BCCC Inquiry Report

Banks' compliance with the Banking Code's guarantee obligations

BCCC
Banking Code
Compliance Committee

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Contents

Executive summary

In 2019, the Banking Code Compliance Committee (BCCC) commenced an Inquiry into banks' compliance with the guarantee obligations in the Code of Banking Practice.[1]

The Code's guarantee obligations help ensure people can make fully informed decisions before agreeing to be a guarantor. The Inquiry was prompted by unexplained inconsistencies in banks' breach data over several years. These concerns were underscored by the evidence given at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission), which revealed unethical behaviour by banks towards guarantors.

Consumer advocates highlighted the link between guarantees and financial abuse, which can stem from elder abuse or family violence. Banks are well placed to recognise and act on warning signs that a guarantor is not entering into a transaction by their own free will, or that they may be experiencing vulnerability.

For the first time in a BCCC Inquiry, a sub-set of banks conducted performance audits which identified non-compliance with several important Code provisions, including pre-guarantee disclosure obligations. Equally concerning, audits found numerous instances where banks could not demonstrate compliance.

What we did

- We reviewed submissions made to the Royal Commission and sought **insight from community legal centres** on guarantor issues and outcomes.
- We collected and analysed **qualitative and quantitative data** from the 13 banks that subscribed to the Code when the Inquiry commenced, including their written policies and processes.
- We reviewed four banks' **performance audit results** to assess their operational compliance with the Code's guarantee obligations.

What we found

- In 2018, approximately **$500 billion** worth of consumer and small business credit was supported by guarantees - see Page 16.
- While banks had adequate written policies and processes, we were concerned to find that banks **frequently failed to comply** with the Code's guarantee obligations in practice - see key findings on Page 5.
- Banks **must improve practices** to meet the BCCC's expectations for compliance with the current Banking Code - see recommendations for improved practice on Page 7.

1 Clause 31 of the 2013 Code of Banking Practice.

The Inquiry found that while banks had adequate written policies and processes to comply, banks:

- lacked effective record management practices
- conducted inadequate or ineffective monitoring of compliance controls
- dealt with non-compliant guarantees on a case-by-case basis and too heavily relied on legal advice when considering whether to enforce a non-compliant guarantee
- lacked guarantee-related data capability.

The BCCC is concerned about failures to consistently provide full disclosure of key information to guarantors - an issue closely linked to banks' poor record keeping practices and the challenges associated with disparate systems, business units and subsidiary brands.

The Code obligations are a crucial safeguard to ensure guarantors understand the risks involved when providing a guarantee. With more than $500 billion of credit supported by guarantees in 2018, it is essential that banks strictly comply with the Code's guarantee provisions.

Banks are also at risk if they fail to comply with the Code. The report highlights that the Australian Financial Complaints Authority (AFCA), which can consider complaints from guarantors, may decide that the bank cannot rely on the guarantee if it finds it did not meet its Code obligations to the guarantor.

The BCCC has made 23 recommendations for improved industry practice across the guarantee provisions.

The BCCC has serious concerns about guarantee practices and expects banks to take immediate action.

Key findings

1) Frequent failure to comply with Code obligations before taking a guarantee

Banks frequently failed to comply with their pre-guarantee Code obligations based on the breach data, BCCC investigations and the audit results. This includes the requirements to provide key disclosure information to prospective guarantors before accepting a guarantee and banks' arrangements for a guarantee to be signed in an appropriate environment.

The audits also identified instances where the bank could not evidence compliance on individual guarantor files. This was largely linked to poor record management practices.

These failures mean that a prospective guarantor may not receive adequate information to understand the risks and make an informed decision about giving a guarantee.

2) Banks lacked effective record management practices

The leading reason audited banks could not demonstrate compliance with the pre-guarantee obligations was because of poor record keeping controls. For example, some banks could not show that key information was given to a prospective guarantor before accepting the guarantee, or that the guarantee was executed in the absence of the primary borrower.

Community legal centres highlighted record keeping as a key issue when requesting guarantee documents on behalf of clients – citing instances where key documents had not been retained or had been lost.

If these audit results are representative of broader industry practice, then there is a risk that banks will be unable to demonstrate compliance with their guarantee obligations either during bank or BCCC monitoring activities, or to the guarantor in the event of a dispute or a complaint.

3) Banks' monitoring of compliance controls was inadequate or ineffective

All audited banks found control gaps in their guarantee process which were not previously detected by their routine monitoring activities. For example, one bank's audit found control gaps relating to both pre-existing controls to comply with the 2013 version of the Code and newly developed controls to comply with the current Banking Code.

Again, if the audit results are representative of industry practice, the risk that guarantee compliance is not being adequately monitored or that compliance gaps are not being detected is of serious concern. Banks must test the effectiveness of monitoring and controls to comply with the current Banking Code even where improvements have been made.

4) Banks dealt with non-compliant guarantees on a case-by-case basis and relied too heavily on legal advice

When banks become aware that they have not complied with the Code when obtaining a guarantee, they consider what actions to take on a case-by-case basis. Most banks assessed the materiality of the Code breach when deciding on their approach. They relied too heavily on their solicitors for legal advice on the validity and enforceability of a guarantee.

While it is appropriate for the bank to obtain legal advice, it is also important that banks avoid an overly legalistic approach. Banks' treatment of non-compliant guarantees must take into account the Guiding Principles that underpin the Code and banks' obligations under clause 10 to engage with guarantors in a fair, reasonable and ethical manner.

Banks did not provide details about when or how they communicate non-compliance to impacted customers and guarantors.

5) Banks lacked guarantee-related data capability

Banks confirmed that they had difficulty providing requested data about guarantees. Banks store guarantee data in a variety of ways, including as paper files in branches or storage facilities, in individual customer files and have different systems for subsidiary brands and business units. Collecting guarantee data for the BCCC was a largely manual process.

Some banks could not distinguish between consumer and small business loan guarantees. The majority of banks do not have readily available data about guarantee outcomes, such as the number of guarantees enforced by the bank for any given period.

A lack of guarantee-related data such as the types of guarantees held and the outcomes experienced by guarantors will impact banks' ability to pro-actively identify trends and compliance risks and make continuous improvements to their guarantee process.

Recommendations for improved practice

The report contains 23 recommendations for improved practice, including practical examples to illustrate these recommendations.

Pre-guarantee obligations

1. Banks should review relevant processes and training to ensure staff are adequately supported to distinguish between different types of guarantors and when the Code's guarantee liability limit applies.

2. Relevant staff should make a prospective guarantor aware if the transaction is covered by the Code and where they can get further information.

For example, raising awareness of this during initial guarantor interviews.

3. Banks should periodically review deed of guarantee templates to ensure they meet the requirements of the Code.

4. Where possible, banks should meet face-to-face with the prospective guarantor to highlight the matters disclosed in the terms and conditions under clause 96 of the Code.

5. Update policies and processes to require staff to consider the prospective guarantor's unique circumstances when delivering key disclosures, particularly if they show signs that they may need extra help to understand the nature and effect of the guarantee.

For example, for a prospective guarantor who does not speak English as a first language, lending staff should engage an interpreter to ensure they receive real time explanation of the disclosures and are given an opportunity to ask the lender questions in the absence of the borrower.

6. Processes, systems and technology should enhance staff capability to:

- **a)** identify vulnerable guarantors who may require additional support to understand the guarantee information provided.
- **b)** tailor their approach to disclosing the matters contained in clause 96 of the Code in a meaningful and accessible way to suit the individual.
- **c)** keep contemporaneous records about any indicators identified and any additional care taken to give the pre-contractual disclosures.

For example, some banks described adopting a standard guarantor conversation template that can be used to document all interactions with the guarantor, including internal lender notes. A single source of record keeping with respect to the guarantor can be useful in the event of a dispute or compliance review.

7. Banks should include clear guidance in processes to help staff to locate, retrieve and store guarantee disclosure information, particularly where the bank has disparate systems, business units and subsidiary brands.

8. Banks should build the requirements of clauses 97 and 99 of the Code into the design of their processes and systems to help staff to comply.

For example, update systems to automate the creation of guarantor disclosure documents to reduce the reliance on manual processes or develop staff checklists with required communication and documents to be given to a prospective guarantor.

9. Staff training should educate staff about the essential role they play to ensure a prospective guarantor is given all key information to understand the risks, to help to protect their interests and to make an informed decision.

For example, use case studies in lenders training to illustrate the long-term harm that can occur when a bank fails to ensure the guarantor is making an informed decision.

10. Banks should capture a director guarantor's request to receive or waive their right to receive the documents listed in clauses 96-99 of the Code.

For example, one bank developed a system control that prompts a guarantor information pack election form that requires the director guarantor to 'Opt in or Opt out' of receiving disclosure documents. On receipt of this form, the information is included in the guarantor information pack. The form is retained for internal records.

11. Banks should strengthen record management requirements in pre-guarantee processes and procedures to ensure that evidence always exists on the file to demonstrate compliance.

12. Banks should audit compliance with the current Code's guarantee obligations. Audit samples should include guarantees obtained since 1 July 2019. Audits should include an assessment of the controls in place to ensure compliance with the Code's guarantee obligations.

13. Banks should review the robustness of guarantee-related Quality Assurance processes to ensure that they effectively identify, record and report Code breaches for investigation.

Signing a guarantee

14. Banks should assess how they monitor compliance with the guarantee execution obligations and make improvements where gaps are identified. This includes where banks are reliant on their solicitors to arrange for the guarantee to be executed.

15. Bank staff should keep accurate records of the circumstances in which the guarantee is executed to demonstrate compliance.

For example, one bank reported that it has a branch manager complete a witness statement that attests the guarantee was signed in the absence of the borrower. This record is kept on the guarantor file which allows the bank to demonstrate compliance in the event of a review or dispute.

16. Banks should develop guidance to support lending staff who detect signs that the prospective guarantor may be at risk of financial abuse, including during the signing of the guarantee.

For example, if there are concerns that a prospective guarantor appears to be uncertain or showing signs of potential financial abuse or any other vulnerable circumstances – lenders should be empowered to delay, escalate and address these concerns before the guarantee is executed.

During the guarantee

17. Processes should clearly articulate how staff should handle guarantor requests to limit liability, including record keeping.

For example, create a standard guarantor record template to keep an itemised record of all guarantor requests. Staff should be required to apply the notes directly into the customer file/system, updating inputs and detailing the request and its outcome.

Enforcement of a guarantee

18. Banks should conduct pre-enforcement reviews of a guarantee to ensure that it has been obtained in accordance with the Code before commencing enforcement action.

19. Banks should develop guidance to help staff to negotiate alternative debt recovery options with the primary borrower before enforcing a guarantee - to embed a culture where enforcement is a last resort.

20. Enforcement of a guarantee should require the oversight and authorisation of a senior level executive of the bank, especially if enforcement involves repossession of the guarantor's primary place of residence.

21. Banks should develop an escalation process to ensure its non-compliance is dealt with appropriately and proactively – before a guarantor makes a complaint, or the bank commences enforcement action.

22. Where a bank becomes aware of a non-compliant guarantee or where it cannot demonstrate compliance for an individual guarantee, it should:

- **a)** deal with the impacted guarantee/guarantor in accordance with clause 10 and the Guiding Principles that underpin the Code
- **b)** proactively determine if the guarantee is unenforceable and take appropriate action to rectify and remediate impacted customers and guarantors
- **c)** ensure that customer and guarantor impact assessments consider the risk of current and future financial and non-financial loss because of the bank's non-compliance, and
- **d)** communicate with impacted customers and guarantors in a clear and timely manner – including providing them with information about how to lodge a complaint with the bank or AFCA.

23. Banks should strengthen their data capability by collecting guarantor outcome data, such as enforcement and complaints data, to gain insights into guarantee trends, compliance risks and customer outcomes for continuous improvement across the guarantee process.

Next steps

Banks should carefully consider the BCCC's report and 23 recommendations against their current capabilities and practices, and develop an implementation plan to close any gaps. We also encourage banks to consider the recommendations in the BCCC's Building Organisational Capability Report when developing these plans. The BCCC expects that banks will report to their relevant Board audit and risk committees with updates about the bank's implementation plan and progress to improve compliance with the Code.

We will follow up with banks on the actions they have taken to address the findings and recommendations in this report to improve the outcomes for guarantors and customers in March 2022.

Introduction

What are the guarantee obligations, and why are they important?

The Code explicitly prescribes what steps a bank must take when a guarantor gives a guarantee to secure a loan the bank has provided to an individual or a small business customer.

There are obligations for banks before accepting a guarantee, when executing a guarantee, during a guarantee and in the event of enforcement of a guarantee.

The Code obligations are listed in full in Appendix A and detailed, where applicable, throughout the report.

The current version of the Code came into effect in July 2019 and the guarantee provisions in the current Code largely mirror those in the 2013 Code. Some changes were made to enhance the protections for existing and prospective guarantors and these are highlighted throughout the report.

Guarantees have significant legal and financial implications for consumers. If the primary borrower defaults on the loan and the guarantee is enforced, some of the risks to the guarantor include:

- severe financial hardship
- being forced to sell assets to pay the debt
- being evicted from their home if it is used as security against the loan, and
- their home being sold by the bank.

Guarantees, and the risks they pose for consumers, have been the subject of criticism for several years. The Royal Commission heard submissions from individuals and consumer advocacy groups about the significant financial and non-financial harm experienced by guarantors.

The Royal Commission heard evidence of unethical behaviour by banks towards guarantors. There were cases where guarantors were not told by the bank about extensions of business facilities for which they were providing security. There were also instances where guarantees were taken from (and sought to be enforced against) guarantors who claimed not to have understood the effect of the guarantee or their waiver of independent legal advice.

It also became clear that the avenues for redress once the guarantee was in place were expensive, complex, stressful and time-consuming for guarantors, especially if the matter ended up in court.

As part of this Inquiry, the BCCC heard from community legal centres, Consumer Action Law Centre (CALC), Justice Connect and Seniors' Law. Each highlighted the link between guarantees and elder financial abuse, citing instances where older clients had guaranteed loans for their adult children without being told about or fully understanding the risks or seeking legal advice prior to signing the guarantee. In some cases, this was due to the elderly parent not speaking English, having limited education or literacy, or feeling too embarrassed to raise their concerns about the guarantee arrangement.

Specific examples were provided of poor compliance practices by banks when dealing with guarantors and/or their legal representatives, including cases where:

- the guarantor was asked to sign the guarantee in the presence of the borrower
- the guarantee was signed on the same day that the guarantor received the loan documents
- the bank had not documented the signing of the guarantee
- poor record keeping resulted in documents being lost or not retained by the bank
- there were inconsistent or non-existent policies relating to how a guarantee will be enforced.

Banks are well placed to identify guarantors who may be vulnerable, and to protect them from experiencing the types of scenarios described above. The Code is an essential tool for enabling this, so it is vital that banks demonstrate strict compliance with the Code's guarantee provisions.

Why we reviewed compliance with the guarantee obligations

In recent years, the BCCC has identified banks' compliance with the guarantee provisions of the Code as an area of ongoing risk. In addition to receiving notification of potentially systemic breaches of these provisions, we have also seen an increase in the number of guarantee-related breaches self-reported by banks in their periodic compliance statements.

Concerns were first identified in the 2017–18 reporting period, when banks reported 184 guarantee breaches – up 411% from the 36 breaches reported the previous year. Guarantee breach numbers remained high in 2018–19, with 118 breaches recorded and one major bank self-reporting 55% more guarantee breaches than it had in the previous period.

Many banks with large numbers of guarantee breaches provided no explanation for the increase.[2]

At the same time, we have seen some banks report zero breaches of the guarantee obligations, including banks that reported zero breaches for every reporting period since 2017–18. This raised additional concerns about banks' capability to identify and respond to guarantee-related non-compliance, as zero breaches is unlikely to accurately reflect the true situation on the ground.

In response to these concerns, and to better understand the reasons for these contrasting outcomes, the BCCC commenced an Inquiry into banks' compliance with the Code's guarantee obligations in May 2019.

The purpose of the Inquiry was to establish and understand industry practice, assess how banks ensure compliance with the guarantee obligations and report on banks' level of operational compliance.

Separately, the BCCC also has several targeted inquiries in progress into individual banks' compliance with the guarantee obligations. The issues predominately relate to banks' failure to consistently comply with the pre-contractual disclosure obligations.

2 The BCCC publishes reports about banks' compliance with the Code on an annual and six monthly basis.

What we did

The Inquiry assessed banks' compliance with clause 31 of the 2013 Code, and the 13 banks that subscribed to that Code were required to respond to the Inquiry.

To understand guarantor issues and outcomes we reviewed submissions made to the Royal Commission and sought insight from community legal centres.

We collected and analysed qualitative and quantitative data from the 13 banks that subscribed to the Code when the Inquiry commenced, including their written policies and processes.

We also required four banks to conduct a performance audit to assess their operational compliance with the Code's guarantee obligations. Three banks used their internal audit team, while one engaged an external auditor to conduct the required audits.

The BCCC requested that each bank's audit include:

- a review of individual files from a sample of all guarantees taken by the bank pursuant to the 2013 Code from 1 July 2017 to 30 June 2018 (inclusive);
- as much as practicable, a proportional representation of the bank's total portfolio of guarantees during this period, and
- a prioritised sample of guarantees that have been enforced, waived, released or settled.[3]

Banks were asked to table their final audit report at their Operational Risk Committee and Board Risk Committee (or equivalent).

The audit findings are published throughout this report in the form of case studies. Participating banks have been de-identified, with banks instead referred to as Bank A, Bank B, Bank C and Bank D.

3 **Enforcement** - the point at which a default notice is issued to a guarantor by the bank seeking payment pursuant to the guarantee. **Waived** - enforcement rights under the guarantee arrangement enlivened but the bank chose not to enforce its rights in relation to the guarantor liabilities. **Released** - liability under the guarantee is extinguished due to repayment of the guaranteed portion of the loan prior to completion of the original loan term (excludes enforcement). **Settled** - liability under the guarantee is extinguished upon completion of the original loan term (excludes enforcement).

What we found

Guarantees in banks: A brief overview

To assist the BCCC to understand the nature and extent of how banks use consumer and small business guarantees, they were asked to provide quantitative data relating to guarantees for four reporting periods spanning 1 July 2014 to 1 July 2018.

During early consultation with banks, they explained that procuring the requested guarantee data would be difficult. Banks gave the following reasons for the challenges:

- The data was not collected or located in a central place.
- The data was not readily available, as many paper files were held in branches or archived with third parties.
- The data was held on individual customer files.
- The data was held in various subsidiary brands, business units or systems.
- Collecting the data would be a largely manual process and require various business units to locate and review individual files to ascertain where a guarantee secures, or secured, a loan, along with any other information required about the guarantee.

The BCCC understands from our Inquiry into banks' transition to the current Banking Code of Practice that banks have enhanced their record keeping practices to some extent, although how this has impacted the collection and retention of data related specifically to guarantees is unknown at this stage.

Banks' quantitative data was submitted to the Inquiry on a 'best endeavours' basis and was aggregated by the BCCC to provide an indication of the industry's guarantee use and exposure. As such, the data in this report should be treated only as indicative because the BCCC was unable to obtain clear, robust and reliable data from banks.

What did the data reveal?

All banks confirmed that they accept guarantees to support the provision of credit. Most banks offer guarantees for consumer and small business products.

Where do loans with guarantees attached originate?

More than half of the total value of credit with guarantees attached was originated by the bank directly, rather than through a third-party distribution channel such as a broker.

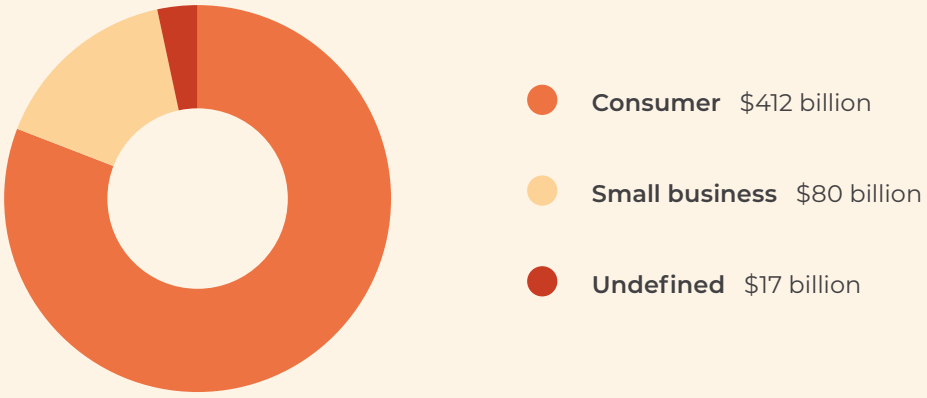
Product types

Banks provided a detailed list of credit products for which they will take a guarantee. The three most common were home loan, business loan and asset finance products, followed by invoice finance, overdrafts, margin lending, commercial credit cards, personal loans and trade finance.

Value of credit supported by consumer and small business guarantees

The total value of credit supported by consumer guarantees was approximately $412 billion (81%) during the 2018 financial year. While the value of credit supported by small business guarantees was approximately $80 billion (16%). The residual value of credit was approximately $17 billion (3%) and was not categorised by banks as either consumer or small business.

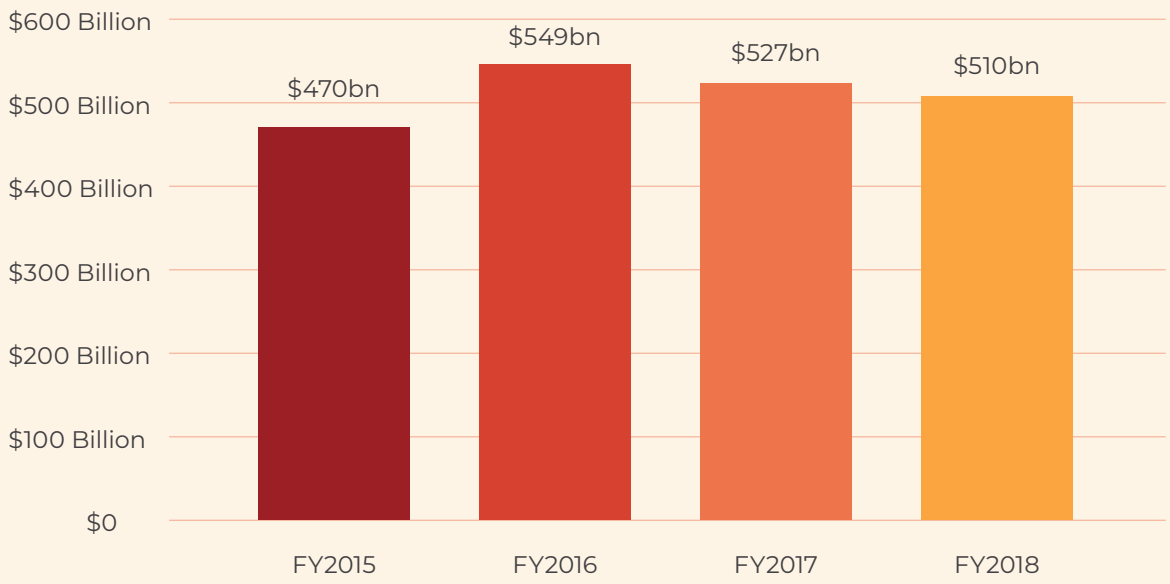
DIAGRAM 1: TOTAL VALUE OF CREDIT SUPPORTED BY CONSUMER AND SMALL BUSINESS GUARANTEES IN FY18



Historical data trends

According to the available data, the value of credit supported by guarantees has been around $500 billion since the 2016 financial year.

DIAGRAM 2: TOTAL VALUE OF CREDIT PRODUCTS GUARANTEED BY REPORTING PERIOD



Pre-guarantee obligations

The intention of the Code's pre-guarantee obligations is to ensure that guarantors are provided with the important information they need to understand the risk associated with the transaction and to make a fully informed decision about giving a guarantee.

This section of the report covers:

- Guarantors covered by the Code (clause 31.1)
- Limiting the liability of a guarantor (clause 31.2)
- A guarantee statement that the Code applies (clause 31.3)
- Providing prominent notice to a prospective guarantor (clause 31.4 a)
- What the bank will tell a prospective guarantor (clause 31.4 b-c)
- Disclosure to the guarantor before accepting a guarantee (clause 31.4 d)
- The bank will give a guarantor any other information requested (clause 31.4 e)
- Compliance monitoring and controls.

Guarantors covered by the Code (clause 31.1)

Clause 31.1 prescribed which types of guarantors are covered by the Code. It provided that clause 31 (the guarantee provisions) will apply to every guarantee and indemnity (guarantee) obtained from an individual to secure a loan facility provided by the bank to another individual or a small business, except as provided in clauses 31.15 and 31.16.[4]

Bank staff must be able to correctly identify a prospective guarantor (for example, an individual versus a sole director or trust) at the application process to ensure that the required disclosures are provided to comply with the Code.

The equivalent obligation under the current Code is set out in clause 93.

Inquiry findings and insights

Banks' policies and processes mostly helped staff identify the types of guarantor that would be covered by the Code. In some cases, processes could have been more clearly articulated to make it easier for staff to identify the type of guarantor.

4 Exceptions to application of guarantee obligations under clause 31.15 – where you are a commercial asset financing guarantor, sole director guarantor or trustee guarantor. In these cases, clause 31.4(b) to (e), 31.5, 31.6 and 31.7 do not apply. Exceptions to application of guarantee obligation under clause 31.16 – if you are a director guarantor, clause 31.4(d) and 31.5 are subject to varied application.

Where banks provided supporting training material for the BCCC to review, clause 31.1 was adequately covered. Based on the training material, the learning outcomes for staff included the ability to distinguish between the types of guarantors that would be subject to the Code, and those that fall outside of the Code's remit.

Many banks exceeded the minimum Code requirements and applied their own internal classification or definition that extended the guarantee protections to a broader range of prospective guarantors than those prescribed by the Code.

Compliance with the Banking Code: What the BCCC expects

In November 2020, the BCCC published its 2019 Transition Inquiry report, which assessed the steps banks had taken to transition to and comply with the 2019 Code. It found that 11 out of 19 banks intended to apply a broader definition to small business customers than that prescribed by the Code. In the context of this report, that means this extends to guarantors of the subject small business' loans.

We raised concerns that two of the 11 banks adopting a broader definition of small business had reserved the right to contend that the Code does not apply to the relevant customer in the event of a BCCC investigation. The BCCC found this approach to be unacceptable and expects that the Code's small business obligations, if broadly applied by a bank, should continue to apply for the purposes of any complaint, BCCC inquiry or investigation. This extends to the application of the guarantee protections.

Limiting the liability of a guarantor (clause 31.2)

Clause 31.2 requires banks to ensure that guarantor liability is limited. Liability limitation information should be clearly disclosed in the deed of guarantee.

It is essential that guarantors understand the amount of liability and therefore the level of risk they will be accepting by providing the guarantee.

Inquiry findings and insights

The Inquiry found that banks met the requirements of clause 31.2 in the following ways:

- credit policies included detail about the liability limits of a guarantee.
- standard operating procedures required staff to ensure that the guarantee liability is limited.
- liability limitation clauses and details were contained in standard form deeds of guarantee.

While banks' documents support compliance, the training material submitted by some banks did not comprehensively cover the treatment of limiting guarantee liability. When training material did cover clause 31.2, the information was brief and lacking the level of detail needed to ensure staff understand the importance of limiting a guarantor's liability.

PERFORMANCE AUDIT CASE STUDIES

- Bank A audited a sample of 137 customer loans and the associated guarantee it accepted in accordance with clause 31 of the 2013 Code.

  The audit found **nine guarantor files** where the deed of a consumer guarantee provided that the guarantor was liable for an unlimited amount.

  The **root cause** was poor processes that did not support staff to correctly identify the 'guarantor type' (for example individual, sole director, trust or company) and then to limit liability as required.

- Bank B audited a sample of 100 customer loans and the associated guarantee.

  The audit found **15 guarantor files** where the bank could not provide evidence to confirm that it complied with clause 31.2 (to limit the guarantee liability).

  The **root cause** was poor records management. In this case documents could not be retrieved and provided to the audit team to assess compliance.

Compliance with the Banking Code: What the BCCC expects

Clause 94 of the current Code mirrors the requirements of clause 31.2 in the 2013 Code. Compliance with this obligation should be considered alongside clause 96(d) which confirms that a prospective guarantor can limit their liability in accordance with the Code or as allowed by law.

For a prospective guarantor to make an informed decision, they must understand the risks involved with the transaction. Customers expect and rely on the bank to provide loan agreements that are compliant with both the Code and the law.

Some banks reported that, as part of their transition to the current Code, programs of work included enhanced systems controls to identify different guarantor types and ensure relevant information is provided to them, including system prompts to limit liability.

RECOMMENDATION

1. **Banks should review relevant processes and training to ensure staff are adequately supported to distinguish between different types of guarantors and when the Code's guarantee liability limit applies.**

A guarantee statement that the Code applies (clause 31.3)

Clause 31.3 required guarantees to contain a statement to the effect that the relevant provisions of the Code apply. This is essential to raise awareness of the Code's application and the guarantor's rights under the Code.

Inquiry findings and insights

A review of banks' deeds of guarantee indicated that all banks comply with this clause by including a guarantee statement where relevant. Notwithstanding this, two audited banks could not demonstrate compliance with this requirement.

PERFORMANCE AUDIT CASE STUDIES

- Bank A audited a sample of 137 loans and the associated guarantees.

  The audit found **one guarantor file** where the deed of guarantee and indemnity did not appropriately detail that the Code protections applied to the guarantee. In another **three guarantor files** Bank A did not have evidence to show that the deed had a statement to this effect.

  The **root cause** was a combination of factors including:

  - Staff using incorrect template deed documents that did not contain the statement required
  - Insufficient oversight of deed of guarantee documents – including legal review
  - Processes and systems were not set up to ensure that relevant information/documentation is appropriately captured and stored.

- Bank B audited a sample of 100 loans and the associated guarantees.

  The audit found that there were **16 guarantor files** where the bank could not provide evidence to confirm it included a statement that the Code applies.

  The **root cause** was poor record management.

Compliance with the Banking Code: What the BCCC expects

Clause 2 of the current Code is the equivalent requirement of clause 31.3 of the 2013 Code.

Banks must include a statement in the guarantee terms and conditions that the relevant provisions of the Code apply to the guarantee. The BCCC considers it good industry practice for banks to also include a statement to this effect in the deed of guarantee document.

RECOMMENDATIONS

2. **Relevant staff should make a prospective guarantor aware if the transaction is covered by the Code and where they can get further information.**

   For example, raising awareness of this during initial guarantor interviews.

3. **Banks should periodically review deed of guarantee templates to ensure they meet the requirements of the Code.**

Providing prominent notice to a guarantor (clause 31.4 a)

The Code sets out what information banks must provide to the guarantor before it can obtain a guarantee.

These disclosure obligations are to protect prospective guarantors by ensuring that they are given relevant information to make an informed decision about whether to guarantee a loan.

Banks are required to give prominent notice that a prospective guarantor:

- should seek independent legal and financial advice
- can refuse to enter into the guarantee
- takes on certain financial risks when providing a guarantee
- can limit their liability
- can request information about the guaranteed transaction(s).

Some of these requirements overlap the warnings set out in Form 8 of the National Consumer Credit Protection (NCCP) Regulations 2010.

Inquiry findings and insights

Banks' policies and processes indicated they had measures in place to ensure they provide prominent notice of the disclosures required in clause 31.4 (a). The majority of banks use a combination of written and verbal methods, at various stages in the loan origination process.

At a minimum, all banks provided guarantors with written disclosure in the deed of guarantee - which was not accepted by banks until at least one day after the information is provided to allow the guarantor time to consider the disclosure information.

Some banks went beyond this minimum and provided the disclosures, at least in part, verbally during the early interview stages with the prospective guarantor in addition to the written notices provided in the deed of guarantee.

During initial interviews, banks also provided prospective guarantors with detailed information sheets that included the mandated notices.

Checklists and signed guarantor's certificates were used by some banks to evidence that disclosures had been provided to the prospective guarantor.

Some banks reported that they commonly include a separate, signed certificate confirming that:

- the prospective guarantor understands the guarantee
- the bank has advised the prospective guarantor to obtain independent legal advice
- the bank has received a certificate from a solicitor confirming the provision of independent legal advice to the prospective guarantor.

These certificates also included the disclosure notifications required by clause 31.4 (a), giving the banks that used them a separate, signed document that can be used as evidence that the guarantor has been provided with the notices and understands the transaction.

PERFORMANCE AUDIT CASE STUDY

- Bank A audited a sample of 137 customer loans and the associated guarantees.

  The audit found **17 guarantee files** where the bank could not provide evidence to show that it provided the guarantor with prominent notice of key information before accepting the signed guarantee.

  The indicative **root cause** was a combination of factors, including that templates had not been reviewed to ensure all Code requirements were appropriately documented. Poor record management also made it difficult to evidence that key information was provided or communicated prior to entering a guarantee.

Compliance with the Banking Code: What the BCCC expects

The corresponding provision to clause 31.4(a) in the current Code is clause 96. Unlike clause 31.4(a), clause 96 prescribes where the 'prominent notice' is to be provided - in the terms and conditions of the guarantee. The BCCC considers it good practice to go beyond this minimum standard.

Banks should move away from a 'one size fits all' approach in providing a prominent notice of the key disclosures set out in clause 96, as the effects of disclosure differ from person to person and from situation to situation.

A joint report prepared by the Australian Securities and Investment Commission (ASIC) and the Dutch Authority for the Financial Markets (AFM) focused on the real-world context in which disclosure operates.[5] It highlighted that while disclosure is necessary, by itself it is often not sufficient to drive good consumer outcomes. We should not assume that disclosure alone, including warnings, is effective in protecting consumers or helping them make good decisions.

The submission by Legal Aid NSW to the Royal Commission highlighted the need for banks to consider how they provide information to vulnerable groups including older people and people from culturally and linguistically diverse backgrounds.

The BCCC agrees with this view and considers it good practice for banks to provide information in a manner that is accessible and meaningful to the individual who receives it – for example, providing prominent notices of key disclosures in languages other than English.

Consumer Action Law Centre's submission to the Financial Services Royal Commission highlighted that, while banks have policies and procedures to comply with the requirements to provide prominent notices, vulnerable people may agree to sign a guarantee to their detriment, even though the risks associated with the transaction have been explained to them. For example, a sense of familial duty or pressure from a family member can result in someone giving a guarantee without truly considering or understanding the consequences of a default.

Other examples of guarantors who may be in situations of vulnerability can include people who:

- are pensioners
- do not speak English
- are recent immigrants
- have low levels of literacy or education
- have family members who become company directors shortly before the loan application
- have received legal advice from the borrower's solicitor
- are director guarantors with no involvement in the transaction or the business
- are parents offering to guarantee the business borrowings or loans of their children
- are unable to afford independent legal advice.

5 Disclosure: Why it shouldn't be the default, ASIC and AFM, October 2019.

In accordance with clause 38 of the Code, banks must take 'extra care' with customers and prospective guarantors in vulnerable circumstances. Banks reported that the transition to the current Code included the development of vulnerability training which covers prospective guarantors and the loan/application process.

CASE STUDY: PENSIONER GUARANTEES THE BUSINESS OF HER ADULT DAUGHTER

The bank sought to repossess the guarantor's home after the borrower defaulted on the loan. The guarantor was a pensioner mother who signed a guarantee to assist her daughter to secure a business loan to purchase a small business.

At the time of the loan application, the prospective guarantor had poor eyesight and trouble speaking, and her only source of income was a disability pension. She was offering her home as security for the guarantee.

To assist the guarantor, the bank pre-filled an acknowledgment that she had been properly advised and understood the guarantee. This was filled out before the mother had an opportunity to seek independent legal and financial advice.

When the small business failed and the bank took steps to enforce the guarantee, the validity of the guarantee was challenged. The bank had difficulty demonstrating how the staff member was satisfied the guarantor knew and understood the risks involved before accepting the guarantee.

Some banks require all retail guarantors to sign a statutory declaration confirming that they have obtained independent legal advice before they can sign a guarantee. While this is an important protective measure, this alone is not a silver bullet.

Some good practice was observed by one major bank that requires face to face meetings with all prospective guarantors, and associated staff training encouraged lending staff to listen, stay curious and sensitively ask questions to identify any potential vulnerable circumstances, particularly when something doesn't feel right. This included taking the time to sensitively ask clear, factual and non-threatening questions about why they want to be a guarantor.

Other practices observed included:

- where a guarantor has limited English or literacy skills, a statutory declaration must be completed by the guarantor confirming they have received an independent translation of the guarantee and sought legal advice.
- to look for signs that the guarantor may appear under duress or lack the ability to make an informed decision.
- to look for signs of financial abuse including when a guarantor appears withdrawn, silent or unclear of their reasons for being a guarantor.

Importantly, banks need to equip staff with resources and guidance to external support services that can be offered to the guarantor, where the guarantor may be in a vulnerable situation.

One major bank provides warnings to guarantors in the guarantee documents about factors that may make them vulnerable. It has also established a dedicated phone line so that guarantors can contact the bank to discuss any concerns they may have in confidence. Another major bank has mandated face to face interviews between lenders, brokers and guarantors. As part of the interview, the lenders and brokers must give the guarantor a copy of the bank's guarantor information sheet and confirm that the guarantor is providing the guarantee freely and understands the risks involved.

When providing disclosures required by clause 96 banks should move away from one size fits all. Lending staff should consider if there are any indicators that suggest the prospective guarantor may require extra support to understand the nature and effect of the guarantee. Staff should tailor their approach to disclosing the matters contained in clause 96 in a meaningful and accessible way to suit the individual's needs.

RECOMMENDATIONS

4. **Where possible, banks should meet face-to-face with the prospective guarantor to highlight the matters disclosed in the terms and conditions under clause 96 of the Code.**

5. **Update policies and processes to require staff to consider the prospective guarantor's unique circumstances when delivering key disclosures, particularly if they show signs that they may need extra help to understand the nature and effect of the guarantee.**

   For example, for a prospective guarantor who does not speak English as a first language, lending staff should engage an interpreter to ensure they receive real time explanation of the disclosures and are given an opportunity to ask the lender questions in the absence of the borrower.

6. **Processes, systems and technology should enhance staff capability to:**

   a. **identify vulnerable guarantors who may require additional support to understand the guarantee information provided.**

   b. **tailor their approach to disclosing the matters contained in clause 96 of the Code in a meaningful and accessible way to suit the individual.**

   c. **keep contemporaneous records about any indicators identified and any additional care taken to give the pre-contractual disclosures.**

   For example, some banks described adopting a standard guarantor conversation template that can be used to document all interactions with the guarantor, including internal lender notes.

   A single source of record keeping with respect to the guarantor can be useful in the event of a dispute or compliance review.

What the bank will tell a guarantor (clause 31.4 (b–c))

Before a bank could accept a guarantee, it needed to inform the prospective guarantor of the following matters contained in clause 31.4(b-c):

- If any demand notices were issued or any facilities with the bank were dishonoured in the previous two years.
- If any facilities with the bank had been in excess or overdrawn by $100 or more in the previous six months. The bank had to provide a list that demonstrates the extent of the relevant excesses or overdrafts.
- If any existing facilities would be cancelled, or if the facility would not be provided if the guarantee were not provided.

This information provided the prospective guarantor with insight into the borrower's financial history which they may otherwise not be privy to, and which could also influence their willingness to provide a guarantee. For example, if disclosures reveal recent or habitual delinquency with the bank, the prospective guarantor would have good reason to be wary of placing their property or financial position at risk to guarantee the loan.

Inquiry findings and insights

Clause 31.4 (b) and (c) information is provided by banks in the guarantor loan packs provided to the guarantor.

Banks were able to demonstrate that they have processes for gathering this information and ensuring relevant staff disclose it to the prospective guarantors. It was evident that the processes, including the role responsible for compiling the information, varied depending on the business unit/portfolio within the bank.

Banks relied heavily on the use of standard operating procedures and checklists to ensure staff complied with the disclosure obligations.

While banks could demonstrate they had processes in place to collate the relevant information to provide to guarantors, a number of banks self-reported difficulty in consistently complying with this obligation in practice. Issues with operational compliance were also identified by banks' audit results.

Banks' self-reported breaches and compliance challenges

During transition to the 2019 Code, some banks self-reported compliance gaps to the BCCC which related to issues providing consistent disclosures to guarantors. This was commonly due to complex and disparate systems.

One major bank reported compliance failures disclosing notices of demand to prospective guarantors due to system and brand fragmentation that prevented group-wide visibility and/or accessibility of relevant notices. This led to prospective guarantors not receiving full disclosures of information as required by the Code. To resolve this issue, the bank began generating monthly datasets evidencing notices of demand being issued across all brands.

Another major bank reported that its asset finance and consumer margin lending units had failed to provide the required disclosures to guarantors. This issue was fixed during the transition to the current Code in 2019.

One mid-sized bank also reported issues disclosing information due to a process failure. The process in place to comply with clause 31.4(b) was not operating effectively in all instances. This led to prospective guarantors not receiving full disclosures about the performance and/or conduct of separate loan facilities that the borrower held with the bank. Producing the disclosure notices specified in the clause required extracting information from several of the bank's systems and consequently some information was missed. The bank improved its existing process to prevent reoccurrence.

PERFORMANCE AUDIT CASE STUDIES

- Bank A audited a sample of 137 customer loans and the associated guarantees.
  - With respect to clause **31.4 (b)** the audit found **85 guarantor files** where the bank could not provide evidence to assess and confirm positive compliance. For the impacted files there was no documented evidence that Notices of Demand or excesses/ overdrafts were communicated to the guarantor.
  - With respect to clause **31.4 (c)** the audit found **77 guarantor files** where the bank did not have evidence of compliance.
- The **root causes** included:
  - Inconsistent processes whereby some business units required staff to use a checklist and signed Guarantor's Certificates to indicate where documents were provided, while others did not.
  - Processes and system controls not set up to ensure key information/ documentation was appropriately captured and, where appropriate, stored with the customer file.
  - Lack of system integration across the bank affecting its ability to capture and provide appropriate evidence of compliance with the Code.

Compliance with the Banking Code: What the BCCC expects

The equivalent obligation to clause 31.4 (b) and (c) in the current Code is clause 97. However, clause 97 does not require banks to provide a prospective guarantor with details of any overdrawing or excess of $100 or more on any facility the debtor has, or has had, with the bank.

With respect to collating, providing and storing the information required to be disclosed under clause 97, banks reported making various improvements as part of their transition to the current Code in 2019. Programs of work resulted in strengthened guarantee processes and systems, including:

- Updating the guarantor cover letter provided in home loan guarantee packs to clearly indicate what may happen if the guarantee is not provided.
- Developing a guarantor interview checklist to provide clear instructions to staff on the information that needs to be covered during guarantor interviews.
- Introducing a system and process change to ensure all guarantor disclosure documents are stored as soft copies.
- Enhancing operating procedures to make document retention requirements more explicit and reinforcing this in associated staff training.

The BCCC considers these good practice initiatives should improve compliance with clause 97. It encourages all banks to test the effectiveness of existing controls that ensure staff provide full disclosures to guarantors, particularly where cross-brand and system information is required.

RECOMMENDATION

7. Banks should include clear guidance in processes to help staff to locate, retrieve and store guarantee disclosure information, particularly where the bank has disparate systems, business units and subsidiary brands.

Disclosure to the guarantor before accepting a guarantee (clause 31.4 (d))

Before the bank could accept a guarantee, it was required to provide the prospective guarantor with further disclosures prescribed by clause 31.4 (d). These were more detailed than the disclosure requirements previously described. They informed the prospective guarantor of the terms and structure of the proposed credit contract, the borrower's financial position and serviceability history. There were exceptions for director guarantors.[6]

Disclosure requirements included providing a copy of:

- any related credit contract together with a list of related security contracts. The list had to include descriptions of the type of security contract and of the property subject to it, to the extent that the property is ascertainable. The bank was required to give the guarantor a copy of any relevant security contract on request
- the final letter of offer, including the details of any conditions that had to be met before the final offer was issued to the borrower by the bank
- any related credit report from a credit reporting agency
- any current credit-related insurance contract in the bank's possession
- any financial accounts or statement of the borrower's financial position given to the bank by the borrower within the previous two years
- the latest statement of account related to a facility that was subject to a notice of demand, or where a dishonour occurred (the bank was required to inform the guarantor of such facilities under 31.4 (b) (i))
- any unmet demand made by the bank in relation to the facility where the notice was given within two years.

Again, this information was intended to support the guarantor to better understand the risk of the transaction and make an informed decision about whether to guarantee the credit.

6 As stated in clause 31.16, if the individual is a director guarantor then clauses 31.4(d) and 31.5 apply as follows:
(a) The bank will tell you that:
  - you have the right to receive the documents described in clause 31.4(d), and
  - those documents contain important information that may affect your decision to give a guarantee

(b) you may choose to receive some or all of the documents described in clause 31.4(d)
(c) the bank will tell you how you can make these choices
(d) the bank will provide you with a copy of any document described in clause 31.4(d) that you have requested
(e) you can tell the bank that you do not wish to have the benefit of the period referred to in clause 31.5(b)
(f) apart from telling you the things set out in clause (a) and ii, 31.16 (b) and 31.16(c) and as required under other provisions of this Code, we will not attempt to influence your choices under clause 31.16(b) and 31.16 (e).

Inquiry findings and insights

The findings and insights highlighted for clause 31.4(b-c), above, are also relevant here.

In some cases, lending staff managing the credit file are responsible for determining what information the prospective guarantor requires under clause 31.4 (d). Back-office processing staff are then instructed to compile the required documents into a disclosure pack to be given to the guarantor.

In other cases, banks have solicitors that collect and compile the required disclosure documentation for distribution to the prospective guarantor.

With respect to the director guarantor exception in clause 31.16, banks commonly used a guarantor checklist that requires staff to confirm the type of guarantor and the documents they should receive. If a prospective guarantor is to be a director guarantor, the form instructs staff to advise the director guarantor that they can receive any or all of the disclosure documents under the Code and to ask for their preference. Other banks described providing a director guarantor document election form to complete and return to the bank.

PERFORMANCE AUDIT CASE STUDIES

- Bank A audited a sample of 137 loan files and the associated guarantees.

  The audit found **50 guarantee files** where the bank could not demonstrate that all disclosures were provided to the guarantor under clause 31.4(d).

  The **root cause** was systems and procedures that were not set up to capture key documentation provided to the guarantor. Relevant processes did not require staff to record all key information that was provided during the guarantee process.

- Bank D audited a sample of 60 loan files and the associated guarantees.

  The audit found **one guarantee file** where the bank did not provide the credit report in the guarantor pack.

  The **root cause** was identified as conflicting policy documents. A credit-check policy noted that all credit reports had to be destroyed by staff within 50 days of being completed. This was at odds with the guarantee policy, which required staff to retain the credit report for the guarantor pack.

  The audit found **eight guarantee files** where the bank did not have records to show that debtors' financial statements were provided in the guarantor pack.

The **root cause** was due to inadequate staff training, staff were not aware of the requirement to include debtors' financial statements in the guarantee packs. Also due to a control failure, the contents of the guarantor packs were not being checked.

With respect to the exception for director guarantors, the audit found **one guarantee file** where the bank did not have a record of the director guarantor waiving their right to receive all disclosure documents that they were entitled to under the Code.

The **root cause** was a control failure – there was no check conducted to confirm a waiver was received from the guarantor and retained in the system by relevant staff.

Compliance with the Banking Code: What the BCCC expects

Clause 99 of the current Code contains the list of documents that must be provided to a prospective guarantor. The BCCC's expectations highlighted in the section above for clause 31.4(b-c) are also relevant here.

Many of the compliance challenges surrounding disclosure have related to the complexity of banks':

- differing business units and functional teams
- subsidiary brands
- system fragmentation.

All four banks conducting a performance audit identified compliance issues in this area – either non-compliance, or an inability to evidence compliance. The audits revealed process and control failures. These compliance gaps were concerning.

Processes and checklists can be effective for staff to meet disclosure requirements. However, these should not be treated as a 'set and forget', the BCCC expects banks to regularly test the effectiveness of these controls and to monitor compliance.

Improved processes, systems and technological capability – for example, an automated holistic view of customer profiles or a bank-wide 'one stop shop' for document retrieval – would support more robust compliance with the disclosure obligations. We accept that this may not be viable for all banks.

Banks should consider ways they can enhance existing processes, systems and technology to achieve consistently compliant outcomes. To comply with the clause 99 disclosure obligations, one bank reported that all required guarantor documents are automatically uploaded to a workflow management system supporting staff to comply. These changes have also reduced the risk of non-compliance due to human error.

Lending staff play an essential role in providing prospective guarantors with all key information to understand the risks, help them to protect their interests and to make an informed decision. Educating staff on the customer harm that can result from failure to do so can help to influence the right behaviours from staff and prevent a 'check-box' attitude to compliance.

As highlighted earlier in the report, banks must avoid a one size fits all approach to disclosure. A tailored approach may be required where there are indicators that the guarantor needs more care.

In addition to providing copies of documents, staff should routinely explain the contents and purpose of the documents provided. Prospective guarantors should also have the opportunity to ask questions to better understand the nature of the transaction and the risks involved before agreeing to guarantee a loan.

RECOMMENDATIONS

8. Banks should build the requirements of clauses 97 and 99 of the Code into the design of their processes and systems to help staff to comply.

For example, update systems to automate the creation of guarantor disclosure documents to reduce the reliance on manual processes and/or develop staff checklists with required communication and documents to be given to a prospective guarantor.

9. Staff training should educate staff about the essential role they play to ensure a prospective guarantor is given all key information to understand the risks, to help to protect their interests and to make an informed decision.

For example, use case studies in lenders training to illustrate the long-term harm that can occur when a bank fails to ensure the guarantor is making an informed decision.

10. Banks should capture a director guarantor's request to receive or waive their right to receive the documents listed in clauses 96-99 of the Code.

For example, one bank developed a system control that prompts a guarantor information pack election form that requires the director guarantor to 'Opt in or Opt out' of receiving disclosure documents. On receipt of this form, the information is included in the guarantor information pack. The form is retained for internal records.

11. Banks should strengthen record management requirements in pre-guarantee processes and procedures to ensure that evidence always exists on the file to demonstrate compliance.

The bank will give the guarantor any other information requested (clause 31.4 (e))

Before the bank could accept a guarantee, it needed to address any requests made by the prospective guarantor for further information about the loan. To comply with clause 31.4 (e), the bank must give the prospective guarantor other information it holds about the loan (including any loan with the bank to be refinanced by the subject loan) but not its internal opinions.

Inquiry findings and insights

This obligation was generally covered in banks' training materials and reflected in standard operating procedures.

However, the audit results revealed that in practice banks had difficulty demonstrating compliance with this obligation.

PERFORMANCE AUDIT CASE STUDY

- Bank B audited a sample of 100 loan files and the associated guarantees.

  The audit found **45 guarantee files** where the bank could not provide evidence to assess and confirm positive compliance.

The **root cause** was poor records management - there was no standard form or document to record guarantor requests and banker actions, resulting in challenges for the business to show compliance or non-compliance.

Compliance with the Banking Code: What the BCCC expects

Clause 99(g) is the equivalent provision to clause 34.1(e) in the current Code.

Lending staff should encourage prospective guarantors to ask questions about the transaction and make them aware that they can request any further information relating to the loan that would assist them to make an informed decision.

To improve compliance capability, banks are expected to keep accurate and timely records of requests made by the guarantor.

During the transition to the current Code in 2019, some banks described improvements made to comply with clause 99(g) - good practice examples included:

- Introducing a dedicated phone line for guarantors to request further information or ask questions in confidence.
- Developing a guidance document for lending staff about the types of documents that a prospective guarantor may ask for and where staff can find them - such as profit and loss statements, cashflow forecasts and tax returns.

- Capturing details of guarantor and bank interactions, including interview discussions, guarantors' requests for further information and subsequent staff actions taken - in a dedicated Guarantor Interview Record form. This form is signed and dated for internal records.
- Updating existing guarantor checklists to include a provision for additional information requested and provided. This is then held on the customer file.

Banks should consider these good practice examples when improving their record management practices.

Compliance monitoring and controls

Overall, the BCCC found that banks frequently failed to comply with their pre-guarantee obligations in the 2013 Code based on banks' breach data, BCCC investigations and the Inquiry's audit results. All audited banks found control gaps in their guarantee process which were not previously detected by their routine monitoring activities. For example, one bank's audit found control gaps relating to both pre-existing controls to comply with the 2013 version of the Code and newly developed controls to comply with the current Code. This included the requirements to provide key disclosure information to prospective guarantors before accepting a guarantee.

The audits also identified instances where banks could not evidence compliance on individual guarantor files for numerous pre-guarantee requirements. This was largely linked to poor record management practices and the challenges associated with disparate systems, business units and subsidiary brands.

If the audit results are representative of industry practice, the risk that guarantee compliance is not being adequately monitored or that compliance gaps are not being detected is of serious concern. The BCCC expects banks to consider the audit case studies in this report and test the effectiveness of monitoring and controls to comply with the current Code - even where improvements have been made by the bank during transition programs.

RECOMMENDATIONS

12. **Banks should audit compliance with the current Code's guarantee obligations. Audit samples should include guarantees obtained since 1 July 2019. Audits should include an assessment of the controls in place to ensure compliance with the Code's guarantee obligations.**

13. **Banks should review the robustness of guarantee-related Quality Assurance processes to ensure that they are set up to effectively identify, record and report Code breaches for investigation.**

Signing a guarantee

This section of the report covers:

- Before asking the prospective guarantor to sign a guarantee (clause 31.5)
- Providing the guarantee to sign (clause 31.6)
- Where the bank placed the warning notice (clause 31.8).

Before asking the prospective guarantor to sign a guarantee (clause 31.5)

Clause 31.5 was designed to give the prospective guarantor the opportunity to review all the information about the guarantee before they signed. It aimed to prevent the prospective guarantor from feeling pressured or rushed into signing the guarantee.

It required that the bank not accept a signed guarantee unless it had allowed the prospective guarantor until the next day to consider the information provided, subject to some exceptions.[7] Under the current Code, the time period has been extended to three days.

Inquiry findings and insights

Banks had policies and procedures in place that supported compliance with this obligation.

This obligation was also made known to prospective guarantors through banks' standard form documents (such as the cover letter to the deed of guarantee documents), which describe the guarantor's rights to the time to review the information and seek independent legal advice prior to signing.

Good practice was observed for one major bank that required lending staff to inform prospective guarantors verbally of the bank's obligations under clause 31.5, explain the purpose of this requirement and encourage the guarantor to take time to consider the guarantee information before signing.

Commonly, bank processing teams undertook a verification process that involved cross-referencing the date the guarantor received the guarantor pack or signed certificate of acknowledgement with the date they signed the guarantee.

7 If the prospective guarantor obtained independent legal advice after receiving the information set out in clause 31.4 of the Code, the bank can waive the 24-hour cooling-off period and accept the signed guarantee on the spot.

Two banks self-reported instances where guarantees were signed and accepted before the Code's time period had concluded and where an exception did not apply. Both banks undertook improvements during transition to the current Code in 2019 to prevent reoccurrence.

COMPLIANCE FAILURES DURING THE SIGNING PROCESS CAN BE COSTLY

The BCCC's report on banks' compliance with the 2019 Banking Code of Practice for the period 1 July to 31 December 2019 highlighted the financial impact that an AFCA outcome can have on a bank as a result of compliance failures during the guarantee signing process.

In one example, AFCA found that the bank involved had not been able to demonstrate it complied with the guarantee provisions of the Code when it provided the guarantee documents to the complainant for signing. As such, the guarantee and supporting mortgage provided by the complainant were considered unenforceable. The financial impact on the bank was $452,805.

In another example, AFCA found that the bank did not comply with its obligations in obtaining the guarantee because it could not demonstrate it met with the complainant to discuss the loan application, or that the loan documentation was issued to the complainant. The bank also could not demonstrate that the complainant had the appropriate time of 24 hours to consider the guarantee before signing it. The financial impact on the bank was $220,000.

PERFORMANCE AUDIT CASE STUDIES

- Bank D audited a sample of 60 loan files and the associated guarantees.

  The audit found **four guarantee files** where the bank did not have records to prove that the guarantor received the guarantor pack prior to signing the guarantee, and at least one day prior where they did not obtain independent legal advice.

  The **root cause** was poor processes between the bank and its panel solicitors – namely, that signed guarantee documents were usually returned to the bank a significant time after the panel solicitors' compliance certificate was received. This resulted in many guarantees passing through to settlement without proper monitoring of the panel solicitors' certification process. Further, the bank's legal department only conducted ad hoc compliance monitoring of the panel solicitors with regards to Code guarantee obligations.

- Bank B audited a sample of 100 loan files and the associated guarantees.

  The audit found **19 guarantee files** where Bank B could not retrieve and provide the audit team with documents as evidence of positive compliance.

  The **root cause** was found to be poor records management.

Compliance with the Banking Code: What the BCCC expects

Clause 107 of the current Code goes further than clause 31.5(b) to require that banks provide prospective guarantors at least three days to consider the information provided in guarantor packs before it can accept a signed guarantee. Clause 108 lists the instances where a guarantee can be accepted earlier.

Lending staff should be required to strongly recommend to prospective guarantors that they use the time to thoroughly review the information and obtain independent legal and financial advice.

Relying on document processing teams to manually cross-check dates to comply with clause 107 carries the inherent risk of human error. During transition to the current Code in 2019, one major bank described implementing a system control in its consumer and

business bank that prevents a guarantee from being accepted by staff until the third day after the guarantor information pack is provided.

Another major bank stated that its system has built in a validation process to check the dates and compliance with the three-day rule. Its system also prevents future dating or entering a date before loan documents have been generated for the guarantor.

RECOMMENDATION

14. Banks should assess how they monitor compliance with the guarantee execution obligations and make improvements where gaps are identified. This includes where banks are reliant on their solicitors to arrange for the guarantee to be executed.

Providing the guarantee to sign (clause 31.6 a-b)

Clause 31.6 outlined the steps banks were to take during the signing of a deed of guarantee, namely:

- not to give the guarantee to the debtor, or someone acting on the debtor's behalf, to arrange the signing (unless they are a legal practitioner or financial adviser); and
- ensure that the deed is signed in the absence of the debtor if the bank was present at the signing.

Anecdotal evidence submitted by consumer advocates to the BCCC's Inquiry highlighted historical instances where banks were alleged to have asked the prospective guarantor to sign the deed in the presence of the borrower. This commonly occurred when the borrower and the guarantor were related to each other - to increase pressure on the guarantor and avoid embarrassment.

These obligations are designed to prevent the borrower, or someone representing the borrower's interests, from pressuring the prospective guarantor to sign the deed.

Inquiry findings and insights

Banks' policy documents, standard operating procedures and checklists used by lending staff were designed to ensure compliance with clause 31.6.

Banks commonly posted or emailed guarantor information packs and deeds of guarantee for execution to the address provided by the prospective guarantor. Responsibility for this varied from bank to bank. In some cases, front-line lending staff or back-office document

preparation teams managed the process, while in other cases, external panel solicitors or even mailing houses were responsible.

Three banks require staff to be in attendance when the guarantee is signed to ensure compliance with clause 31.6 (b). The BCCC considers this to be good practice. Lending staff are required to attend all guarantee signings and to use a checklist to record that the debtor was not present. Another bank requires the broker and mortgage manager to be present at the signing of the deed.

Banks conducted hindsight file reviews to check that the guarantor had a different address to the borrower and any of the borrower's representatives, and that checklists or file notes had been appropriately recorded by relevant staff.

The performance audits revealed that some banks were unable to provide evidence of segregating guarantors and borrowers when providing and executing guarantees. One such example is included below.

PERFORMANCE AUDIT CASE STUDY

- Bank A audited a sample of 137 loan files and the associated guarantees.

  With respect to clause 31.6 (a) and (b), the audit found **37** and **46 guarantee files respectively**, where the bank could not provide the audit team with evidence to confirm positive compliance, that is, show that the guarantee was not provided to the debtor to arrange execution and that the guarantee was signed in the absence of the debtor.

The **root cause** was a lack of processes and system controls to capture supporting evidence of compliance, as well as a knowledge gap by staff about the execution requirements.

Compliance with the Banking Code: What the BCCC expects

The equivalent provisions to clause 31.6(a-b) in the current Code are clauses 109 and 110. One notable change is the removal of the exception that allowed the bank to provide the guarantee documents to a legal representative or financial adviser acting on the borrower's behalf for signing. Clause 109 requires that the bank give the guarantee documents directly to the guarantor or their representative.

Failure to strictly comply with this obligation can put prospective guarantors at risk of undue influence and financial abuse. Lending staff play a crucial role in safeguarding against these risks.

Banks' audit findings raised serious concerns that banks did not have robust controls in place to uphold these protections for prospective guarantors.

The BCCC was informed that banks had strengthened procedures for staff to follow, to ensure compliance with these obligations, during banks' transition to the current Code in 2019.

The BCCC expects strict compliance with these obligations and banks should be able to demonstrate this in the event of a dispute or compliance review.

UNDER THE CURRENT CODE, DOCUMENTS CANNOT BE GIVEN TO A BORROWER'S FINANCIAL ADVISER TO SIGN

Following the outcome of an AFCA complaint, one bank self-reported a breach of its obligations to a guarantor when it provided the guarantee documents for signing to the broker who was representing the guarantor's former partner.

The bank did not give a copy of the loan and guarantee documents to the guarantor directly. The bank was financially impacted in the amount of $427,005.

RECOMMENDATIONS

15. Bank staff should keep accurate records of the circumstances in which the guarantee is executed to demonstrate compliance.

For example, one bank reported that it has a branch manager complete a witness statement that attests the guarantee was signed in the absence of the borrower. This record is kept on the guarantor file which allows the bank to demonstrate compliance in the event of a review or dispute.

16. Banks should develop guidance to support lending staff who detect signs that the prospective guarantor may be at risk of financial abuse, including during the signing of the guarantee.

For example, if there are concerns that a prospective guarantor appears to be uncertain or showing signs of potential financial abuse or any other vulnerable circumstances – lenders should be empowered to delay, escalate and address these concerns before the guarantee is executed.

Where the bank placed the warning notice (clause 31.8)

Clause 31.8 required banks to provide a warning notice directly above where the deed was to be signed advising the prospective guarantor of important disclosure information about the guarantee. The warning notice had to substantially take the form required by section 55 of the National Credit Code (NCC) and detailed in Form 8 of the National Consumer Credit Protection (NCCP) Regulations 2010.

Inquiry findings and insights

A review of the banks' deed of guarantee documents found that the mandated warning was in place above the execution panel, demonstrating that all banks' documents were compliant with clause 31.8. There were, however, some compliance issues identified through the performance audits, as highlighted in the case studies below.

PERFORMANCE AUDIT CASE STUDIES

- Bank A audited a sample of 137 loan files and the associated guarantees.

  The audit found **one file** where the warning was on a separate page to the execution clause and **two files** where the warning was missing or not visible in the deed at all.

  The **root cause** was due to template deeds that were not reviewed to ensure Code compliance; and a knowledge gap by staff who were unaware of the required warning notices and editing the standard template.

- Bank B audited a sample of 100 loan files and the associated guarantees.

  The audit found **13 files** where the bank could not provide evidence to assess and confirm positive compliance.

  The **root cause** was poor records management.

Compliance with the Banking Code: What the BCCC expects

Clause 98 of the current Code mirrors clause 31.8 of the 2013 Code.

Based on the audit findings, there is a greater risk of non-compliance with clause 98 by banks where:

- multiple standard deed templates are in circulation across the various business units of a bank
- templates can be edited without oversight
- legal review of templates is not conducted.

The BCCC expects banks to conduct periodic reviews of all standard deed templates, to ensure they are compliant with clause 98.

Banks should also consider implementing process and system controls to prevent the risk of non-compliant guarantee templates circulating (for example, a central repository that contains approved guarantee templates). These templates should be tracked for review by owners and include a date of currency.

During the guarantee

This section of the report covers:

- Guarantor requests for additional copies of documents (clause 31.7)
- Guarantor requests to limit the amount or nature of the liability – and exceptions (clause 31.9)
- Extinguishing the guarantee (clause 31.10)
- Withdrawing the guarantee (clause 31. 11).

Guarantor requests for additional copies of documents (clause 31.7)

Clause 31.7 requires banks, if requested, to provide guarantors with additional copies of any disclosure documents listed under clause 31.4 (d). It also sets out the following timeframes for when these documents must be given to the guarantor:

- Within 14 days, if the original came into existence one year or less before the request.
- Within 30 days, if the original came into existence more than one year before the request.

The clause also includes an exception: the bank does not need to provide additional copies of documents if the guarantor was provided with the requested information within the three months prior to the request.

Inquiry findings and insights

Banks complied with clause 31.7 by inserting the obligations in their policy documents and/or standard operating procedures for staff.

Banks' audit findings highlighted compliance gaps with respect to this clause – see the case study example below. One audited bank explained that guarantor requests for additional information were rare and managed on a case-by-case basis.

Banks did not have clearly articulated processes or otherwise robust record keeping practices to document requests made by guarantors for additional documents and the bank's subsequent response.

PERFORMANCE AUDIT CASE STUDY

- Bank C audited a sample of 103 loan files and the associated guarantees

  The audit found that there were **81 guarantee files** where the bank could not provide evidence to assess and confirm positive compliance.

The **root cause** was due to poor records management: there was no standard-form document to record guarantor requests and banker actions.

Compliance with the Banking Code: What the BCCC expects

The equivalent provisions to clause 31.7 in the current Code are clauses 102 and 103. The Code now extends the timeframe requiring all requested copies of documents to be provided to the guarantor within 30 days of the request.

The BCCC received anecdotal evidence from community legal centres about issues relating to requests for copies of guarantee documents from the bank on behalf of a guarantor client. They described challenges where banks would inform them that documents had not been retained or had been lost.

To assist staff to comply with clause 102, clear processes should be in place to meet guarantor requests for additional copies of documents. For example, one bank's process requires copies of documents provided to be attached to the original application. This makes it easy for staff to locate and provide copies of documents in the event they are requested.

Separate to the imperative of better record keeping practices, banks must ensure that staff have capability to find and access document retrieval systems, including how guarantor requests for additional copies of documents should be recorded internally.

Guarantor requests to limit the amount or nature of the liability – and exceptions (clause 31.9 a-b)

Clause 31.9 obliged banks to accept written requests to reduce the guarantor's liability limit, subject to the exceptions listed in clause 31.9 (a) and (b).

This obligation was an important mechanism that allowed guarantors to incrementally reduce their liability as the debt is paid down.

Inquiry findings and insights

Overall, banks' policy, process and/or procedural documents lacked coverage of this requirement. There was little detail about how guarantors' requests should be assessed and recorded in internal systems, which also made it difficult to produce evidence of compliance.

These concerns were validated by the audit findings. One bank noted it did not conduct audit testing on clause 31.9 because it interpreted the clause as 'guidance for guarantors' and not a 'call to action for financial institutions'. Another bank was unable to demonstrate positive compliance with clause 31.9 for any files sampled.

Compliance with the Banking Code: What the BCCC expects

Clause 95 of the current Code is the equivalent provision to clause 31.9. It includes the addition of clause 95(c) which allows the bank to deny a guarantor's request to limit liability: where the bank would be unable to preserve the current value of an asset (i.e. property used as security) for the loan without making further advances.

When a bank relies on clause 95(c) to decline a guarantor's request, the BCCC expects the bank to apply the fair, reasonable and ethical lens to its decision making. If the bank determines that it must make further advances to preserve the value of the security, it should take such steps in a timely manner, with clear and transparent communication to the guarantor.

Banks' decision-making with respect to clause 95 more generally can have a significant impact on the financial well-being of guarantors. Banks should ensure that the management of any guarantor's request to limit liability be assigned to experienced staff that can competently assess such requests. Banks must be able to demonstrate compliance with this obligation.

RECOMMENDATION

17. Processes should clearly articulate how staff should handle guarantor requests to limit liability, including record keeping.

For example, create a standard guarantor record template to keep itemised record of all guarantor requests. Staff should be required to apply these notes directly into the customer file/system, updating inputs and detailing the request and its outcome.

Extinguishing the guarantee (clause 31.10)

A guarantor can end their liability under the guarantee at any time, provided they do one of the following:

- pay the outstanding amount owed by the debtor, including any future or contingent liability
- pay any lesser amount to which the liability is limited by the terms of the guarantee
- make alternative arrangements agreed to by the bank.

This clause provided flexibility for the guarantor in case their circumstances changed during the term of the contract (for example, if their financial position or relationship with the borrower changes).

Inquiry finding and insights

Banks informed guarantors of their right to extinguish the guarantee and the conditions under which this is allowed in the deed of guarantee. Some banks also provided this information in supporting documents, such as guarantor fact sheets.

There was limited information about the requirements under clause 31.10 in banks' internal policy and procedure documents.

Compliance with the Banking Code: What the BCCC expects

Clause 112 of the current Code provides the equivalent obligations to clause 31.10.

The BCCC expects all banks to have clear procedures for staff to follow in the event of a guarantor request to end the guarantee. Procedures should include how to review and assess the guarantor's request, respond to the guarantor in a clear, transparent and timely manner and maintain file records of the same. This process should be undertaken by experienced staff.

Withdrawing the guarantee (clause 31.11)

Clause 31.11 allowed the guarantor to withdraw from the guarantee under the following circumstances, without bearing personal liability:

- At any time before the credit is first provided under the relevant credit contract.
- Shortly after the credit has been provided if the credit contract is substantially different from the one given to the guarantor pre-signing.

A guarantor may choose to withdraw from a guarantee at the last minute for different reasons – for example:

- Their financial circumstances may have changed.
- Their relationship with the borrower may have changed.
- They may no longer be willing to accept the risk of guaranteeing the loan.

Inquiry findings and insights

We found limited information about guarantors' rights to withdraw from a guarantee in banks' policy, process and procedure documents. Staff did not have clear guidance about how to assess a guarantor request to withdraw from a guarantee and comply with their Code obligations.

Banks did not appear to keep standard records of withdrawal requests and therefore would likely have difficulty demonstrating positive compliance. Bank C's audit results validated this concern – it was unable to demonstrate compliance for any of the guarantees sampled. It informed the BCCC that guarantor requests to withdraw a guarantee are uncommon and managed on a case by case basis.

Compliance with the Banking Code: What the BCCC expects

Clause 111 of the current Code contains the equivalent obligations to clause 31.11.

The BCCC considers it good practice to include this information in the deed of guarantee and guarantor information packs. Banks should actively communicate this information to guarantors to ensure they understand the conditions under which they can and cannot withdraw from the guarantee.

Clause 111(b) limits the protection to guarantors when they withdraw from a guarantee by providing a carve-out. The guarantor's right to withdraw on the basis that the signed loan differs substantially from the proposed loan will be nullified under the conditions set out in **clause 104**:

> *If a borrower obtains a new loan or has changes made to an existing loan, then these may be covered by your guarantee to the extent they fall within the limit contained in your guarantee.*

Clause 111 highlights the importance of lenders providing prospective guarantors with clear and useful information in a timely manner during the pre-contractual stage of the guarantee. This includes updating them on any relevant changes to the credit contract that occur during these stages, so that the prospective guarantor can make an informed decision before signing the guarantee.

Acknowledging that guarantor withdrawal requests may not be commonplace, the BCCC expects all banks to have clear procedures for staff to follow in the event a withdrawal request is received. Procedures should include how to review and assess the request, respond to the guarantor in a clear, transparent and timely manner and maintain file records.

Enforcement of a guarantee

This section of the report covers:

- Enforcement where future credit was provided (clauses 31.12 and 31.13)
- Enforcement of a judgment (clause 31.14)
- Banks' approach to non-compliant guarantees
- Enforcement data and customer outcomes.

Enforcement where future credit was provided (clauses 31.12 and 31.13)

It's imperative that banks keep comprehensive records of all documents and correspondence relating to future credit contracts and guarantees, along with the guarantor or mortgagor's written acceptance of any extension to the mortgage or guarantee.

Inquiry findings and insights

Overall, banks had robust policies and procedures in place for ensuring that third-party mortgagors and guarantors were provided with the appropriate documentation set out in clauses 31.12 and 31.13, and that acceptance of any extension to the guarantee or third-party mortgage is obtained in writing.

All banks provide staff with procedural documents that clearly articulate the required steps for ensuring guarantors were given relevant documents and that their written consent was required prior to the guarantee being extended.

A review of banks' procedural documents showed that, despite the exception under clause 31.13[8], banks extended the protections of clause 31.12 – notably the requirement of written consent from the guarantor, along with the required documents – even in cases where the bank does not require written consent to be compliant. The BCCC considers this approach good industry practice.

8 "A Guarantee given by you will be enforceable to the extent the future credit contract (together with all other existing credit contracts secured by that Guarantee), is within a limit previously agreed in writing by you and we have included in the notice we give you under clause 31.4(a) a prominent statement that the Guarantee can cover a future credit contract in this way."

One bank reported that lending staff use a checklist during the credit extension process that prompted staff to provide key documents and to obtain the guarantor's written consent. There was limited information in banks' documents about how the clauses were monitored for compliance. Pre- enforcement reviews conducted by the banks' panel solicitors were the most common form of compliance review reported.

PERFORMANCE AUDIT CASE STUDY

- Bank C audited a sample of 103 loan files and the associated guarantees.

  With respect to **clause 31.12** the audit found that there were **two guarantee files** where the bank could not provide evidence to confirm positive compliance.

  With respect to **clause 31.13** the audit found that there were **three guarantee files** where the bank could not provide evidence to confirm positive compliance.

  The **root cause** was poor records management.

Compliance with the Banking Code: What the BCCC expects

The equivalent provisions to clause 31.12 and 31.13 in the current Code are clauses 104–106.

Banks should exercise the same standard of disclosure during the process of increasing the guarantor's liability limit under clause 105 - as would be applied when dealing with a new guarantor, to assist them to make an informed decision about increasing their liability.

One audited bank noted that since the transition to the current Code in 2019 it implemented a policy and process change whereby previously accepted guarantees can no longer be relied upon for additional lending. Instead, new guarantees are required to be taken in all instances where a new loan contract is entered into. The BCCC considers this approach to be good industry practice.

Enforcement of a judgment (clause 31.14)

Clause 31.14 outlined the circumstances in which a bank could seek to enforce a judgment against a guarantor. The obligation prevented banks from enforcing a guarantee without first seeking to recover the debt from the primary borrower.

Some of the circumstances in which a bank could seek to enforce a judgment against a guarantor included where:

- the bank had written to the borrower seeking repayment of the debt but the borrower had failed to comply within 30 days
- the bank had made reasonable attempts to locate the borrower without success
- the borrower was insolvent
- a court, tribunal or other body had relieved the bank of the obligation to proceed first against the borrower.

Under the 2013 Code, the protections did not extend to small business loan guarantors.

Inquiry findings and insights

The majority of banks took a more limited approach to enforcing guarantees than was prescribed in clause 31.14. Five banks reported that they only enforced a guarantee when a shortfall debt remained after collecting net proceeds from the borrower – and even then, only after they had sought to collect the full amount from the primary borrower.

A further four banks said they only sought enforcement against a guarantor in circumstances where:

- the guarantor had provided a mortgage or other security for their liability under the guarantee and the principal debtor had not provided a mortgage or other security for the guaranteed liability (clause 31.14(e)); or
- the principal debtor had provided a mortgage or other security for the guaranteed liability and the bank had enforced that mortgage or other security or reasonably expected that the proceeds of its enforcement would not be sufficient to repay the guaranteed liability (clause 31.14(f)).

Banks relied on various controls to ensure compliance with clause 31.14, such as product and telephony systems that made reasonable attempts to contact the primary borrower to recover the debt.

All banks described hindsight loan reviews and checks that were undertaken prior to seeking enforcement against a guarantor. These reviews were either conducted internally, externally by panel solicitors representing the bank, or by both. Some banks reviewed elements of the guarantee for Code compliance but we are concerned that some banks advised Code compliance was not specifically considered during its enforcement review process.

The BCCC considers that banks had some good-practice processes in place for ensuring compliance with clause 31.14, including the following examples:

Recovering debt from the primary borrower:

- One major bank described its shortfall assessment process to determine if the borrower could pay the outstanding debt or if they had other means or assets they could use to service the debt. If not, the bank considered enforcement against the guarantee as a last resort.
- Another bank also seeks alternative payment/settlement agreement with the primary borrower prior to enforcing the guarantee. This approach resulted in several examples where the borrower had been able to negotiate alternative repayment options, such as unsecured lending or settlement of the debt for less than the amount owing, without the bank having to enforce the guarantee.

Conducting a pre-enforcement guarantee review:

- One major bank reported that it introduced an *ethical checklist* that staff used to assess whether internal process and policy were followed and to conduct a customer impact assessment. This was in addition to its hindsight loan reviews. Both controls were implemented to prevent proceeding with enforcement action against a borrower, including a guarantor, where the review resulted in an adverse finding.
- Two major banks provided their legal teams with all relevant guarantee documents. The legal team then completes a guarantee-specific checklist to check:
  - ✓ whether the guarantee was addressed directly to the guarantor
  - ✓ whether the guarantor obtained any independent legal advice
  - ✓ whether there was a signed solicitor's certificate
  - ✓ whether the guarantee was correctly executed
  - ✓ the date of the execution to ensure at least one day after the letter of offer unless an exception applied
  - ✓ the guarantee limit
  - ✓ any supporting security provided by the guarantee
  - ✓ whether the guarantor is deceased or bankrupt.

- One of the two major banks went further by reviewing:
  - ✓ its internal guarantee compliance summary form
  - ✓ if a guarantor director opted out of receiving documents, the internal record of conversation with the guarantor to check the records held on the decision to opt out
  - ✓ where independent advice had been obtained, that there is either a solicitor's certificate of advice in those States that permit this, or a signed acknowledgement from the guarantor that they had received independent legal advice.

Banks also relied on collections/recovery teams to raise any concern about the validity of a guarantee with the credit and/or legal departments, which then review the guarantee prior to taking action.

The BCCC considers banks' proactive review of the guarantee to ensure that it has been obtained in accordance with the Code, before commencing any enforcement, to be good industry practice. Banks should not wait for a guarantor to raise a concern or lodge a complaint.

Compliance with the Banking Code: What the BCCC expects

The equivalent provisions in the current Code to clause 31.14 are clauses 114 and 115. Clause 113 requires a bank to not enforce any mortgage or other security the guarantor may have given the bank in connection with the guarantee unless the bank has first enforced any mortgage or other security that the borrower has provided for the guaranteed liability. Importantly, the Code now extends these enforcement protections to guarantors of small business loans.

To rely on clause 114(b), the BCCC expects banks to set internal expectations or benchmarks for what it deems to be adequate attempts and methods to contact the primary borrower (to gather information and/or recover the debt) before enforcing a guarantee.

Noting the good practice examples mentioned above, the BCCC commends banks that take a pragmatic and flexible approach to finding alternative options to pursuing enforcement action against the guarantor.

RECOMMENDATIONS

18. **Banks should conduct pre-enforcement reviews of a guarantee to ensure that it has been obtained in accordance with the Code before commencing enforcement action.**

19. **Banks should develop guidance to help staff to negotiate alternative debt-recovery options with the primary borrower before enforcing a guarantee - to embed a culture where enforcement is a last resort.**

20. **Enforcement of a guarantee should require the oversight and authorisation of a senior-level executive of the bank, especially if enforcement involves repossession of the guarantor's primary place of residence.**

Banks' approach to non-compliant guarantees

The inquiry questionnaire asked each bank about the approach they would take in a hypothetical case involving a guarantee that had not been obtained in accordance with the Code's guarantee obligations (for example, where the pre-contractual obligations were not met). Banks were asked to confirm whether they would continue to rely on the guarantee for the purposes of enforcement action.

Banks' responses to this question were general in nature and did not refer to a dedicated process or policy that was followed by staff when dealing with a non-compliant guarantee.

In summary, the qualitative responses indicated that:

- Banks generally deal with non-compliant guarantees on a case-by-case basis. If a case arose, any enforcement activity would be suspended while the issue was internally investigated and an approach decided.
- Banks relied heavily on their solicitors for advice regarding the enforceability of a guarantee.
- When deciding how to proceed with the guarantee, banks consider several matters. A predominant consideration is to assess the materiality of the breach.

While it is appropriate for banks to obtain legal advice, it is also important that they avoid an overly legalistic approach. Banks' treatment of non-compliant guarantees must take into account the Guiding Principles that underpin the Code and banks' obligations under clause 10 to engage with guarantors in a fair, reasonable and ethical manner.

Staff should be trained and encouraged to form a balanced view and to escalate concerns of non-compliance. For example, one major bank's good practice initiative required staff to complete an 'ethical checklist and customer impact assessment' which would assist to achieve this outcome.

The BCCC expects banks to adopt a strict approach to compliance with the Code's guarantee obligations. When things go wrong, the BCCC expects banks to have a mechanism that ensures non-compliance is dealt with appropriately and pro-actively, that is, before enforcement commences or a guarantor raises the issue.

RECOMMENDATIONS

21. Banks should develop an escalation process to ensure non-compliance is dealt with appropriately and proactively – before a guarantor makes a complaint, or the bank commences enforcement action.

22. Where a bank becomes aware of a non-compliant guarantee or where it cannot demonstrate compliance for an individual guarantee, it should:

a) *deal with the impacted guarantee/guarantor in accordance with clause 10 and the Guiding Principles that underpin the Code*

b) *proactively determine if the guarantee is unenforceable and take appropriate action to rectify and remediate impacted customers and guarantors*

c) *ensure that customer and guarantor impact assessments consider the risk of current and future financial and non-financial loss because of the bank's non-compliance, and*

d) *communicate with impacted customers and guarantors in a clear and timely manner – including providing them with information about how to lodge a complaint with the bank or AFCA.*

Enforcement data and customer outcomes

The Inquiry requested bank enforcement data about guarantees, including the outcomes for customers. However, we found that banks did not have readily available data on this.

Therefore, we were unable to reach any meaningful conclusions from the data we did receive, including ascertaining the proportion of guarantees that had been called upon by industry in the reporting period (2014 to 2018). Most banks did not have data on the enforcement of guarantees specifically. Some commented that their 'last resort' approach to enforcing a guarantee had resulted in such low numbers of enforced guarantees that they had not seen the need to collate data about them.

Notwithstanding this view, banks should collect data on the enforcement of guarantees. Data about the volumes of guarantees that proceed to enforcement and the resulting outcomes for guarantors are lagging indicators of the underlying credit quality and guarantor outcomes that banks should use for continuous learning and improvement of customer experience.

RECOMMENDATION

23. Banks should strengthen their data capability by collecting guarantor outcome data, such as enforcement and complaints data, to gain insights into guarantee trends, compliance risks and customer outcomes for continuous improvement across the guarantee process.

Next steps

Banks should carefully consider the BCCC's report and 23 recommendations against their current practices and develop an implementation plan to close any gaps. We also encourage banks to consider the recommendations in the BCCC's Building Organisational Capability Report when developing these plans. The BCCC expects that banks will report to their relevant Board audit and risk committees with updates about the bank's implementation plan and progress to improve compliance with the Code.

We will follow up with banks on the actions they have taken to address the findings and recommendations in this Report to improve the outcomes for guarantors and customers in March 2022.

Appendix A: Guarantee obligations

2013 CODE OF BANKING PRACTICE	CURRENT BANKING CODE OF PRACTICE
31.1 This clause 31 applies to every guarantee and indemnity obtained from you (where you are an individual at the time the guarantee and indemnity is taken) for the purpose of securing any financial accommodation or facility provided by us to another individual or a small business (called a "Guarantee"), except as provided in clauses 31.15 and 31.16.	**93** **When this part applies** If you are an individual who gives a guarantee and/or indemnity to secure a loan that we give to another individual or small business, and this Code applies to the loan, then this part of the Code applies to your guarantee and/or indemnity.
31.2 We may only accept a guarantee if your liability: a) Is limited to, or is in respect of, a specific amount plus other liabilities (such as interest and recovery costs) that are described in the guarantee; or b) Is limited to the value of a specified security at the time of recovery.	**94** **Limiting liability - before accepting a guarantee** Your guarantee will be limited to: a) a specified amount and/or category of amounts owing under a specific loan, plus other liabilities and amounts as described in the guarantee (for example, interest and recovery costs); or b) the value of a specified property or other assets under a specified mortgage or other security at the time of recovery.
31.3 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.	**2** **The Code forms part of our banking services and guarantees** Our written terms and conditions for all banking services and guarantees to which the Code applies will include a statement to the effect that the relevant provisions of the Code apply to the banking service or guarantee.
31.4(A) We will do the following things before taking a guarantee from you: a) Give you 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).	**96** **Notice to you** The terms and conditions of the guarantee will contain a prominent notice that: a) you should seek independent legal and financial advice; b) you can refuse to sign the guarantee; c) there are financial risks involved; d) you can limit your liability in accordance with the Code or as allowed by law; e) you can request information about the transaction or loan; and f) if applicable, that the guarantee may cover future credit facilities or variations of the existing loan.

2013 CODE OF BANKING PRACTICE	CURRENT BANKING CODE OF PRACTICE
31.4(B-C) We will do the following things before taking a guarantee from you: b) 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 2 years before we tell you this; and 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 6 months before we tell you this, and we will give you a list showing the extent of these excesses or overdrawings; c) tell you if any existing facility we have given the debtor will be cancelled, or the Facility will not be provided, if the guarantee is not provided.	**97** **Before accepting a guarantee** We will tell you: a) about any notice of demand we have made in the borrower for the guaranteed loan, or any loan the borrower has (or has had) with us, within the previous two years; and b) if any existing loan we have given the borrower will be cancelled if the guarantee is not provided. This paragraph does not apply if you are a commercial asset financing guarantor, sole director guarantor or trustee guarantor.
31.4(D-E) We will do the following things before taking a guarantee from you: d) 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 statements of financial position given to us by the debtor for the purposes of the Facility within 2 years prior to the day we provide you with this information;	**99** **Guarantee documents** We will give you a copy of the following documents in relation to the borrower: a) A proposed loan contract. b) A list of any related security contracts. c) Any related credit report from a credit reporting body. d) Any current credit-related insurance contract that is in our possession. e) Any financial accounts or statements of financial position that the borrower has given us in the previous two years for the purposes of the guaranteed loan. f) The latest statement of account relating to the loan for a period in which a notice of demand was made by us within the last two years. g) Other information we have about the guaranteed loan that you reasonably request – but we do not have to give you our own internal opinions. This paragraph does not apply if you are a commercial asset financing guarantor, sole director guarantor or trustee guarantor.

2013 CODE OF BANKING PRACTICE	CURRENT BANKING CODE OF PRACTICE
vi) the latest statement of account relating to the Facility (and any other statement of account) for a period during which a statement of demand was made by us, or a dishonour occurred, in relation to which we are required to give you information under clause 31.4(b)(i); vii) any unsatisfied notice of demand made by us on the debtor in relation to the Facility where the notice was given within 2 years prior to the day we provide you with this information; and e) give you other information we have about the Facility (including any facility with us the be refinanced by the Facility) that you reasonably request, but we do not have to give you our own internal opinions.	
31.5 We will not ask you to sign a guarantee, or accept it, unless we have: a) provided you with the information described in clause 31.4 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 the information. We do not have to allow you the period referred to in clause 31.5(b) if you have obtained independent legal advice after having received the information required by clause 31.4.	**107-108** **When we can accept your guarantee** **107.** We will not accept a guarantee from you until the third day after you have been given the information provided at paragraphs 96-99. **108.** However, we can accept the guarantee earlier if you: a) have obtained independent legal advice about the guarantee; b) have accepted an extension of the guarantee; c) are a commercial asset financing guarantor, sole director guarantor or trustee guarantor; or d) you are a director guarantor and you choose to sign and deliver the guarantee earlier. We will not influence your choice.
31.6 We will: a) not give the guarantee to the debtor, or to someone acting on behalf of the debtor, to arrange the signing (except if they are a legal practitioner or financial adviser); and b) ensure that you sign the guarantee in the absence of the debtor where we attend the singing of the guarantee.	**109-110** **Signing your guarantee** **109.** We will give the guarantee documents directly to you or your representative. We will not give the guarantee documents to the borrower, or to someone acting on behalf of the borrower, to arrange for you to sign the guarantee. **110.** If we attend the signing of the guarantee, we will ensure that you sign the guarantee in the absence of the borrower. Paragraphs 109-110 do not apply if you are a commercial asset financing guarantor, sole director guarantor or trustee guarantor.

2013 CODE OF BANKING PRACTICE	CURRENT BANKING CODE OF PRACTICE
31.7 We will also provide you, on request, with additional copies of any information described in clause 31.4(d) that we have given you and will do so: a) within 14 days, if the original came into existence 1 year or less before the request is given; or b) within 30 days, if the original came into existence more than 1 year before the request is given, except we do not need to do so if we have given the requested information within 3 months prior to the request.	**102-103** **Provision of additional copies of information** **102.** If you ask us to, we will give you additional copies of any information we have given you – we will do so within 30 days. **103.** However, we do not need to give you those copies if we have given you the information you requested within three months before the request. Paragraphs 102 and 103 do not apply if you are a commercial asset finance guarantor, sole director guarantor or trustee guarantor.
31.8 We will ensure that the warning notice (substantially in the form required by section 55 of the National Credit Code, and detailed in Form 8 of the National Consumer Credit Protection Regulations 2010 and which is consistent with this Code) appears directly above the place where you sign.	**98** **Required warning notice** We will ensure that a warning notice appears above the place where you sign the guarantee. The warning notice will be substantially in the form required by section 55 of the National Credit Code, and detailed in Form 8 of the National Consumer Credit Protection Regulations 2010 and consistent with this Code.
31.9 You may, by written notice to us, limit the amount or nature of the liabilities guaranteed under the guarantee, except that we do not have to accept such a limit if: a) it is below the debtor's liability under the relevant credit contract at the time plus any interest or fees and charges which may be subsequently incurred in respect of that liability; or b) we are obliged to make further advances or would be unable to secure the present value of an asset which is security for the loan (for example, a house under construction).	**95** **Requests to limit the amount or nature of the liability** You may write to us to limit, or further limit, the liabilities you have guaranteed under your guarantee. However, we do not have to accept your request if: a) the amount, or nature, of the limit you request does not cover the borrower's existing liability (plus any interest owed, or any fees, or any charges that we may incur in respect of that liability) under the relevant loan contract at the time; b) we are obliged to make further advances to the borrower; or c) we would be unable to preserve the current value of an asset which is security for the loan without making further advances.

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31.10 You may, at any time, extinguish your liability to us under a guarantee by paying us the then outstanding liability of the debtor (including any future or contingent liability), or any lesser amount to which your liability is limited by the terms of the guarantee, or by making other arrangements satisfactory to us for the release of the guarantee.	**112** **Ending your guarantee** You may end your liability under a guarantee you have given us by: a) paying us the lower of: i) the borrower's outstanding liability, including any future or contingent liability; or ii) the amount to which your guarantee of the borrower's liability is limited under the guarantee; or b) making other arrangements we agree to in return for releasing you from your guarantee.
31.11 You can, by written notice to us: a) withdraw from the guarantee at any time before the credit is first provided under the relevant credit contract; or b) withdraw after credit is first provided, if the credit contract differs in a material respect from the proposed credit contract given to you before the guarantee was signed, c) but only to the extent the guarantee guarantees obligations under the credit contract.	**111** **Withdrawing your guarantee** You may, by written notice to us, withdraw from the guarantee: a) at any time before we provide credit under the relevant loan; or b) after credit is first provided, if the signed version of the relevant loan differs in a material respect from the proposed loan we gave you before you signed the guarantee. This does not apply to any change to the loan described in paragraph 104. However, you may do so only to the extent of the obligations under the guarantee.
31.12 A third party mortgage will be unenforceable in relation to a future credit contract or future guarantee unless we have: a) given the mortgagor a copy of the future credit contract document or future guarantee document; and b) subsequently obtained the mortgagor's written acceptance of the extension of the third party mortgage. **31.13** A guarantee given by you will be unenforceable in relation to a future credit contract unless we have: a) given you a copy of the future credit contract document; and b) subsequently obtained your written acceptance of the extension of the guarantee. However, a guarantee given by you will be enforceable to the extent the future credit contract (together with all other existing credit contracts secured by that guarantee), is within a limit previously agreed in writing by you and we have included in the notice we gave you under clause 31.4(a) a prominent statement that the guarantee can cover a future credit contract in this way.	**104-106** **Extending your guarantee** **104.** If a borrower obtains a new loan or has changes made to an existing loan, then these may be covered by your guarantee to the extent they fall within the limit contained in your guarantee. **105.** If we agree to increase the limit contained in your guarantee, we will: a) give you what is required under paragraph 99; and b) obtain your written acceptance of the extension of the guarantee. **106.** In these circumstances, we will provide you with any unsatisfied notice of demand by us on the borrower in respect of the loan.

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31.14 We will not, under a guarantee, enforce a judgment against you unless: a) we have obtained judgment against the principal debtor for payment of the guaranteed liability which has been unsatisfied for 30 days after we have made written demand for payment of the judgment debt; b) we have made reasonable attempts to locate the debtor without success; c) the debtor is insolvent; d) a court, tribunal or other body with relevant jurisdiction has relived us of the obligation to proceed first against the principal debtor; e) you have provided a mortgage or other security for your liability under the guarantee and the principal debtor has not provided a mortgage or other security for the guaranteed liability; f) the principal debtor has provided a mortgage or other security for the guaranteed liability and we have enforced that mortgage or other security or reasonably expect that the proceeds of its enforcement will not be sufficient to repay the guaranteed liability, but these rules in clause 31.14 do not apply where the principal debtor is a small business.	**113-115** **How we will enforce our rights under the guarantee** **113.** We will not enforce any mortgage or other security you have given us in connection with the guarantee unless we have first enforced any mortgage or other security that the borrower has provided for the guaranteed liability. This paragraph does not apply where the guaranteed liability arises under a standard margin loan. **114.** We will not enforce any judgment against you under the guarantee unless: a) we have first enforced any mortgage or other security that the borrower has provided for the guaranteed liability; and b) if one, or more, of the following has occurred: i) we have obtained Court judgment in our favour against the borrower for payment of the guaranteed liability; and the judgment debt remains unpaid for at least 30 days after our written demand for its payment; ii) we have made reasonable attempts to locate the borrower without success; or iii) the borrower is insolvent. **115.** However, the restrictions under paragraphs 113 and 114 do: a) not apply if you have specifically agreed in writing after the default notice is issued and we have informed you of the limitations of our enforcement rights under this chapter and that they do not apply; or b) not require us to first enforce any mortgage or other security that the borrower has provided if we reasonably expect that the net proceeds of that enforcement will not be sufficient to repay a substantial portion of the guaranteed liability, or because of the borrower not providing us with information, documents, or access to premises or assets as required, we are unable to reasonably assess whether the net proceeds of that enforcement will not be sufficient to repay a substantial portion of the guaranteed liability.
31.15 Where you are a commercial asset financing guarantor, sole director guarantor or trustee guarantor clauses 31.4(b) to (e) (inclusive), 31.5, 31.6, and 31.7 do not apply.	

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31.16 If you are a director guarantor clauses 31.4(d) and 31.5 apply as follows: a) we will tell you that: i) you have the right to receive the documents described in clause 31.4(d); and ii) those documents contain important information that may affect your decision to give a guarantee; b) you may choose not to receive some or all of the documents described in clause 31.4(d); c) we will tell you how you can make these choices; d) we will provide you with a copy of any document described in clause 31.4(d) that you have requested; e) you can tell us that you do not wish to have the benefit of the period referred to in clause 31.5(b); and f) apart from telling you the things set out in clauses 31.16(a)(i) and (ii), 31.16(b), and 31.16(c) and as required under other provisions of the Code, we will not attempt to influence your choices under clauses 31.16(b) and 31.16(e).	**100** **What we will tell you if you are a director guarantor** If you are a director guarantor (other than a sole director guarantor) we will tell you that you have the right to receive the documents in paragraphs 96 to 99, and that these documents contain important information that may affect your decision to give a guarantee. You may choose not to receive some or all of the documents, and we will not influence your choice. *(Equivalent provision to clause 31.16(e) of the 2013 Code found in clause 108(d))*

Appendix B: Further information about the BCCC

The Banking Code Compliance Committee (BCCC) is an independent monitoring body established under clause 207 of the Banking Code of Practice (Code). Its purpose is to monitor and drive best practice Code compliance.

To do this, the BCCC:

- examines banks' practices
- identifies current and emerging industry wide problems
- recommends improvements to bank practices
- sanctions banks for serious compliance failures, and
- consults and keep stakeholders and the public informed.

The BCCC's 2021–24 Strategic Plan sets out its overall objectives to fulfil its purpose to monitor and drive best practice Code compliance. The BCCC's 2021–22 Business Plan sets out the priority areas and activities it will undertake to meet the objectives in the Strategic Plan.

The following represent the priority areas that the BCCC will likely focus on in 2021–22:

- Challenges caused by the COVID-19 pandemic, including financial difficulty
- Customers experiencing vulnerability
- Small business and farming customers
- Banks' organisational capability to comply with the Code
- Deceased estates
- Banks' communications with customers and provision of information

The BCCC has published Operating Procedures which provide guidance about how the BCCC conducts its monitoring activities. The activities are determined with reference to its Code Monitoring Priority Framework.

Further information about the BCCC and members of the Committee is available on the BCCC's website - bankingcode.org.au.

Contact details

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PO Box 14240
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1800 931 678
(This is a telephone service provided by AFCA – please ask to speak to the Code Compliance and Monitoring team)

BCCC
Banking Code Compliance Committee