

AUSTRALIAN PAYMENTS CLEARING ASSOCIATION (APCA)

SUBMISSION IN RESPONSE TO THE REVIEW OF THE CODE OF BANKING PRACTICE ISSUES PAPER

4 June 2001

Mr Richard Viney
Code of Banking Practice Review
PO Box 2045
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Dear Mr Viney

ISSUES PAPER REVIEW OF CODE OF BANKING PRACTICE

We have reviewed the Issues Paper in the Review of the Code of Banking Practice and provide the comments set out below on the section relating to Direct Debit (referred to in the Issues Paper as “direct debits from accounts other than credit cards”).

APCA co-ordinates and manages policies, rules and technical procedures in its Bulk Electronic Clearing System (known as BECS) for clearing direct entry payments between member banks (including the Reserve Bank), building societies and credit unions. The BECS rules and procedures include direct debit. APCA introduced the Direct Debit Request (DDR) arrangements in BECS in March 2000.

Our response to the Issues Paper covers the following areas:

1. Management arrangements for BECS;
2. Background to the introduction of the DDR arrangements;
3. The legal basis for financial institutions debiting customers' accounts;
4. Exposure to risk of fraud;
5. Cancellation procedures; and
6. Claims and disputes procedures.

1. MANAGEMENT OF BECS

- 1.1 One of the important reasons APCA was established in 1992 was to facilitate the co-ordination of payments clearing arrangements between banks, building societies and credit unions in order to achieve greater efficiency. Before

APCA's establishment, banks, building societies and credit unions had their own separate arrangements for direct credit and direct debit.

- 1.2 ***APCA's facilitation role in co-ordinating payments clearing arrangements for direct debit would be undermined if aspects of the direct debit system within its management were assumed under other regulatory arrangements such as the Code of Banking Practice.***
- 1.3 The rules of BECS operate as a contract between all BECS members and APCA. Under the contract, operational oversight of BECS has been allocated to a management committee which is representative of all the members. That part of the rules known as the BECS Procedures regulates the technical operation of direct credits and debits. The management committee has the right to amend the BECS Procedures, without the need to go back each time to the broader membership. This means that operational changes to the system can be introduced relatively quickly, subject to necessary lead times for implementation.
- 1.4 ***Changes can be made to direct debit processes under the BECS rules faster, more simply and, as required, more frequently than under the Code of Banking Practice.***

2. INTRODUCTION OF DIRECT DEBIT REQUEST ARRANGEMENTS

- 2.1 The DDR is the customer authorisation of direct debit payments. Introduction of the new DDR arrangements in 2000 involved a new form of customer authority to debit users, a revised procedure for the handling of those customer authorities, introduction of new minimum rights and responsibilities for inclusion in a direct debit service agreement between debit users and their customers, and a new claims process.

In developing the DDR arrangements, the priorities were not solely ““efficiencies” from the viewpoint of all parties except the consumers”, as the Issues Paper concludes (p.81). Practical implementation since March 2000 may have resulted in areas where processes need to be improved for the consumer (both within the BECS Procedures and in BECS members' internal systems) but consumer needs were very much taken into account when the DDR arrangements were being developed.

- 2.2 The DDR arrangements were intended to facilitate electronic commerce and bring a number of benefits, not only to financial institutions and debit users but to customers also, over the previous authorisation arrangements. These benefits to customers are summarised below:
 - greater choice and flexibility for customers in the way they could give authorisations (e.g. electronically);
 - greater flexibility to include conditions on the DDR such as a dollar limit and frequency of drawings;
 - the ability for the debit process to be implemented immediately the authorisation was given to the debit user; and
 - reduction of physical handling of customer authorities, minimising opportunities for the customer's authority to go astray, with associated problems this caused for all parties.

2.3 A benefit introduced specifically for customers was the requirement that debit users provide a minimum service level agreement. This is a mandatory requirement; the sponsor financial institution does not have a choice about requiring its debit users to apply it. The service agreement was intended to provide benefits for customers by ensuring that, unlike previous arrangements, all customers would have minimum rights and obligations, clearly set out. These include:

- clear advice about the basis on which the debit user would initiate debits and issue billing advices to the customer;
- a minimum period of notice (14 days) required to be given by the debit user if it intended to vary those arrangements;
- details of a process for deferring or altering the agreed drawing schedule;
- description of the dispute resolution process offered by the debit user.

2.4 Another new aspect of direct debit under the DDR arrangements was the establishment of a claims process between the customer and his or her financial institution (the “ledger institution”). Since no uniform claims process previously existed, the guarantee of a response to a claim within seven business days of making the claim was an important benefit for the customer. It was intended that the new process would enable claims to be processed efficiently. The question of a claims procedure in the nature of a guaranteed refund to the customer was considered at length, but not proceeded with for a number of reasons (see paragraph 6.6 below).

3. LEGAL BASIS FOR DEBITING A CUSTOMER’S ACCOUNT

3.1 The Issues Paper refers to the views of the Australian Banking Industry Ombudsman (ABIO) (p.75) about the entitlement of banks “... *to debit a customer’s account solely on the assertion, made by a third party [i.e. the debit user] that they have authority to debit a customer’s account.*”.

There is comment (p.76) as follows: “*It is also, in my view, doubtful that the authorisation by the customer (in the signed DDR) of the debit user to instruct Ledger FI on the customer’s behalf, is effective to overcome the problem raised by ABIO, unless and until that authorisation is given to the Ledger FI.*”. One of the conclusions (p.81) is that “*There are reasons for concern about the legitimacy of the scheme in so far as there are doubts (as expressed by the ABIO) that the ledger FI is authorised to debit the customer’s account.*”.

When the DDR arrangements were being developed, APCA considered carefully the question of the legal basis for financial institutions’ debiting their customers’ accounts. APCA and the ABIO had discussions at some length on the issue prior to the introduction of the arrangements. APCA provided the ABIO with details of legal opinion obtained by both APCA and many of its members on the point, which supported the legitimacy of the approach taken.

For these reasons, we would like to record APCA’s views on the issue.

3.2 There is no legal requirement for an order to be addressed to a financial institution to enable that institution to properly debit its customer’s account.

A customer can authorise a third party to draw upon his or her account without personally advising his or her financial institution of this authorisation. Indeed, in the normal course, a customer who has given authority to a debit user to debit the customer's account will be estopped from claiming his or her financial institution had no authority to debit the account in accordance with the debit user's instructions.

- 3.3 In any particular circumstance, it will always be a question of fact as to whether a given drawing was authorised (for example, refer to the ABIO's list of circumstances in which that office would regard a drawing as unauthorised). The DDR does represent an instruction by the customer, authorising the debit user to debit the customer's account. If the debit user is not authorised, or acts outside the terms of its authority, the customer's financial institution is at risk for breach of the "banker-customer" contract.

4. EXPOSURE TO RISK OF FRAUD

- 4.1 Comment is made (p.77) that "... *Ledger FIs are in no position to check the authenticity of direct debit requests as and when received. It is essentially left to the customer to challenge a debit which the customer believes is unauthorised.*". The conclusion is drawn (p.88) that the present system "... *exposes customers to risk of loss to fraudulent or inefficient debit users. Ledger FIs process debit requests in good faith without checking the authenticity of the request, leaving to the customer to detect and challenge unauthorised debits. The potential for debit user fraud is obvious.*".

While there is of course always a possibility of fraud by a debit user, and that possibility can never be removed, comment is required on aspects of the system relating to this issue and measures designed to minimise the risk.

- 4.2 The inability in the customer's institution to check the DDR does not of itself increase the likelihood of a risk of fraud by the debit user. Prior to the introduction of the DDR, financial institutions did not, and were unlikely to be able to, check whether a particular drawing was valid in terms of the underlying agreement between the debit user and the customer. The new administrative arrangements relating to the debit user holding the DDR do not change the situation as it previously existed.
- 4.3 All debit users must be sponsored into the direct debit system by a BECS member. The sponsor stands behind the debit user and is responsible for the way the debit user conducts its business. The risk that a debit user would put through debits without a valid DDR in place was adjudged to be low. Such a debit user would jeopardise its sponsorship into the system and expose itself to liability. Under the BECS Procedures, a sponsor must be satisfied as to the debit user's continued suitability for access to BECS and, where required, undertake reviews to the extent necessary.
- 4.4 The DDR arrangements introduced the requirement of a wide-ranging indemnity given by the financial institution sponsoring the debit user into the direct debit system. As between the members of BECS, the sponsor effectively bears the risk of error or fraud by debit users and is responsible in

all circumstances to all ledger institutions for unauthorised activity by the debit user.

5. CANCELLATION PROCEDURES

5.1 *Consumer concerns about the existing cancellation procedures are acknowledged.*

5.2 The DDR arrangements in the BECS Procedures do require the following in relation to cancellation:

- the customer is to be advised by the debit user (through the DDR service agreement) to direct all requests for cancellations to the debit user in the first instance;
- the DDR service agreement is to set out in reasonable detail the procedures available to the customer to cancel a DDR with the debit user; and
- the debit user is to act promptly in accordance with any instruction given by a customer to cancel a DDR.

The DDR arrangements also require a customer's financial institution to ensure that any cancellation instruction it receives is addressed by the customer to the debit user, and to forward that instruction to the debit user either directly or through the debit user's sponsor.

However, it should be understood that the BECS Procedures were not intended to, and do not, change the contractual relationship between the financial institution and its customer. The Procedures also specify that the DDR arrangements are not to be taken to require the customer's financial institution to debit the customer's account where doing so would be contrary to the customer's formal instructions to it. This means that if a customer notifies his or her financial institution that it is no longer to rely on the DDR, it is expected that the institution will act accordingly, consistent with its ordinary obligations to its customers.

5.3 The BECS Procedures were intended to provide a simple cancellation process, consistent with the DDR being held by the debit user, while at the same time recognising the right of the customer, within the "banker-customer" relationship, to give an instruction to his or her financial institution. However, the Procedures in some cases may not have adequately addressed the needs of customers in being able to simply and effectively cancel a DDR.

5.4 *APCA is reviewing consumer safeguards in its BECS Procedures. Amendments to the Procedures are being prepared to facilitate ledger institutions acting on a request by their customers to cancel a DDR. A small working group has already been formed to address this issue as a matter of urgency.*

We will keep you informed of progress.

6. CLAIMS AND DISPUTE PROCEDURES

Clarification of the Current Claims Process

- 6.1 One of the conclusions in the Issues Paper (p.81) is that “*Some banks discourage customers from initiating the dispute process at the bank and encourage the customer to try first with the debit user. This is despite the fact that once the process is initiated with the banks, the customer is guaranteed an outcome within 7 business days.*”.

The reason financial institutions encourage customers to first try and resolve a dispute with the debit user is because the BECS Procedures currently have that requirement.

- 6.2 The BECS Procedures’ provisions which encourage a customer to first approach the debit user to resolve any claim before initiating the claims process with his or her financial institution are as follows:

- the customer is to be advised by the debit user (through the DDR service agreement) to direct all queries about debits to the debit user in the first instance;
- the DDR service agreement is to set out in reasonable detail the procedures available to the customer to dispute any debit with the debit user;
- the DDR service agreement is to set out in reasonable detail the debit user’s dispute resolution process for its customers; and
- the customer’s financial institution is to ensure, to the extent it reasonably can, that the customer initially attempts to settle the matter directly with the debit user, before the customer lodges a claim with it.

- 6.3 The Issues Paper notes (p.78) that “*it is not easy to see what advantage a customer will gain by first approaching the direct debit user in circumstances where the user is under no obligation to respond speedily (or at all) ...*”. At the time the arrangements were being developed, it was expected that often the subject matter of the dispute would be in the direct knowledge of the debit user, rather than the customer’s financial institution, so that the debit user would usually be better placed to resolve a problem. Since the customer also has a commercial relationship with the debit user, it was thought at the time that it would be appropriate, and sensible, to have queries or disputes considered first by the debit user.

- 6.4 The BECS Procedures are not in conflict with ABIO guidelines on claims processes (detailed at pp.77-78). While they do encourage financial institutions to request their customers to first try to resolve a dispute with the debit user, they do not prevent the customer from lodging a claim with the financial institution.

Liability for Loss

- 6.5 APCA appreciates that the loss resulting from an unauthorised debit may be greater than the amount of the unauthorised debit. The DDR arrangements do not prevent a customer from claiming against the appropriate party for the total loss suffered as a result of an unauthorised debit, and the refund provisions of the BECS Procedures refer to the customer’s financial institution refunding the amount of the “claim”, which is not limited to the amount of the

unauthorised debit. The ABIO guideline referred to (p. 77-78) is consistent with this approach.

- 6.6 When the DDR arrangements were being developed, extensive consideration was given to introducing a claims procedure in the nature of a guaranteed refund to the customer on receipt of a customer's claim. The reasons this proposal did not proceed at the time related to concerns about business customers using a procedure intended for the benefit of consumers, and difficulties in obtaining the support of debit users to the concept.
- 6.7 Interim recommendations relating to the provision of a Direct Debit Guarantee similar to that in the UK, and additional obligations for customers' financial institutions, are noted.

APCA will review the guarantee provisions in the UK's scheme, and other recommendations in the Issues Paper, within the general review of consumer safeguards referred to at paragraph 5.4.

We will keep you informed of progress.

If you would like to discuss or clarify any of the information provided, please telephone me or APCA's Director Public Affairs, Jo-Anne Ryan, on (02) 9221-8944.

Yours sincerely

Peter Smith
CHIEF EXECUTIVE OFFICER

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