



Code Compliance Monitoring Committee

Submission to the review of the Code of Banking Practice

Discussion Paper

External compliance monitoring and dispute resolution: Essential and complementary, but distinct, functions under the Code of Banking Practice

Introduction:

Over the last decade or so Australia, in common with many other developed economies, has been experimenting with a move away from market regulation through direct government intervention, towards greater reliance on industry based self regulation.

In 1997, the then Prime Minister told business that *“the Government is keen for industry to take ownership and responsibility for developing effective and efficient self-regulatory mechanisms where this is appropriate”*.¹ The Government identified voluntary codes of conduct, as the *“main tool used to achieve effective self regulation”*² on the basis that they *“achieve greater and lasting improvements in business practices by using negotiation and consultation rather than prescriptive legislation and enforcement”*.³

This paper looks at the development of one model of self regulation, the 2004 Code of Banking Practice (the 2004 Code). Particular attention is paid to the functions that underpin the credibility of the 2004 Code, specifically external compliance monitoring and dispute resolution. The paper will explore the distinction between these functions and the potential significance of structural separation of the bodies which perform them.

Background:

The antecedent of the 2004 Code was the Code of Banking Practice 1993 (the 1993 Code). In the review which preceded the introduction of the 2004 Code⁴

¹ “More Time for Business” a statement by the Prime Minister, The Honourable John Howard, MP on 24 March 1997, page 79. <http://www.innovation.gov.au/Documents/mt4bguide.pdf>

² “Codes of Conduct Policy Framework” released by the Honourable Warren Truss MP, Minister for Customs and Consumer Affairs March 1998, page 1.

³ Ibid.

⁴ For information about the review visit: www.reviewbankcode.com.au

the independent reviewer appointed by the Australian Bankers' Association ("ABA"), Mr Richard Viney, consulted widely on the effectiveness of the 1993 Code. The review established that the 1993 Code was *"not highly regarded by consumer advocates"*⁵. More generally it was seen as *"unduly narrowly conceived"*⁶ with one bank commenting that it was *"all but irrelevant"*⁷.

A rare positive comment about the 1993 Code during the Code Review was that *"...the main achievement of the Code has been the development of a culture more open to alternative dispute resolution"*⁸.

Many submissions to the review drew comparisons between *"what they regard as the defensive approach of the existing Code and the outgoing positive approach of the United Kingdom's Code of Banking Practice"*⁹ (the UK Code). In particular, reference was made to the Key Commitments in the UK Code.

A number of submissions were highly critical of the lack of any provisions for the effective monitoring and administration of the 1993 Code¹⁰. This was not surprising given that in the time since the 1993 Code was adopted, the Government had issued guidelines on industry codes of conduct which recommended that the codes should provide for some form of administration body¹¹.

The Issues Paper for the review of the 1993 Code canvassed three different options to meet the need for transparency and accountability in administration and monitoring of the Code:

1. ASIC¹² - As the regulator, it had an existing role in monitoring compliance with the original Code. It was suggested this could be expanded to include audits where there may be evidence of non-compliance.
2. Industry, possibly in the form of the council of the Australian Banking Industry Ombudsman ("ABIO") (now the Banking and Financial Services Ombudsman - "BFSO"). However Banks had strong views that the ABIO, as a quasi-judicial body should not be involved in

⁵ Review of the Code of Banking Practice Issues Paper, page 8.

⁶ Joint submission to the Review of the Code of Banking Practice by Consumer Credit Legal Centre (NSW) Inc, Consumer Credit Legal Service (Vic) Inc, Consumer Credit Legal Service (WA) Inc, Consumer Law Centre Victoria Inc, Care Inc Financial Counselling Service (ACT) and Financial Services Consumer Policy Centre Inc, page 5.

⁷ NAB submission to the Review of the Code of Banking Practice.

⁸ Submission from Financial Counselling Qld to the Review of the Code of Banking Practice.

⁹ Review of the Code of Banking Practice Issues Paper, page 9.

¹⁰ Review of the Code of Banking Practice Issues Paper pg 25.

¹¹ See the "Codes of Conduct Policy Framework" and "Fair Trading Codes of Conduct: Why have them, how to prepare them". A guide prepared by Commonwealth, State and Territory Consumer Affairs Agencies June 1998.

¹² ASIC's role is set out in the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001*.

*“...auditing the practices of banks whose decisions it is required to critically examine in the course of dispute resolution”.*¹³

3. Independent third parties such as auditors or a body such as the United Kingdom’s Banking Code Standards Board. Banks were generally not supportive of a new monitoring entity being set up for this purpose¹⁴.

ASIC’s submission¹⁵ addressed the three options, setting out the advantages and disadvantages of each. It referred to potential conflict over resource allocation where the monitoring function was undertaken by the ABIO Council or ASIC rather than an independent body. Although monitoring by the ABIO Council had the advantage of utilising a body which had consumer confidence and was already established in the industry, ASIC identified that the skills required for monitoring compliance with the Code were different to those required for dispute resolution.¹⁶

Consumer advocates pointed out that in addition to a body which administered and monitored compliance with the Code, for the Code to be effective, there needed to be a body which could make determinations on whether the Code had been breached. The Ombudsman’s role was distinguished in two ways:

- although the ABIO could apply the Code to its dispute resolution matters, disputes may often be resolved prior to and without the need for a determination of breach, and
- the ABIO’s terms of reference prevented it from hearing matters where the customer had not suffered a loss.

Consumer advocates therefore argued that a body other than the ABIO was required.

Ultimately, the ABA and consumer advocates put a persuasive case for an independent monitoring body which was capable of imposing sanctions for Code breaches. The final report of the review identifies this issue as crucial to the efficacy of the Code, pointing out that the original Code’s lack of credibility was due to the absence of effective monitoring and sanctions¹⁷.

The inclusion of Key Commitments in the Code of Banking Practice reflected a real and accountable commitment on the part of industry to raising

¹³ ABA submission appendix 5 to the Review of the Code of Banking Practice Issues Paper page 175.

¹⁴ Ibid.

¹⁵ ASIC submission to the Review of the Code of Banking Practice, pages 19 to 21.

¹⁶ ASIC submission to the Review of the Code of Banking Practice, page 20.

¹⁷ Review of the Code of Banking Practice Final Report October 2001, page 28.

standards of practice and providing benefits to consumers. This was a bold step by Industry seeking the trust and confidence of consumers, reinforced by the fact that the Code formed part of the Bank's contract with the customer¹⁸. These points may be part of the reason why, when the Issues Paper to the Code Review was released in March 2001, the then Minister for Financial Services, Joe Hockey, described the Code as "...effectively a bill of rights for bank customers".¹⁹

The 2003 and 2004 Codes of Banking Practice

The review resulted in the release of a substantially revised Code in 2003 (the '2003 Code') which responded to most of the criticisms of the 1993 Code and represented a commitment by signatory banks to be held accountable for their conduct across a broad range of banking services. The 2003 Code's provisions relating to guarantees were updated in 2004, with the result that the ABA refers to the current Code as the 2004 Code. In accordance with the 2004 Code, it must be reviewed every 3 years in consultation with subscribing Banks, consumer organisations and other relevant stakeholders²⁰.

Importantly, and consistent with government policy for industry codes of conduct, that "*the culture should be one of continuous improvement*"²¹, the 2004 Code includes key commitments that, amongst other things, banks will:

- Continuously work towards improving standards of products and services;
- Promote better informed decisions; and
- Act fairly and reasonably, always having regard to their prudential obligations.

Significantly, the 2004 Code also established a body, the Code Compliance Monitoring Committee ("the Committee"), to provide "*...an independent, transparent and efficient process for monitoring banks' compliance with the Code*"²².

The Committee, which was established in April 2004, is constituted by three persons and is serviced by a small secretariat. Consistent with the National Fair Trading guideline on codes of conduct²³, and in accordance with the provisions of the 2004 Code²⁴, the Committee includes a consumer and small

¹⁸ Code of Banking Practice, Clause 10.3.

¹⁹ Sally Loane interviewing Joe Hockey, Minister for Financial Services & Regulation, Transcript No. 006 ABC 702 2BL 6 March 2001.

²⁰ Code of Banking Practice 2004 Clause 5.

²¹ Codes of Conduct Policy Framework op cit page 18.

²² Review of the Code of Banking Practice Final Report October 2001, p 28.

²³ "Fair Trading Codes of Conduct: Why have them, how to prepare them". A guide prepared by the Commonwealth, State and Territory Consumer Affairs Agencies, June 1998.

²⁴ Code of Banking Practice 2004, Clause 34(a).

business representative, a member with banking experience and an independent chairperson. It is fully funded by the subscribing banks.

Equipped with both industry and consumer input when performing the functions of monitoring and sanctioning subscribing banks' compliance with the Code, the Committee:

- Requires banks to complete, on an annual basis, a comprehensive statement addressing all aspects of Code compliance;
- Undertakes compliance monitoring exercises such as shadow shopping and compliance visits;
- Engages in dialogue with subscribing banks on their obligations under the Code²⁵;
- Assists banks to interpret and meet the requirements of the Codes;
- Monitors and enforces compliance with the Codes and takes disciplinary action for material breaches, and
- Investigates and determines allegations that the 2004 Code has been breached.

The 2004 Code is administered by the ABA. It is the ABA and not the Committee which has responsibility for:

- Ensuring sufficient coverage of the Code among industry participants;
- Educating subscribers and the public about the Code;
- Promoting the Code; and
- Managing the process for review of the Code.

Whilst the ABA's continued ownership of the Code harnesses common interest in maintaining the reputation of those Banks which subscribe to it²⁶, only 13 of the 25 ABA member banks²⁷ currently subscribe to the 2004 Code. That some ABA members, albeit with limited market share, have not signed up to the Code means voluntary subscribers are bearing costs which benefit

²⁵ Code Compliance Monitoring Committee Annual Report 2006/07.

²⁶ See the list of strengths of self regulation, set out in the Better Regulation Taskforce Self Regulation Interim Report October 1999 page 4.

http://archive.cabinetoffice.gov.uk/brc/upload/assets/www.brc.gov.uk/self_regulation.pdf

²⁷ The following banks have adopted the Code of Banking Practice 2004: Adelaide Bank, ANZ Bank, Bank of QLD, BankWest, Bendigo Bank, Citibank, Commonwealth Bank, HSBC, ING (Australia) Bank, National Australia Bank, St George Bank (incl. BankSA), Suncorp Metway and Westpac Bank.

the entire industry.²⁸ It also potentially undermines the credibility of the Code as an effective self-regulatory tool. Notably, the UK Banking Code has significantly greater industry coverage extending beyond banks to other deposit-taking institutions, for example credit unions, building/friendly societies²⁹.

The significance of an independent code compliance monitoring function

Professor David Llewellyn³⁰ argues that in financial transactions there is a higher consideration for the consumer beyond the basic characteristics of the product or service. Consumers look for trust and confidence in the products and services as well as in the institutions supplying them³¹. Professor Llewellyn argues that the embedding of trust and confidence needs to become part of the business strategy of financial services providers³².

Signatory banks have seized the opportunity to build the trust and confidence of customers by participating in the Code of Banking Practice. However customers must find the Code, like any voluntary self regulatory regime, credible for trust and confidence to be established. ABA Chief Executive Officer, David Bell recently stated *“Independent compliance monitoring is an important feature of a Code if the Code is to be credible and seen as of value by customers”*³³.

The existence of an independent code monitoring body is seen as providing subscribing banks with the “best of both worlds”. It reinforces consumer trust and confidence by demonstrating, as part of the banks’ commitment to high industry standards, their willingness to have that commitment independently scrutinised.

The significance of an independent monitoring body for Codes of Conduct in the financial services sector is reflected in ASIC’s Policy Statement (PS) 183, which gives guidance to industry about how and when ASIC will approve financial services sector Codes of Conduct³⁴. It requires that a Code must have an administrative body, independent of industry to, inter alia:

- Monitor compliance with Code;
- Publicly report annually on Code Compliance; and

²⁸ The ABA are reluctant to publish the names of member banks which are non subscribers to the Code, despite being asked to by the body set up to monitor compliance with the 2004 Code.

²⁹ Banking Code Standards Board 2006/07 Annual Report pp23-24. <http://www.bankingcode.org.uk/>

³⁰ David Llewellyn is professor of Money and Banking at Loughborough University in the UK.

³¹ Llewellyn, DT, “Trust and confidence in financial services: a strategic challenge”, *Journal of financial regulation and Compliance*, Vol 13, Number 4, 2005 p336.

³² Ibid.

³³ “Review of the Code of Banking Practice” Australian Bankers Association media release 21

December 2007, <http://www.bankers.asn.au/default.aspx?ArticleID=1145>

³⁴ As allowed under s1101A of the Corporations Act 2001.

- Hear complaints about breaches of the Code, imposing sanctions and remedial measures.

The functions of the Committee are consistent with PS 183 and the ultimate sanction available to it is to name a non compliant Code subscriber publicly.

The significance of an effective external dispute resolution (“EDR”) scheme

In addition to a requirement to provide a process for internal dispute resolution,³⁵ the 2004 Code requires banks to make an ASIC approved EDR scheme available to customers and to publicise the availability of the scheme³⁶. For the Banking Industry, the relevant ASIC approved EDR scheme is the Banking and Financial Services Ombudsman (“BFSO”).

The Banking Ombudsman was established in 1990 as a voluntary scheme for the Australian banking industry.³⁷ Following the commencement of the Financial Services Reform Act in March 2002, licensed financial services providers were required to belong to an EDR scheme approved by ASIC.

The Hon. Mr Chris Pearce, a former Parliamentary Secretary to the Treasurer, stated that EDR schemes play a vital role in the Australian financial services regime, as they “provide consumers with a quick and inexpensive way to resolve complaints. He noted that “in this way, they reduce the risk of expensive and lengthy court proceedings that can cost consumers dearly and come between them and their financial goals and promote market confidence by encouraging prompt, fair and consistent dealing for consumers”³⁸.

The difference between the code compliance monitoring and EDR

a) Code compliance monitoring:

Effective compliance monitoring identifies specific and broad-scale non compliance, and encourages the rectification of compliance failings at a systemic level. Compliance monitoring usually incorporates root cause analysis and should also work to strengthen the compliance regime that overlooked the failure. For consumers, compliance monitoring should not just help solve problems for today but for tomorrow and not only in regard to a specific product or service, but more generally.

The compliance monitoring function provides macro and micro level oversight of a bank’s activities with regard to its obligations under the Code.

³⁵ Code of Banking Practice 2004 Clause 35.

³⁶ Code of Banking practice 2004 Clause 37.

³⁷ Speech by Colin Neave at the Commonwealth Ombudsmen’s Conference, 8 August 2007
[http://www.comb.gov.au/commonwealth/publish.nsf/AttachmentsByTitle/seminar_notes_Colin_Neave/\\$FILE/seminar_notes_Colin_Neave.pdf](http://www.comb.gov.au/commonwealth/publish.nsf/AttachmentsByTitle/seminar_notes_Colin_Neave/$FILE/seminar_notes_Colin_Neave.pdf)

³⁸ Opening address by Chris Pearce, Parliamentary Secretary to the Treasury, to the Financial Industry Complaints Service Annual Conference 6 March 2007
<http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2007/002.htm&pageID=005&min=cjp&Year=&DocType=1>.

At a macro level effective monitoring ensures regulatory compliance and risk management systems are working effectively to identify areas of non compliance. These systems can be tested by comparing self reported results with external analysis of how bank products, services, policies, procedures and staff training comply with the Code. At a micro level, investigating customer complaints enables policies, procedures and training to be tested against a set of facts, providing a valuable window into a bank's actual regulatory compliance.

b) External dispute resolution:

The primary focus of industry based external dispute resolution schemes, as the name suggests, is to resolve disputes efficiently and effectively. The BFSO seeks to provide a forum for consumers to resolve complaints in a manner quicker and cheaper than the formal legal system³⁹. Dispute resolution also presents an opportunity to improve relations between industry participants and consumers⁴⁰.

Industry standards of conduct are often improved as a result of effective dispute resolution. At a practical level EDR scheme structures provide incentive to members by charging industry participants on the basis of disputes raised and progressed, in addition to membership fees. Financial services EDR schemes are responsible for identifying, recording and referring systemic issues to ASIC. This responsibility provides EDR schemes generally, and the BFSO specifically, with more scope to improve standards of practice. The additional scope is however just that – additional to the primary function of resolving disputes.

c) The distinction in action: responding to consumer complaints

The Committee's role in investigating consumer complaints that a bank has breach the Code, has caused some confusion for stakeholders in differentiating the Committee and BFSO roles. It is however an instructive example of the differences between two distinct but complementary functions. The main distinction, and therefore a key reason enshrining the separation of the functions, is the different outcomes the functions provide to a complainant customer.

For example, a customer complains that they have been charged a fee by their bank that was not disclosed in their product disclosure statement ("PDS"). The Customer knows that in accordance with the 2004 Code, a bank must disclose all standard fees and charges in its terms and conditions⁴¹. The Customer would like the following outcomes:

1. Their money back;
2. A finding that the bank has breached the Code;

³⁹ ASIC Policy statement 139.

⁴⁰ *ibid.*

⁴¹ Banking Code of Practice Clause 10.4.

3. The bank to change the PDS so that it accurately reflects the fees charged, and
4. The bank's procedures improved to ensure that fees for all products are properly disclosed so that other customers do not share the experience.

The customer could choose to take her complaint to the BFSO, because she has suffered a loss. In pursuing this option it is likely the customer's dispute will be resolved by the bank refunding the fee and possibly providing a small amount of compensation for the customer's inconvenience. As in 93% of complaints received by the BFSO⁴², the bank will resolve the issue directly with the customer, without the need for the BFSO to investigate and make a formal finding. However, even if Case Manager did conduct an investigation and make a finding on the matter, the emphasis would remain on resolving the dispute. It would be up to the bank to initiate any internal improvements.

Alternatively (or additionally) the customer could take her complaint to the Committee because she feels that the bank has breached the 2004 Code. The Committee would inform the customer that it could not deal with the issue of compensation explaining that the BFSO could. If the customer wanted to proceed with the issue, the Committee would investigate and would likely find a breach of Clause 10.4 of the Code. Although it is Committee practice to write to the customer informing them of its determination, the relationship is akin to that of an informant advising a disciplinary body of some wrongdoing. What the customer does with the Committee's determination is up to the customer. The Committee is not involved in resolving the dispute and cannot provide the customer with financial compensation.

Where it has determined a breach of the Code, the Committee will often make recommendations of remedial action to ensure the breach is rectified. In this case a likely a recommendation would be that the error in the PDS is corrected. Further the Committee would work with the Bank to improve its compliance regime so that PDS content is properly monitored in future and errors identified.

It is possible that after the Committee's breach determination the bank would refund the fee to the customer, but the Committee cannot request or require this. Significantly, if the Bank had already resolved the dispute or refunded any money before referral to the Committee that would not affect the Committee's investigation of the allegation of breach or its finding.

There are of course further possible variations on the example provided. For example, if this matter was one of the 7% of cases which go through to a Case Manager at the BFSO, it would likely be referred to the BFSO's systemic issues manager. This is because the bank error could potentially affect more

⁴² BFSO 2006/2007 Annual Report page 15.

than one customer. As part of a systemic issue investigation the BFSO may have regard to the Code and, if a systemic issue is found, it is possible the BFSO may make a finding that the Code has been breached. In settling the systemic issue, the BFSO may require the bank to amend the error in the PDS and to identify and reimburse other customers affected. The BFSO would be obliged to refer the matter to ASIC, if the bank did not resolve the systemic issue to the BFSO's satisfaction.

d) Separate functions, separate structures

Clearly a code compliance focus is different to a dispute resolution focus. One may follow the other – and often does. The existence of both is most definitely complementary but it is that dual existence however that ensures both outcomes are possible in all Code related matters. Separating the functions appears to have been part of making this possible.

To avoid conflicting findings on the Code with resultant confusion for banks, the Committee is required under its constitution to:

- Desist from investigating any complaint being considered by the BFSO until finalised, and
- Accept any findings the BFSO may make that the Code has been breached⁴³.

The Committee does however have a role in following up on alleged breaches, including systemic breaches, of the Code once the dispute is resolved.

It is important to remember however that whereas the Committee's jurisdiction is limited to subscribing Banks and the provisions of the 2004 Code the BFSO's is not. It provides dispute resolution generally to a broad range of financial services providers.⁴⁴ The BFSO's terms of reference enable it to consider the Code if it is relevant to its resolution to the dispute between bank and customer⁴⁵.

The distinct advantages of separate code compliance monitoring and EDR functions are founded on a shared commitment to give effect to the Code by setting standards of good banking practice. These advantages rely on effective systems for the identification and exchange of relevant and appropriate information between the Committee and the BFSO.

Conclusion

Although there is still debate about the adequacy and the type of regulation required it is broadly accepted that self-regulation has had, and will continue to have, a role in the financial services sector. The nature and extent of that

⁴³ CCMC Association Constitution clauses 8(b)(i) and (ii).

⁴⁴ See BFSO 2006/2007 Annual Report Appendix B for a list of bank and non bank members.

⁴⁵ BFSO Terms of Reference Clause 7.1.

role will depend critically on public confidence in the institutions providing those services and the products and services provided.

Against a background of changing public perceptions, voluntary self regulation such as the Code of Banking Practice must establish meaningful standards which are properly and effectively administered in order to build and maintain public trust and confidence. The challenge to the sector, and to the agencies involved, is to ensure that self regulation continues to meet developing public expectations.