

# The FOS Approach to 2013 Code of Banking Practice

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We have created a series of FOS Approach documents, such as this one, to help consumers and financial services providers better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and dispute types that we see at FOS. However, it is important to understand that each dispute that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no FOS Approach document can cover everything you might want to know about key issues.

## 1 At a glance

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### 1.1 Scope

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The Code of Banking Practice (the Code) is a voluntary code of practice that Australian financial services providers (FSPs) can choose to adopt. The Code sets out standards of good banking practice, and FSPs that adopt it promise to follow the Code when they deal with consumers who are, or may become, their individual or small business customers. The Code is published by the Australian Bankers Association.

This document sets out the way we take the Code into account when we consider disputes. We consider the Code represents good industry practice and generally reflects the common law obligations of financial services providers (FSPs).

The Code was revised in 2013, with the changes effective from 1 February 2014. This document refers to the 2013 version of the Code.

### 1.2 Summary

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#### Who should read this document?

1. Financial services providers (FSPs) that have already adopted the Code, or that plan to adopt it.
2. FSPs that want to understand what we consider to be good industry practice.
3. Anyone who is an individual or small business consumer of an FSP that has adopted the Code.
4. Anyone who wants to learn more about how we take the Code into account when we consider banking and finance disputes.

#### Summary of the FOS Approach

We consider that if an FSP adopts the Code but does not comply with it, then the FSP has breached its contract with the consumer.

The Code is voluntary. We consider that if an FSP adopts the Code, the FSP must comply with it.

This document will particularly focus on:

- chargebacks (clause 22) and direct debits (clause 21)
- the FSP's decision to provide credit (clause 27)
- a consumer's financial difficulty (clause 28)
- joint debtors (clause 29)
- guarantees (clause 31)
- the closure of a consumer's account (clause 33).

## 2 In detail

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### 2.1 How we apply the Code to FOS disputes

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The Code says that:

- "Any written terms and conditions will include a statement to the effect that the relevant provisions of this Code apply to the banking service but need not set out those provisions." (Clause 12.3)

This means that if an FSP has adopted the Code, all contracts between the FSP and its consumers include the FSP's commitment to comply with the Code.

We consider that if an FSP adopts the Code but does not comply with it, then the FSP has breached its contract with the consumer. In this case, the consumer may be entitled to compensation for any loss they suffer as a result of the breach.

### 2.2 Chargebacks and direct debits

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A chargeback is like a refund. It occurs when a consumer disputes a transaction on their credit or debit card or through a direct debit, and asks for the charge to be reversed.

The terms and conditions of the credit or debit card or the bank account will explain when and how a consumer can claim a chargeback.

Chargebacks can only be made for certain reasons. The credit or debit card schemes (such as Visa and MasterCard) decide what the reasons are, and these reasons are specific to the type of card used.

If the consumer's reason for disputing the transaction does not fall within these reasons, their FSP may not be able to reverse the transaction. In these circumstances, the consumer may need to take up their complaint directly with the merchant (the company that provided the goods or service).

Clause 22 of the Code explains that an FSP must claim a chargeback if a consumer asks it to do so, as long as the consumer has asked within any applicable time limits and for an appropriate reason.

The clause also says that if the merchant's bank refuses the chargeback, the FSP must not accept this refusal unless it is consistent with the rules of the relevant card scheme.

If a consumer has cancelled a direct debit authority, the time limits to claim a chargeback under the relevant credit or debit card scheme may not apply. In these circumstances, the FSP should consider whether it had the consumer's instructions to make the payment. If it did not have this instruction, it should reverse the payment.

## **2.3 Chargebacks and small business merchants**

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Small business consumers who have a merchant facility with an FSP should also be aware of how chargebacks work.

It is important to remember that the cardholder's bank is required to claim a chargeback and the merchant's bank is obliged to process a chargeback against the small business's merchant's facility if the reason for the chargeback is consistent with the relevant card scheme rules.

A merchant should therefore respond promptly to any chargeback request and supply relevant information.

A merchant's facility agreement usually includes the merchant's permission for its bank to refuse to accept a transaction if it is not valid, if the cardholder disputes it, or to charge it back if the bank has already processed it.

## **2.4 The FSP's decision to grant credit**

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Before an FSP decides to provide credit to a consumer, it must pay careful attention to whether the consumer can afford to repay the money. This is referred to in the Code as the FSP "exercising the care and skill of a diligent and prudent banker".

If a consumer claims that an FSP has provided funds to them but they did not have the capacity to repay the debt at the time the loan was provided, we will consider whether it was appropriate for the FSP to lend the money.

## **2.5 Consumers experiencing financial difficulty**

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Financial difficulty occurs when a consumer is unexpectedly unable to meet their repayment obligations. This can be as a result of a variety of causes including accident, separation, death of a family member, unexpected medical or funeral expenses, reduction of work hours, redundancy, or a downturn in business.

The Code requires FSPs to work with their consumers to help them overcome their financial difficulty. This could be done, for example, by helping consumers to develop a repayment plan.

You can read more about [our approach to financial difficulty disputes](#) on our website at [www.fos.org.au/approach](http://www.fos.org.au/approach).

You can read more about financial difficulty in the Code at clause 28.

## 2.6 Joint debtors

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Joint debtors are also referred to as co-debtors. If more than one person agrees to repay money that the FSP has provided to them, they are co-debtors.

The Code says that a consumer should not be treated as a co-debtor if they are not receiving a benefit from the loan funds.

We consider that to be treated as a co-debtor, a person must receive a *substantial* benefit from the loan, for example owning a fair share of a property that has been purchased with the loan.

We consider that just being able to live in or use a property that has been purchased with the loan funds is not a sufficient benefit on its own to indicate that a consumer should be treated as a co-debtor.

If a consumer is not receiving a benefit from the loan funds, then they may be asked to provide a guarantee for the debtor who would receive a benefit. This means that they guarantee to pay back the loan if the borrower does not. If the consumer agrees to provide a guarantee, then the FSP would need to ensure that it followed the Code guidelines that relate to guarantees.

You can read more about joint or co-debtors in the Code at clause 29.

You can read more about [our approach to guarantees](http://www.fos.org.au/approach) at [www.fos.org.au/approach](http://www.fos.org.au/approach).

## 2.7 Guarantees

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A guarantor is a person or business who guarantees to pay back a loan if the borrower does not.

The Code sets out a number of obligations for FSPs dealing with a consumer who is a guarantor.

Some of these obligations include:

- notifying the consumer that they should seek independent legal and financial advice on the financial risks involved in providing a guarantee
- providing sufficient information about the credit contract that the consumer is being asked to guarantee
- providing any related report from a credit reporting agency, as well as financial accounts or details that the borrower has provided within the last two years
- allowing the consumer until the next day to consider this information
- not giving the guarantee to the borrower (or someone acting for the borrower) to arrange the signing of the guarantee
- ensuring the consumer signs the guarantee without the debtor being present.

If the consumer obtains legal advice about the guarantee, the FSP does not need to wait until the next day to accept the guarantee.

If the consumer is a director of the company responsible for the debt, they may choose not to receive some or all of the information described above. They may also choose not to wait until the next day to sign their guarantee.

We consider that FSPs should comply strictly with these obligations.

The Code represents good industry practice and generally reflects the FSP's common law obligations. If they comply with the Code, FSPs can be reasonably sure that their consumers have willingly and knowingly entering into their guarantee obligations, and the guarantee will be enforceable.

You can read more about guarantees in the Code at clause 31.

## 2.8 Closing a consumer's account

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The Code says that if an account is in credit, an FSP must close a consumer's account if they ask for it to be closed.

The FSP is entitled to charge the consumer for its reasonable costs to close the account.

An FSP can also choose to close a consumer's account (if it is in credit) by giving reasonable notice and by paying the consumer the account balance.

We consider that, in normal circumstances, an FSP should provide at least 14 days' notice to its consumer if it chooses to close their account.

You can read more about closing accounts in the Code at clause 33.

## 3 Context

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### 3.1 Case studies

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#### **Case 1: Chargebacks - Cancellation of travel club contract during cooling-off period**

John attended a presentation given by a travel club organisation and was persuaded to pay a deposit of \$1,500 on a contract for full membership. John used his MasterCard to pay the \$1,500.

John regretted his decision almost immediately. He contacted his state's Department of Fair Trading and was told that a "cooling-off" period applied to that type of contract. While he was still within the cooling-off period, he sent a registered letter to the travel club to cancel the contract and to request reimbursement of the deposit. The travel club did not refund the \$1,500 to him.

John then contacted his financial services provider and requested the \$1,500 charge be reversed. He provided the FSP with copies of the cancellation letter, the transaction voucher, and a signed Credit Card Authority that he had given to the travel club. The FSP said it could not assist him, and suggested he go back to the merchant or to his state's consumer authority. The FSP said that because John had

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acknowledged his participation in the transaction, it was not able to authorise the chargeback request.

The FSP also said where cancellation policies and procedures were involved, it could not credit his account unless the person selling the goods (the merchant) issued a credit voucher.

John went to his state's Consumer Tribunal, which ordered the travel club to pay him \$1,500. The order was worthless because the travel club had disappeared from its nominated address. John then lodged a dispute with FOS.

The FSP again declined to help John, saying it could not act without a valid credit voucher from the merchant. However, we considered that because John had cancelled the contract, the FSP should have taken into account that the merchant had a legal obligation to issue a credit voucher. The FSP could have exercised a chargeback right under Reason code 4860 – Credit Not Processed. The FSP had therefore not complied with its Code obligation to claim a chargeback right (for the most appropriate reason) where one existed.

### Case 2: Chargebacks – Bad call

Conrad ran a small computer sales business and was the victim of a credit card fraud. Conrad said that a consumer had paid cash for two laptops, then rang with a story that their friends also wanted to purchase laptops. The consumer provided credit card details over the telephone, and all but one of the transactions went through when Conrad sought authorisation.

Later, Conrad discovered that his financial services provider had charged back these transactions because the cardholders said they had not authorised the transactions. Conrad complained that he had sold computers to the value of \$10,000 and his FSP had no right to charge back these transactions.

Conrad lodged a dispute with FOS. We considered that Conrad had taken a risk by accepting the card details over the phone and not obtaining authorisation from the cardholder by signature or PIN. The FSP's authorisation only verified that none of the cards had been reported stolen and that there was sufficient credit available on the cards to complete the transaction. It did not guarantee the cardholder's authorisation for the transaction.

We decided that the FSP was entitled to chargeback the transactions, because the true cardholders had not authorised the use of their cards for the purchase of the laptops.

### Joint debtors

Anne, a retiree and pensioner, owned her home. She entered into a loan contract with her son, Brian, to provide funds to extend her home so her son could live with her. Anne secured the loan with a mortgage over her home, and Anne and Brian's ability to pay the loan was based on Anne's pension and Brian's wage. Anne could not afford the loan solely on her income.

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After approving the loan, the financial services provider also provided further advances under the loan contract. The money was used to pay Brian's outstanding credit card debts, and for Brian to purchase a car.

Brian left his job to travel overseas and stopped making repayments on the loan. Anne could not afford the repayments and the financial services provider said it would take possession of Anne's home. Anne lodged a dispute with FOS.

After considering the dispute, we concluded that Anne was appropriately a co-debtor in the original loan contract, as she had received a direct benefit from the loan (the extension to her home and therefore an increase in its value). However, we considered that she was not liable for the further advances as she did not directly benefit from the application of the funds. Even though the repayment of Brian's credit card debts may have provided more towards the household income, this was not a direct benefit to Anne. Neither was the purchase of a car for Brian, as there was no information to show that Anne used the car or relied on Brian to transport her.

We decided that the FSP was obliged to work with Anne to reach a repayment arrangement for the original loan. If Anne could not repay the loan even if it was varied, then Anne would be required to sell her home.

## Guarantors

Bill and Julie entered into a guarantee to secure a credit facility provided to a company that was managed by their son, Chris. When the company stopped making payments, the financial services provider called on the guarantee to require Bill and Julie to make payments, and they lodged a dispute with FOS.

Bill and Julie said that they had only entered into their guarantee on the understanding that their son, Chris, and the company's sole director and secretary, Wendy, would also provide a guarantee. Chris had signed a guarantee but Wendy had not.

The information given to us as part of the dispute showed that Bill, Julie, Chris and Wendy had all signed the loan application in which they offered to provide guarantees, and the failure to obtain Wendy's guarantee was an oversight. The information also showed that Bill and Julie had provided guarantees to other FSPs for their own business enterprises and had previously obtained legal advice about their obligations as guarantors. We considered that, without consideration of the FSP's obligations under clause 28 of the Code, Bill and Julie's guarantee would be enforceable as they appeared to be aware of a guarantor's obligations, and in all likelihood they would have supported their son by providing their guarantee.

However, we noted that the FSP had delivered the company's letter of offer, supporting financial information and the guarantee to Bill and Julie on 1 September, and witnessed them signing their guarantee that same day. There was no information to show that Bill and Julie had been given the opportunity to seek independent legal advice about the guarantee after they received the documents. By accepting Bill and Julie's guarantee without allowing them the opportunity to



properly consider the documents and to obtain independent advice, the FSP had failed to strictly comply with clause 31 of the Code. As a consequence, the FSP could not rely on Bill and Julie's guarantee to recover the outstanding company debt.

### **Closing a consumer's account**

Zara had a cheque account with the financial services provider, which was seeking to recover \$6,234.37 that Zara owed on the account.

Zara said that she had asked the FSP to close the account. The FSP told her that the account would need to be cleared before it could be closed, so she paid straight away what the FSP told her was the account balance. Afterwards, Zara sent an email to the FSP confirming that the account should be closed. Zara said the \$6,234.37 the FSP sought to recover related to transactions that were charged to the account after she instructed the FSP to close it, and which she therefore had not authorised.

The FSP said Zara's payment did not cover the interest and fees that had accrued and were subsequently charged to the cheque account, and this meant that it could not close the account. Zara lodged a dispute with FOS.

The information given to us as part of the dispute satisfied us that Zara had intended to close the cheque account, and had paid the balance owing on the account as at the date of her request. This was confirmed by her email to the FSP. Therefore, the FSP should have stopped all transactions on the account from that date— including direct debits, presented cheques and interest.

In our view, the additional transactions and charges on the account were the result of the FSP's mistake. However, Zara had still enjoyed the benefit of the FSP covering her liabilities and therefore she needed to pay the FSP for the cheques and direct debits it had paid on her behalf after she asked it to close her account. But we decided that the FSP was only entitled to receive interest from the date it had demanded that Zara pay these charges. This was because the courts have held that a person who is entitled to recover a mistaken payment is entitled to recover simple interest on the amount of the mistaken payment from the time a demand for payment is made.

## 3.2 References

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### Definitions

Word	Definition
Bank	A financial services provider that subscribes to the Code of Banking Practice
Cardholder	A consumer who uses a credit card to purchase goods or services
Chargeback	A right which may be exercised in certain situations by a cardholder's financial institution against a merchant's institution, to charge back responsibility for a credit card transaction from the cardholder's financial institution to the merchant's financial institution
Code	Code of Banking Practice
FSP	Financial services provider (a business that has chosen FOS as their external dispute resolution scheme). Reference to an FSP may also include a bank.
Merchant	A business accepting a credit card payment for its supply of goods or services to a consumer

### Useful links

A copy of the [2004 version of the Code](http://bit.ly/28TB89y) is available at <http://bit.ly/28TB89y>.

A copy of the [2013 version of the Code](http://bit.ly/28RuYrE) is available at <http://bit.ly/28RuYrE>.

A list of the [banks subscribing to the Code](http://bit.ly/28Pv9zO) is available at <http://bit.ly/28Pv9zO>.

A subscribing bank's breach of the Code can be reported to the [Code Compliance Monitoring Committee](http://www.ccmc.org.au) (CCMC). For more information, visit the CCMC website at [www.ccmc.org.au](http://www.ccmc.org.au).

If you'd like to [read more about the way Australian courts have approached the issue of co-debtors](http://www.austlii.edu.au), (www.austlii.edu.au) please see these cases: Permanent Trustee Co of New South Wales v Hinks (1934) 34 SR (NSW) 130 at 138, applied in Kennard & Anor v AGC (Advances) Ltd. & Ors (1986) ATPR: 40-747).

[Our website](http://www.fos.org.au) (www.fos.org.au) contains more information about what we do, the types of disputes we can consider, and our dispute resolution processes.

We have published other documents that outline [the FOS Approach](http://www.fos.org.au/approach), including the FOS Approach to Financial Difficulty disputes. You can see them all at [www.fos.org.au/approach](http://www.fos.org.au/approach).