CURRENT DEVELOPMENTS IN BANKING LAW

Recent Developments in Consumer Protection — The New Code of Banking Practice

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INTRODUCTION

Thank you for the opportunity to participate in the 1993 Banking Law and Practice Conference and to speak on progress with the banking code of conduct. I welcome the opportunity to respond to George Weaver's important and thoughtful paper. I congratulate him on the extent to which he has been able to analyse and provide insights into the issues addressed by the November draft of the code.

George Weaver acknowledges in his paper that he has focused on criticisms rather than compliments and his perspectives on and criticisms of the draft code will be very useful to the task force in the further development of the code.

I should emphasise, however, that I am speaking in a private capacity today and my comments should not be taken as necessarily representing the views of the task force or the Government.

MEETING THE OBJECTIVES OF THE BANKING CODE

In discussing the issues raised in the paper, we need to keep our attention focused clearly on what the banking code is seeking to achieve. These are set out in paragraph 3.1 of the draft code. However, the underlying objective of the code is to improve the banker/customer relationship by providing relevant comprehensible information to customers on bank products and the legal rights and obligations they involve.

The objective of the code is therefore to prevent problems from occurring in the first place through improved understanding on the part of bank staff and customers, thus reducing complaints and disputes and the need for many cases to go to arbitration or the courts.

While the paper provides a number of constructive criticisms of the November draft, it stops short of offering positive suggestions about how many of the difficulties it identifies might be overcome in order to address the objective of improved information disclosure more effectively. Rather the reader is left with the impression that many of the legal and retail banking matters the code seeks to address are far too complex to be explained to or understood by bank customers and should be left largely to bankers and their legal advisers as has been the practice in the past. In that sense the paper sidesteps the difficult issues that the code is seeking to address.

George Weaver rightly points out that the drafters of the code have embarked on a difficult, even dangerous, undertaking given the complexity of the issues. But that is the challenge for the banking code and for the task force, financial institutions and their legal advisers.

A similar challenge is facing the insurance industry today and life offices in particular are now accepting the need to develop plain English contracts and documentation and to communicate more effectively with their policy holders about their products and their legal implications. The same criticisms are being made in that sector but the process goes on largely because marketplace pressures and the consumers of financial products and services in particular are demanding better information about their products and their legal rights and remedies.

PROCESSES AND CURRENT STATUS OF THE BANKING CODE

A task force of TPC, Treasury, FBCA and RBA was established to facilitate consultation, negotiation and drafting of the code.

Consultation has occurred/will continue with:

- financial institutions/their associations
- consumer groups
- pensioner organisations
- State/Territory consumer affairs departments.

An issues paper was circulated to those groups for comment in July and there were bilateral meetings with all interest groups in July.

A round table meeting with all representative groups was held in August to discuss the issues/approach to the code.

The task force circulated a first draft of the code in November which sought to reflect those discussions. The draft was intended to provide an initial basis for further detailed discussion and the parties were advised that there was flexibility to change it to reflect criticisms, practical problems and suggestions for improvement.

Meetings were held with consumer pensioner groups and non-bank financial institutions in December to obtain their comments. But major banks expressed fundamental concerns and refused to discuss the draft prior to the election. In early April there was a meeting with ABA representatives to obtain their comments on the code.

The task force is now preparing a revised draft of the code to reflect the views provided which will be circulated for further discussion with interest groups about the end of May. The broad structure and content of the code remains the same but many drafting changes and other changes have been made to reflect practical banking and other problems raised with the task force.

The next round of discussions/negotiations should occur in June and the hope is to be able to reach final agreement on the code by about August 1993. However, much will depend on the reaction of the financial institutions to the next draft.

CONTENTIOUS AREAS OF THE NOVEMBER DRAFT

In the initial round of discussions on the November draft the following issues proved to be the most contentious:

- enforceability of the code through terms and conditions documents including a warranty that other code provisions would be observed;

- the treatment by the code of conduct of existing statutory obligations eg:
  - Taxation Laws (tax file numbers)
  - *Financial Transactions Reports Act*
  - *Privacy Act*
  - *Trade Practices Act*
  - State/Territory *Credit Acts*
- the so-called 'comparison rate' which reduces the cost of credit to a single number to assist consumers in comparing the cost of credit products on offer in the marketplace;
- the treatment of third party securities under the code of conduct;
- the requirement for monitoring by and reporting to the APSC on compliance with the code.

These issues are being addressed in various ways in the revised draft but they remain to be resolved and agreed in the negotiations ahead.

COMMENTS ON MAIN CRITICISMS IN THE GEORGE WEAVER PAPER

The paper makes three broad criticisms of the November draft of the code:

(a) the process of using a task force of Canberra bureaucrats to develop the code rather than allowing 'expert' retail bankers to do the job and uncertainty about the 'status' of the November draft;

(b) the implications for established common law and banking practice of the code and the requirement for express terms and conditions documents for all personal products and services; and

(c) the perceived lack of appreciation by the task force of the legal and retail banking complexities of the issues the code seeks to address.

I will comment briefly on each of those criticisms before addressing some of the more detailed criticisms in George's paper.

The task force process

It is not for me to second guess the Government's reasons for choosing the task force approach in preference to giving the task to the financial institution themselves or to an independent 'expert'. However, the following points seem relevant in explaining the preference for the task force approach:

- the code needs to reflect a balance between the interests and concerns of those on both sides of the market (ie suppliers **and** users of financial services) and an 'honest broker' is needed to facilitate their inputs and the negotiations between them;
- an open process providing for even-handed and ongoing contributions from both sides of the market is more likely to achieve consensus and broadly-based support than one which is controlled or influenced disproportionately by financial institutions

- the task force or 'honest broker' approach has worked successfully in the past for codes of conducts; eg
  - the EFT Code which is regarded as a great success by bankers and consumers alike; and
  - the oil code which is also considered a success by oil companies and their dealers.
- the Martin Committee recommended an approach similar to the one adopted by the Government; and
- finally the task force approach provides the Government with a role in facilitating a cost-effective means of overcoming information and other problems in the personal banking market rather than resorting to more prescriptive legislation such as the *Credit Acts* to achieve the same ends.

The paper expresses regret that the expertise of experienced retail bankers and banking lawyers has not been available to the task force. While that expertise has not been absent in the process to date, the expectation was and is that the process of consultation and comment on the draft code by bankers and their legal advisers and by the legal profession generally will ensure that kind of input prior to the finalisation of the code.

The paper also notes that the UK and NZ banking codes were drafted in the first instance by the banks with comments from other interest groups being obtained later in the process. Different strategies were, of course, possible but the 'honest broker' approach has been successful in other similar situations. It also has the advantage facilitating balanced debate and discussion and of ensuring that the views of disparate users of personal banking service are adequately represented in the process.

Implications for established law and banking practice

The paper is incorrect in suggesting that the wording of paragraph 1.4 of the draft code to the effect that it '... operates without prejudice to Commonwealth and State laws ...' is intended to mean that in cases of conflict, the code will prevail.

The opposite is intended and the current draft clarifies this point using the following wording:

> *'To the extent that the code conflicts with relevant legislation, the legislation will prevail to the extent of the inconsistency.'*

At the same time the code seeks to provide for bank staff and customers a general framework of principles for all personal banking practice and services, including those addressed by legislation, rather than covering only issues not already addressed by statute. It will seek to reflect the requirements of legislation as far as possible but where there is conflict or the code does not address certain issues, the law is to apply not the code. It should be emphasised, however, that the primary objective of the code is to prevent disputes in the first place and when they do occur to assist in their resolution by the institutions themselves or an ombudsman.

Similarly it is not intended that the code would prevail over common law to the extent there is conflict, **except** where financial institutions choose to include express terms in their personal banking contracts which may consciously over-ride or clarify particular areas of common law or traditional banking practice.

The paper asks if the code is not to over-ride the common law why is it considered necessary to repeat well established rules of law in the code. Again the purpose is to provide a general reference document which spans the field of banking products, terms and conditions documentation and practices as a general guide to bank staff and customers and ombudsmen. To the extent that matters are taken to litigation and the issues in dispute are not addressed adequately by the terms and conditions documents, the courts will of course have regard to the common law in reaching a decision.

Legal and retail banking complexities

The paper expresses concern at the apparent lack of appreciation by the task force of the legal and retail banking complexities of many of the issues the code seeks to address. It cites as examples:

- the requirement that terms and conditions documents set out the respective liabilities of customer and banker for unauthorised transactions; and
- the requirement that institutions provide customers with information explaining certain features of cheque accounts and their operation.

The paper suggests that an explanation of liability for unauthorised transactions would 'stun the reader into incomprehension' given the complexity of the law and legal precedents on this topic.

In effect the paper appears to be saying that something as fundamental as when the customer is liable and when the banker is liable for unauthorised transactions cannot be set out in contracts for individual bank products. And yet this is a central feature of the EFT code and of electronic banking contracts. Bank customer information documents such as Westpac's *You and Your Bank* also try to set out such issues in straightforward language.

If contracts cannot be written to address this issue effectively the paper is effectively saying customers must simply accept the interpretation of bankers and their legal advisers. The drafters of the code are suggesting that is unacceptable.

The paper also suggests provision of the information required by the code on cheque accounts would require 'a short text book' and failure to address the issues in that detail would involve the risk that courts would find that significant information had been omitted.

The first point to make is that excellent documents such as *You and Your Bank* already seek to provide useful information to customers on cheque accounts of the kind suggested.

The paper misses the point which is to inform customers of the essentials of cheque account services and of their rights and obligations in operating them. It is not intended to be an all embracing legal treatise but practical information to assist the customer to understand and use the service.

The paper appears to argue that the mystique and complexity of the law and the risk of unfavourable treatment in court is sufficient reason for denying customers practical information about everyday banking services.

I understand that major banks that publish documents such as *You and Your Bank* recognise that courts may take them into account in ruling on disputes but appear to have made the judgment that the gains in customer knowledge and satisfaction they achieve more than offset that risk.

OBSERVATIONS ON SOME MORE DETAILED CRITICISMS

Guarantees

The paper questions the limitation in paragraph 24.1 on indemnities where a guarantee would suffice. The redraft omits that limitation and the paragraph now applies equally to all third party securities, including indemnities and guarantees. It now seeks to address 'Amadio' cases more explicitly by applying the section to third party securities for all borrowings, except where the guarantor has a financial interest in the purpose of the loan.

The paper also queries the requirement that guarantees be for a specified amount. The redraft now says the third party security shall be initially for a specified liability (which may exceed the initial borrowing)

which may be varied subsequently with the written and informed consent of the guarantor. This approach is currently adopted by the Commonwealth Bank as normal practice.

The paper says it is inappropriate for a banker to explain the legal effects and consequences of a guarantee to the guarantor. The code is not calling for legal advice, only information that 'When you sign the guarantee it means you accept responsibility for the borrowers debt if he defaults. That may mean we acquire and sell the asset you offer as security'. Many banks are now including such explanations in the preamble of their guarantee contracts.

Monitoring by APSC

The paper suggests that the requirement that institutions report to the APSC on their compliance with the code in effect requires self-incrimination and is contrary to the Australian tradition.

The paper appears to take a legalistic and negative view of what is intended as a positive measure:

- monitoring and reporting on compliance has become a common feature of effective codes of conduct including the EFT Code which is regarded as a success by banks, customers and governments alike;

- it provides a mechanism for self-audit and corrective action by individual institutions, a public performance indicator of the effectiveness of the code and a means of identifying any problems with the code which need correction.

CONCLUSION

Can I conclude by again congratulating George Weaver on his thorough and very thoughtful paper.

There are many other detailed comments and criticisms in the paper which I am happy to discuss should they be raised in questions.

I should also emphasise again that the draft we are discussing today is currently being revised to reflect the comments we have received. It will be revised further before it is agreed and implemented. I am confident that by that time most of the contentious issues, including many of those raised by George Weaver, will have been resolved.