

CODE OF BANKING PRACTICE REVIEW
SUBMISSION FROM
FINANCIAL COUNSELLING SERVICES (QLD) Inc.

INTRODUCTION:

Since the Code of Banking Practice (the Code) was introduced in November 1996 there has been significant developments in the legislative and regulatory environments affecting consumer protection. Many of these developments address issues the Code was meant to address, yet problems remain. It is difficult to attribute better consumer protection to the Code or to point to where the Code has effected outcomes consistent with its objectives and principles, other than in the area of alternative dispute resolution. In our view, the Code is unnecessary, as it is limited, lacks both force and flexibility, is superceded and faces unrealistic expectations from all stakeholders.

In announcing a review of the Code of Banking Practice, the Australian Bankers Association (ABA), made a strong statement in support of it. Such a statement clearly indicates the review is predisposed to amending the provisions of the Code, rather than debating its fundamental role and efficacy. Because of the ABA's stated commitment to the Code, our recommendations have taken a pragmatic approach. While our main recommendations are based on alternatives to the Code, those same recommendations can be incorporated into a revised Code.

The views of this service have been reached through an analysis of the systemic issues identified by our casework. All casework examples given are current. We have the following comments to make on the Objectives and specific Principles of Conduct in light of the legislative and other developments in the banking sector since the introduction of the Code.

1. Objectives

1.1 Standards of practice and service

While the Code purports to describe standards of good conduct and service, in our view it has had little, if any effect, on the policies and practices of financial institutions. While its introduction was politically expedient, the main issues it was meant to address still remain significant factors in the casework experience of this service. Even the Australian Banking Industry Ombudsman commented on the increase in complaints about service issues in his 1998-99 Annual Report. It appears the Code has been more about form than substance.

1.2 Disclosure

Despite a commitment to disclosure in the Code, legislation has overtaken disclosure provisions for most banking products. The Uniform Consumer Credit Code (UCCC) and the Financial Services Reform Bill (FSRB), assuming it becomes law, will have displaced the disclosure provisions of the Code. If the Code had been effective in this provision, the detailed provisions of both the UCCC and FSRB would have been unnecessary. The introduction of the FSRB four years after that of the Code tends to support this view.

Although disclosure is the current mantra in relation to financial products, from the consumer perspective, its relevance and usefulness is limited strictly to the initial undertaking of a particular product. Disclosure of itself does not necessarily lead to certainty about the terms and conditions of the contract. This applies to both credit contracts and other deposit taking

products. As the right to vary terms and conditions of almost all products remains with the financial institution, disclosure is more a marketing feature than a significant indicator of an ongoing informed and effective relationship.

The disclosure provisions of the Code will not add any more certainty to the legislative provisions of either the UCCC or the FSRB. While there are mechanisms within the legislation to ensure compliance with the disclosure provisions, the Code is voluntary. To superimpose voluntary compliance over legislative requirements is to ensure the Code remains irrelevant.

The Code has neither mitigated the need for further legislative provisions in relation to disclosure nor has it promoted more effective relationships.

1.3 Promote informed and effective relationships

How is an “effective” relationship defined? Effective for whom? Perhaps “effectiveness” is most put to the test when there are complaints and defaults. An indicator of the effectiveness of the relationship between banks and their customers is the manner in which financial institutions handle these problem areas and the types of outcomes achieved.

As mentioned above, the Banking Ombudsman has called on banks to improve the quality of service to their customers. The Ombudsman cautioned the Banks to manage their relationship with their customers more effectively, predicting a further rise in complaints otherwise. Of the nearly 50,000 complaints received by the Ombudsman in the 1998-99 financial year, approximately 47% related to housing loans and consumer finance, areas that relate specifically to this service.

The experience of this service indicates that the letter of the law mitigates both the objectives of good practice and service and informed and effective relationships. In areas where life meets legislation, such as relationship breakdown, unemployment and sickness resulting in financial crisis, the theoretical objectives of the Code fail to counteract legislative intransigence. The Code has the potential flexibility to promote effective relationships at a time when it is most needed. The Banks however resile from creative solutions to crisis situations and resort to the security afforded them by letter of the law, effectively damaging the bank/customer relationship.

Given the reliance on legislation when problems arise, objectives concerning effective relationships are limited and, in many cases, meaningless.

1.4 Dispute resolution

A main objective of the Code is the requirement for Banks to have dispute resolution procedures. We believe that the main achievement of the Code has been the development of a culture more open to alternative dispute resolution. The efficacy of both internal and external dispute resolution schemes should be investigated further as our experience indicates there are significant impediments to consumers in utilising them effectively.

The increasing number of complaints received about the banking sector by the Ombudsman also indicates a lack of effective internal dispute resolution processes. While the Code may appear to have a role to play in relation to the schemes, again legislative developments and initiatives by the Australian Securities and Investment Commission indicate that the initiative has been taken away from the banks.

The *Financial Services Reform Bill* will require the holder of an Australian Financial Services Licence who provides services to retail clients to have internal and external dispute resolution processes in place. Australian Securities and Investment Commission (ASIC) approval will be required for these processes. Standards will be established for both processes. The internal scheme will be governed by the Australian Standard on Complaints Handling and the external scheme by ASIC, in keeping with Policy Statement 139.

It is recommended that the FSRB be amended to require all financial institutions to provide IDR and ADR schemes in keeping with the standards mentioned above. The alternative is to improve the provisions of clause 20 of the Code to require Banks to meet the standards indicated by the Australian Standard on Complaints Handling and ASIC's Policy 139.

2. Summary of developments since the introduction of the Code

It can be seen from the above comments that legislative and other mechanisms have superceded significant areas of the Code. The following table indicates the developments in the areas the Code was meant to address.

CREDIT UNION CODE	DEVELOPMENTS
Disclosure	Financial Services Reform Bill (FSRB) & Uniform Consumer Credit Code (UCCC)
Pre-contractual Conduct	FRSB & UCCC
Opening of Accounts	FRSB
Variations of terms and conditions	FRSB & UCCC
Account Combination	FRSB
Foreign currency transactions	FRSB
Privacy	UCCC & National Privacy Principles
Payment Instruments	FRSB & EFT Code
Statement of Accounts	FRSB & UCCC
Provision of Credit	UCCC
Joint Accounts and Subsidiary Cards	UCCC & EFT Code
Guarantees	UCCC (consumers only)
Advertising	UCCC, ASIC Act & Trade Practices Act
Closure of Accounts	UCCC
Compliance and contract law	FRSB & UCCC
Dispute resolution	FRSB, ASIC PS 139

There is a view that the Code should "flesh out" the provisions of legislation. Given the complexity and number of other Codes and statutes that affect the matters to be addressed, it is difficult to see how any Code could provide this level of detail and remain current. There will be conflicts as soon as there are judicial interpretations of any of the statutes. Any financial institution will look to legislation and legal precedent for guidance over the provisions of a voluntary and unenforceable Code.

Where significant problems still exist, we support amendments to the relevant legislation to effect the consumer protections required. From the casework of this service, guarantees are an area that has not improved since the implementation of the Code, despite the provisions in the Principles of Conduct.

3. Principles of Conduct

3.1 Guarantees

Despite stated principles, conduct around guarantees remains poor, particularly where the elderly and incapacitated are involved. More than twenty-five percent of the casework conducted by the civil litigation lawyer at this service relates to unconscionable guarantees. Attachment A lists four case studies where the disadvantage suffered by the guarantors included intellectual disability, addiction, age and significant health problems. With all of the actions currently on foot, it would have been clear to any lending officer that the relationships between these guarantors and the principle borrowers were inequitable given the disadvantage suffered by the guarantors.

The practice of Banks in enforcing guarantees is ambiguous. Some allow the guarantor to repay the loan in place of the borrower in accordance with the credit contract. Others require immediate payment of the loan in full. There is conflict between the intent of clause 17.4 of the Code and sections of the UCCC. Clause 17.4 of the Code states that the Bank will provide the prospective guarantor with a written warning about the possibility of the prospective guarantor becoming liable instead of, or as well as, the borrower. This infers that the guarantor can assume the responsibility of the borrower and continue payments. This view is reinforced by s81 of the UCCC that provides for a guarantor to remedy a default.

Some banks however require the loan to be repaid in full when a default is not remedied by the borrower. The ambiguity is further compounded by third party guarantees for business/investment loans. The Code is the only consumer “protection” that exists for guarantors in this situation, yet the definition of “customer” would appear to exclude a class of people who need adequate protection. The position of the consumer, not the nature of the loan, should determine the consumer protections available. The casework of this service clearly indicates the ineffectiveness of the current provisions to protect these vulnerable consumers.

As the Code has not lead to better consumer protection, we propose that the matter of guarantees be addressed by amendments to the Uniform Consumer Credit Code. The UCCC should be amended to cover a guarantee provided by a consumer, whether to secure business or personal lending. To ensure that the guarantor fully understands the obligation they are undertaking the following processes are recommended:

- Guarantor is dealt with independently of the principle borrower(s);
- Guarantor is provided with all the information used by the creditor to assess the borrower’s capacity to repay;
- The guarantor is provided with the reasons the creditor will not undertake the risk without a guarantor;
- The guarantor has the capacity to repay without the sale of assets if section 81 of the UCCC is to be relied upon.

While it is not our preference, we acknowledge the likelihood of the Code remaining in some form or another. Should this be the case then we recommend the inclusion of the above in that Code. In this case we recommend the following clause be added:

- The guarantor be required to sign a simple statement acknowledging they are prepared to sell their assets to pay out the contract if the borrower defaults.

3.2 Joint Accounts

The nature of the work undertaken by this service focusses on credit matters and financial hardship. Our comments on the Code are restricted to those concerning joint debts and in particular, relationship debt.

3.3 Joint Debts

Relationship debt is fraught with assumptions and contradictions that make for poor lending and debt recovery. Blatant unconscionability still exists, but less obvious injustices underpin many more relationship debts. Assumptions concerning similarity of interests, access to information, equality of decision making power, the rights of main income earners, understandings of legal liability, and the meshing of business and personal finances all contribute to a complexity that is not necessarily apparent at the time of signing a contract. Protecting the interests of all parties is made more difficult when emotion are involved.

The simplest measure of reducing relationship debt is to ban all joint loans, guarantees and loans where a third party is the beneficiary. Such a concept is likely to be acceptable to no one, even if it is the most obvious. Most of problems surface after the signing of the contract and usually only when the relationship or the business is in trouble.

Despite the various disclosure provisions contained in this Code and the relevant statutes, it is questionable whether greater information at the time of entry into a contract will make any substantive difference to the conduct of the loan when co borrowers are treated as a single entity. Better education of prospective debtors about the implications for them as individuals, not as couples, may lead to a reassessment of their involvement prior to signing a contract. Capacity to repay is the most significant issue, given the statistics on relationship breakdown.

Couples are signed to contracts while it is quite clear that one party has limited capacity to repay. As an individual that person would not meet the lending criteria for the loan. If the bank is aware that the person is unable to service the loan itself, it is unfair to allow a person to sign a contract where there is joint and several liability. In these situations, it is fairer to apportion liability according to capacity to repay at the time of entry into the contract.

In these situation we believe the Code has been ineffective in resolving these matters, despite a commitment to an effective relationship with customers. We recommend the matter be dealt with under the Uniform Consumer Credit Code and incorporate the following:

- Assess individual capacity to repay full loan
- Educate on meaning of “joint & severally” liable
- Apportion liability on capacity to repay at the time of entry into the loan
- Secure business/investment loans by business assets only, not the family home
- Prior to entry into contracts, consumers to be provided with a short summary of the legal action that will be taken if the loan cannot be repaid as agreed

While the entry end should not be ignored, it may mean solutions should be focussed more on the debt recovery aspect of these loans. Under the existing Code, this is an opportunity for “effective” relationships to be fostered, but, as mentioned earlier, legislative intransigence overrides common sense.

3.4 Debt Recovery

An area that has been completely ignored by banks in promoting effective relationships has been the area of debt recovery. Inflexibility by financial institutions in accepting realistic repayment options when personal circumstances change encourages consumers to seek the

protection of the Bankruptcy Act. More reasonable and realistic repayment options that cater for individual circumstances would lessen this potential. Self interest of individual banks is often counter to the collective good.

A distinction needs to be drawn here between debt collection practices and debt recovery policy. ASIC has developed Guidelines on section 60 of the *Trade Practices Act* to cover debt collection practices. While collection practices of some banks still fall below the standard set by this guideline, it is the underlying debt recovery policies of banks that need improvement.

Banks need to remember that many people in financial crisis are also suffering a major personal crisis such as unemployment, relationship breakdown or business failure. Relying on the letter of the law for recovery in such circumstances is unrealistic and results in undesirable outcomes. Inflexible attitudes and requirements lead to a perception amongst consumers and financial counsellors that some creditors prefer debtors to lodge their petitions for bankruptcy. The debt collection practices of some banks would indicate this.

Should the Code be amended, we recommend that debt collection policy and practices be included under the objective of fostering effective relationships, given that “effective” should be a two way street with both parties deriving benefit. The following matters should be included:

- Industry commitment to work co-operatively to resolve problems arising from financial hardship (rather than the self interest that currently exists)
- Development of realistic, and publicly known, debt collection policies and practices
- Increased flexibility in repayment options
- Commitment to use of Part IX Agreements where no other equitable solutions exists

4. Credibility

This service has never used the Code as a means of consumer protection. Given the developments mentioned above, we believe the Code will do little to further the consumer protections unless there is some means to enforce compliance. Without this, the Code will remain an enigma and a platitude.

5. Summary

Given the rapid changes occurring in the banking sector we do not believe a Code can be developed that will remain current, flexible and effective in keeping with the expectations of all stakeholders. Legislation and other developments have superseded much of the current content of the Code. Experience indicates that the areas of most concern to this service will not be effectively addressed by inclusion in the Code and should be dealt with by amendments to existing legislation. We acknowledge though the ABA’s commitment to the Code and appreciate a revised Code will be the outcome of the review.

From our perspective, the main achievement of the Code has been the development of a culture more open to alternative dispute resolution. We would support the retention of this aspect of the Code if it will lead to a commitment from the banks to the further development of both IDR and ADR schemes. While the majority of our recommendations point to other means of resolving issues of concern to us, they can be incorporated into any revision of the Code. In this case, debt recovery should be included.

Our recommendations on the matters raised are as follows:

- Dispute resolution: Code requirement that Banks meet the standards indicated by the Australian Standard on Complaints Handling and ASIC's Policy139.
- Disclosure: The disclosure provisions of the Code will not add any more certainty to the legislative provisions of either the UCCC or the FSRB.
- Guarantees: Amendments to Parts 3,4, & 5 of the Uniform Consumer Credit Code
- Joint Debts: Amendments to Parts 2 and 4 of the Uniform Consumer Credit Code
- Debt Recovery: Guidelines for inclusion in the Code of Banking Practice if the Code remains
- Credibility: Compliance mechanism required

Contact:

Kate Keating
Manager
Financial Counselling Services (Qld) Inc
PO Box 711
Fortitude Valley Qld 4006

Phone: (07) 3257 1957 or 3257 1958

Fax: (07) 3257 1958

Email: fcsq@powerup.com.au

Attachment A: Guarantor case studies