APPENDIX "A"

SUMMARY OF TRADE PRACTICES COMMISSION GUIDELINE ON THE ADVERTISING OF DEPOSITS AND LOANS CHECKLIST OF FACTORS FOR CONSIDERATION IN THE ADVERTISING OF DEPOSITS AND LOANS

[Note: This is a Summary of the Commission's Guideline. Specific Paragraph References to the Commission's Guideline are not here reproduced]

The Following Points are Stressed by the Commission in the Advertising of Deposits and Loans

Interest Rates

- Avoid quoting unqualified interest rate figures, ie, indicate how an interest rate figure applies to an investment, eg, "minimum monthly balance", "daily balance".
- Disclose whether interest rates are fixed or variable.
- If the account being promoted has a fluctuating interest rate, include a qualification to the effect that "the rate quoted may bear no relationship to future yields", and use recent figures for illustrative purpose.

Fees and Charges

- Disclose the existence of fees or charges that apply to accounts.
- Care should be taken in using the word "free".

At Call

- Unless otherwise appropriately qualified, only use "at call" to mean "available on demand".

Penalties

- Ensure that investors are aware of penalties on early withdrawal.

Cheque Clearance

- Inform customers of the institution's policy on clearing cheques.

Comparative Advertising

- Compare "like with like".

Affiliations with other Institutions

- Correctly represent affiliations with other institutions.

Security of Investments

- Check that promotional material does not misrepresent the types of security in which the institution invests.
- Check that promotional material application forms correctly describe the nature of the consumer's investment.
- Avoid ambiguous references to security.

Taxation Benefits

- When promoting taxation benefits as an incentive, ensure that potential investors are made aware of any matters which may affect those benefits being available.

Investment Advisory Services

- Ensure that clients are aware of any qualifications that apply to the advice.
- Maintain adequate organisations and office procedures to guard against mistakes and outdated information.
- Avoid extravagant performance claims.
- Claims as to independence should be capable of substantiation.

- Disclose the existence of commission and of pecuniary interest.

Comparisons
- Avoid sweeping generalisations and ensure that comparisons with other leaders' terms are valid.

Fees and Repayments
- Provide information on repayment frequency and the duration of loans well before the loan agreement is signed.
- Ensure that promotional material makes reference to the existence (and, if possible, to the nature and likely amount) of any additional charges, eg, loan service fees.

Penalties
- Inform customers, well before the loan agreement is signed, of penalties that apply to early termination of loans and to late repayments.

Extravagant Claims
- Avoid making extravagant claims about the cost of the loan.

Eligibility Requirements
- Ensure that promotional material makes reference to eligibility requirements.

Security on Loan
- Ensure that borrowers are aware of fees and conditions in relation to secured loans.

Insurance
- Do not deny borrowers access to an insurer of their choice.

AUTHOR'S NOTE: The Trade Practices Commission announced on March 18, 1992 [see *Australian Financial Review*: March 19, 1992] that it was investigating certain financial institutions for possible proceedings for misleading or deceptive conduct. The Commission noted that fees charged by some such institutions had a dramatic effect on the relative attractiveness of loans in the first year. The benefits of advertised discounts were often offset by these fees. In addition, advertised interest rates often did not match the actual interest rate paid in the initial period. A *Financial Review* survey showed that financial institutions did not reveal all fees unless specifically asked. Loans advertised by Westpac at a 9.25% rate involved an actual payment of 11% in the first year. The State bank was said not to charge its advertised rate of 8.75% on the first year of its loans because its fees made such loans more expensive than this. CBA was said not to charge its advertised rates because of transaction fees in the first year though the amount of these fees was stated.

Commissioner Asher of the TPC commented "... the Commission is and has been for some time concerned at the use of ... short term benefits that can easily induce people to enter into contracts on false premises". He said that the issues showed the need for an industry wide code of advertising practice.

- The above article led to a Letter to the Editor of the *Financial Review* from the State bank the next day [*Financial Review*: March 20, 1992]. The State Bank claimed that the *Financial Review* had overstated the State Bank fees in its March 19 article. No doubt letters to the *Financial Review* will continue – as will the interest of the Trade Practices Commission.

APPENDIX "B"

OBSERVATIONS BY MR CLEM MITCHELMORE, DEPUTY CHAIRMAN OF THE COMMERCIAL TRIBUNAL OF NEW SOUTH WALES - RURAL CREDIT INQUIRY 1987.

A number of examples were given in this Inquiry of financial institutions attempting to bypass the provisions of the *Credit Act* 1984 (NSW). The present relevance of the Inquiry, however, is the examples it gives of misleading or deceptive conduct by financial institutions. These examples may well constitute breaches of Section 52 or Section 52A (or both) of the Trade Practices Act.

The examples are:

- A finance company saying that "leasing is the only form of financing available" when this was not the case.
- The misleading of customers by banks imposing undisclosed or misleadingly disclosed "charges" which could have the effect of increasing interest rates by up to two per cent. One accountant described these charges as the "fudge factor". Perhaps the most dramatic illustration of the point was that a farmer whose account was debited $31,700, the debit being described, without further explanation, as a "Miscellaneous Debit".
- The nondisclosure by banks of interest rates or how interest was calculated. There were many cases reported of the inability of bank managers to explain interest rate calculations.
- Interest charges being debited at variable times at the whim of banks.
- Letters, forwarded by banks in relation to interest charges, not revealing the true picture. For example, a letter saying that interest will be charged quarterly instead of half yearly may completely omit to advise the customer of the effect of this change of policy on the amount the customer is ultimately required to pay. This point may not be mentioned at all. Nor may it be mentioned that the change of policy in practice amounts to an effective increase in the rate of interest.
- Incomprehensibility of documentation.

It is not the purpose of this present paper to underwrite the findings of the *Mitchelmore Report* but the above examples must be of concern. They show the clear need, at least at that time, for better training systems in financial institutions. The present writer has suggested elsewhere a managerial checklist for banks and financial institutions to follow in relation to loans [see WJ Pengilley, "Misleading or Deceptive Conduct and Financial Institutions" (1989) 1 *Bond Law Review* 157 at 174-177].

APPENDIX "C"

OBSERVATIONS BY THE TRADE PRACTICES COMMISSION ON PROBLEMS ARISING FROM CONSUMER GUARANTEE TRANSACTIONS

In March 1992, the Trade Practices Commission issued a document entitled:

'G.U.A.R.A.N.T.O.R.S: PROBLEMS AND PERSPECTIVES -DISCUSSION PAPER'.

This paper covers some 34 pages. Set out below are some of the points made at pages 15-16 of that paper under the heading:

'PROBLEMS WITH CONSUMER GUARANTEES: RISK ASSESSMENT AND INFORMATION CONSTRAINTS'.

The Commission made the point that market failure in the form of information constraints was the principal problem with guarantees. The Commission accepted that lending institutions were reasonably competitive.

The Commission saw several dimensions to information problems, these being:

- The lack of understanding by consumer guarantors of the nature and consequences of guarantees.
- The difficulties and costs faced by lending institutions in assessing the level of risk of a loan proposal.
- An asymmetry of information between the parties. The lender and borrower are likely to hold more information relating to the risk of the transaction than the consumer guarantor.

The Commission noted a number of complaints about guarantees and these were summarized in Appendix "D" of its Discussion Paper (not here reproduced). Inadequate understanding by consumer guarantors of the terms and conditions of the contract they were entering into was the primary cause of concern about guarantee use. The Commission noted that, in the United States, Legal Aid Attorneys estimated that only 20% of consumer guarantors understood the nature and extent of their obligations. Some consumer guarantors believed that they were merely providing a reference, and of those who were aware of the basic fact of liability, many were unaware of the extent of their obligations.

The Commission noted that the Australian Banking Industry Ombudsman had found that guarantee complaints were a major source of complaints about banks. Submissions by consumer groups to the *Martin Committee of Enquiry into Banking* suggested the following reasons for inadequate understanding by many consumer guarantors of their obligations and the risks facing them as well as the problem of decisions being founded upon emotional ties:

- Guarantees are not generally well understood in the community, particularly amongst non-English speaking migrants.
- Consumer guarantors are less likely to carefully examine the details of their transaction because they are taking on a prospective rather than an immediately realisable liability.
- Even when they have information on, eg, a principal's business venture, consumer guarantors may not have the skills needed to assess the risk.
- Guarantees are sought where there is doubt about the principal borrower's capacity to service the debt. Consequently, loans involving guarantees may inherently involve high risk.
- Emotional ties may compel close relatives to assist in obtaining loans whatever the risk.
- Consumer guarantors may be unable to gain adequate information on the financial position of the principal for two reasons:
- Banks are reluctant or unable to provide intending consumer guarantors with risk assessment information. There are confidentiality and privacy constraints at common law and statute.

- Emotional ties may prevent a consumer guarantor from cross-questioning the principal.

Guarantees can take the form of limited and unlimited 'all moneys' guarantees. A limited guarantee limits the potential liability of the consumer guarantor to the size of the initial loan taken by the principal, interest owed on that loan and late fees or collection costs. With an unlimited guarantee the loan amount is not capped, leaving the consumer guarantor potentially liable for the principal's future as well as current debt.

The use of unlimited guarantees present special problems in addition to those already mentioned.

- Until the guarantee is called upon the guarantor may have little or no knowledge of the extent to which the debt has changed.
- The guarantor may underestimate the potential consequences of an unlimited guarantee due to their assessment focusing on the amount being provided to the principal at the time of signing.

The Commission's paper is a Discussion Paper only. The Commission, however, responded (at 26 *et seq* of its Paper) to various recommendations of the *Martin Committee of Enquiry into Banking*. The Commission's responses were:

(i) That an enforceable Code of Conduct monitored by the TPC should be introduced after consultation with all interested groups. This Code should include an obligation upon Banks to inform guarantors as to the reasons for requiring a guarantee.

(ii) The Code of Banking Conduct should require a bank to disclose to prospective guarantors all material facts known to it relating to the borrower and the proposed transaction.

(iii) The Code of Banking Conduct should also require a Bank to advise a guarantor of the state of a borrower's account on enquiry or as soon as the account becomes overdue.

(iv) The *Privacy Act* should be amended to permit banks, with the consent of borrowers, to disclose information about the borrower or prospective borrower to a prospective guarantor.

(v) The use of unlimited guarantees should no longer be permitted.

(vi) There should be a requirement for plain English documents to be incorporated in the Banking Code of Conduct. Priority should be given to producing important consumer documents such as mortgage and guarantee documents in plain English terms.

(vii) Banks should continue to offer training opportunities to their staff - especially with regard to improvements in customer relations.

(viii) Banks should ensure that their assessment of risk and other related areas such as ability to repay are thoroughly investigated. Credit scoring systems should be amended to incorporate criteria such as income or, where this already exists, to strengthen this requirement. Bank loan officers should be adequately trained in risk assessment techniques.