NSW GOVERNMENT

SUBMISSION TO REVIEW OF BANKING CODE OF PRACTICE

AUGUST 2000

1. INTRODUCTION

Banking is an essential service like the supply of water, electricity and telecommunications. For many people the use of the cash, non-bank economy is not an option. A large section of the population receives its income via direct deposit bank accounts and is locked into bank use.

The banking industry is also a sector where there can be considerable inequality of bargaining power. The terms and conditions of most contracts are on a "take it or leave it" basis. Many accounts have extensive conditions. Many contracts give the banks discretion to change fees and conditions unilaterally. Banking is governed by a complex range of statute and common law, of which most consumers would be ignorant. This makes it difficult, if not impossible, for consumers to be sure the banking contract they are considering is fair in all details.

In this environment, it is essential that banks are governed by a quite extensive set of standards, in order to ensure consumers receive fair treatment. If these standards are not in legislation, they should be included in a code of practice. It cannot be left up to banks to unilaterally determine what they consider "fair conduct".

The vast majority of clauses in the current Code relate to issues of disclosure. While disclosure is important, the fairness of the contract and on-going relationship between the bank and customer is also important. Some specific suggestions are made later in this submission.

2. CODE COVERAGE

The current Code only covers Customers who are individuals, and then only covers banking services which are "*wholly and exclusively for his or her private and domestic use*".

This is in contrast to the Consumer Credit Code, which covers credit which is provided or intended to be provided *wholly or predominantly* for personal, domestic or household purposes.

The banks have extended the Australian Banking Industry Ombudsman scheme to cover complaints from small business. The ABIO terms of reference criteria for small business are:

- have less than 15 employees,
- have a turnover less than $1 million at the time of the complaint, and
- be independently owned and managed.

The Banking Code of Practice should also cover small business. The Code covers basic protections that should be widely available. Many small business people are no

more sophisticated than the average consumer in their understanding of financial services.

Recommendation 1
The Code should cover banking services which are provided or intended to be provided *wholly or predominantly* for personal, domestic or household purposes. In addition, the Code should cover banking services provided to small business. Further investigation is needed on an appropriate definition of small business.

3. EFFECTS OF BANK CLOSURES ON SMALL COMMUNITIES

The closure of branches and reduction of services has had a major negative impact on suburbs and small communities. Sudden closure leaves people with little time to organise alternative bank accounts. Where the closing branch is the last one, communities need time to explore the establishment of alternative banking outlets.

In some instances, banks appear to have deliberately given short notice of branch closures in order to minimise the number of customers who transfer accounts to other financial institutions.

Where banks do have to close branches, it is important that they do so in a responsible fashion.

The House of Representatives Standing Committee on Economics, Finance and Public Administration conducted an inquiry into alternative means of providing banking and like services in regional Australia. Its final report 'Regional banking services - money too far away' was released in March 1999. The Report's second recommendation was:

> *The Committee recommends that the Code of Banking Practice be amended to require banks to give customers two month's written notice before transferring accounts between branches without the permission of that customer.*

This is a significant recommendation from a bi-partisan committee. However, the length of notice recommended is inadequate if the bank branch closing was the last bank in town. Two months would not allow a community to arrange and open an alternative banking facility.

Recommendation 2
If not included in legislation or licence conditions, the Code should include a requirement to comply with a branch closure protocol:
- in non-metropolitan areas where the last branch is closing, 6 months notice of closure;
- in other cases, 3 months notice of closure; and
- for customers of closed branches, banks should be required to waive exit penalties and fees for moving accounts and loans to another institution.

4. FEE DISCLOSURE AT ATMS

There has been a substantial increase in the fees and charges associated with transaction costs in recent years. On the one hand, consumers are encouraged to use electronic methods of transaction with the reduction in direct branch services. On the

other hand, substantial fees are now being imposed on consumers for using these electronic means.

There is an obligation on banks to disclose fees and charges for various accounts. This is generally done when a consumer opens a transaction account.

As banks offer more options for remote banking (ATMs, EFTPOS, telephone and Internet), with different charges, they have a responsibility to keep consumers informed about the cost of different transaction methods. Transaction costs are expensive and complicated, taking into account fee-free transactions, different costs for different types of transactions and who owns a particular ATM. There are also surcharges imposed for the use of ATMs that do not belong to the issuer of cards.

While consumers have the convenience of using ATMs, in practice, this can be quite a costly option. Improved information on transaction costs would empower consumers to manage their banking more effectively and minimise costs where possible. The same issues apply to electronic banking by businesses.

A submission from the Australian Consumers' Association (ACA) to the Australian Securities and Investments Commission (ASIC), September 1999, cited "unequivocal support from consumers for better disclosure of bank fees and charges".[1] The ACA highlighted that as institutions expand the possibilities for remote electronic access, they have a responsibility to provide consumers with a basic standard of disclosure about the costs of these transaction methods. Disclosing this information only once, that is, when consumers open accounts, is not adequate.

It would be desirable if consumers could get information on the cost of a particular transaction on the screen when using an ATM. Information available should include:

- the cost of the transaction;
- the number of remaining fee free transactions for the month; and
- an opportunity to terminate the transaction without penalty.

At present the technical arrangements are not in place to provide such disclosure. ASIC is proposing discussions with industry and consumer groups on how ATM fee disclosure might be introduced in the future.

The issue of ATM fee disclosure is not unique to Australia. Consumers in other countries have also raised concerns about the adequacy of fee disclosure by banks and there have been a number of responses by government and the banking industry.

In the United States, ATM fees vary widely and can be up to $4. ATM fee disclosure was one item in the Clinton-Gore Plan for Financial Privacy and Consumer Protection in the 21st Century, announced in May 1999. The Plan supported legislation requiring ATM owners to post a clear and conspicuous notice of surcharges on the machine as well as on-screen, and imposing sanctions for failure to make the mandated disclosures. In effect, if using an ATM incurs an additional fee compared to using an ATM with your own financial institution, the fee must be disclosed at the ATM. The ATM Fee Reform Bill has been incorporated within the Financial Modernisation Bill. The bill passed the House of Representatives and is currently in the Senate.

---

[1] ASIC is investigating the adequacy of the current disclosure regime and exploring practical ways of addressing problems. This issue has been raised with ASIC on a number of occasions.

In the United Kingdom, banks and building societies will be forced to warn customers of charges for ATMs under changes being introduced with the new banking code. Concerns over the cost of using ATMs have come to a head with several big banks changing their charging structures. Barclays will make its ATMs available for free to its own customers but will charge rivals' customers (except Lloyds TSB and Bank of Scotland) one pound for using Barclay ATMs. The re-drafted banking code of industry will require banks and building societies to display an on-screen warning of charges to a consumer as soon as a card is inserted.

The same disclosure issues apply to other forms of electronic service delivery, such as Internet banking, phone banking and direct electronic banking by businesses.

> **Recommendation 3**
> Banks should provide information on the cost of electronic banking transactions (eg via ATM, phone banking, Internet banking, direct business banking) at the time of the transaction. This information should include:
> - the cost of the particular transaction;
> - the number of remaining fee-free transactions for the month; and
> - an opportunity to terminate the transaction without penalty.

Banks have already been put on notice about increased community expectation for fee disclosure. An implementation period of 2 years is proposed, starting from when the obligation is formally imposed. Such a lengthy period would allow electronic banking systems to be revised in an orderly fashion, without undue cost. By comparison, almost the entire accounting system for Australia was revised in less than 2 years to implement the GST.

> **Recommendation 4**
> The timetable for implementation depends on the time needed to revise interchange standards, revise computer programs and (if necessary) upgrade equipment. An implementation period of up to two years is recommended.

5. CREDIT ISSUES

Australians owe about $69 billion in personal household debt. This is in addition to $252 billion in home loans. [2]

Personal debt levels in Australia have increased by about 10-15% per annum since 1995. Debt on revolving credit is currently growing by about 30% per annum. By October 1999, outstanding debt on bank credit cards was around $13 billion.

5.1 Responsible lending and capacity to repay

The present Code has a clause on a bank's obligation to assess a customer's capacity to repay before providing credit [para 15.1]. However, the clause:

- only requires the bank to *consider* the issue, not decline credit if the consumer does not have the capacity to repay;
- is completely subjective, as a bank is only required to consider the factors that *the bank* considers relevant;
- only lists the factors which *may* be relevant to consider.

[2] Australian Financial Review, 6 May 2000, p3

In contrast the Mortgage Industry Code of Practice avoids relying on whatever the lender considers relevant:

> *9.4 A Member will always make such enquiries as are necessary to determine an applicant's capacity to repay the proposed loan.*

5.2 Code for credit assessment

In December 1999 the Department of Fair Trading and the Department for Women convened a roundtable seminar to discuss issues faced by women as consumers of financial services, especially relationship debt, and to develop strategies to address these issues. The *Finances Working for Women* seminar involved representatives from industry, government and community sectors, and the Australian Banking Industry Ombudsman. The report on the seminar, *Report on Outcomes and Action Required,* was launched in June 2000.

One of the issues raised at the *Finances Working for Women* seminar was inconsistent and inadequate credit assessment.

High risk borrowers who are rejected by one lender can apply and receive a loan from another because of the different rules of individual lenders. However, in a competitive market, lenders are under pressure to maximise the number of new customers, including some high-risk borrowers.

A uniform code of practice for all lenders with provisions for credit assessment criteria would help overcome inconsistencies in lending practices. The industry's acceptance of this and its effectiveness as a strategy need further investigation.

The seminar recommended that the value of a uniform code of practice for all lenders with provisions for credit assessment criteria be investigated. If adopted, such a code could be incorporated in the Banking Code of Practice.

> **Recommendation 5**
> The value of a uniform code of practice on credit assessment criteria should be investigated.

5.3 Implementing Family Court decisions

Parties to Family Court proceedings sometimes find difficulty in implementing a settlement or Family Court ruling as it relates to joint debts.

The most common situation is where, as part of a Family Court endorsed settlement, it is agreed that ownership of the family home (and the associated mortgage) should be transferred from joint ownership to one party. The bank holding the mortgage is not a party to the proceedings, and so is not bound by the Court's decision. Legal Aid solicitors have reported cases where the bank has refused to transfer the mortgage to one name only, even where the property is adequate security for the debt and mortgage payments are up to date. The only option left for the parties is to completely discharge the mortgage by re-financing elsewhere. This can be an expensive exercise, due to the bank fees, legal fees and government charges.

> **Recommendation 6**

Where a Family Court ruling or settlement involves the removal of one party from a joint mortgage, the Code should require a bank to effect the mortgage transfer and consent to any related transfer of title.

6. GUARANTEES AND CO-BORROWERS

The problems women face as consumers of financial services have recently received much attention in the media. There is evidence and many case studies from legal and financial counselling organisations of women who have found themselves left with a debt or a financial contract that were signed, sometimes under pressure, but provided no benefit to themselves. A number of recent court cases, such as Garcia v National Australia Bank (1998), also highlight the situations women find themselves in when going guarantor for their partner or family member. They also highlight the need for the provision of adequate information to women.

6.1 Coverage

The guarantees section of the Code excludes contracts where the borrower is [paraphrased]:

- a corporation of which the guarantor is a director, secretary or member or any of its Related Entities;
- a trustee of a trust of which the guarantor is a beneficiary or in a class of beneficiaries;
- a partner, co-owner, agent, consultant or associate of the guarantor or any related entity.

The exclusions are far broader than are justified for policy reasons. Research on relationship debt (or "sexually transmitted debt") shows that many guarantors have little understanding of the commercial arrangements or debts being guaranteed. Due to the dynamics within many family relationships, many potential guarantors have little chance of dealing with either the bank or the borrower on equal terms.

Many inequitable guarantees involve family members who may also be token or minor players in a family business, company or trust.

The protections offered by the Code to guarantors are fairly basic, and there is no reason why they should not also be extended to small business loans. The only reasonable exclusion is public corporations.

The wording of this section of the Code is also so convoluted as to be virtually incomprehensible.

Recommendation 7
The Code's provisions for guarantors should only exclude loans where the borrower is a public corporation.

6.2 All money guarantees

All money mortgages are a particular trap for guarantors, as the bank can extend credit far exceeding what the guarantor anticipated, or at a later time when circumstances have deteriorated. The current banking code [para 17.2] bans the acceptance of "all money" guarantees. Guarantees may only be accepted if they specify the amount of the guarantee (aside from liabilities such as interest and recovery costs). However, there may be many all money guarantees which were accepted before the credit part of the Banking Code of Practice came into force. Banks should be required to remove "all money" clauses within a specified time period.

Recommendation 8
The Code should require banks to revise all current guarantees with an "all moneys" clause. A one year grace period should be specified. Any "all moneys" clause should be deleted and replaced with a specified limit on the guarantor's liability (plus other liabilities such as interest and recovery costs). The bank may insist that the specified maximum liability be no less than the borrower's liability at the time.

If the clause is not revised by the bank, the guarantor's liability should be limited to the borrower's liability at the end of the grace period (plus subsequent interest and recovery costs).

6.3 Information provided to guarantor

The current code requires the bank to seek the borrower's consent to providing a potential guarantor with a copy of the loan contract and the most recent account statement [para 17.3].

This provision is inadequate in light of current Consumer Credit Code requirements and should be revised accordingly. The Banking Code does not give the guarantor all the information necessary to assess the risk involved in guaranteeing a loan. This issue is critical, as in many situations the guarantor is bearing all the risk and gaining no benefit from the loan.

Recommendation 9
Banks should be obliged to disclose a wider range of information to potential guarantors. The Code should require banks to make available to potential guarantors (with the borrower's consent) all the information which the bank had available to assess the loan risk (or a summary). If the borrower does not consent, the bank should refuse to accept the guarantee.

A situation worth particular attention is where the bank requests a guarantee over existing credit. There have been allegations that banks have sought guarantees on existing loans because the risk of a borrower default is increasing. In this situation, the bank obtains a direct benefit as the risk profile is reduced.

Recommendation 10
Where a guarantee is obtained over existing credit, the onus should be on the bank to prove that appropriate information was given to the guarantor.

6.4 Reducing guaranteed amount

After a loan guarantee has been signed, circumstances may change.

- The financial situation of the borrower may deteriorate.
- The guarantor's relationship with the borrower may change.
- The financial situation of the guarantor may deteriorate.

Recommendation 11
The guarantor should have the right to unilaterally vary the amount of the guarantee (eg refuse to guarantee further advances). However, the bank should have the right to reject a reduction, to the extent that it would:

- be below the borrower's liability under the relevant accounts at the time; or
- prevent advances necessary to secure the present value of an asset which is security to the loan (eg a house under construction).

6.5 Independent Legal Advice

The current Code provides that a bank shall recommend that a prospective guarantor obtain independent legal advice. The legal certificate may absolve financial institutions from responsibility, however, it is questionable whether this legal advice fills in all the information gaps. For example, a lawyer independent of the lender and without the benefit of the lender's information cannot provide an assessment of the risk of the borrower defaulting. Nor can the lawyer make an assessment of the guarantor's ability to repay the loan now or in 10-20 years time. Some lawyers are against taking on this responsibility particularly as it also affects the lawyer's professional indemnity insurance.

The recommendation that co-debtors and guarantors obtain independent legal advice does not address the situations where a person signs as co-borrower or guarantor due to pressure from the other person in the relationship.

Recommendation 12
The following issues need further investigation:

- What information is disclosed to the potential guarantor by the lender to enable them to access risks;
- The appropriateness and value of "independent" legal advice to potential guarantors, particularly when there is a close relationship between the borrower and potential guarantor; and
- The benefits of advice on commercial risk as well as legal issues in a guarantee.

7. APPLICATIONS REQUIRING FACE TO FACE INTERVIEWS

One of the issues raised at the *Finances Working for Women* seminar was the situation where information was not adequately communicated to a potential borrower because of the absence of a face to face meeting with the lender.

In the past 20 years there has been a massive increase in the types of products and organisations providing loans and credit. Entering into loan contracts is getting easier with the introduction of electronic banking and quick cover-the-phone loan approvals. This often means that there is a reduced emphasis on providing adequate information to borrowers. While this may not be a problem for some consumers, it is problematic for co-borrowers and guarantors who need to fully understand their risk and obligations.

In response to this situation, the seminar identified a need to categorise transactions into those that can be dealt with electronically and those that require person to person contact or personal interview. The seminar concluded that this issue should be addressed in the industry Codes of Practice.

Recommendation 13
The Code should specify the kinds of contracts where a face to face meeting is necessary to ensure the customer understands the key features and risks of a banking service.

8. JOINT ACCOUNTS

Where two or more parties are jointly liable for a debt, circumstances between the parties may change. A common situation is where the relationship breaks down. Another situation is where one party discovers the other has a gambling or drug addiction or is spending money in a way not originally anticipated.

Problems currently exist where a bank may require all joint or secondary credit cards to be surrendered before advances can be stopped. This is obviously impossible where one party has disappeared. It is also in contrast to the immediate stop applied if a card is reported stolen or lost.

> **Recommendation 14**
> The Code should require a bank to immediately cease further advances on a credit facility at the request of an account holder (regardless of whether it is a joint account or a single account with a secondary card).

While it is acknowledged that this provision might cause some consumers inconvenience, it would help to avoid potentially huge debts accrued by one partner. Each partner could then organise separate credit facilities.

Problems also arise where parties have an understanding about being responsible for a certain proportion of a joint debt, but the formal documentation only allows for the debt to be owed jointly and severally. This can result in one party being pursued for the entire debt, when that party only intended to be responsible for part.

> **Recommendation 15**
> The Review should consider whether the Code should require joint credit applications to offer a choice between joint and several liability versus a specified proportion of the outstanding debt.

9. MONITORING AND REPORTING

The reporting and monitoring provisions in the current Code do not reflect the regulatory framework in which banks now operate. The monitoring role is officially undertaken by the Reserve Bank. This is an inappropriate agency, as the Reserve Bank does not have a role in retail banking at the individual consumer level, or in regulating the fairness of the bank/customer relationship.

Under the current rules, the review of the Code is to be conducted in consultation with the Payments Systems Council. However, the Payments Systems Council is heavily dominated by banks.

It is important that the monitoring and reporting on the Banking Code of Practice is carried out by an organisation with experience in consumer banking issues, and which is seen to be independent of the banks. The Australian Securities and Investment Commission is one such agency. Compliance with the Code should be able to be independently double-checked, and not rely entirely on a bank's self assessment.

> **Recommendation 16**
> The Code should be monitored and reviewed by an organisation which is:
> - Experienced in consumer banking issues;
> - Independent of banks;
> - Able to independently verify compliance with the Code.

The Australian Securities and Investment Commission is one such agency.