Court Rules Banking Code Must Be Adhered To By Bankers

Summary:
NAB tried to argue that the industry's self-regulatory Banking Code of Practice has no legal effect. Judge lashes NAB's attitude and states the code has contractual force, and that, because NAB breached it, the bank could not recoup $6 million in loan guarantees for a series of failed Gold Coast property investments.

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Author: Richard Baker, Nick McKenzie, Sarah Danckert
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Court Rules NAB Unable To Recover Gold Coast Millions Due To Breach Of Banking Code

Customers and small businesses taking on their banks over rip-offs have won a massive boost after a landmark court ruling that requires financial institutions to stick to their own code of conduct.

In a judgment that has sparked predictions of major changes in a sector that has already faced

numerous consumer scandals in recent years, the Victorian Supreme Court has ruled NAB broke the banking industry's code of conduct in its dealings with a wealthy property investor.

The precedent setting judgment will cost NAB millions of dollars and sparked a scramble from the industry as it means the code of conduct goes from being a guide to contractually binding.

NAB suffered the defeat in court after it tried to argue that the industry's self-regulatory Banking Code of Practice has no legal effect.

> Victorian Supreme Court Justice James Elliott ruled in March that the code has contractual force, and that, because NAB breached it, the bank could not recoup $6 million in loan guarantees for a series of failed Gold Coast property investments.

Justice Elliott dismissed NAB's claim after finding a senior Melbourne NAB banker had failed warn businessman John Rose of the risks involved in guaranteeing multi-million-dollars loans to companies he ran with his former friend, bankrupt property speculator, Timothy Rice.

The banker also failed to tell Mr Rose, the founder of the Rosebank "Stackhat" safety helmets, that he should seek independent legal and advice, and failed to offer a 24-hour cooling off period, Justice Elliott ruled.

These actions were a breach of clauses 28.4 and 28.5 of the code, Justice Elliott found, and meant NAB could not enforce the guarantees made by Mr Rose.

A spokesman for NAB said the bank will appeal the decision on the basis it did not breach the code and had been found by Justice Elliott not to have acted unconscionably.

Mr Rose's lawyer, Grant Walker of Madgwicks said it was a very important ruling.

"The judgment places a spotlight on the code of banking practice and banks will need to seriously consider their compliance with the code now that it's been held to be of contractual force, pending the appeal," he said.

In a separate case this year between the Commonwealth Bank and a Melbourne couple over a disputed mortgage arrangement, Supreme Court Judge Kim Hargrave found the code had contractual force but stopped short of finding the bank had breached the code.

Bright Law principal David Jacobson said Judge Elliott's ruling was an important decision that showed the Code of Banking Practice was not just a series of "motherhood statements."

"It is precedent in terms of the status of the code of banking practice and the Code of Banking practice is not just a set of general principals about how banks will deal with customers but it actually incorporates the code obligations into the loan contract and mortgage terms."

"It's a significant decision because it means banks will be held to account if they say they are going to give certain information or make certain disclosures and then don't," Mr Jacobson, who also edits industry journal Australian Regulatory Compliance Review, said.

Australian Bankers Association chief executive Steven Munchenberg said the ruling enforced the contractual obligations he said was inherent in the voluntary code.

"We're not planning to make any changes to the code following this ruling," he said.

Mr Rice and Mr Rose bought seven Gold Coast properties in 2007 and 2008 with the aid of the NAB loans.

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The value of these properties plummeted in the wake of the global financial crisis, resulting in multi-million-dollar losses. One property, 247 Hedges Avenue in Mermaid Beach, was bought in 2008 by the pair for $9.5 million but was sold two years later for just $5 million.

Evidence before the court showed NAB was prepared to loan Mr Rice, and companies effectively run by him, up to $23 million despite knowing his income was insufficient to meet his expenses and that his proposed investments were "speculative" and came at a time where the risk of a downturn in the Gold Coast property market was "high".

> To overcome these hurdles, senior Melbourne NAB banker John D'Angelo included in his loan submission the revenues earned by Mr Rice's wife from her private medical practice, even though NAB had no security or legal right to the profits of that business.

Mr Rice, who is accused in a separate Queensland legal case of being involved in the payment of a $100,000 secret commission to a controversial Gold Coast real estate agent, was responsible for negotiations with NAB and purchasing properties.

Mr Rose, who Justice Elliott noted was independently wealthy and able to look after his own interests, was a passive investor. He told the court he was involved Mr Rice for a "bit of fun".

The court heard that Mr Rose had been told by Mr Rice his liability as guarantor was just for the interest of the loans, not the millions-of-dollars actually loaned.

Justice Elliott ruled that documents prepared by NAB to execute the guarantee agreements with Mr Rose contained "fundamental errors".

"Most certificates have serious issues with them. They also contained statements which D'Angelo knew to be untrue," Justice Elliott ruled.

At the start of the case, NAB's counsel tried to argue that the banking code of conduct – which requires banks to provide full disclosure to clients and act with integrity – was of "no legal effect" and merely a "desirable" way of doing business.

But NAB changed its view as the case came to a close and accepted, though only for the purposes of this proceeding, that the code of conduct was contractually binding in respect of its dealings with Mr Rose.

Justice Elliott said regardless of NAB's change of position, he would have found "that the relevant provisions of the banking code relied upon in this proceeding applied with contractual force".

"Rose's evidence was clear and unequivocal that if he had been told D'Angelo that he should obtain legal advice before signing any of the guarantees, he would have done so. Such legal advice would most likely have informed Rose of the true extent of his potential liability under each of the guarantees ... if he had known he would become potentially liable for all the debts of the borrowers he would not have signed any of the guarantees," Justice Elliott ruled.

Two Of The Mansions That NAB Loans Bought

247 Hedges Avenue, Mermaid Beach

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A three-level house on one of the Gold Coast's most sought-after strips. Nearly every room in the six bedroom, five bathroom house has an ocean view. Three car garage, walking access to beach and a home theatre add to its appeal. The house was formerly owned by former Australian IT tycoon turned FBI informant Daniel Tzvetkoff.

31 Hedges Avenue, Mermaid Beach

INSERT PIC

A four storey mansion, "Bellagio Lodge" was bought by Mr Rice from former Carlton footballer Rod Galt. The house has five bedrooms, panoramic ocean views, an infinity pool and a spa. Marble floors and spiral staircases add to its grandeur.

What The Judge Said...

Justice James Elliott's comments on NAB's conduct:

On NAB including profits earned by a business owned by Mr Rice's wife in its loan assessments: "NAB had no security or other basis by reason of which it could assert a legal entitlement to any profits of this business. Without the inclusion of his wife's profits, Rice would have had, according to NAB's information, an inability to meet his expenses from his income. Accordingly, these further anticipated profits were a 'crucial component' of NAB's financial assessment of the viability of 'Mr Rice's group'."

On NAB's errors in documentation: "NAB was dismissive of errors in its documentation. The errors were described as tangential and ultimately immaterial. Given the litany of mistakes referred to above (which is non-exhaustive), I cannot accept this submission. For the reasons stated, I find the errors were significant and raised serious doubts about the evidence of D'Angelo that he strictly followed banking procedures when dealing with security documentation and related matters."

On NAB's position on the legal force of the banking code: "When the case was opened on behalf of NAB, counsel stated that NAB did not accept that the Banking Code was promissory or contractual. It was contended that the Banking Code imposed no contractual obligation, but merely provided a 'desirable code of practice'... In short, it was stated that the Banking Code was of no legal effect."

Websites For More Information: Court Rules NAB Unable To Recover Gold Coast Millions Due To Breach Of Banking Code
http://www.smh.com.au/business/court-rules-nab-unable-to-recover-gold-coast-millions-due-to-breach-of-banking-code-20150508-ggwjp6.html

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