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Reviewing the Code of Banking Practice in the New Environment

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REVIEWING THE CODE OF BANKING PRACTICE IN THE NEW ENVIRONMENT

Introduction

The first review of the Code of Banking Practice commenced on 12 May 2000. The Terms of Reference for the review are set out at the end of this paper.

The background against which the current review of the Code of Banking Practice has been carried out is remarkably different from that which prevailed when the Code was first adopted. There have been fundamental changes in expectations of what a modern code of practice ought to contain. There have also been changes in expectations of the processes which should be followed when reviews of codes are conducted.

In my view the principal driving force behind these changes has been a growing body of opinion during the 1990s that to a large extent codes of practice were failing to meet the objectives enunciated by those who promoted them. I think it is worth spending a few minutes looking at some of the developments which led to the recognition that codes need to meet certain standards and to be formulated by more open processes, if they are to achieve their objectives.

But first a few observations on the development of our Code of Banking Practice. In 1992 and 1993 when the Code was put together, there were no detailed or accepted standards for codes of practice, at least in the financial services sector. The Trade Practices Commission was yet to issue its guidelines for industry codes of practice. There were also no mandatory consultation requirements. Indeed, as we know, while there was initially a representative task force which prepared two drafts of a code, the Code finally adopted by the banks in November 1993 was not a version developed by the task force but rather one developed by ABA itself.

In all of these circumstances, it is, at least in hindsight, no real surprise that the existing Code contains little by way of administration, independent monitoring or sanctions, and has a number of clauses which fall short of creating finite obligations.

Changes since 1993

Since 1993 a great deal of change has occurred in this country and in the United Kingdom with respect to the standards expected to be met by self regulatory schemes and especially codes of practice.

In Australia we first had the Trade Practices Commission's guidelines to which I have already referred. These were followed by the guide issued in 1998 by Commonwealth, State and Territory Consumer Affairs Agencies entitled "FAIR TRADING Codes of Conduct: *Why have them, how to prepare them?*" The importance of matching modern standards in codes of practice is also one of the themes of the December 2000 report of the Taskforce on Industry Self – Regulation tabled in the Federal Parliament by the Minister for Financial Services, The Hon. Joe Hockey. Cumulatively, these developments have made it inevitable that the Code of Banking Practice must undergo very substantial change in the course of this review if it is to gain significant recognition and relevance.

There have been very significant developments in the United Kingdom. In February 1998 the UK Office of Fair Trading published a report entitled "Raising Standards of Consumer Care – Progressing Beyond Codes of Practice". There had been a forerunner to that report, namely the December 1996 consultation paper entitled "Voluntary Codes of Practice". There had also been extensive surveys of consumers to ascertain the extent to which consumers were aware of industry codes of practice or codes of conduct and measure consumer sentiment about the worth of such codes. There were also research projects to measure the extent to which codes were being flouted or disregarded by signatories. The conclusion reached by all this research was alarming. It demonstrated that with some notable exceptions codes of practice in the UK had generally failed to achieve their objectives.

These studies found:

- there was low consumer awareness and a lack of monitoring and sanctions;
- in many industries trade associations were reluctant to set minimum standards of conduct unless all members of the industry would subscribe;
- industry associations and like bodies were reluctant to expel members not living up to their obligations because of the loss of fee income, the likelihood that the expulsion of members would bring adverse publicity on the whole industry and finally the risk that once expelled a member concerned might do the industry's reputation even more damage.

Turning now specifically to the banking industry in United Kingdom, the Cruickshank review of UK banking services was launched in January 1999. One recommendation proposed establishing an independent financial services consumer council covering all financial services. Another was that the rules of the new Financial Services Ombudsman scheme should specify that the Ombudsman is to draw up consumer guidelines which would then be used to determine in dispute resolution whether banking suppliers actions are fair and reasonable.

In its response to the report the government acknowledged that the Cruickshank report raised serious concerns about whether current self-regulatory approaches such as the Banking Code were delivering real benefits for consumers. The following quote from the government-spokesman may strike you as somewhat prophetic in our context:

> "the government welcomes the steps the industry has taken to improve compliance with the Code and in particular the independent scrutiny recently introduced by the Banking Code Standards Board. However the first survey by the Board found worryingly low levels of compliance on some other key aspects of the Code especially in relation to the disclosure of information to consumers. The government resolved to establish a small review group of five to seven members with representatives from consumer groups, the industry and other affected parties to examine:

- whether the voluntary codes are delivering sufficiently strong benefit consumers;
- what scope there is to introduce greater independence and consumer representation in the drawing up of codes;
- what role there is for the Ombudsman in influencing or determining standards for consumers; and
- whether greater information disclosure can be achieved without the need for further regulation."

The first Banking Code in the United Kingdom was established in 1991. There have since been three revised versions. The second last version commenced on 31 March 1999 and the current version was launched in September 2000 to take effect from 1 January 2001. However it appears that the government is still far from satisfied that the UK Banking Code is delivering the needed benefits to consumers. On 8 November 2000 the UK Economic Secretary announced a review of all industry codes of practice in the banking and financial services sector. Dr Julius, Chairman of the Banking Services Consumer Code Review Group, remarked when launching the review:

> "Despite long experience with Banking Codes, the Cruickshank Report found that many customers are concerned about the level of service they get from banks and building societies.
>
> They are confused about what is on offer and may sometimes find complaints are not followed up.
>
> We need to see whether the voluntary codes are doing enough to help consumers and consider the scope for improvements."

Dr Julius then called for views on seven key issues concerning the codes:

- is the consultation process of drawing them unsatisfactory?
- do they cover all issues that they should?
- are they fully complied with by the industry?
- are they monitored and enforce effective?
- do they offer adequate redress for legitimate grievances?
- could consumers the better informed about what their rights are?

- do customers need more information or more clearly presented information?

The 2001 version of the UK banking Code is a modern plain English document which in both form and content is markedly superior to our present Code. In these circumstances, that the UK still considers it essential to ask such basic questions about the adequacy of the 2001 Code may illustrate how far our banking code may have to move to meet legitimate community expectations.

What modern codes of practice can achieve

Codes of practice can serve a number of extremely useful purposes as the following passage from the guide "FAIR TRADING Codes of Conduct: *Why have them, how to prepare them*" referred to earlier shows:

> "Fair Trading codes of conduct can deliver large benefits for both business and consumers. While they advance consumer confidence in products and individual companies, they also promote good business practices. Properly conceived and drafted, they are as much a positive tool for industry as a safeguard for consumers.
>
> "**Benefits**
>
> "Codes offer a comprehensive range of benefits:
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> - Developed voluntarily on the initiative of an industry, they can provide a flexible, cost effective approach to problem areas. Market failure problems can be addressed on an industry-wide basis, and so enhance the competitive process. Also, by addressing recurring or structural problems, codes can establish a form of industry quality control. They offer the flexibility and sensitivity to market circumstances necessary for product innovation, diversification and development.
> - They can address industry specific problems and practices and consumer needs and can respond more readily to the dynamics of the market place.
> - Members of an industry can feel some ownership over the regulation of that industry.
> - Codes developed by industry in consultation with consumer affairs agencies and consumer/user groups can set agreed quality standards of work which can serve as a benchmark in settling disputes between industry members and consumers. They can provide public access to quick and informal complaint handling and redress mechanisms.

- They can provide a positive guide for ethical traders on agreed best practice benchmarks - going further than outlining minimum legal behaviour. They provide a sector of an industry wishing to gain a competitive advantage with the means to contend that it meets higher standards of fair trading than others in the industry.
- Adherence to a code of conduct written as a condition of a contract allows for a private right of action for remedies when there is a breach of the code."

But it is an essential prerequisite to obtaining the benefits listed above for there to be demonstrable reasons for consumers and regulators (as well of course for industry participants) to have confidence that there will be a high level of compliance with the code and that breaches of the code will result in adequate sanctions being imposed. This is, in my view, all the more essential if the banking industry wishes its code to be seen as an effective alternative to black letter law or other regulatory intrusions in providing solutions to practical problems.

Consumer and Regulatory views of the current Code

It is obvious from the submissions received from the voluntary consumer agencies and the public generally that the Code is held in very poor regard indeed. Universal criticisms are absence of independent monitoring of compliance and adequate sanctions and the failures by banks to support and promote their Code and to train bank staff adequately in Code requirements, especially in the areas of compliant handling and internal dispute resolution.

These submissions identify a major problem. Consumer representatives argue that in failing to properly monitor code compliance and by failing to promote and support the Code, banks are demonstrating that they do not regard the Code as important. I have to say that my experiences early in the Code review process gave me a similar impression. Banks did not seem particularly interested in the Review and only four formal submissions were received. None of these was extensive and there was little evidence that they had attempted to familiarise themselves with the developments in code of practice issues since the Code was adopted in 1993.

Another frequent criticism encountered during the review was that no attempt appears to have been made by the industry to use its Code to address problem areas. A brief look at three well-known problem areas may illustrate this point.

Guarantees

Research carried out in the course of the Review* indicated that there are substantial shortcomings in the protections provided to persons being asked to guarantee obligations of bank customers. Although the Issues Paper identifies a number of deficiencies in clause 17, the most obvious and significant shortcoming arises from the exclusion from the operation of clause 17 of guarantees which are commonly taken to support loans to family businesses. Whatever may have been the original justification for this exclusion, the failure to address it when the banks took their much publicised decision to introduce the "Set of Principles – Banks and Small Business working together" inevitably calls into question the extent of commitment to an effective Code.

Subsidiary Cards

Consumer representatives have long complained that banks refuse to take reasonable steps to assist a primary cardholder who is seeking to cancel a subsidiary card but is unable to surrender the subsidiary card to the issuing bank. The practice has been for banks to rely on the terms and conditions of the primary cardholder's contract which oblige them to cancel a subsidiary card only if it is returned to the bank. As a consequence, the primary cardholder is exposed to liability for further transactions effected by the use of the subsidiary card.

Experienced consumer advocates advise that in practice there is little difficulty getting a practical solution; the card is simply reported as lost or stolen. But they also add that the fact that this device works simply exposes the unwillingness of banks to genuinely assist the customer. Consumer advocates

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* I am grateful for the valuable research and advice provided for the Review on the law of guarantees, joint accounts and mutuality and set-off by Dr. Elizabeth Lanyon, Faculty of Law, Monash University.

are aware that Code clause 16.2 (ii) requires a bank to inform the primary cardholder of the fact that cancellation of the subsidiary card may not be effective until the card is surrendered but they argue that, having regard to the practicalities of the situation as analysed above, this has become a case where the banks are in effect using the Code to justify frustrating consumers.

Complaint handling and dispute resolution

In the course of my review it became apparent that there are widely divergent practices among banks with respect to complaint handling. At a practical level this means that customers from bank X have little or no difficulty getting their complaints resolved under X bank's internal dispute resolution process but customers of bank Y find the same task impossible. The relevant clause in the Code, clause 20, is not in ideal terms. It provides that "A dispute arises where a bank's response to a complaint by a customer about a Banking Service provided to that Customer is not accepted by that Customer". It is glaringly obvious that as a consequence nothing in clause 20 casts any obligation on a Bank to deal with a customer's complaint until the bank provided a response to the complaint. Thus it appears that a bank can frustrate its customers simply by refusing to respond to the initial complaint. This is an entirely unacceptable outcome for a code of practice.

Where to from here

From all of this, it appears that the current perceptions of the Code of Banking Practice could be summarised in the following way:

- The Code has not been seriously supported by the industry;
- There has been no sense of the industry wanting to enhance its Code or use it as a means of dealing with new issues;
- The Code has not succeeded in improving bank/customer relationships;
- The Code has become largely irrelevant to banks and consumers alike.

Despite all that I have said here today I am very hopeful that there will be a significant change for the better. Banks have indicated that they are now

seriously considering the recommendations made in the Issues Paper. Within days of the release of the Issues Paper, Mr David Bell, Chief Executive of the Australian Bankers' Association announced that the banking industry considered most of the recommendations in the issues paper made good banking sense. On the critical area of Code administration and monitoring the banks indicated in December 2000 that they conceded that the present arrangement whereby banks do their own assessment of their compliance with the Code was unsatisfactory and that a more transparent independent system of monitoring was required.

It is difficult to overstate the importance of that change in attitude. In my view once the industry publicly recognises that effective, independent and transparent monitoring is essential and is prepared to incorporate provisions to that effect in its Code, that will be seen as a very significant change. It will surely encourage all stakeholders to engage in a consultative process which is genuinely directed towards the creation of a Code of Banking Practice which meets today's expectations.

If however banks fail to take this chance to get their Code right, pressure for some more coercive means of improving bank customer relationships may be irresistible. However I am sure that the banks are aware of this now, particularly as the government has publicly supported the review process and has given some general endorsement of its recommendations.

I do not believe that banks will let this opportunity go past.

APPENDIX 1: TERMS OF REFERENCE REVIEW OF BANKING CODE OF PRACTICE

1. The Code of Banking Practice (CBP) is an instrument of banking self-regulation. CBP was first published in November 1993. With the agreement of the Federal Treasurer, CBP became fully operative from 1 November 1996.
2. CBP is to be reviewed every three years in accordance with the Objectives and Principles set out in the Preamble to CBP and having regard to the views of interested parties.
3. **The Objectives of CBP.**
   CBP is intended to
   (i) describe standards of good practice and service;
   (ii) promote disclosure of information relevant and useful to Customers;
   (iii) promote informed and effective relationships between Banks and Customers; and
   (iv) require Banks to have procedures for resolution of disputes between Banks and Customers.
4. **The Principles of CBP.**
   The Objectives are to be achieved
   (i) having regard to the paramount requirement of Banks to act in accordance with prudential standards necessary to preserve the stability and integrity of the Australian banking system;
   (ii) consistently with the current law and so as to preserve certainty of contract between a Bank and its Customer; and
   (iii) so as to allow for flexibility in products and services and in competitive pricing.
5. The relevance and operation of CBP and its provisions will be reviewed in accordance with the Objectives and Principles stated above having regard to:
   - the views of interested parties;
   - government policies;
   - changes which have occurred in the legal and regulatory environment (including self-regulation);
   - changes which have occurred in the banking services market and in the needs and behaviour of consumers as a whole;
   - consistency with relevant self-regulatory and regulatory measures; and
   - anticipated changes in the banking services market in the next three years.
6. The independent person appointed to oversee and direct the review is to report findings and recommendations to ABA as close as practicable to 31 August 2000. ABA will publish the report.