

Customer Owned Banking Code of Practice

Independent Review 2019

AFCA submission

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1 Introduction

The Australian Financial Complaints Authority (AFCA) is the new independent external dispute resolution (EDR) scheme for the financial sector. It replaced the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the work of the Superannuation Complaints Tribunal (SCT).¹

AFCA sees its purpose as providing fair, independent and effective solutions for financial disputes. It does this not only by providing fair dispute resolution services, but also by working with financial firms to improve their processes and drive up industry standards of service, thereby minimising disputes.

More broadly, AFCA will play a key role in restoring trust in the financial services sector.

In addition to providing solutions for financial disputes, AFCA has responsibilities² to identify, resolve and report on systemic issues and to report matters such as serious contraventions of law, which go beyond resolution of individual disputes. A separately operated and funded business unit of AFCA also provides secretariat services to code compliance monitors including the Customer Owned Banking Code Compliance Committee.

On 1 May 2018 AFCA was authorised pursuant to the *Corporations Act 2001*. The AFCA Rules, which govern our operations, were approved by the Australian Securities and Investments Commission (ASIC) in September 2018. We began to receive complaints under these rules on 1 November 2018.

AFCA welcomes the opportunity to contribute to the development of the Customer Owned Banking Code of Practice (COBCOP) by providing feedback to the current independent review. This submission³ draws on the experience of AFCA and its predecessors who have handled banking and finance disputes for more than 25 years.

Key points in this submission are:

Code approval, application and enforceability

The Royal Commission into financial services recommended amendments to the law to establish a new framework for industry codes in the financial sector including COBCOP (in Recommendation 1.15). If this framework is established, industry codes:

¹ The Appendix provides a brief overview of AFCA. For comprehensive information about AFCA, see our website www.afca.org.au.

² See ASIC's Regulatory Guide 267 *Oversight of the Australian Financial Complaints Authority*.

³ This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

- will be mandatory
- require ASIC approval
- will be enforceable at law.

Adopt the recommendations of the Royal Commission

The COBCOP should adopt recommendations 1.8, 1.13 and 1.16 of the Royal Commission

Expand the definition of small business

AFCA supports expanding the definition of 'small business' in the COBCOP. The definition should align with the definition announced by the Minister for Revenue and Financial Services' on 14 February 2018⁴, and with the definition contained in AFCA's Rules.

Adopt the higher code standard

The Banking Code of Practice 2019 (BCOP) is a more recent example of a code of conduct in the financial services sector than the COBCOP. The BCOP takes effect from 1 July 2019 and will replace the Code of Banking Practice 2013.

The BCOP expands some of the concepts contained in the Code of Banking Practice 2013 and introduces new ones.⁵

To the extent that:

- the COBCOP and BCOP differ, AFCA supports adopting the higher standard⁶
- the BCOP expands on concepts (or introduces new ones) stated in the COBCOP, AFCA supports adopting the expanded (or new) concept.⁷

Adopt recommendation 2 of the inquiry into the impairment of customer loans

The COBCOP should adopt the initiatives in recommendation 2 of the Parliamentary inquiry into the impairment of loans, some of which have been partially adopted by the BCOP.

⁴ <http://kmo.ministers.treasury.gov.au/media-release/015-2018/>

⁵ An example is Chapter 23 which deals with how much notice a subscriber will give to a small business before the end of a loan.

⁶ Subject to any further comments in our submission

⁷ Subject to any further comments in our submission

Non-monetary defaults and acts of bankruptcy

The COBCOP should adopt the concept of a subscriber not taking default-based action where there is no payment default. Any exceptions should be consistent with the law, including section 301 of the Bankruptcy Act 1966.

Financial difficulty

The BCOP adopts a higher standard and introduces new concepts not found in the COBCOP. The COBCOP should adopt these higher standards and new concepts.

Intermediaries

Customers can become confused about the role played by intermediaries, and whether the intermediary is their agent or a representative of the financier. Where a transaction involves an intermediary, the COBCOP should require subscribers to clearly outline to a customer the role played by that intermediary.

Remedies for breaching the COBCOP

The COBCOP should outline the remedy for breaching the COBCOP. AFCA supports a tiered system of remedies with substantial remedies for serious breaches and less substantial remedies for other breaches.

2 Code approval, application and enforceability

AFCA considers that the COBCOP should meet the standards set by ASIC through its Regulatory Guide 183. These standards address crucial matters such code coverage, enforceability and regular independent reviews. ASIC approval under Regulatory Guide 183 would be a strong signal to consumers that they can have confidence in the code.

We anticipate that the regulatory requirements for industry codes including COBCOP will soon be overhauled comprehensively. One recommendation made by the Royal Commission into financial services was to establish a new framework for industry codes in the financial sector:

Recommendation 1.15 — Enforceable code provisions

The law should be amended to provide:

- that ASIC’s power to approve codes of conduct extends to codes relating to all APRA-regulated institutions and ACL holders;
- that industry codes of conduct approved by ASIC may include ‘enforceable code provisions’, which are provisions in respect of which a contravention will constitute a breach of the law;
- that ASIC may take into consideration whether particular provisions of an industry code of conduct have been designated as ‘enforceable code provisions’ in determining whether to approve a code;
- for remedies, modelled on those now set out in Part VI of the Competition and Consumer Act, for breach of an ‘enforceable code provision’; and
- for the establishment and imposition of mandatory financial services industry codes.

While acknowledging that major reforms are being developed, we consider that improvements consistent with planned reforms should be made in the current review, before the new framework is implemented.

We suggest that, as a priority, the COBCOP should be made enforceable by guarantors. At present, the ‘Commitment to comply with Code’ on page 6 appears to apply only in relation to customers within the definition of ‘you’, and the COBCOP is incorporated by reference into contracts between subscribers and their customers⁸. Provisions of the code should form part of the contracts between subscribers and customers **or guarantors**.

Enforceability is key to confidence in the industry’s commitment to comply with COBCOP’s obligations. Making all the obligations in the code legally binding would also provide certainty and clarity to the industry.

3 Adopt the recommendations of the Royal Commission

The Royal Commission made other recommendations regarding the BCOP:

- Recommendation 1.8 - Amending the Banking Code
- Recommendation 1.10 – Definition of ‘small business’
- Recommendation 1.13 – Charging default interest
- Recommendation 1.16 – 2019 Banking Code

⁸ See ‘Commitment to comply with Code’ on p6 of the COBCOP.

AFCA supports the COBCOP adopting recommendations 1.8, 1.13 and 1.16 of the Royal Commission.

AFCA's view on expanding the COBCOP to small business, and the definition of 'small business', is set out in the following section.

4 Expand the definition of small business

The current definition of 'small business' found in the COBCOP does not align with the definition announced by the Minister for Revenue and Financial Services' on 14 February 2018 or AFCA Rules. AFCA's Rules adopt the Minister's definition which is broader than the definition currently found in the COBCOP.

A situation in which a small business is able to lodge a complaint with AFCA about a code subscriber's conduct but not obtain the benefit of the COBCOP is undesirable.

As a result, AFCA supports broadening the definition of 'small business' in the COBCOP to align with the Minister's (and AFCA's) definition. The definition of small business in the AFCA Rules is:

Small Business

means a Primary Producer⁹ or other business that had less than 100 employees at the time of the act or omission by the Financial Firm that gave rise to the complaint.

5 Adopt the higher code standard

The COBCOP and BCOP are significant codes of practice in the financial services sector.

AFCA considers that the new COBCOP should adopt the higher standard of the two codes and apply the following drafting principles:

- to the extent that the COBCOP and BCOP differ, the higher code standard should be adopted
- to the extent that the BCOP expands on some of the concepts stated in the COBCOP (or incorporates new ones), the expanded (or new) concept should be adopted.

⁹ Primary Producer is defined in the AFCA Rules as "...a primary production business within the meaning of s 995.1(1) of the Income Tax Assessment Act 1997. The Primary Producer must also be a Small Business."

Example 1 – Safeguards for co-borrowers

Paragraph 11.1 of the COBCOP 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-borrower if we are aware, or ought to be aware, that you will not receive a benefit from the loan or other credit facility.

In contrast, paragraphs 54 and 55 of the BCOP impose more extensive requirements for co-borrowing, in particular that the co-borrower receive a 'substantial benefit'.

AFCA's view is 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 AFCA is consistent with case law.¹⁰

Example 2 – When a loan will not be extended

Chapter 23 of the BCOP outlines that a bank will give a small business at least 3 months' notice of its decision not to extend a loan. This is a new concept that:

- is not present in the current version of the COBCOP
- introduces a higher standard of conduct.

AFCA supports this new concept. AFCA also notes that one of the recommendations of the Parliamentary inquiry into the impairment of loans was that a bank should commence discussions with the small business at least 6 months before the expiry of the loan term. AFCA is supportive of this additional measure.

¹⁰ 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].

6 Adopt recommendations of inquiry into the impairment of customer loans

The report on the Parliamentary inquiry into the impairment of loans included the following recommendation.¹¹

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.

AFCA supports the COBCOP adopting the initiatives in Recommendation 2. We note some of the initiatives have been (partially) adopted in the BCOP, including:

- non-monetary default (Chapter 22)
- decision not to extend loan (Chapter 23)
- revaluation (Chapter 24).

7 Non-monetary defaults and acts of bankruptcy

Chapter 22 of the BCOP adopts the non-monetary default initiative in Recommendation 2.

Should the COBCOP adopt the provisions in Chapter 22 of the BCOP, the list of situations where a subscriber may still take default-based action where there is no payment default should not include an act of bankruptcy.

¹¹ [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.

Chapter 22, clause 80(a) of the BCOP includes the situation *when a consumer or guarantor is insolvent, goes into bankruptcy, voluntary administration, other insolvency process or arrangement, or no longer has legal capacity.*

In AFCA's view clause 80(a) of the BCOP is inconsistent with the section 301 of the Bankruptcy Act 1966 (Cth).

Section 301 of the Bankruptcy Act says a clause in a contract that allows a lessor, mortgagee or chargee to rely on an act of bankruptcy to exercise any power or remedy under the lease, mortgage, charge etc is void.

AFCA's view is that an act of bankruptcy is not, by itself, sufficient to call in a loan where there is no payment default. This position is consistent with recent case law.¹²

AFCA supports the COBCOP adopting the concept of a subscriber not taking default-based action where there is no payment default. Any exceptions should be consistent with the law, including section 301 of the Bankruptcy Act.

8 Financial difficulty

As outlined earlier in our submission, AFCA supports the COBCOP adopting the higher code standard (whether the current COBCOP or BCOP), and the initiatives in Recommendation 2 of the Parliamentary inquiry into the impairment of loans.

Some of financial difficulty provisions of the BCOP adopt a higher standard and introduce new concepts not found in the current COBCOP. For example:

- 'you' in the BCOP includes a guarantor
- the subscriber contacting a customer if the subscriber thinks a customer is in financial difficulty (Chapter 40)
- that waiving a debt may be appropriate (Chapter 41)

AFCA supports the COBCOP adopting these new concepts and higher standards. In addition, AFCA considers it desirable that the following measures also be adopted:

- staff involved in small business collections should receive more extensive training about the COBCOP 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 areas
- small business customers be provided with information about how to access AFCA:
 - > when a request for financial difficulty is declined

¹² *Morris Finance Ltd v Hodges & Anor* [2018] FCCA 3235

- > when a default notice is issued
- > when they receive notice that a subscriber does not intend to renew a loan that is about to expire.

9 Intermediaries

A question that often arises in complaints - especially in the area of responsible lending and misleading conduct - is whether an intermediary in a transaction, such as a broker, was acting as the agent of the financier 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 financier. This can be crucial where the customer provides important information to the broker which is not communicated to the financier.

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

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 financier 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 financier.

10 Remedies for breaching the COBCOP

The COBCOP does not specify the consequences of non-compliance. For example, section 12 relating to guarantees.

Section 12 of the COBCOP uses wording like "we will" and "we will not" to describe what a subscriber will, and will not, do when taking a guarantee.

Given this wording, AFCA's view is that non-compliance with section 12 of the COBCOP should mean the guarantee is unenforceable. Not only does this outcome accord with the strong words used in the COBCOP. It also helps ensure that a subscriber's 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.

AFCA adopts this approach in resolving complaints.

Although the enforceability of industry codes of conduct, and remedies for breaches, are the subject of consultation with Treasury, the inclusion of a provision that a breach of the paragraphs relating to guarantees causes the guarantee to be unenforceable would send a strong message to consumers (and Treasury) about the importance subscribers place on dealing with code breaches that can result in very significant consumer detriment.

For other less substantial breaches, AFCA supports a tiered system of remedies being specified in the COBCOP. This would involve specifying substantial remedies for breaches regarded as particularly serious and less substantial remedies for other breaches.