Irish Banking Codes of Practice: A Case for Reform.

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Table of Contents

"A thriving vibrant and well regulated sector is good for the customer, the industry and the economy. We need to ensure…that the pricing of financial products is transparent and competitive…[and] that the institutions themselves deal with their customers at all times on the basis of decency, probity and fairness that we all have a right to expect."

Charlie McCreevy
20 February 2001

Introduction

Codes of practise lay down acceptable standards of behaviour. In such a dynamic area as financial services, a code of practise is essential. To be effective, a code must move beyond general principles and guarantee substantial protection to customers. The current regulatory situation in Ireland does not offer customers the protection they need and deserve. In this submission I will examine the current situation in Ireland and other jurisdictions. I will look at the various forms of regulation available and make recommendations for future improvements.

1. The Code of Practise Debate.

(a) Benefits of a Banking Code of Practise.

Unlike banks in other jurisdictions, Irish credit institutions have not developed a unified voluntary code of practice. While there are several codes regulating specific areas of the financial services, there is no single, all-encompassing, voluntary code of practice. The argument is made that the codes currently in existence such as the *Code of Practise on Transparency in Credit Charges for Personal Customers* and the *Code of Practice for Personal Customers* effectively regulate the banker/customer relationship. Admittedly these codes govern the banker-customer relationship in significant areas. However, gaps exist and a comprehensive code is desirable.

The financial services industry underestimates the importance to consumers of perceived fairness and responsiveness of banks. This is exemplified by two surveys conducted by Deloitte Research. In the first Survey[1], financial executives stated that the key area governing customer satisfaction with the financial services industry was "online access to information and products." These executives further stated that face-to-face contact at branches is becoming less important to customers. In contrast, a survey of customers[2] revealed that "satisfaction with personal customer service" is the most important factor that determined whether a consumer was satisfied overall with their financial provider. "Personal customer service" includes being treated as a valuable customer and responsive service of complaints and inquiries.

The argument is also made that competition will force banks to cater to its customers' needs and that competition itself is the best regulator. However, research shows that consumers demonstrate a "level of comfort" in dealing with their current financial providers. Correspondingly, in all countries surveyed by Deloitte more than half of consumers stated that when shopping for a new financial product they would go to their current provider rather than shop around. In an industry demonstrating such a high level of consumer loyalty, the strength of competition as an effective regulator is inadequate. Further research indicates that "standards of banking practice are not high on the list of matters in which banks compete with each other and…left to themselves, the banks will take a long time to accept that competition in this area is necessary."[3] Consequently some mechanism of regulation is essential.

(b) Voluntary vs. Statutory Code

[1] Deloitte Research-1998, Survey of 133 senior executives in 17 countries
[2] Deloitte Research- 2000, Myth vs. Reality in Financial Services
[3] Report on Banking Services: Law and Practice 1989 (The Jack Report), para 16.04

Not surprisingly, the banking industry tends to favour voluntary rather than statutory codes. However, the effectiveness of non-statutory codes is questionable. As noted by Donnelly[4] while there are substantial arguments in favour of industry wide voluntary codes of practice, the legal effect of these codes must not be over-estimated. Although divergence from the standards may facilitate a customer in an action for breach of its duty of care, such codes are voluntary and do not have the force of law. Cranston states that in exceptional cases a voluntary code may constitute trade usage and give rise to an implied contractual term with a customer. While at the other extreme a court may treat the code's standards as having nothing to do with whether a customer can claim against its bank for the banks conduct.[5] Essentially, the legal effect of a voluntary code which proposes to expand consumer rights is unclear and statutory codes may offer more substantial protection.

However, in other jurisdictions, statutory codes of practice have encountered resistance from the financial sector. It is argued that a statutory code might fail because "the climate in which it would be introduced would lack the support and goodwill it needed to be successful,"[6] and that "…in the absence of a culture of compliance they (statutory codes) may be insufficient to protect the customer."[7]

The argument is also made that the fiduciary relationship between the banker and customer is "primarily a moral/ethical relationship" and not suitable for statutory regulation[8]. However, the DIRT inquiry of 1999 and the subsequent facts of National Irish Banks Ltd v Raidió Teilifís Éireann[9] indicate that self-regulation of the bank-customer relationship may be inadequate. Indeed Breslin argues that the law is not "effective to control potential abuse by bans and other credit institutions in the conduct of their business with customers."[10]

In the remainder of this submission, I will examine current codes in Ireland and other jurisdictions with a view to reform.

2. Ireland Today

(a) Code of Practice for Credit Institutions

In June 2001 the Central Bank for the first time, utilised its powers under S117(1) of the Central Bank Act 1989. S117(1) of the Act enables the Central Bank, after consultation with the Minister for Finance, to draw up codes of practice relating to any persons supervised by the Central Bank. While S117(2) states that:

> In drawing up codes of practice, the Bank shall have regard to
> (a) the interests of customer and the general public, and
> (b) the promotion of fair competition in financial services markets in the State.

In June, this power gave rise to a *Code of Practice for Credit Institutions.*[11].

CODE DESCRIPTION

[4] Donnelly, The Law of Banks and Credit Institutions p. 132.
[5] Cranston, Principles of Banking Law p. 217
[6] *supra 3* para 19.07
[7] Niall Gallagher, Ethical Challenges in Banking p. 7
[8] *Ibid.* p. 6
[9] [1998] 2 IR 465 and [1998] 2 ILRM 196
[10] John Breslin, "Recent Developments in Banking Law" 1997 16 ILT p. 249
[11] *Code of Practice for Credit Institutions*.

The introductory section of the code states, inter alia:

- This Code of Practice contains standards of good banking practice which are to be followed by all credit institutions.
- Credit Institutions should seek to comply with both the letter and spirit of these standards.
- Credit institutions should ensure that all their officers and employees are aware of and apply the standards outlined in this Code of Practice.
- A failure by a credit institution to comply with a standard outlined in this Code shall not of itself give rise to any right of action by persons affected thereby nor shall such a breach affect the validity of any transactions.

The body of the code states:

A credit institution shall ensure in providing its banking services to consumers that it:

1. acts honestly, fairly and reasonably in conducting its business activities;
2. acts with due skill, care and diligence in its dealings with consumers. In particular, it must not recklessly, negligently or deliberately mislead a consumer as to the perceived advantages or disadvantages of any banking service provided;
3. has and effectively employs the resources and procedures that are necessary for the proper performance of its business activities;
4. will, on request, assist a consumer in understanding the service or product that the consumer has chosen from its product range;
5. makes adequate disclosure of relevant material information, including charges, in accordance with the relevant statutory provisions;
6. corrects errors and handles complaints speedily and efficiently. Where a complainant is not satisfied with the outcome of the credit institution's internal investigation into his/her complaint, the credit institution shall ensure that the complainant is notified of his/her right to refer the matter to the Ombudsman for Credit Institutions, or in the case of charges imposed for services to consumers and consumer issues generally, to the Director of Consumer Affairs;
7. issues statements on all accounts held at least on an annual basis, unless otherwise agreed with the consumer;
8. complies with all regulatory requirements applicable to the conduct of its business.

IS THIS A "STATUTORY" CODE?

This code is "issued in accordance" with a statute and is not actually in statutory form. It is not what is typically envisioned as a "statutory" code. However, a notable feature of the Code is the existences of sanctions for non-compliance.

Under s117(3)

> The Bank may-
>
> (a) Require any licence holder or other person supervised by it to provide all relevant information to the Bank to

enable the Bank to satisfy itself as to compliance with the code by such licence holder or other person,

(b) Issue a direction in writing to such licence holder or other person or other person to comply with practices specified in the direction where this in necessary, in the opinion of the Bank, to secure observance of the code.

Section 117(4) further specifies that any person supervised by the Bank who fails to provide information in accordance with subsection 3(a) or comply with a direction under subsection 3(b) "shall be guilty of an offence." This framework allows the Central Bank to regulate compliance with a S117(1) Code. However, it is important to note that non-compliance by a credit institution does "not of itself give any right of action by persons affected."[12] Under s6, a consumer can make a complaint to the Ombudsman for Credit institutions or to the Director of Consumer Affairs. There is no mechanism available for individuals to complain directly to the Central Bank. Furthermore, enforcement of the Code rests with the Central Bank.

INADEQUACY OF THE CODE

Approximately one page in length, the Code is drafted using broad statements that do not lend themselves to coherent specific obligations. The code does not address specific issues such as account operations (i.e. running of accounts, cards and pins, lending) and protection (i.e. confidentiality, protecting accounts). The Code includes significantly lesser provisions than voluntary codes of banking practice employed in other jurisdictions. As it stands, this code will be of limited value to customers. The language used is vague and lacks the certainty and comprehensiveness essential for a successful code.

(c) ***FINANCIAL SERVICES SINGLE REGULATORY AUTHORITY***

On October 20, 1998 the Government agreed in principle to the introduction of a single regulatory authority for the financial services sector. Following a report of the Working Group on Financial Services (also known as the McDowell Group)[13], the Minister for Finance announced a plan for legislative restructuring of the financial services sector.

While the majority of proposals relate to the structure of the financial services, the McDowell Report and subsequent government plans also focus on the area of consumer protection. Following the recommendations of the McDowell Report, the government plans to establish a single regulatory authority (SRA) for the financial services sector. The main aim of the new structure is to "put consumer issues at the heart of the regulatory regime."[14] This includes consideration of such questions as[15]:

Are the customer's needs taken into account?
Are the interest and other charges correct?
Is the customer sold the right product?
Is the customer fully informed?

[12] *ibid.* introduction
[13] The Working Group on Financial Services which was chaired by Michael McDowell presented its report to the Minister for Finance in June 1999.
[14] Address by Minister for Finance Charlie McCreevy T.D. on the announcement of a New Structure for Financial Services Regulation. 20th February 2001.
[15] *ibid.*

Under the new regime, the government proposes to establish a Financial Services Ombudsman, who will be fully autonomous in investigating complaints. A formal system of Consultative Panels will operate to enable consumers and the industry to express their views about the industry to the Regulator. The SRA will also have the power to impose sanctions on a financial services provider. Finally, the government states that "we are putting in place additional arrangements to put the protection of consumers on an equal footing alongside the prudential regulation of financial services."[16]

To date, these proposals have not yet been put on legislative footing. However, in giving efficacy to customer protection proposals, the Government should seriously consider the benefits of a statutory code and examine the content, processes of review and publication/sanctions employed in other jurisdictions.

3. ***INTERNATIONAL APPROACH***

(a) THE UK

The UK Code of Banking Practice was voluntarily introduced in 1992 following the *Report on Banking Services: Law and Practice 1989 (the Jack Report)*[17] This report specified that if a voluntary code was not adopted by the industry, one would be statutorily imposed. After examining the benefits and disadvantages of both a voluntary and statutory code, the Jack report concluded that "pure self-regulation by the industry was likely to be of limited application to the problems addressed in this report." A purely statutory code was also dismissed as "the climate in which it would be introduced would lack the support and goodwill it would need to be successful."[18] The Jack Report concluded that the banks would be asked to formulate an agreed Code of Practice within a reasonable time. If banks failed to do so or developed an inadequate code, a statutory code would be introduced.

The key aspect of the UK Code to be considered in this submission is its content. The UK Code places more obligations on banks than the Irish Code for Credit Institutions. The Code lists ten "key commitments" to consumers, including the promise to "act fairly and reasonably"[19] and if things go wrong, correct mistakes, tell you how to make a complaint, and handle your complaint quickly."[20]

Where the UK Code differs substantially from the Irish Code of Practice is in its application of these commitments to specific products and services. The Irish Code is silent on application of its general principles. In contrast, the UK Code applies these principles to specific areas:[21]

- Current accounts
- Basic accounts
- Deposit and saving accounts
- Cash mini ISAs and TESSA only ISAs

[16] *supra* 14
[17] *supra 3.*
[18] *supra* 3 para 16.06
[19] UK Banking Code of Practice. Section 2.1a.
[20] *ibid.* section 2h
[21] *supra* 19 section 1.5

- Card services and cash machines
- Loans and overdrafts
- Payment systems, including direct debit and standing orders
- Foreign exchange transactions
- Electronic purses

It is this application that gives force to the UK Code. This is seriously lacking in the Irish Code. To be effective, any future code in Ireland must go beyond general principles and apply such principles to actual products and services.

(b) AUSTRALIA

The Australian Banking Code of Practice was adopted by the Australian Bankers' Association (ABA) in November 1993 with member banks agreeing to implement all the provisions of the Code by the end of 1994. This submission will examine several aspects of the Australian Code.

- the process for review,
- public awareness of the code,
- sanctions for non-compliance.

REVIEW PROCESS

The financial services industry is a rapidly developing industry. To be effective, a code must incorporate a mechanism for timely and adequate review. The Australian Code of Banking Practice contains provisions for review at least every 3 years. The first review, issued in a 200 page "issues paper" was published in February 2001, with final recommendations being published in October 2001.

The in depth review process of the Australian code is noteworthy and well worth and well worth studying when establishing an Irish Code. The first Review of the Australian Code was established on May 12, 2000. Letters announcing the review and inviting submissions were sent by the ABA to banks, consumer representatives, state ministers of fair trading and consumer affairs, members of Parliament and other persons and organisations likely to have an interest in the review. The review process involved extensive meetings with bankers and consumers and a final issues paper was presented to the ABA. In its final recommendations, this review stated:[22]

> The Code should provide that an independent review of the Code is conducted every three years under a process which ensures:
> - adequate consultation with banks, consumer organisations, ABA and other interested industry associations, relevant regulatory bodies and other Stakeholders:
> - interested parties have adequate time to present views; and
> - the process is transparent
>
> The Code should provide for the establishment of a forum for the regular exchange of views between banks and consumer advisors on banking issues.

A review process is essential to maintaining an effective code and should be seriously considered when designing an Irish code. Such a review should be conducted by an independent body and involve consultation with all parties affected by the code.

PUBLIC AWARENESS AND SANCTIONS

[22] Australian Banking Code of Practice: Final report. p. 33.

The Australian Review found that customers were very critical of the Code. In contrast, banks appeared satisfied with the Code.

CUSTOMER OPINIONS

Overall, consumers found the code lacked clear, consumer protection measures and lacked sanctions required to make it effective. The Australian Consumer Association's submission stated, "The Banking Industry's Code of Practice fails banking consumers. Its provisions are not well known, and provide limited coverage or guidelines for standard banking activities. Despite widespread consumer dissatisfaction with banks, the Code makes no attempt to promote consumer protection, service outcome or industry best practice."[23] The ACA also had "reservations about the effectiveness of self-regulation in financial services,"
And emphasised "the need for co-regulation and strong support for minimum standards of consumer protection which should accompany and underpin any industry code – even more importantly in an area of essential service such as banking."[24]

The New South Wales Government submitted that "In this environment, it is essential that banks are governed by a quite extensive set of standards, in order to ensure consumers receive fair treatment… It cannot be left up to banks to unilaterally determine what they consider to be 'fair conduct.' "[25] The Joint Consumer Submissions argues that "self assessment by banks alone is manifestly inadequate as a method for monitoring compliance and that before any reliance can be placed on the results of self assessment, those results should be validated or supplemented by some other form of compliance monitoring undertaken by an independent, external body."[26]

BANKS' OPINIONS

In contrast to consumers groups, banks advocated minimal regulation, the Commonwealth Bank of Australia (CBA), stated that "The Code's value lies in it being a relatively straightforward and easy to understand account of the relationship between banks and customers."[27] While the Australian and New Zealand Banking Group (ANZ) submitted that a redrafted code should be "a comparatively concise document of principles and benchmarks."[28]

REVIEWER'S OPINION

The first observation noted that to be effective, a code needs to be brought to the attention of consumers and bank employees. The Australian Review concluded that:[29]

- The Code should oblige banks to ensure all relevant staff agents have an adequate knowledge of its provisions.
- The Code should require the Code Administration to promote the Code among Bank customers, consumer advisors and the public generally
- Banks should be obliged to display the Code and have copies available on request by any person, at all branches.

[23] *Supra* 22. ch. 3, p.8
[24] *supra* 22 ch. 3 p.9
[25] *supra* 22. ch. 3 p. 3
[26] *supra* 22. ch. 3 p. 26
[27] *supra* 22 ch. 3 p.26
[28] *supra* 22 ch. 3 p. 11
[29] *supra* 22. p. 31

The Australian approach to this issue should be seriously considered when drafting an Irish Code. Logically, a code will offer no practical benefit to consumers, if they are not aware of its existence. Some Mechanism must be employed to ensure public awareness of a code.

The Australian experience also demonstrates that to be effective, a code needs sanctions for non-compliance. While one would hope the banking industry would take it upon itself to comply with codes, inevitably compliance will be greater with the threat of sanctions. A statutory code which imposes significant sanctions for non-compliance not only give banks an incentive to comply but can also give consumers an option to take legal action.

THE WAY FORWARD

The financial services industry is dynamic and progressive. Consumers can choose from an increasing amount of products and services which cater to their financial needs. However beyond this, it is essential to establish basic standards of fairness and transparency in banks' dealings with customers. A substantive code of practice would establish such standards. The current *Code of Practice for Credit Institutions* falls far short of "adequate protection." It is submitted that the way forward in this area is development of a substantive code which covers all areas of the banker-customer relationship. Such a code would be more in line with other jurisdictions. However, Ireland should move beyond other jurisdictions and give statutory force to a code of practice.

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30