Compliance in Financial Services 2003- 2004: Are You There Yet?

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1 Outline

The Code of Banking Practice has more than doubled in length as a result of the Viney review. While an exhaustive discussion of all aspects of the Code is beyond the scope of this paper, I will:

(a) discuss some key features of the new Code that may prove problematic for banks from a compliance perspective;

(b) explain how the new Code fits into the broader retail banking regulatory environment; and

(c) examine why financial institutions and not just banks subscribing to the new Code need to be aware of its significance.

This paper discusses the current draft release of the new Code and does not take into account any amendments which may appear in the final release of the Code prior to its release in August.

2 Some key features of the new Code

2.1 Scope

(a) The 1993 Code

The 1993 Code applies to two types of individuals:

(1) a customer acquiring a deposit, loan or other banking facility from a bank solely for his or her private or domestic use; and

(2) a guarantor securing any financial accommodation or facility provided by a bank to certain individuals.

It does not cover services in relation to a bill of exchange, a variation of a term or condition of a facility or a debt arising from an unauthorised overdrawn account.

(b) The new Code

In contrast, the new Code is considerably broader in scope, applying to:

(1) all financial products or services provided by bank for any purpose to an actual and potential customer who is an individual or small business (a reference to a "customer" in this paper includes a reference to an actual or potential customer); and

(2) a guarantor who is an individual and whose guarantee secures any financial product or service provided by a bank to any individual or small business customer for any purpose.

Consistently with the Corporations Act 2001 (Cth) ("Corporations Act"), "small business" is defined to mean a business employing:

(1) less than 100 full time (or equivalent) employees if the business is or includes the manufacture of goods; or

(2) in any other case, less than 20 full time (or equivalent) employees.

Banks will need to implement the new Code for all of their financial products or services that are acquired by individuals or small businesses, whether they are acquired from the bank's staff or authorised representatives or through an intermediary such as a finance broker or financial planner.

Banks will also need to implement the new Code when distributing or supplying the financial products or services of other business units or organisations. For example, even though the terms and conditions of an insurance product provided by a bank's insurance subsidiary and sold through a bank's branch network will not need to comply with the content

requirements of the new Code, bank staff selling the product must be able to explain and provide information about the product in plain language.
The new Code reflects the approach of Chapter 7 of the Corporations Act in using the terms financial "products" and "services" provided by a bank. As these terms are not defined by reference to the Corporations Act, however, a broader range of financial products and services will be subject to the new Code than fall under the rubric of the financial services reform provisions. For example, even though a credit facility is specifically excluded from the definition of a "financial product" under the Corporations Act, such a facility will be regulated by the new Code.

(c) Financial products and services regulated by the Corporations Act

In an attempt to harmonise the new Code with the new financial services provisions of the Corporations Act, banks providing a "financial product" or a "financial service" within the meaning of the Corporations Act will only need to comply with the new Code when providing such a product or service to customers who fall within the definition of "retail client" under that Act. Although special provisions apply to general insurance, superannuation and retirement savings account products and related services, generally speaking, a financial product, or a financial service related to such a product, is provided to a person as a retail client except where:

(1) the person is a professional investor;

(2) the person is a high net worth individual, with certified net assets or income over specified limits;

(3) the price of the financial product, or the product in relation to which the financial service is provided, equals or exceeds certain limits; or

(4) the financial product or service is provided for use in connection with a business that is not a small business.

(d) Implementation issues

Who takes the benefit of the new Code?

Banks seeking to comply with the new Code will face the challenge of determining the threshold question of which customers and guarantors fall under the new Code's protection, especially when dealing with retail clients under the Corporations Act and small business customers.

For example, banks will need to have processes in place prior to the introduction of the new Code in order to reliably determine how many employees a business has at the time that the banking service in provided. This in turn will determine whether the customer is a small business that can take the benefit of the new Code's provisions.

Issues of correct characterisation are not confined to business customers. Banks may also face confusion when determining whether a "financial product" or a "financial service" within the meaning of the Corporations Act is provided to an individual as a "retail client". For example, a bank will not have to comply with the provisions of the new Code when providing a deposit-taking facility to a high net worth individual as set out in the Corporations Act, as such a person will not be a "retail client" for the purposes of Chapter 7 of the Act. The new Code, however, will apply to the same high net worth individual who applies for a credit facility or acts as guarantor for an individual or small business customer of the bank.

It is unclear whether individual or small business customers provided with an ongoing banking service, such as a credit facility, can continue to take the benefit of the new Code if they cease to be a small business customer during the life of the product. It is similarly unclear whether banks will be obliged to comply with the new Code with respect to an ongoing banking service if a large business customer subsequently becomes a small business customer. Presumably banks will only need to apply the individual or small business customer test at the time of providing a particular banking service. However, this issue should be clarified before the new Code is finalised.

Staff, authorised representatives and intermediaries

A bank will be responsible for ensuring that all staff, authorised representatives and intermediaries supplying or otherwise dealing in the bank's financial services or products comply with those new Code obligations that the bank has delegated to them.

As banks should always maintain direct control over the terms of the financial products themselves, the conduct of bank staff, authorised representatives and intermediaries will generally be a particular issue when these individuals are:

(1) providing the correct documentation and disclosure information to customers;

(2) explaining the contents of brochures about the bank's financial products and services to customers;

(3) providing advice or referrals concerning such products and services to customers;

(4) assessing whether a joint-debtor will receive a direct benefit under a credit facility; and

(5) ensuring that guarantees are signed in accordance with the provisions of the Code.

(e) Checklist

(1) Banks will need to consider how they will determine whether a customer falls within the protection of the new Code. Issues that banks will need to address include determining whether a business customer can be properly characterised as a "small business" for the purposes of the new Code. Another issue that will need to be addressed is which concept of "individual" is appropriate for the particular financial service or product. If the financial product or service is regulated by Chapter 7 of the Corporations Act, only retail clients for the purposes of the Corporations Act will be entitled to

obtain the protection of the new Code. Banks should be combining this process with their preparations for the full implementation of Chapter 7 of the Corporations Act.

(2) In view of the expanded scope of the new Code, banks will need to review computer systems, policies, staff training, documentation and procedures for small business products and services as well as for all financial products and services which are not deposit, loan or banking facilities under the previous Code, such as the sale of travellers cheques and the provision of bill acceptance facilities. New pro-forma terms and conditions may need to be prepared, for example, to remove references to the privacy provisions of the 1993 Code and to include details of how the bank will process the cancellation of a direct debit request. Additional disclosure statements may need to be prepared for certain products and services, such as credit cards, to ensure that customers receive general information about chargebacks with credit card statements at least once every 12 months. Banks will also need to amend their general descriptive information concerning financial products and services to reflect the provisions of the new Code; and

(3) Banks are specifically obliged to train "staff" and "authorised representatives" to have an adequate knowledge of the new Code and to be able to competently and efficiently discharge their functions when providing banking services. Banks are also obliged to ensure that their "representatives" are adequately trained and competent to provide financial product advice to retail clients under Chapter 7 of the Corporations Act. Banks will need to ensure that their representatives meet specific standards of knowledge and skill with respect to providing such financial services in order to comply with the Corporations Act. This training will presumably be adequate to ensure that bank staff and authorised representatives are able to competently and efficiently discharge their functions when providing banking services under the new Code. However, banks that adopt the new Code should ensure that their Corporations Act training program also covers off:

(A) financial products and services not caught by the Corporations Act, such as loan products and guarantees;

(B) customers excluded from the protections of Chapter 7, such as high net worth individuals who will nevertheless take the benefit of the new Code when provided with a financial product or service not covered by the Corporations Act; and

(C) general training concerning the provisions of the new Code.

Although banks are not specifically obliged to train their "intermediaries" under the new Code, given that banks should ensure that intermediaries comply with those new Code obligations delegated to them, banks may also wish to require intermediaries to undergo similar training. This will be especially important in relation to intermediaries who are not "representatives" for the purposes of the Corporations Act.

Banks may also wish to review the contractual provisions in place between themselves and their authorised representatives and intermediaries in light of the new Code. In particular, any indemnity provisions may need to be reviewed in order to take into account the new Code and Chapter 7 of the Corporations Act.

Finally, banks may also wish to retain control of certain crucial decisions, such as whether to accept a person as a potential co-debtor under a credit facility.

2.2 Guarantees

(a) The 1993 Code

The 1993 Code provisions exclude guarantees in relation to certain debtors from its protection, including guarantees given to secure banking services provided to:

(1) public corporations; and

(2) corporations of which the guarantor is a director, secretary or member.

(b) The new Code

In contrast, the new Code applies to all guarantees provided by individuals that secure the debts of customers who are individuals or small businesses. Consistently with the 1993 Code and the UCCC, banks are not able to accept such guarantees unless the guarantor's liability is limited to either the value of a specific security or to a specific amount plus liabilities such as recovery costs. In all other respects, however, the new Code significantly expands on the protections currently afforded to guarantors.

To the extent that a guarantee is or will be covered by the provisions of the UCCC, the provisions of the UCCC also need to be complied with.

Information and documents to be provided before a guarantee can be taken

Before a guarantee is taken, a bank must:

(1) provide information about becoming a guarantor, including a prominent notice that the potential guarantor:

  (A) should seek independent legal and financial advice on the effect of the guarantee;

  (B) may limit his or her liability;

  (C) can refuse to enter into the guarantee; and

  (D) will face financial risks.

These requirements are similar to the warnings and notices required to be given under the UCCC;

(2) advise whether any existing facility will be cancelled, or if the facility will not be provided, if the guarantee is not provided;

(3) inform the potential guarantor of any notice of demand made by the bank on the debtor and any excess, overdrawing or dishonour in relation to any facility the debtor had with the bank which occurred within 2 years before the guarantor was provided with the information; and

(4) provide the potential guarantor with documentation relating to the credit facility to be guaranteed as well as certain documents concerning the debtor's financial position. The potential guarantor is entitled to be provided with more documentation under the new Code than under the UCCC. For example, a potential guarantor is entitled to be provided with an unsatisfied default notice under the credit facility that will be guaranteed given in the previous 2 years and the financial accounts given to the bank by the debtor for the purposes of the facility within the previous 2 years.

Circumstances in which a guarantee document can be signed

Guarantors must be allowed to consider the information provided to them by the bank until the next day, unless the guarantor obtains independent legal advice.

Generally speaking, banks must not allow the debtor, or someone acting on behalf of the debtor to arrange for the signing of the guarantee (although some limited exceptions apply). When attending the signing, banks must also ensure that the guarantor signs in the debtor's absence.

Varying a guarantor's liability

After the guarantee has been signed, the guarantor may generally reduce the amount of the guaranteed liabilities provided that the new guaranteed amount is no less than the debtor's outstanding liability at the time plus any charges

which may be subsequently incurred in relation to that liability. Alternatively, a bank does not need to agree to a request by a guarantor to a reduction in his or her liability under a guarantee if the bank is obliged to make further advances under a relevant credit facility or would be unable to secure the present value of an asset over which the bank has taken security. Guarantors may also generally extinguish their liability to a bank by paying either the debtor's outstanding liability or any lesser amount to which the guarantor's liability is limited by the terms of the guarantee.

Under the new Code, a future credit contract offered to a debtor under an existing guarantee will not be covered by the guarantee, unless:

(1) it is within a limit previously agreed to by the guarantor and the notice of the guarantor's right to limit liability, given to the guarantor before that guarantee was taken, included a statement that the guarantee could cover a future credit contract; or

(2) the guarantor has been provided with a copy of the future credit contract and the bank has subsequently obtained the guarantor's written acceptance of the extension of the guarantee.

The UCCC contains a similar provision, although the UCCC does not allow a guarantor to agree upfront to his or her guarantee extending to a future credit contract which falls within a previously agreed limit. Under the UCCC, the guarantor must be provided with a copy of the future credit contract and consent to it.

Similar provisions exist under the new Code in the relation to third party mortgages securing a future credit contract or guarantee.

Limitations on the enforcement of guarantees

Banks cannot enforce a judgement against a guarantor under the new Code unless:

(1) the debtor is insolvent;

(2) the bank has made reasonable attempts to locate the debtor; or

(3) a judgment previously obtained against the debtor has not been complied with within 30 days of a written demand.

As these provisions reflect those in the UCCC, banks should already be familiar with these requirements.

(c) Transitional provisions

The new Code states that the 1993 Code will continue to apply to a guarantee subject to that Code, although certain of the new Code provisions will also apply to the guarantee. From the time that the new Code commences, a guarantor under such a guarantee:

(1) will be able to reduce the amount of the guaranteed liabilities, subject to the limitations discussed above;

(2) will be able to withdraw from his or her guarantee before credit is first provided to the debtor; and

(3) will not be liable in relation to a future credit contract offered to the debtor under the guarantee unless one of the exceptions outlined in 2.2(b) above applies.

(d) Implementation issues

The new guarantee provisions require banks to give potential guarantors an extensive range of personal information concerning the debtor's financial situation before the guarantee can be taken. The new Code makes it clear, however, that banks must comply with all laws relating to banking services, including privacy laws, and can only comply with the new Code to the extent permitted by law.

Part IIIA of the Privacy Act 1988 (Cth) ("Privacy Act") states that a credit provider can only disclose a report relating to an actual or potential debtor's

credit worthiness to a potential guarantor with the debtor's specific consent. The practical result of this provision is that banks cannot take a guarantee falling under the new Code's protection unless the debtor has expressly consented to the bank providing his or her relevant personal information to the guarantor.

As discussed above, guarantees falling within the ambit of the new Code will be unenforceable in relation to future credit contracts unless the guarantor has either been provided with a copy of new credit contract and accepted the extension of the guarantee, or has previously agreed that the guarantee will cover future credit provided to the debtor within certain limits. It seems clear that a "future credit contract" will include refinancing an existing credit facility. It is not clear, however, whether a variation of an existing facility (for example, to increase a credit limit) would be caught by this provision, particularly given that the UCCC draws a clear distinction between the extension of guarantees to cover future credit contracts (section 54 of the UCCC) and an increase in a guarantor's liabilities under the terms of an existing credit contract (section 56 of the UCCC).

The UCCC specifically states that if the terms of a credit contract are changed to increase or allow for an increase in liabilities under a credit contract, the liabilities of a guarantor securing the credit contract are not increased unless the guarantor has been notified of the changes and has agreed to extend the guarantee to those increased liabilities. The new Code does not include such a specific provision regulating the variation of an existing credit contract to increase the debtor's liabilities. It would appear that guarantors covered by the new Code can only take the benefit of this provision where their guarantee is also caught by the UCCC.

Banks will not be able to extend a guarantee regulated by the UCCC to cover a future credit contract merely because the extension is within a limit previously agreed to by the guarantor in accordance with the new Code. Even though the new Code allows banks to extend a guarantee to cover a future credit contract where the extension is within a pre-agreed limit, banks must not do so where this would lead to a breach of the UCCC.

It seems that the new Code does not require banks to provide guarantors with ongoing disclosure of information concerning the debtor's financial position, such as ongoing notices of demand, as:

(1) the bank's obligation to provide guarantors will additional copies of information concerning the debtor's financial situation only extends to copies of those documents already provided to the guarantor before the guarantee was taken; and

(2) the bank's general obligation to provide copies of certain documents on request does not extend to guarantors.

This result seems anomalous, given that guarantors have the ability both to further limit their liability under the guarantee and to extend any guarantee to cover future credit contracts in certain circumstances.

It should also be noted that the new Code requires banks to merely recommend that a potential guarantor seek independent legal or financial advice, and does not require banks to insist that such advice be taken before accepting a guarantee. Banks will need to understand that compliance with the new Code will not protect them against actions based on the principles in Garcia or unconscionable or misleading and deceptive conduct.

(e) Checklist

(1) The Privacy Commissioner has approved the Credit Reporting Code of Conduct, which is binding on all credit providers. This Code includes a sample consent form to be signed by an actual or potential debtor, allowing a credit provider to disclose a report containing consumer credit information to a potential or existing guarantor in accordance with the Privacy Act. Banks would be wise to extend this consent to cover any information required to be disclosed under the new Code and ensure it is completed by a debtor before any personal information concerning the debtor is provided to a potential guarantor;

(2) Banks refinancing a pre-existing credit facility secured by a guarantee governed by the new Code must comply with the provisions of the new Code relating to the extension of a guarantee. It may also be prudent to follow these procedures when varying an existing credit contract to increase a credit limit (while this would not appear to be strictly necessary under the new Code, it is nevertheless good banking practice). Where a guarantee is regulated by the UCCC, the provisions of that Code must also be complied with.

(3) Banks may consider:

(A) including a guarantor acknowledgment in guarantee documentation to the effect that ongoing information concerning the debtor's financial position will only be provided at the bank's discretion (to avoid any implication that the guarantor has such a right); and

(B) requiring, and not merely recommending, that guarantors receive independent legal advice before signing up a guarantor who is not acting at arms length and does not appear to be receiving any benefit under the guarantee;

(4) More generally, banks should review guarantee documentation, procedures, computer systems, policies and staff training to ensure that:

(A) all guarantees that now fall within the scope of the new Code are identified and captured by the bank's processes and procedures and pro-forma guarantee documentation is modified; and

(B) all relevant guarantors receive the necessary information concerning the debtor's financial position; and

(5) Banks will need to ensure that staff, authorised representatives and intermediaries taking guarantees are trained to provide the correct documentation to potential guarantors and ensure that guarantees are

validly and correctly signed in accordance with the provisions of the new Code.

2.3 Joint debtors

(a) Implementation issues

Banks cannot accept a co-debtor under a credit facility if it is clear on the facts known to the bank that the debtor will not receive any direct benefit under the facility. Although the wording of the provision suggests that the direct benefit need only be minor, it is not clear exactly what a direct, as opposed to an indirect, benefit would include. Although a joint debtor receiving a life tenancy in relation to a property that is being purchased by the other debtor, but financed under a joint home loan would probably qualify as a direct benefit, signing up a co-debtor to a home loan whose name does not appear on title as a co-owner would generally be more appropriately structured as a guarantee.

Banks must also take all reasonable steps to ensure that potential co-debtors understand they may be liable for the full amount of the debt. It is not clear what will constitute "reasonable" steps for the purposes of this provision. Will it be sufficient, for example, for a bank to explain the effect of these provisions in plain english, or will banks need to ensure co-debtors receive independent legal and/or financial advice?

(b) Checklist

(1) As a result of the general overriding obligation to act "fairly and reasonably" in a "consistent and ethical manner", banks will need to make at least some basic enquiries of the potential co-debtor, and the principal debtor, as to what direct benefit the co-debtor will receive;

(2) Banks will need to consider:

  (A) including an additional acknowledgement in the credit documentation to the effect that the debtor is receiving a direct benefit (although this is unlikely to be determinative,

particularly if the bank has reason to believe that in fact there is no direct benefit to the co-debtor); or

(B) possibly requiring a co-debtor to receive independent legal and/or financial advice; and

(3) Banks will either need to ensure that mortgage originators are trained to properly assess whether a co-debtor is receiving a direct benefit under a facility or else put documentation and procedures in place so that they can make this decision themselves.

2.4 Changes to interest rates

(a) Implementation issues

The new Code provides that banks are not required to notify customers of variations to an interest rate in relation to an existing banking service where the interest rate is linked to an external reference rate of which banks cannot provide advance notification.

It is not clear exactly how "visible" such a link will have to be for banks to avoid their disclosure obligations with respect to such variations. An interest rate of "BBSY + 2%" would clearly fall within the contemplation of the exception, although a "rate of the day" based on an undisclosed index may trigger the notification provisions.

2.5 Fairness requirement

The new Code commits banks to acting fairly and reasonably towards customers in a consistent and ethical manner, taking into account the bank's own conduct, the customer's conduct and the banker-customer contract.

(a) Implementation issues

The New Zealand Code of Banking Practice contains a similar fairness requirement, which was criticised in the course of the review of the Australian

Code as subjugating the notion of certainty of contract to a version of fairness that arguably applies only to conduct not expressly authorised by contract.

The new Code's fairness obligation is not, nevertheless, a new obligation for Australian banks. The application of "fairness" in the banker-customer relationship already has a history in Australia, as this principle (along with the law and good banking practice) is one of the criteria the Australian Banking Industry Ombudsman ("ABIO") is bound by its terms of reference to apply in the resolution of customer complaints. The ABIO has articulated and implemented guidelines for the application of this principle. Banks are also obliged to do all things necessary to ensure that the financial services covered by their Australian Financial Services Licence are provided efficiently, honestly and fairly, while the UCCC allows a court to reopen unjust transactions where, among other things, the credit provider used unfair pressure, undue influence or unfair tactics.

(b) Checklist

(1) Banks should interpret all new Code obligations in the light of this fairness requirement. For example, as outlined in 2.3(b)(1) above, banks will need to make some enquiries of a potential co-debtor as to the direct benefit a co-debtor will receive under a loan facility. Banks will also particularly need to be aware of their fairness obligation when handling complaints, and ensure their procedures meet the requirements of Australian Standard AS4269-1995 which detail a range of rights, on both sides, which will satisfy the requirement under the Standard; and

(2) Banks should ensure that all training programs, procedures, policies, computer systems and documentation relating to banking services covered by the new Code are consistent across the organisation to ensure consistency of approach in dealing with customers who have the protection of the new Code.

2.6 Provision of credit

(a) The 1993 Code

When considering whether to provide, or to provide further, credit to a customer, the 1993 Code requires banks to take into account several factors to establish whether the customer has, or may have in the future, the capacity to repay. These factors include:

(1) the customer's income and expenditure;

(2) the banking service's purpose;

(3) credit scoring; and

(4) customer's assets and liabilities.

(b) The new Code

The new Code replaces these specific factors with a general requirement to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in formulating an opinion about the customer's ability to repay the debt.

In addition to these requirements, where a credit contract is governed by the provisions of the UCCC, a credit provider should ensure that at the time that the credit contract, mortgage or guarantee is entered into or changed, the debtor can pay in accordance with the terms of the contract without substantial hardship. Otherwise, the contract may be liable to be re-opened under section 70 of the UCCC.

(c) Checklist

(1) Banks will need to review all retail product procedures, including those relating to credit cards, to ensure that credit decisions are always made with the standard of due care and diligence required under the new Code and with due regard to the debtor's ability to repay; and

(2) More broadly, credit providers operating in the ACT are also required by the Fair Trading Act 2002 (ACT) to apply the standard of a "diligent and prudent creditor provider" when assessing a debtor's financial situation in connection with providing a continuing credit contract for a credit card or increasing the amount of credit available.

2.7 Complaint handling

An Australian Standard on Complaints Handling (AS4269-1995) has been adopted under the new Code as the core requirement of a bank's internal dispute resolution mechanism. This Standard was originally produced as a reference document on best practice for "sole traders, small businesses and other organisations" when implementing complaint handling processes as part of an organisation's "quality management" program. In the new Code the loose set of principles set out in the Standard has been pressed into service as an essential element of a bank's compliance with the new Code. The same principles have been adopted by ASIC in connection with a financial services licensee's obligations under Chapter 7 of the Corporations Act.

Even a brief review of the essential elements of effective complaint handling set out in the Standard, however, raises a number of questions about how these broad principles should be implemented by a large bank, and (given that they have contractual force under the new Code) what the remedy may be for breach. For example, it is a requirement that complaints shall be dealt with quickly (subject to other timing requirements found in the Code) and courteously. Does this elevate courteous customer service when handling complaints to the status of a contractual right of customers, potentially entitling them to damages if it is breached?

More seriously, the Standard requires "appropriate systematic recording of complaints and their outcomes" and that complaints are classified and analysed for the "identification and rectification of systemic and recurring problems". A bank will need to draw on its own past experience in complaint handling and management to develop suitable complaint categories and procedures that comply with the standard.

2.8 Transitional provisions

(a) The new Code

The 1993 Code's provisions relating to:

(1) terms and conditions;

(2) foreign exchange services; and

(3) guarantees,

will continue to apply to existing banking services, foreign exchange services and guarantees which are subject to that Code. In all other respects, the new Code's provisions will apply to any ongoing financial service or product provided by a bank before it adopted the new Code, with the exception of those provisions relating to statements of account, third party mortgages and electronic communications. For example, although banks will not need to re-issue terms and conditions complying with the new Code to account holders subject to the 1993 Code, such account holders will need to be notified of any changes to the terms and conditions of their account in accordance with the new Code provisions.

(b) Implementation issues

As outlined in 2.2(d), it is likely that the refinancing of a credit facility subject to the 1993 Code, or the provision of a financial service in relation to such a refinancing, will amount to the provision of a new credit facility. This means, for example, that a bank re-financing an existing home loan after it announces that it will be bound by the new Code will need to re-issue terms and conditions for that loan as refinanced which accord with the new Code's requirements.

While as a matter of strict Code compliance, it is not necessary to amend terms and conditions of existing banking facilities, banks may nevertheless

wish to amend existing terms and conditions to ensure that all terms and conditions are consistent for all customers.

3 The new Code and the broader retail banking regulatory environment

3.1 The interaction of the new Code with retail banking regulation

Banks seeking to comply with the new Code must determine how the new Code interacts with the expanding retail banking regulatory regime. As the Issues Paper to the Viney Review points out, there were no national or state-based laws requiring the detailed disclosure of non-credit banking products or services when the 1993 Code was released and, accordingly, there was no overlap with the 1993 Code's obligations. Since that time, however, banks have been faced with an extraordinary explosion of national, state and industry-based regulation, including:

(a) the new financial services provisions of the Corporations Act;

(b) the introduction of the UCCC;

(c) the extension of the Privacy Act;

(d) changes to the Australian Securities and Investment Commission Act 2001 ("ASIC Act"), the Trade Practices Act 1974 and the various State Fair Trading Acts; and

(e) the revision and addition of several industry-based codes, including the Electronic Funds Transfer Code of Practice ("EFT Code"), the Credit Reporting Code of Conduct and the General Insurance Code of Practice.

This increasing regulation of the retail banking sector meant that the 1993 Code came to overlap and conflict with some of these new regulatory requirements. The new Code, therefore, seeks to clarify how its requirements interact with the broader retail banking environment in the following manner:

(a) banks must comply with all relevant laws relating to banking services and must not comply with the new Code where to do so would lead to a breach of such a law. For example, as outlined in 2.2(d) above, even though the new Code requires banks to give certain personal

information regarding a debtor to a potential guarantor, the Privacy Act forbids banks from so doing without the debtor's consent. In this situation, the Privacy Act's requirements "trump" those of the new Code, such that banks can only take a guarantee under the new Code after obtaining certain consents from the debtor. Banks must, however, comply with any of the new Code's obligations that are more onerous than those contained in a law relating to banking services;

(b) certain products and services subject to alternative regulation are carved out of the new Code's operation, such that:

(1) banks do not need to include the repayment details of a loan regulated by the UCCC in the terms and conditions applying to that loan. Banks are already required to provide a pre-contractual statement setting out such repayment details in this situation;

(2) the obligation to disclose a fee for the provision of a bank cheque or an inter-bank transfer when the service is provided or at any other time on request does not apply where the service is regulated by Chapter 7 of the Corporations Act. The Product Disclosure Statement for such a service will already set out the applicable fees and charges; and

(3) the UCCC and not the new Code will govern notice requirements for changes to the terms and conditions of UCCC regulated products and services. For products and services regulated by Chapter 7 of the Corporations Act, the Corporations Act will specify notice requirements in relation to changes to fees and charges, but other changes to the terms and conditions of such products and services are to be governed by the more detailed and precise provisions contained in the new Code. For example, a bank varying the method by which interest is calculated on a deposit account will need to provide a retail customer with 30 days' prior written notice, even though under the Corporations Act the bank need

only disclose the variation before the change takes place or as soon as reasonably practicable after it has occurred; and

(c) certain obligations contained in the UCCC are expressly extended to cover products and services not regulated by this regime, such that:

(1) a customer whose credit account is not regulated by the UCCC will be given an account statement in accordance with the UCCC if:

(A) the UCCC would have applied had the customer been an individual acquiring credit wholly or predominantly for personal, domestic or household purposes; and

(B) it is practical to apply the UCCC provisions to the account; and

(2) banks must place a warning notice substantially in the form required by the UCCC directly above the place where guarantors sign.

In addition, in the case of inconsistency between the new Code and the EFT Code, the provisions of the EFT Code will prevail. This reflects the position under the 1993 Code.

4 The significance of the new Code

(a) Consequences of breaching the new Code

Given the potential difficulty banks will face in seeking to comply with the new Code, the question arises as to the consequences of failing to comply. There are two main consequences of failing to implement the new Code.

First, although some independent monitoring was undertaken by the ABIO under the 1993 Code, banks largely self-reported their compliance and violations did not attract any penalty, unless a customer could sustain a complaint to the ABIO or bring legal action against the bank for breach of contract. Under the new Code, the Code Compliance Monitoring Committee ("CCMC") will monitor Code compliance. There is a possibility of being named in a CCMC report in connection with serious, systemic or other behaviour tending to demonstrate that the bank does not take its obligations under the

new Code seriously. Given that the new Code is largely focused on improving banker-customer relations, this has the potential to be a particularly significant consequence of breaching the new Code. A bank subscribing to the new Code will need to monitor and address breaches and ensure that systems are in place so that dealings with the CCMC are given appropriate priority, and requests from, or undertakings given to, that body are promptly communicated and acted upon as necessary throughout the organisation.

Second, any written terms and conditions of a financial product or service must include a statement that the new Code applies to the product or service. This provision effectively gives a customer an action for breach of contract if the bank fails to comply with the new Code. The new Code also states that banks must comply with all relevant laws relating to banking services. Such laws would include the UCCC, the Corporations Act, the Privacy Act and the various State-based Fair Trading Acts. Reading these two provisions of the new Code together means that customers will also be able to sue banks for breach of contract if the bank fails to comply with a relevant law relating to banking services. For example, a bank disclosing information concerning a debtor's financial situation to a potential guarantor without first gaining the debtor's consent as required by the Privacy Act will be liable to the debtor for breach of contract.

(b) The broader significance of the new Code

The new Code is also potentially significant for other financial institutions, and not just those banks that have adopted the new Code. The ABIO has indicated that the new Code provisions will assist in determining whether a financial institution has followed good banking practice in a customer dispute situation. This means that a financial institution could be effectively bound by the provisions of the new Code, even without a public announcement that the new Code will apply to it. Although this will only be relevant to those financial institutions who are signatories to the ABIO scheme, institutions subject to Chapter 7 of the Corporations Act will need to be a member of an external dispute resolution scheme to the extent that they provide financial products or advice to retail clients. Most banks have chosen the ABIO scheme as a means of satisfying this requirement.

The new Code has also been approved by ASIC under the Corporations Act. Although ASIC will not be able to take direct legal action against a bank unless a relevant law is breached, ASIC will be able to monitor compliance with the new Code and use its influence in a breach situation by generating adverse publicity and taking up an unofficial regulatory role.

ASIC has also indicated that, in the light of financial services reform, approved Codes such as the new Code have a role to play in:

(1) establishing best practice standards in areas which are not covered by the Corporations Act;

(2) fleshing out requirements of certain Corporations Act provisions, such as those relatin to Product Disclosure Statements; and

(3) providing guidance on what needs to be done to comply with certain Corporations Act provisions.

5 Looking to the future

It is difficult to predict the full significance of the new Code for the financial services industry. This is particularly the case given that the new Code and the broader retail banking regulatory environment within which it operates together form a "work in progress". For example:

(a) reforms to the UCCC and the financial services provisions of the Corporations Act and associated regulations are ongoing;

(b) some jurisdictions are beginning to pick up new Code standards and apply them to a wider range of financial service providers. For example, the Fair Trading Act 1992 (ACT) was amended in 2002 to require a credit provider to apply the standard of a "diligent and prudent creditor provider" when assessing a debtor's financial situation in connection with providing a continuing credit contract for a credit card or increasing the amount of credit available;

(c) the final release of the new Code in August 2003 is expected to amend the new Code;

(d) an independent task force is currently reviewing the Credit Union Code of Conduct in the light of the new Code and the new financial services provisions of the Corporations Act and it is expected that the Building Society Code of Practice will similarly face such a review;

(e) the ABA must review the new Code at least every three years or sooner if appropriate, taking into account the views of banks adopting the new Code, consumer organisations, interested industry associations and relevant regulatory bodies such as ASIC and APRA; and

(f) the ABA must establish a forum to allow consumer, small business and banking industry representatives to exchange views on the effectiveness of the new Code and must take these views into account when reviewing the Code.

It also remains to be seen how the CCMC will interpret its role, what significance ASIC will place on the new Code as an approved Code under the Corporations Act and whether consumers will seek to enforce their rights under the new Code. Both banks adopting the new Code and the general financial services industry will clearly need to live with the new Code for some time until its full ramifications become apparent.