

**Review of Code of Banking Practice
Australian Bankers' Association
Headline Issues Response for Reviewer – December 2000**

Future Role of CBP

QUESTION: Are Codes the viable alternative to legislation as problems develop as ASIC believes?

On the broad view, ABA believes the Code should retain its simplicity, reflected by its current drafting, by providing for principles or benchmarks for good banking practice that, at the minimum, banks must meet. This allows for banks to adapt these principles or benchmarks to their particular business structures and operations and is more likely to create an environment where banks can actually compete on the means of achieving (and exceeding) them.

That said, there will be some provisions where principles alone may not suffice, such as the provisions relating to guarantees and we recognise this. In our discussions on 10 October 2000 the issues of training and service standards were considered. ABA indicated its preference for non-prescriptive, “outcome “ orientated principles with banks devising for themselves how those standards might be achieved. We continue to support that position.

A Code that is shaped this way will be easy to understand, both by customers and bank staff, because of its lack of complexity.

Taking the particular issue of the FSR, it is reasonable to assume that once the FSR has been finalised the major disclosure obligations will be contained in legislation. This can be contrasted with 1993 when the Code was formulated when there were no nationally uniform disclosure laws.

A possible problem with the FSR is the lack of detail that delineates a licensee's disclosure obligations. This “detailing” is a task that is achievable by one or a combination of regulations, ASIC policy statements, codes or simply leaving it to licensees to devise their own detailed compliance arrangements.

One possible way for accommodating the FSR requirements under the Code would be to explain in the Code how each of the existing Code provisions satisfies the FSR PDS requirements. This would avoid the “detail” appearing in the Code. This would be an extension of the “signposting” function. It would aid consistency and retain provisions that are already familiar to banks and the community.

ABA believes the Code is not the best way to tease out the detail in the FSR legislation. The job of deciding what should be the law is the job of government or, more correctly, the parliament, not industry or even regulators. We agree with the Reviewer's concerns over the practicalities of the Code operating as *de facto* sub-ordinate regulation because from experience, the time it takes to amend a code is quite lengthy.

Also, with a voluntary code, there could be consumer confusion if non-subscribing entities adopted their own but different standards of detail or other ADIs adopted codes with different standards of detail.

The level of detail required to specify and “fill out” for example the disclosure requirements for the PDS could be very specific leading the Code to become a highly complex statement of prescribed rights and responsibilities. This would lead to the Code being an inflexible document that would not be “reader friendly”. Recent examples of this prescriptive approach are found in the areas of life insurance and superannuation.

There is general agreement that the Code should “signpost” the reader to the existence of disclosure laws rather than re-invent them. The Code could provide “gap” coverage between laws and community expectations where those “gaps” are identified and agreed. This would be achieved through a process of engagement with the relevant stakeholders.

We strongly believe that the Code should operate as an instrument to improve standards of conduct and provide consumers with a point of reference for this. In other words, we see the Code not as a tool for complying with the law, but rather something that customers can rely on as regards the behaviour of banks toward them that is not necessarily dealt with by the law.

Monitoring and Administration

QUESTION: What model do banks consider suitable to meet the need for transparency and accountability in compliance monitoring and administration under Code?

The Reviewer believes compliance should be demonstrable and “marking one's own card” on its own lacks this quality. Another model should be considered.

Models include oversight by

- Regulator
- Industry
- Independent third parties e.g. auditors.

In the UK the Banking Code Standards Board monitors compliance with the UK Banking Code. Its board is comprised of a majority of independent directors and representatives from banks and building societies.

ASIC currently has a (less than clear) statutory role under section 12FA of the ASIC Act 1989 to monitor and promote market integrity and consumer protection in relation to the Australian financial system and the provision of financial services. This includes

monitoring compliance with industry standards and codes of practice. ASIC took over from the APSC in 1998 the role of compliance monitoring of CBP. There is some member support for this agency to fulfil this role with certain modifications. ASIC's view would be relevant here if it were to be both the market regulator and the compliance monitor and how it saw these roles working together.

ASIC has submitted that improvement could be made to the current monitoring process and plans to review the process once the Code is finalised. This, of course, may mean little if the final outcome of the Code review is that another monitoring model is implemented. However, there could be improvements to the monitoring of compliance with the Code building on the current practice of "marking one's own card" with ASIC directing targeted external monitoring (audits) where there might be evidence of non-compliance.

ABIO could serve this role but its directors are not supportive of this role for ABIO.

Alternatively, the Council of the ABIO could undertake this function given its composition. There is some support for this approach but within the membership of ABA there is a strong view to the contrary about any ABIO involvement in this function. This is relevant to both organs of ABIO. The concern is that a quasi-judicial body, such as ABIO, would become involved in auditing the practices of banks whose decisions it is required to critically examine in the course of dispute resolution.

Member banks would not be supportive of a new monitoring entity being set up for this purpose.

There is no single view among our members on the best model for monitoring and administering the Code. Our members do agree that there needs to be greater transparency achieved through some external scrutiny of the self-assessment process but avoiding inefficiency and disproportionate cost. This external scrutiny would extend beyond just compliance assessment on the basis of complaints or disputes and extend to compliance generally irrespective of whether a complaint has been made. We believe that the "how" should be able to be sorted out through a consultative process with relevant stakeholders at a later time.

Principle of "Fairness"

QUESTION: How is "fairness" working under the NZ Code? How does ABIO manage consideration of fairness under its terms of reference?

Our members aim to treat their customers fairly. At issue is, what is meant by "fairness" in the context of a Code that gives rise to contractual and other legal obligations that necessarily involve a desire for some precision. "Fairness" is a subjective concept that will vary from circumstance to circumstance.

An example of the subjectivity of “fairness” as a test under the Code would be where a bank closes a branch and the effect on one customer is substantial. Must the bank maintain the branch under a contractual obligation to that customer to act fairly?

“Fairness” appears in the NZ banking Code but is heavily qualified. Reports are that it has not raised any significant problems. The New Zealand Code provides, relevantly, Section 1.7, the governing principles and objectives of the code:

1.7.2 (iv) act fairly and reasonably towards you, our customers, in a consistent and ethical manner.

1.7.3 What may be fair and reasonable in any case must depend on all the circumstances of the particular case, but we will take into account, among other things:

(i) Our conduct and yours, having regard to the fact that the relationship between banks and their customers is contractual, with mutual rights and obligations:

(ii) The steps taken by us to ascertain your needs in order to enable you to make the choice that best meets your needs; and

(iii) Compliance with this Code of Banking Practice

With these qualifications that clarify the contextual application of the principle of “fairness” the reported lack of significant problems in New Zealand is, perhaps, understandable.

We are awaiting information from the British Bankers Association on its inclusion in the UK Banking Code.

The ABIO has a guideline for administering the notion of fairness in its decision-making role. It allows the Ombudsman to make a decision which:

- *Takes into account the specific circumstances of a case which may justify not applying the law rigidly;*
- *Allows for a balancing or weighting of the information available;*
- *Recognises the possibility of a higher standard of care being placed on a bank by the requirements of good banking practice in certain circumstances;*
- *May excuse one or both of the parties for minor breaches which might otherwise lead to harsh results in the circumstances; and*
- *Takes account of any uncertainty in the facts, the law or good banking practice as they apply to a particular case.*

We believe that despite the legal and practical complexities of applying the “fairness” principle, the above examples show how the notion of “fairness” can be accommodated in the Code without detracting from the overall objective.

Scope of the Code

QUESTION: Why can't the Small Business Principles be incorporated into the Code? Are there disclosure principles in the SBPs that could be incorporated into the Code?

Ultimately, ABIO will entertain disputes between banks and small business customers as they will be defined under the FSR Act once it has become law. The ABIO scheme already has been extended to cover some incorporated small business complaints.

ABA acknowledges there are community expectations that small businesses should enjoy some of the protections that a range of service providers, including banks, already provide to individual consumers. The SBPs cover small business issues, particularly credit. The ABIO is able to take account of the SBPs in determining disputes concerning small businesses that the scheme currently is able to entertain under its terms of reference.

If the SBPs were incorporated in to the Code they would be confined to small businesses. They would presumably have to stand in the Code separately from some personal banking provisions. Incorporating them would be to adopt a compendium approach to the Code. If this were done there would be a preference for them to be incorporated in a separate part or chapter to reflect the different nature of small business banking. As an alternative, the Code could be simply a "signpost" to the SBPs. For business borrowers, there are parts of Principle 1 and all of Principles 5, 6, 8, 9 and 10 that deal with borrowing. There are some of them that do not really apply in a purely individual personal banking relationship, for example the ongoing provision of financial statements and facility review provisions.

The Reviewer has acknowledged that, in the case of credit, the Code should not introduce, through its terms, a regime comparable to the UCCC to cover small business.

If the Reviewer decides that no distinction should be drawn between personal and small business banking, presumably, once the range of customers covered by the Code is defined, there would be no longer any need to differentiate the types of transaction they undertake i.e personal/private, business, investment and so on. They would all be covered because of the type of customer. It is perhaps neater to have the Code "signpost" the SBPs for small businesses and "signpost" the non-business borrower to the UCCC.

ABA suggests that if small business is to be covered under the Code, there should be a provision in the Code, similar to one in the UCCC that the point in time for determining the customer's status as a small business should be the time when the contract is made. We understand the FSR is to take a similar approach. Otherwise, if unknown to the bank, the status of the customer changed during the course of the contract the bank could find itself unwittingly in breach of the Code.

If small business is to be defined under the Code, ABA would be keen to see the definition as consistent as possible across relevant codes and legislation. The preferred position would be to adopt whatever the FSR defines to be a “retail client”. This is consistent with what the ABIO is to do. Over time, it can be expected that other codes and so on will move to adopt this single definition.

Small business customers tend to require a greater degree of flexibility in product design and application. Whilst some of the protections afforded to non-business customers could apply equally to small business customers, we mention that the SBPs were written in recognition of the need to preserve this flexibility.

Banking Services

QUESTION: Are there any issues with an approach that “banking service” should mean a bank’s conduct in everything that the bank sells that should be made known to the Reviewer?

The Reviewer favours the Code “signposting” that other entities in bank groups (but not the bank entity) are bound by other sectoral codes e.g General Insurance Code of Practice.

He believes the Code should not apply to the non-banking products themselves but possibly to the conduct of bank staff engaged in the selling activity of the non-bank entity products. ABA agrees that the Code should not apply to non-bank entity products. It should apply only to banking products.

However, there is a view that it may prove very difficult to have the Code’s provisions differentiate between the activity of selling a product and the product itself. For example, if the provisions of section 6.1 are retained how would the clause distinguish between general descriptive information about a strictly bank product and one where the bank is not the issuer of the product?

There is a close correlation here with the FSR regime where licensees will have to ensure that their authorised representatives are competent to engage in such activities. In this sense there is there would be no “gap” to cover.

There is the possibility that extension of “banking products” under the Code as suggested could stray into legislated areas of market conduct in regard to non-banking products such as insurance or travellers cheques. For example, in a one-off sale of travellers cheques that are the product of a non-related entity, under FSR the bank would have to supply the PDS for the product plus the FSG disclosing the commission arrangements.

This risk can be minimised at the time of re-drafting the Code by, for example “signposting” that legislation.

Non-Consumer Credit

QUESTION: What assistance can ABA provide to the Reviewer on this issue? Are the SBPs an appropriate source for a solution?

This issue links back to the scope of the Code and the proposal to include small business generally.

We refer to our comments above dealing with the Small Business Principles. If there was to be small business coverage for credit products, we believe there will be the need, for reasons already set out above, for some segmentation, perhaps two separate sections dealing with the issues.

Complaints and Disputes

QUESTION: Should the Code clause 20.1 be a more forward-looking requirement and what might it say?

The Reviewer says that Code clause 20.1 cannot stand in its present form. It does not cover the situation where a bank simply fails to respond to a complaint and the submission of a complaint to an IDR process does not have to occur until the bank's response is given. ABA would support an appropriate time limit being imposed on a response to a complaint after which the complaint becomes a "dispute".

Also, we support the Code stating clearly the IDR requirement, referring to the relevant standard and including a requirement to make the existence and the detail of IDR well known to consumers.

ABA endorses a more proactive approach on IDR processes. The FSR will overlap with this provision. The FSR will not cover small business credit. The Code could state affirmatively that a bank's IDR process will apply to all customers covered by the Code irrespective of whether the FSR applies.

Some suggested issues for inclusion in an enhanced IDR provision in the Code are:

- Broadening the scope of IDR starting with the complaint once it has been first made;
- Describing the key parameters or features of the IDR (this could include where the ABIO fits into the scheme of things);
- Guidelines for better informing the complainant when the dispute is acknowledged;
- Setting response time service standards for each step of the process (with a facility to reasonably extend time and advising the complainant so that resolving the complaint is given every chance of success whilst not cut short by arbitrary time limits);
- Guidelines for communication channels for ongoing contact with the complainant through the process;
- Key responsibilities for those bank staff entrusted with the carriage of the complaint;

- Staff training (but see later comments); and.
- Achieving at least the Australian Standard for IDR processes.

Training of Staff

QUESTION: How much and what detail should be included in the Code on training and competence?

The Reviewer believes that the focus should be on “competence” rather than training. Training is a process with the objective being competent staff.

Competency would extend to lending/credit products.

FSR will require licensees to ensure that their representatives are adequately trained and are competent to provide financial services.

ABA supports the principle that training must be an “outcome” focused obligation. We agree that staff should be trained so that they are competent to provide the financial services that they are authorised by the bank to provide. The FSR will impose this obligation on banks as licensees. The obligation will extend not only to staff training but also to authorised representatives.

For these reasons, there would appear to be no point in the Code prescribing training details. It could “signpost” the FSR requirement. On another but related point, the more detailed and prescriptive the Code is the harder it will be to ensure that staff are adequately trained. It increases the prospect of non-compliance due to its complexity.

Guarantees

QUESTION: What information should be disclosed by the bank to a prospective guarantor? Should this envisage things such as a prominent written warning in the guarantee, an obligation to obtain the borrower’s explicit consent to disclosing relevant information to the prospective guarantor, advising prospective guarantors to seek independent financial advice, ongoing information like statements of account, demand notices etc?

The Reviewer believes that Clause 17 of the Code is too narrow, particularly its limitation on guarantors who may have an interest in the borrowing entity.

He believes the Code should contain a promise that adequate information including the risk of giving the guarantee generally and pertaining to the particular case should be given to the prospective guarantor. The Reviewer suggests that independent legal advice on its own is not enough. There must be provision of relevant information as well to ensure that advice is complete.

Banks believe the current Code provisions on guarantees are too complicated. Also, banks have concerns about taking on a “duty of care” as advisors to the prospective guarantor and to the conflict of interest banks have in advising on whilst reaping the benefit of the guarantee.

ABA supports the idea of all guarantors receiving relevant and adequate pre-contractual information. A general obligation to provide “relevant information” is too vague. Possibly, the point here is whether the bank actually knows of some circumstance concerning the borrower that, if this circumstance were made known to the prospective guarantor, the guarantee would be refused or the terms on which it would be given would be changed. This approach would require further detailed consideration by members, particularly the legal issues, which we are prepared to do.

To avoid the conflict of interest difficulty and ensure a level of consistency, a short “warning” document could be given to a prospective guarantor together with a copy of the contract to be guaranteed. The “warning” could include extra information such as

- The guaranteed amount
- What else the liability extends to e.g. interest and expenses
- That the guarantee is not limited to the value of any security taken for the advance; there could be a shortfall and the guarantor may have to pay,
- A strong recommendation to get legal and financial advice from people who are not advising or associated with the borrower.

The minimum terms of the “warning” could be written in the Code.

There is case law to support a guarantor’s right to:

- Have disclosed by the bank to the guarantor without enquiry any “unusual matters” and for the bank to answer specific questions put to it by the prospective guarantor, for example, whether the account to be guaranteed is operating within arrangements, (Goodwin v National Australia Bank (1968-69) 42 ALJR 110 and applied by Gibbs CJ in Amadio v Commercial Bank of Australia (1982-1983) 151 CLR 447 at 455); and
- Obtain information as to the balance then owing, the rate of interest being charged and the amount, if any, realised by the bank in respect of collateral security on the principal debtor’s guaranteed account (Ross v Bank of New South Wales (1928) 28 SR NSW 539).

These rights are available to the guarantor either before or after the guarantee is signed and could be incorporated by reference in the Code.

Statements of account and notices of demand provided to the guarantor during the currency of the facility and during enforcement phase could be a way of keeping the guarantor informed of the status of the guaranteed debt. The borrower’s consent would be required for this because of the bank’s duty of confidentiality to the borrower customer. This could be obtained either in or with the original application form or in the loan contract itself.

Most banks recommend or, in some cases, insist that a prospective guarantor obtains independent legal advice before committing to the guarantee and we support retaining in the Code at least the recommendation for the prospective guarantor to take legal advice.

Supplementary Issues

Shadow ledgers: The Code provisions should go no further than to require a bank to automatically provide customers (including borrowers, regardless of the status of their loans) with timely, accurate and regular statements of account, with the exceptions that currently appear in clause 14.1 of the Code. This is one of two alternative recommendations made by the ACCC (Brisbane Office) submission to this review.

Branch Closures: ABA supports the inclusion in the Code of a provision comparable with clause 16 of the UK Banking Code that recognises that different notice periods might apply depending on whether the branch to be closed is in an urban or rural area.

Single Code for all ADIs: ABA believes that this is premature and that time should be allowed for the financial services reforms including FSR to settle down before a decision is taken. Also this proposal would involve extensive discussions with other industry bodies that could delay the implementation of Code reforms

Prospective customers: Because of the diversity of products and the range of options customers have to “customise” the product to their needs this would be difficult to do. Banks could provide pre-printed terms and conditions that would apply to the product including the standard range of fees and charges applicable to the product. This, of course, would have to be qualified by stating that these could change if the features of the product were changed owing to the customer’s needs or for example another product is taken in conjunction with the first product etc. Our point here is that the general features and terms and conditions of a product could change from the general to the specific once an “offer” for the product is made. In the U.K. Banking Code, clause 3.1, there is stated a simple information process that starts with a general enquiry that might trigger the bank providing information on the key features of a product or service proceeding to a more specific pre-contractual disclosure if the person has already made up their mind about a product. This seems to us a sensible and workable approach. We mention the FSR here, because it will require the PDS to be provided for ordinary banking (non-credit) products with the FSG and SOA (where relevant) for the more complex investment products. Perhaps the Code would “signpost” these requirements.

Advertising: There are no reported compliance difficulties that would necessitate amending clause 18.2 or its deletion from the Code. ABA supports its retention.

Further Requests for Comments.

UK Banking Code.

ABA supports plain language drafting style for ease of reading for both customers and staff.

Clause 2.1 (b). ABA agrees that the terms and conditions of products and services should reflect the provisions of the Code even though they may not use the terminology of the Code.

Clause 2.1 (a). See our comments on “fairness” above.

Clause 6.1. Subject to comments above on “fairness” ABA supports the view that terms and conditions should be fair in the sense that they set out clearly obligations, legitimate terms particularly as regards the risk undertaken and they are otherwise just and equitable. This extends to the manner in which they are presented. We assume that matters such as pricing decisions are not contemplated to be covered by such a provision.

Clause 15 Financial Difficulties. There is a similar provision in the Small Business Principles that ABA members do support. In clause 15.2 of the UK Code we take the words “We will do all we can to help you overcome your difficulties” leaves the bank’s commercial judgment intact in the sense that if the bank believes that, for example, a borrower’s business is not viable or the business will never be able to service the debt, there is nothing in reality the bank can do but explore ways of reducing the liability or liquidating it through enforcement. “Help” to the borrower may in fact be the appointment of an administrator particularly where there is the real prospect that the borrower may be trading whilst insolvent. In other cases the bank may undertake a “workout” to the extent that is feasible. We are concerned about the need to avoid the bank becoming the adviser to the customer, as there are clear conflicts of interest involved. We assume this is the intent of the provision i.e that the bank will not arbitrarily or capriciously rule out exploring with the customer in difficulty possible alternative measures and in this sense the provision would be supported.

Also, the U.K. provision, through imprecise drafting, could create unrealistic expectations by customers about the extent that the bank should legitimately go to assist them. This type of provision could lead to otherwise avoidable and unnecessary disputes.

Clause 16 Branch Closures - The UK Code clause 16 is simple, to the point and is therefore attractive. We refer to our comments above.

Clause 18 Monitoring and compliance – please refer to our comments above under “Monitoring and Administration”

Direct Debit Guarantee

The Joint Submission from six key consumer groups dated September 2000 suggests that this Code review should examine ways of simplifying the cancellation of direct debit facilities, in particular, where the customer notifies the bank that the authority is revoked.

The direct debit guarantee under the U.K. Code casts upon the processor of the debit (the bank) a reinstatement obligation if an amount has been wrongly taken from the account and the bank is told about it. It is not quite clear whether the reinstatement obligation arises on the mere allegation that a wrongful debit has occurred or once the fact that it was wrongful has been established.

ABA would fully support a provision in the Code that the bank must rectify its own error immediately that is made known to it.

We would support exploring alternative means of assisting customers with cancellations of direct debit authorities as recommended in the Joint Consumer submission.