hardship to the prospective guarantor, the credit facility is not offered. This assessment includes where the prospective guarantor is unable to meet repayments or the family home is being used as the only asset for security.

Our discussions with consumer advocates have indicated that, while the circumstances of guarantors can change, there are historically instances where consumers have alleged that banks have not fully considered affordability when accepting Guarantees. Subsequently, consumers have alleged that when the Guarantee was called upon by the bank, the guarantor has been unable to satisfy the debt and has been forced to sell their homes.

These cases illustrate the considerable consequences, for both individuals and the banks, when banks accept Guarantees from individuals who would not be in a position financially to satisfy outstanding debts if the Guarantee were called upon.

HARDSHIP

During the sample period of 1 January 2012 to 1 June 2012, banks identified 80 instances where a request for Hardship Assistance was received in respect of credit facilities supported by a Guarantee. This represents 5.7% of the total number of Guarantees called upon in the sample period (1392 Guarantees across the banks were called upon between 1 January 2012 to 30 June 2012). Two banks were unable to identify whether the Hardship application was received from the borrower or the guarantor.

Five banks reported that no requests of this type were received in the sample period. One bank advised that, as most of its Guarantees were provided in respect of loans for homes or investment properties, it was unusual to receive a Hardship request from the guarantor as the property would be sold first to satisfy the debt before the guarantor is asked to satisfy it.

The responsible lending obligations under the National Consumer Credit Protection Act 2009 have been enhanced under the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Enhancements Act). This contains a new obligation on credit providers and lessors to assess whether a credit contract or consumer lease is unsuitable for a consumer before making an unconditional representation about whether the consumer can enter a credit contract or lease, or increase the credit limit on an existing credit contract.

The ASIC guidance related to these enhancements, contained in RG209, states:

“The credit contract or consumer lease will be unsuitable if, at the time of the final assessment, it is likely that the consumer will be unable to comply with their financial obligations under the contract, or could only comply with substantial hardship”

These requirements will extend to the assessment of guarantors.

COMPLAINTS
Responding banks reported that they received a total of 157 complaints relating to Guarantees in the sample period of 1 January 2012 to 30 June 2012.

Four banks recorded no complaints in the sample period in respect of Guarantees. In general banks were unable to provide details of when the Guarantees to which the complaints relate were received. Two banks who were able to provide this information, however, have advised that the Guarantees related to the complaints were signed around 2005 and 2006.

Whilst banks have not provided a breakdown of statistics regarding categories of complaints, they have recorded the following issues related to the pre contractual disclosure requirements of clauses 28.3 to 28.6:

- the guarantor not realising that they were guaranteeing the full loan; and
- provision of information to guarantor.

**COMPLIANCE MONITORING**

The response to our questionnaire demonstrates that banks take different approaches with regard to compliance monitoring of the Guarantee process.

Nine banks have provided information which highlights that scrutiny of Guarantees falls within the normal Quality Assurance frameworks. Two of these banks advised that 100% of all Guarantees are scrutinized with a sample check conducted in other banks.

Two responding banks advised that all documentation was provided by external solicitors and these were monitored via the Service Level Agreements in place.

Two banks, however, commented they did no specific monitoring in respect of clause 28.3 to 28.6 of the Code. The CCMC will discuss this matter individually with the banks concerned to determine whether the monitoring of Guarantees falls within other Compliance commitments and obligations.

**FOLLOW UP**

The CCMC discussed the findings and results of this Inquiry with the individual participating banks. These discussions included

- the individual bank’s response to the Inquiry;
- the individual bank’s approach to Guarantees relative to the industry approach; and
- where applicable, the steps the individual bank proposes to take to address any areas of concern.

In the 2013/14 Annual Compliance Statement, the CCMC will ask banks to detail what steps, if any, they have taken to address the issues and implement the recommendations made as a result of this Inquiry.
APPENDIX 1: CCMC QUESTIONNAIRE SENT TO BANKS

This Questionnaire forms part of the CCMC Inquiry into Guarantees and bank compliance with clauses 28.3 to 28.6 of the Code of Banking Practice.

All responses should be for Guarantees and credit facilities to which the Code applies. Please complete and return responses by 1 October 2012.

1. Of the loans (under the Code) written by the Bank in June 2012*, how many were written with a Guarantee?

   *If no guaranteed loans (under the Code) were written in June 2012, please use an alternative month for 2012, stating which month has been used for this question. Please use this alternative month for all subsequent related questions about Guarantees for June 2012.

2. How many of these guaranteed loans written in June 2012* were for:
   (a) personal loans?
   (b) small business (as defined by the Code) loans?
   (c) (If unable to provide specific numbers for small business guaranteed loans under the Code, please estimate and indicate accordingly.)

3. Please provide details of how the Bank ensures that the notice required for a prospective guarantor by 28.4 (a) of the Code is prominently disclosed. Please provide a copy of the template notice with your response to this questionnaire.

4. Please advise how the Bank ensures that it has specifically met the disclosure requirements in 28.4 (b), (c), (d) and (e) when establishing a credit facility. Please also provide copies of relevant pre-contractual documents in respect of 28.4 (b) to (e).

5. How did the Bank ensure that prospective guarantors were aware that they should seek independent legal and financial advice for the guaranteed loans written in June 2012*?

6. Did the Bank take any additional steps to those required by the Code to make the guarantor aware of their liabilities and the circumstances in which the Bank might call on the Guarantee? If so, what were these steps?

7. Does the Bank have any specific pre-contractual processes for clauses 28.3 to 28.6 for guarantors who are spouses, or elderly parents of the borrower, or who are from a non-English speaking background? If yes, please summarise these processes.

8. For the loans taken with a Guarantee in June 2012*, how did the Bank ensure that that the guarantor had the ability to repay the debt if the borrower defaults?

9. For the loans taken with a Guarantee in June 2012*, how did the Bank ensure that guarantors who were from a non-English speaking background understood their liabilities?

10. What steps does the Bank take to comply with its obligations under clause 28.6 of the Code to ensure that:
    (a) the Bank does not give the Guarantee to the debtor to arrange the signing (clause 28.6 (a))?
    (b) the guarantor signs the Guarantee in the absence of the debtor where the Bank arranges the signing (28.6 (b))?
11. Is it the Bank’s policy that a Bank representative attends the signing of the Guarantee?

12. How many Guarantees were called upon by the Bank (for loans under the Code) by the in the period 1 January 2012 to 30 June 2012?

13. How many complaints did the Bank receive regarding Guarantees (for loans under the Code) in the period 1 January 2012 to 30 June 2012? (If unable to provide specific Guarantee complaint numbers under the Code, please provide estimate and indicate accordingly.)

14. What was the nature and type of the complaints received, including information concerning the date on which the Guarantees were signed by the guarantor?

15. How many Hardship applications did the Bank receive between 1 January 2012 and 30 June 2012 from a guarantor (for a loan under the Code) when called upon to repay the debt? (If unable to provide specific guarantor Hardship request numbers under Code, please provide estimate and indicate accordingly.)

16. What monitoring has the Bank undertaken with regard to Code obligations under clauses 28.3 to 28.6 in the last financial year? Please include details of any Quality Assurance undertaken and the involvement of Compliance, Risk and Internal Audit.

*If no Guaranteed loans (under the Code) were written in June 2012, please use an alternative month for 2012 for all related questions about Guarantees for June 2012, stating which month has been used.
APPENDIX 2: SUMMARY OF SELECT COURT DECISIONS

1. Fast Fix Loans Pty Ltd vs. Samardzic (2011) NSWCA 260

In this case, Mr and Mrs Samardzic provided a Guarantee in respect of a loan to their son’s business and in doing so gave a mortgage over their home. Mr & Mrs Samardzic had a limited understanding of English and at the time of providing the Guarantee, they were retired. They advised their son that they could not afford to borrow money but would assist him if their obligation ended after three months.

Subsequently the company defaulted on the loan and the Guarantee was called upon. The Guarantee was set aside by the court for the following reasons:

- having regard to the parents’ limited schooling, knowledge of English, experience with financial transactions and legal advice, they were not reasonably able to protect their interests and there was a material inequality in bargaining power between the parties;
- there was no opportunity for the parents to negotiate the terms of the loan, nor were they advised of such an option. They were being pressured by their son, who they were proud of and trusted. They felt a moral obligation to assist him;
- whilst the parents had received legal advice, they did not fully understand the explanation, in particular, regarding the continuing nature of their liability beyond three months. They also had no knowledge of their son’s or his company’s precarious financial position. The lenders were not concerned about the ability of the borrower to repay the loan as Mr and Mrs Samardzic’s property was used as security.

The appeal court upheld the decision of the court.

While the Code of Banking Practice does not apply to this case, it demonstrates the need for lenders to fully consider the circumstances of the potential guarantor and the likelihood and impact of the Guarantee being called upon. In this case, there were several indicators suggesting that the loan should not have been accepted. These included:

- Mr & Mr Samardzic could be classed as vulnerable for several reasons;
- the inability of the guarantors to repay the debt without selling their home and suffering financial hardship; and
- the precarious nature of the finances of the business to which the loan was provided, which was not disclosed to the guarantors.

2. Bank of Western Australia vs. Abdul (2011) VSC 222

In this case, the Supreme Court of Victoria set aside Guarantees by a wife (Mrs Abdul) which had underpinned loans of about $18 million issued to enterprises operated by her husband.

In making its decision, the court noted the wife’s limited involvement in the business (although she was a director). In addition, it had particular regard to the loan amounts and complexity of the transactions, the wife’s limited capacity to understand the transactions, the circumstances in which the documents were signed and the implications if the Guarantees were called upon (including the potential loss of the family home). Mrs Abdul had not received advice on the transactions before agreeing to them.
In its judgment, the Court noted that the marital relationship between the guarantor wife and her entrepreneur husband and her lack of any direct benefit from the facilities placed her in the position of a ‘volunteer’ and that the bank had failed to appropriately address this disadvantage.

The Court made specific references to concerns regarding the bank’s compliance with clause 28 of the Code and expressed concern regarding the circumstances in which the bank had secured Mrs Abdul’s consent to the transaction.

The Court considered that, in the circumstances, the bank should have insisted that Mrs Abdul receive independent advice before signing the documents.

Further, the Court indicated that the bank’s actions were inconsistent with clause 25.1 of the Code (care and skill of a prudent banker / responsible lending) as it did not give due consideration to Mrs Abdul’s capacity to pay her joint and several obligations under the facilities, particularly where it knew she had not been independently advised.

3. **Agripay Pty Ltd vs. Byrne (2011) QCA 85**

In this case the Queensland Court of Appeal set aside a Guarantee provided by a wife in support of her husband’s loan to invest in an agricultural business. The purpose of the investment was to reduce tax liabilities that had arisen after the sale of a medical business owned by the couple (but operated by the husband).

The financial services provider argued that the wife was not a volunteer, as she had the prospect of obtaining a financial benefit from the performance of the obligations which she had agreed to guarantee and of benefiting from a superannuation fund if the investments eventually became profitable.

The court stated, however, that any benefit derived by a guarantor must be direct or immediate, not indirect and prospective and it considered enforcement of the Guarantee unconscionable in circumstances in which the wife was a volunteer and the effect of the Guarantee was not fully understood by her.

The court found that:

“[a]t best there was some prospect of an eventual profit which may have benefited the family unit if it remained functional; and some small portion of any eventual profit may have found its way to the joint superannuation fund. But the short term profit of a lower tax bill and any profit received in the long term was essentially for [the husband]. There was no clear evidence that the [wife] would actually profit from the scheme. To [be able to] exclude the respondent, a wife, from the category of volunteer in the sense discussed in Garcia because she would benefit from the transaction she was Guarteeing, her gain must be direct or immediate” - judgment of Margaret McMurdo (President of the Court of Appeal).

The Court stated that:

“It may seem odd that in this case a practicing medical practitioner with some business experience can avoid the obligations of her Guarantee under Garcia. But the respondent is not disentitled to the protection of the law because she is tertiary-educated. It must be remembered that the principles explained in Garcia over 13 years ago have long been the law in Australia. Commercial lenders like the appellant [bank] which require partners of borrowers to guarantee their partners’ loans, should be well aware of their legal obligations to ensure such guarantors understand the purport and effect of their Guarantees and the transaction to which they relate. It would not have been difficult for the appellant to itself
have explained, or to ensure that a competent, independent person had explained, to the respondent [wife] the true effect of the Guarantee and the transactions to which it related: see Garcia. Its failure to do so disentitles it to reliance on the respondent’s Guarantee” – judgment of Margaret McMurdo (President of the Court of Appeal).

In addition, the Court stated that:

“‘what impeaches the conscience of the creditor is its failure to properly explain or ensure that a guarantor properly understands a transaction, where it knows that the transaction is not substantially for the benefit of the guarantor but is for the benefit of her husband’ … to the [bank’s] complaint that the rule works a hardship on it the answer is that it has been the law now for seventy years [since Yerkey v Jones] that a creditor can avoid the application of the equity by relatively simple means and here the [bank] failed to adopt those means [i.e. by ensuring the guarantor had an adequate understanding and/or received appropriate advice]” – judgment of McMeekin J.

4. Bank of Western Australia vs. Ellis J Enterprises (2012) NSWSC 313

The bank sought to enforce a Guarantee against a wife when her husband’s company defaulted on a loan of over $11 million. The wife claimed that her signature on the Guarantee documents was not witnessed by her solicitor and she did not receive legal advice regarding the documents.

The judge found:

- the wife understood that the bank could take possession of her property if the moneys due were not repaid. Even though the explanation by the solicitor was brief, it was in clear terms as to the effect of the Guarantee being called upon;
- the wife was subservient to her husband in financial matters. So far as business matters were concerned, the wife did what her husband told her to do and by doing so she had believed that she and her family would be financially better off;
- the wife could speak and understand conversational English well and read relatively complex documents written in English such as loan documents though she had only a partial understanding of their meaning; and
- the wife received independent legal advice in relation to Guarantees she provided and understood that by signing the Guarantees if the family company defaulted in repayment of its loan obligations, she would lose her property.

The wife failed in her attempts to have the Guarantee set aside.
APPENDIX 3: 2004 CODE OBLIGATIONS - GUARANTEES

PRE-CONTRACTUAL DISCLOSURE

28.3 A Guarantee must include a statement to the effect that the relevant provisions of this Code apply to the Guarantee but need not set out those provisions.

28.4 We will do the following things before we take a Guarantee from you:

(a) We will give you a prominent notice that:

   (i) You should seek independent legal and financial advice on the effect of the Guarantee;
   (ii) You can refuse to enter into the Guarantee;
   (iii) There are financial risks involved;
   (iv) You have a right to limit your liability in accordance with this Code and as allowed by law; and
   (v) You can request information about the transaction or facility to be Guaranteed (“Facility”) (including any facility with us to be refinanced by the Facility).

(b) from 1 June 2004 we will tell you:

   (i) about any notice of demand made by us on the debtor, and any dishonour on any facility the debtor has (or has had) with us, which has occurred within 12 months before we tell you this, and from 1 June 2005 within two years before we tell you this;
   (ii) if there has been an excess or overdrawing of $100 or more on any facility the debtor has (or has had) with us which has occurred within six months before we tell you this, and from 1 February 2005 we will give you a list showing the extent of each of those excesses or overdrawings;

(c) we will tell you if any existing facility we have given the debtor will be cancelled, or if the Facility will not be provided, if the Guarantee is not provided;

(d) We will provide you with a copy of:

   (i) Any related credit contract together with a list of any related security contracts which will include a description of the type of each related security contract and of the property subject to, or proposed to be subject to, the security contract to the extent to which that property is ascertainable and we will also give you a copy of any related security contract that you request;
   (ii) the final letter of offer provided to the debtor by us together with details of any conditions in an earlier version of that letter of offer that were satisfied before the final letter of offer was issued;
   (iii) Any related credit report from a credit reporting agency;
   (iv) Any current credit-related insurance contract in our possession;
   (v) Any financial accounts or statement of financial position given to us by the debtor for the purposes of the Facility within two years prior to the day we provide you with this information;
   (vi) the latest statement of account relating to the Facility (and any other statement of account for a period during which a notice of demand was made by us, or a dishonour occurred, in relation to which we are required to give you information under clause 28.4(b)(i)); and
(vii) any unsatisfied notice of demand made by us on the debtor in relation to the Facility where the notice was given within two years prior to the day we provide you with this information; and

(e) we will give you other information we have about the Facility (including any facility with us to be refinanced by the Facility) that you reasonably request but we do not have to give you our own internal opinions.

28.5 We will not ask you to sign a Guarantee, or accept it, unless we have:

(a) Provided you with the information described in clause 28.4 to the extent that that information is required by this Code to be given to you; and

(b) Allowed you until the next day to consider that information. We do not have to allow you the period referred to in clause 28.5(b) if you have obtained independent legal advice after having received the information required by clause 28.4.

28.6. We will:

(a) Not give the Guarantee to the debtor, or to someone acting on behalf of the debtor, to arrange the signing (except a legal practitioner or financial adviser who is working for you); and

(b) Ensure that you sign the Guarantee in the absence of the debtor where we attend the signing of the Guarantee.

EFFECTIVE DISCLOSURE

2.1 We will:

(a) continuously work towards improving the standards of practice and service in the banking industry;

(b) promote better informed decisions about our banking services:

(i) by providing effective disclosure of information;

(ii) by explaining to you, when asked, the contents of brochures and other written information about banking services; and

(iii) if you ask us for advice on banking services:

(A) by providing that advice through our staff authorised to give such advice;

(B) by referring you to appropriate external sources of advice; or

(C) by recommending that you seek advice from someone such as your legal or financial adviser;

(c) provide general information about the rights and obligations that arise out of the banker and customer relationship in relation to banking services;

(d) provide information to you in plain language; and

(e) monitor external developments relating to banking codes of practice, legislative changes and related issues.
FAIR AND REASONABLE CONDUCT

2.2 We will act fairly and reasonably towards you in a consistent and ethical manner. In doing so we will consider your conduct, our conduct and the contract between us.

COMPLIANCE WITH LAWS

3.1 We will comply with all relevant laws relating to banking services, including those concerning:

- consumer credit products;
- other financial products and services;
- privacy; and
- discrimination.
APPENDIX 4: OTHER REGULATORY REQUIREMENTS

National Credit Code – Division 2

54 Application of Division

This Division applies to a Guarantee (under which the guarantor is a natural person or a strata corporation) to the extent to which it Guarantees obligations under a credit contract, whether or not it also Guarantees other obligations (see section 8).

55 Form of Guarantee

(1) A Guarantee must be in writing signed by the guarantor.
(2) It is sufficient compliance with subsection (1) if the Guarantee is contained in a mortgage signed by the guarantor.
(3) The regulations may make provision for or with respect to the content of Guarantees and the way they are expressed.
(4) A Guarantee is not enforceable unless it complies with this section and regulations made under this section.

56 Disclosure

(1) Before a Guarantee is signed by the guarantor, the credit provider must give to the prospective guarantor:
   (a) a copy of the contract document of the credit contract or proposed credit contract; and
   (b) a document in the form prescribed by the regulations explaining the rights and obligations of a guarantor.
(2) A Guarantee is not enforceable unless paragraph (1)(a) is complied with.

57 Copies of documents for guarantor

(1) A credit provider must, not later than 14 days after a Guarantee is signed and given to the credit provider, give the guarantor:
   (a) a copy of the Guarantee signed by the guarantor; and
   (b) a copy of the credit contract or proposed credit contract.
(2) Paragraph (1)(a) does not apply if the credit provider has previously given the guarantor a copy of the Guarantee document to keep and paragraph (1)(b) does not apply if the credit provider has previously given the guarantor a copy of the credit contract or proposed credit contract to keep.
CONTACT US

You can contact the CCMC as follows:

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