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Via email: banking.code.review@cameronralph.com.au

Dear Mr Khoury

Review of the Code of Banking Practice and the Code Compliance Monitoring Committee

Thank you for the opportunity to provide a submission to the current reviews of the Code of Banking Practice and the Code Compliance Monitoring Committee.

I am involved in teaching and researching of issues of financial services and consumer credit law and regulation in the Law School at the Queensland University of Technology, and this short submission is based on my recent research on the Code of Banking Practice (published in the UNSW Law Journal), and my previous experience as a member of the Code Compliance Monitoring Committee (2009-2012).

Role of code

The Code of Banking Practice is one of the oldest codes in the financial services sector, and it has been through two substantial reviews. Overall, the Code is an important part of the mix of regulation in the financial services sector. Although much of its earlier substantive content has now been effectively superseded by legislative developments, and some have suggested that the Code may not be needed in the future, my view is that the Code still plays an important role in at least the following ways:

- providing protections in areas that are not covered by legislation, including where legislation may not be an appropriate policy response;
- providing coverage for some customers and products that are not covered by equivalent legislative protections;
- providing body or detail for broadly framed consumer protections;
- engaging in a regulatory dance with relevant legislation, where, over time, the highest standards swap between the Banking Code and the legislation; and
- influencing the standards imposed upon, and expected of, other members of the financial services sector.

Some examples of each of these roles are set out in detail in my article on the Banking Code, available here http://www.unswlawjournal.unsw.edu.au/sites/default/files/g5_howell.pdf

This review of the Code should be cognisant of the different roles that the Code can, and should play in financial services regulation, and ensure that any recommendations enhance (or at least not detract from) the Code's capacity in each of these roles. Also, the role of the Code in facilitating continuous improvement should be borne in mind (cl 3.1(a)): while the Banking Code is one of the better codes in the financial services sector, this review should consider the opportunity to improve on the existing standards, particularly in light of the current public criticisms of the banking sector. A robust Code, with high standards, and effective administrative and enforcement architecture, can be part of a response to current criticisms.

Substantive rules in the Code

This review provides the regular opportunity to consider the substantive provisions in the Code, in light of the principle of continuous improvement.

Some issues that are relevant for consideration for a revised Code are:

- Amending the financial difficulty provisions to incorporate some or all of the recommendations of the CCMC Own Motion Inquiry (particularly as regards visibility of information about the assistance that banks can provide), and converting some of the principles in the ABA's financial difficulty guidelines into Code rules.
- Expanding key provisions (eg, on responsible lending and financial difficulty) so that small business and investors (and their third party guarantors) obtain similar protections to those available to consumers under the *National Consumer Credit Protection Act 2009* (Cth), including the *National Credit Code*.
- Improving the obligations on banks in relation to staff training and effective promotion of the Code. Consumers have little awareness of the Code, and the ABA has recently acknowledged inadequacies in training about the Code.[1]
- Providing for regular reviews after 3 years (not 5 years as in the current cl 6.1). Given the rapid changes in the technological, economic and regulatory environment, more frequent reviews are necessary if the Code is to be an effective self-regulatory instrument. Further, cl 6.4 should be amended to give more specific requirements as to the frequency of progress reports.

[1] James Eyers, 'Bank industry code training inadequate' *The Australian Financial Review*, 5 September 2016, 16.

Compliance with the Code as a term of the bank-customer contract

It has been regularly stated by the ABA and others that the Code is incorporated into the customer-bank contract, by virtue of cl 12.3, and that consequently, a breach of the Code is also a breach of the contract. If this argument is correct, a customer affected by a breach of the Code could seek a remedy for breach of contract in a relevant court or tribunal. This avenue for redress is particularly important for customers with higher value disputes, as these may be excluded from FOS's jurisdiction. Litigation will then be the only option for resolving a dispute where a breach of the Code is alleged.

However, the approach of the courts to this argument has not always been consistent. A number of the earlier cases were reluctant to give the Code any legal force or contractual status.[2] On the other hand, there have now been decisions of the Courts of Appeal of Victoria[3] and NSW[4] that have accepted that the Code did form part of the contracts in question.

These Court of Appeal decisions are welcome, and the findings on the contractual status of the Code are consistent with the clear intention of the owners of the Code. However, given that the courts have not all always adopted this approach, and there has not yet been any consideration of this issue by the High Court,[5] this review should examine whether amendments to the wording in cl 12.3 are needed to minimise the risk of a future court dismissing an argument that the Code is incorporated into the customer-bank contract.

Cases involving the Banking Code also highlight some other areas where clarification or amendment to the Code may be necessary to ensure that the contractual relevance of the Code is assured, and litigation for breach of contract is a possible option where there has been a breach of the Code.

First, the Code is incorporated into the bank-customer contract by reference. Thus, if the express terms of the contract are inconsistent with provisions in the Code, the express terms will prevail.[6] The Code currently provides, in clause 12.2(c), that the terms and conditions of a banking service will be consistent with the Code. However, cl 12.2(c) is also incorporated into the bank-customer contract by reference, and so may not prevail over an express term that is inconsistent. Perhaps the Code could require banks to include in their terms and conditions an express clause as to the status of the Code provisions.[7] In any case, the CCMC should be empowered to review terms and conditions for consistency with the Code, that is, for compliance with clause 12.2(c); this could, for example, be the subject of a future own motion enquiry.

Second, even if a court or tribunal accepts that non-compliance with a provision of the Code

[2] See for example, *Commonwealth Bank of Australia v Starrs* [2012] SASC 222 [116] (decision upheld on appeal); *Bank of Western Australia Ltd v Abdul* [2012] VSC 222 [100]; *ING Bank (Australia) Ltd v Leagrove Pty Ltd* [2012] 1 Qd R 140, 155.
[3] *National Australia Bank v Rose* [2016] VSCA 169; *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351.
[4] *Brighton v Australia and New Zealand Banking Group* [2011] NSWCA 152.
[5] Leave to appeal the decision in *Doggett v CBA* to the High Court was refused in June 2016: [2016] HCASL 114.
[6] See discussion in *George 218 Pty Ltd v Bank of Queensland* [2015] WASC 434 [235]; although in this case, the Code could not apply because the guarantor was not an individual.
[7] See, for example, the clause in Seeto v Bank of Western Australia [2010] NSWSC 1050 [11].

is a breach of the bank-customer contract, a remedy (of damages) will be awarded only if the claimant can demonstrate that he or she has suffered a loss as a result of the breach.[8] However, for many disputes (eg, on failure to cancel a direct debit) it is likely that the loss will be relatively small. This means that the risk of legal action for breach of the Code will be minimal in many cases. For this reason, additional sanctions need to be available to the CCMC; this is discussed further below.

Third, the remedy that is available for a breach of a code provision will depend on whether the particular term is determined to be a condition, a warranty or an intermediate term.[9] Some clarity of expectations in this regard should be included in the Code.

Fourth, a number of cases have discussed the issue of to whom the Code obligations are owed, particularly in the context of guarantors.[10] This review should consider whether amendments to the Code are also needed to clarify these issues.

Identifying and reporting on breaches of the Code

The current options for identifying and reporting on potential breaches of the Code are not entirely satisfactory, and require change.

While the Financial Ombudsman Service ('FOS') receives the lion's share of customer disputes involving banks, there is no obvious way of monitoring the number / type of Code breaches alleged or found in the disputes referred to, or considered by, FOS. Most disputes made to FOS are resolved without the need for a FOS decision.[11] And even where a FOS decision is required, the decision may not necessarily identify relevant Code breaches.[12] As a result, a disputant may be awarded a remedy, but not a definitive statement from FOS as to whether or not a bank has breached the Banking Code. Also, even if a determination identifies a Banking Code breach, it is not clear that this information is reported other than in the determination itself – for example, the FOS Annual Review does not separately identify the number of disputes in which a Code breach is alleged or found. The CCMC does report on matters that it resolves in accordance with a FOS determination on a Code

[8] Eg, *Australian and New Zealand Banking Group Limited v Aldrick Family Company Pty Limited & Ors* [2010] NSWSC 1000.
[9] Eg, *Commonwealth Bank of Australia v Wood* [2016] VSC 264; *Brighton v Australia and New Zealand Banking Group* [2011] NSWCA 152.
[10] Eg, *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351; *Brighton v Australia and New Zealand Banking Group* [2011] NSWCA 152.

[11] Eg, Financial Ombudsman Service, *Annual Review 2013-14* (2014) 48.
[12] Eg, the CCMC's submission to the 2007–08 McClelland Review showed, over a six month period, only 31 disputes where the Banking Code was considered by the Banking and Financial Ombudsman Service (a predecessor to FOS), and in the majority of these matters, the Code issue was not determinative in determining the merits of the matter or in resolving the dispute: Code Compliance Monitoring Committee, *Submission to the Review of the Code of Banking Practice* (Submission Annexure F, 11 March 2008) 3. In relation to the role of FOS in identifying code breaches, see also Nicola Howell, Joint Consumer Submission to the Review of the Code of Banking Practice and the Review Issues Paper (Submission, 31 July 2008) 29.

breach,[13] however, presumably this applies only to matters that are referred from FOS to the CCMC.

As a result, our understanding of the extent or otherwise of Code compliance is not complete. FOS disputes involving a decision on whether or not a Code provision has been breached should be reported to the CCMC, and also publicly reported, by the CCMC and/or FOS.

Relationship between the CCMC and FOS

The relationship between the CCMC and FOS, and their respective roles in relation to the Banking Code, are not clear. The FOS Annual Review and website refer to the FOS Code team (supporting the CCMC) as being 'a separately operated and funded business unit of FOS'. However, the relationship between the FOS Code team and the part of FOS dealing with dispute resolution, is not clearly spelt out.

The CCMC's most recent workplan (for 2016-2017) includes a plan to develop an MOU between FOS and the CCMC. This is supported. However, it is somewhat surprising that such a document was not negotiated and published soon after the 2013 Code and Mandate were finalised, particularly given the specific reference to the possibility of a MOU in the Mandate itself (cl 1.7).

The Banking Code and CCMC Mandate should also more clearly identify the respective roles of the CCMC and the FOS, and the relationship between the two bodies, particularly in relation to reporting on Code breaches and dealing with systematic or serious issues that may involve a Code breach.

Limitations on the CCMC's role

The CCMC was established following the first independent review of the Code, and its establishment demonstrated a commitment to robust compliance monitoring and investigation. However, the 2013 Code and Mandate contain some provisions that inappropriately limit the ability of the CCMC to effectively fulfil the role that was envisaged following this first review.

Sanctions

One major limitation on the CCMC is the lack of sanctions available to it in the event that the CCMC identifies a Code breach. The only sanction available to the CCMC is to publicly name a bank, and the CCMC is empowered to do so only in limited circumstances (cl 36(j)). To my knowledge, the CCMC has imposed the only available sanction on one occasion, and it is not apparent that use of the sanction had any deterrent or other effect.

[13] There was one such matter reported in 2014-15: CCMC *Annual Report 2014-15*, 24.

The lack of alternative sanctions for CCMC was identified as an issue in the 2007-08 review of the Code, however, the reviewer ultimately recommended that "any consideration of additional sanctions for the CCMC be deferred until after the establishment of the CCMC within the FOS, the terms of reference of the CCMC and the protocols for the exchange of information and the referral of matters between the CCMC and the FOS have been finalised."[14] Given that most of the items have been addressed, this review provides an opportunity to recommend an expansion in the range of sanctions that it has available in the event that a breach of the Code is identified.

A particular issue in respect of sanctions relates to provisions of the Code which are of considerable importance, but which may not cause significant direct losses to an individual consumer. An example here is the Code provisions dealing with direct debits – most disputes about whether a bank has complied with cl 21 would not be pursued by an affected customer in a court or tribunal, or by lodging a dispute with FOS or the CCMC, and this is reflected in the low numbers of disputes about direct debits. However, despite few disputes, shadow shopping exercises undertaken by the CCMC suggest that bank staff sometimes provide incorrect advice about cancelling direct debits. In my view, the current regime does not create sufficient incentives for compliance with cl 21.

One solution may be to implement a regime whereby non-compliance with certain provisions of the Code entitles the customer to a small payment from the bank. Such an approach would create more effective incentives for compliance, and would ensure that banks do place appropriate emphasis on the Code provisions in staff training and other situations.

In considering other sanctions to include in the Code, reference should be made to the types of sanctions that are available in other industry codes (eg, the General Insurance Code) and those that are listed in ASIC's Regulatory Guide 139.

Timeframe

Another relevant limitation on the CCMC's jurisdiction is the time frame within which matters can be brought to the CCMC for consideration. At 12 months, this compares unfavourably with time limits in the EDR schemes and courts. For example, the time limits within which a matter must be brought to FOS are 2 years or 6 years, and there is also provision for FOS to accept older disputes in exceptional circumstances.[15] (clause 6.2 Terms of Reference, as amended 1 January 2015). The time limit has particular significance given the small number of *any* matters referred to the CCMC in the first instance (only 45 new matters in 2014/15).[16]

This review should recommend an expansion of the timeframe within which matters can be brought to the CCMC's attention for investigation.

Key commitments

A further limitation is the fact that the CCMC's functions and powers do not extend to clause 3 or 4 of the Code, unless there is also a breach of another provision in the Code (cl 26(b)(iii)). This was introduced following the 2007-08 review, where the reviewer noted that insufficient

[14] Jan McClelland, 'Review of the Code of Banking Practice' (Final Report, Jan McClelland and Associates, December 2008), p 66-67.
[15] FOS Terms of Reference, as amended 1 January 2015, clause 6.2.
[16] CCMC *Annual Report 2014-15*, 21.

detail in the Code on financial hardship matters had meant that consumer advocates had sometimes resorted to the key commitments to have a matter considered by the CCMC. However, the reviewer suggested that recommendations for change to the financial hardship provisions in the Code would reduce the need to rely on the key commitments. The reviewer also noted concerns of the ABA that the key commitments, including the fairness commitment now in cl 3.2, were uncertain, and therefore should be treated differently to the stricter, enforceable provisions of the Code. The reviewer ultimately and recommended that the CCMC not be permitted to exercise its functions in relation to an allegation of breach of a key commitment if there was not also a breach of another provision of the Code.[17]

However, a concept of fairness as a substantive standard is now part of Australian consumer protection law (for example, the prohibition against unfair contract terms in the Australian Consumer Law and in the *Australian Securities and Investments Commission Act 2001* (Cth))), and the criticism that a fairness obligation is too uncertain to be enforceable now has less force.

The CCMC's most recent annual report included data on breaches of clauses 3 and 4, as reported by the banks. This data shows that there were 375 breaches of clause 3 (key commitments) and 1,125 breaches of clause 4 (compliance with laws) that did not also involve a breach of another provision of the Code.[18] Due to cl 26(b)(iii), none of these matters were ones that could have been investigated by the CCMC. However, the CCMC notes that the fairness commitment was one of the two primary sources of Code breach allegations;[19] presumably these were matters that also involved a breach of another provision of the Code.

A recent report in the Australian Financial Review suggested that the ABA wanted to 'elevate [clause 3.2] to a more prominent position within the code.'[20] One way to do this would be remove the limitation on the CCMC's ability to investigate allegations of non-compliance with, at the least, the fairness commitment. Such a change would also demonstrate that the banks are prepared to hold themselves to account for compliance with all of the standards in the Code.

Code approval and registration

The Banking Code is not a code that has been approved by ASIC under the *Corporations Act 2001* (Cth) or *National Consumer Credit Protection Act 2009* (Cth). Requests for ASIC to approve a code can be initiated by the code owner, and this is a step that should be taken by the ABA.

Being prepared to submit the Banking Code to the ASIC approval process would be a further mechanism for the banks to demonstrate their goodwill in relation to the Code and self-regulation. It will also provide the opportunity for the Code provisions to be tested by the

[17] Jan McClelland, 'Review of the Code of Banking Practice' (Final Report, Jan McClelland and Associates, December 2008), 83-84.
[18] CCMC *Annual Report*, *2014-15*, 10.
[19] CCMC *Annual Report*, *2014-15*, 22.
[20] James Eyers, 'Bank industry code training inadequate' *The Australian Financial Review*, 5 September 2016, 16. Jan McClelland, 'Review of the Code of Banking Practice' (Final Report, Jan McClelland and Associates, December 2008), recommendation 45.

regulator, giving consumer confidence in the legitimacy and relevance of the Code standards.

There is also a regulatory argument associated with code approval. It is arguable that there is not a regulatory threat associated with the Code, such that there would an incentive to introduce or improve a code in order to stave off government regulation. However, there are currently a number of regulatory benefits that arguably flow, at least in part, from the existence of the Code. It has, for example, been suggested that the Code was one of the reasons for winding back some of the obligations under Part 7 of the Corporations Act as they applied to deposit-taking products. Similarly, recent changes to introduce price caps for consumer credit products do not apply to credit products offered by ADIs, including banks. The policy rationale for this exclusion was that ADIs 'are subject to a broader range of prudential and regulatory oversight than other classes of credit providers'; the Banking Code is part of the architecture of regulatory oversight for banks.

Subscription to the Code is not compulsory, even for members of the ABA. Despite this, the regulatory benefits identified above accrue equally to banks (and other ADIs) that subscribe to the Banking Code (or similar code) and those that do not. An approach to facilitate further improvements in the Code would be to make explicit the various regulatory benefits, and make them available only to financial services providers that subscribe to an ASIC-approved code. A precedent for such a regulatory approach does exist in relation to the exemption from certain obligations in the *Corporations Act 2001* (Cth) that is available to members of ASIC-approved codes.[21] This provides an illustration of a mechanism capable of ensuring that regulatory benefits provided, in part, because of the existence of industry codes, are granted only to those industry members that have subscribed to a relevant code.

Of course, restricting regulatory benefits to members of approved Codes would be a role for the legislature; it is not something that can be achieved by the ABA as the Code owners. However, this review is an opportunity to identify this issue of 'free riding' on these regulatory benefits by non-subscribing banks. Making subscription of the Code a condition of ABA membership would also go part-way to achieving a similar objective, and would facilitate a high level of standards for all banks.

If you have any queries in relation to any of the matters raised in this submission, please contact me.

Yours sincerely

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[21] *Corporations Act 2001* (Cth) s 962CA.