



10 December 2007

Michael Funston  
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Dear Michael

### **ABACUS Draft Code of Practice**

CHOICE is a not-for-profit organisation which has been researching and campaigning on behalf of consumers since we were founded in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and campaign for change when markets or regulation fails consumers.

We are pleased to welcome the revised Code of Conduct for the Credit Union and Mutual building societies and congratulate ABACUS and its members on creating a user-friendly document that addresses critical consumer issues. We hope that with our contribution to this process, the association can deliver a robust and meaningful Code that solidifies the leading role of Australian Mutuals in the banking sector.

#### Fair fees

*(4.5) We will make sure any exception fees we charge... are:*

- *Reasonable, having regard to our costs*
- *Clearly disclosed, and*
- *Fairly applied*

Penalty fees, also known as exception or default fees, have been the subject of substantial community concern over the past five months. In partnership with the Consumer Action Law Centre, CHOICE has run a campaign arguing that penalty fees have inflated above underlying costs and are often unfairly applied. We have called on banks, credit unions and building societies to bring all fees in line with costs, scrap blatantly unfair fees and introduce new ways of communicating with customers about their account transactions. Credit union and building societies penalty fees vary significantly. Over the course of the campaign we have become aware of a number of changes made to fees charged by your members (for example reducing deposited cheque dishonour fees) and we congratulate the ABACUS members who made these changes.

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CHOICE commends the decision by ABACUS to address the issue of penalty fees in its Code and we endorse the intent of clause 4.5. The inclusion of this clause confirms that the Code is relevant to consumers. We do, however, recommend one amendment (below) to clarify the provision.

In the course of our campaign against unfair penalty fees, it has also become apparent that the consumer and financial institution understanding of fees is not always the same. The case study below highlights different interpretations of the reasonableness of fees.

#### **Case Study: Complaint about penalty fee**

The customer had banked with the Police Credit Union (PCU) for three years. During that time he had been charged a large number of account overdrawn, direct debit dishonour fees and other penalty fees. Over three years the accumulated fees totalled over \$2000.

Using material available at [www.fairfees.com.au](http://www.fairfees.com.au) the customer wrote to the PCU to challenge the fees, arguing that they were unreasonably high and out of all proportion with the costs to the credit union. The customer sought a refund of the fees.

The credit union denied the customer's request for a refund on a number of grounds including adequate disclosure of terms and conditions. The PCU also argued that the relevant fees compared favourably with similar fees charged by many other financial institutions. It further argued that the charging of fees under its contracts helps the credit union to defray the costs associated with administering those contracts, and results in the credit union being able to maintain its interest rates at very competitive levels. On these grounds they rejected the claim that the fees charged were unconscionable.

Our campaign against unfair penalty fees has been fought on the principle that penalty fees should not exceed the reasonable estimate of loss incurred by the financial institution. The argument that fees are reasonable because they are not the most expensive in the marketplace is not, in our view, sufficient. Nor is it acceptable to build in additional costs to 'deter' particular banking behaviour. The case study above along with other case studies we have received suggest that these practices occur across the sector.

We recommend dot point one, at clause 4.5 is amended to ensure that 'any exception fees charged are':

- A reasonable estimate of costs

We further recommend that more work be done to develop how fees can be 'fairly applied'. Again, we are aware financial institutions have vastly different policies and practices in the application of fees. For example, CHOICE has called for the elimination of deposited cheque dishonour fees on the basis that the consumer has no control whatsoever over the decision of the third party's bank in honouring the cheque. CHOICE has recommended the following improvements that could be made by banks to improve the fairness of penalty fees;

- Eliminate inward cheque dishonour fees.
- Introduce systems to provide a greater range of options and real-time information to consumers where there are insufficient funds to make a due payment. These might include simply declining payments without charging a fee, an automated system to notify consumers by email or text message (or perhaps for concession card holders without electronic facilities, by phone),



or by automated message via the ATM or EFTPOS system, before the payment is processed.

- Adopt one of the following responses to credit card over-the-limit and account overdrawn honour fees:
  - eliminate the fees altogether (we note that credit cards operated successfully in Australia for some 20 years without such fees)
  - offer consumers a choice between declining transactions (at no cost), or charging a reasonable fee no more than the actual cost to the bank or say 2-3% of the amount by which the consumer has exceeded the limit/overdrawn their account, whichever is lower.

While we agree that fees need to be fairly applied, more work remains to be done in this area to ensure the intent and the industry practices are aligned. This work could be undertaken by ABACUS or referred to the Credit Union Dispute Resolution Centre for more precise guidance. CHOICE would be pleased to participate in such a discussion.

### Fair Terms

*(4.2) We will not adopt Terms and Conditions that are not reasonably necessary to protect our legitimate interests, or that you are unlikely to be able to comply with,*

CHOICE again commends ABACUS on the inclusion of this provision and we endorse the intent and content of the terms. As you would be aware, the Victorian Government is currently considering extending its unfair contracts legislation, which already cover banking contracts in that State, to include credit contracts. CHOICE will be encouraging this development as we believe all consumer contracts benefit from this protection. Our expectation is that the ABACUS Code should reflect the standards established by this legislation.

Part 2B of the *Fair Trading Act (Vic)* voids unfair terms in consumer contracts. It defines an unfair terms as one that causes a significant imbalance in the parties' rights and obligation arising under the contract to the detriment of the consumer. Consumer Affairs Victoria states that unfair terms typically fall into the following categories

- Unilateral variation terms
- Terms that limit the liability of the supplier, and
- Terms that impose penalties.<sup>1</sup>

In relation to the banking sector, domestic and small business consumers generally have no opportunity to amend terms and conditions. The relative power imbalance can lead to terms, such as those above, that unreasonably preference the supplier. Clause 4.2 should ensure that all customers of Australian mutuals enjoy fair terms and conditions. We believe that this section should align as much as possible with the Victorian legislation and may benefit from guidance as to the types of terms and conditions that would be deemed unfair.

### Equity Release

*(11.1) If we distribute equity release products, we will only distribute the products of issuers that subscribe to the SEQUAL Code of Conduct. We will only refer our*

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<sup>1</sup> Preventing unfair terms in consumer contracts Consumer Affairs Victoria 2007



*members or customers to a broker, aggregator or other intermediary service arranging equity release loans if that service subscribes to the SEQUAL Code (11.2) If we issue equity release products ourselves, we will subscribe to the SEQUAL Code*

CHOICE is actively involved in the debate around the quality of products and advice in the reverse mortgage industry and has published a number of reports comparing products and looking at the quality of advice. A recent report published by the Australian Securities and Investments Commission (ASIC) titled *All we have is this house* highlights the risks attached to reverse mortgages. While a very small volume of Australian mutuals' business and only a very small percentage of total loans relate to reverse mortgages, these products are unique and complex retirement finance products and it is likely these numbers will increase. We commend ABACUS on including specific provisions for these loans.

It is our understanding that only lenders or 'product manufacturers' of reverse mortgages can be members of the industry association, SEQUAL. Distributors, including brokers, financial planners, aggregators and other intermediaries cannot subscribe to the SEQUAL code. There are at least two accreditations that can be held by distributors of reverse mortgage products and many lenders operate their own product-specific training. SEQUAL has recently launched its Equity Release Accreditation Course designed for brokers, planners, accountants and legal advisers. The Over Fifty Groups Seniors Home Equity Release Loan also has a SEQUAL-endorsed training program. While distributors cannot subscribe to the SEQUAL Code, they can, however, voluntarily elect to distribute only SEQUAL accredited products and ensure relevant staff hold training accreditation.

While CHOICE expects industry regulation will soon increase, currently the best protections available for consumers entering this market is to borrow from a SEQUAL lender through an accredited intermediary. We would encourage ABACUS to adopt terms that reflect this.

We also note that at footnote 12, the Code omits equity release products from its commitment to responsible lending. CHOICE believes that such loans should fall within the ambit of the 'responsible lending'. Section 11 Equity Release Products addresses the requirements of reverse mortgage lenders but does not cover other forms of equity finance. Equity finance, including shared appreciation loans and equity finance mortgages, are not addressed by SEQUAL and its code. We recommend amending footnote 12 to reference section 11, but not exclude the broad spectrum of equity release products from the credit unions' and building societies' responsible lending obligations.

#### Code Status and Compliance

*"we have not sought to require subscribing institutions to give their members and customers contractual rights in respect of the Code's Commitments...[doing so] would be at odds with the aspirational style of drafting of the Code... our members will have significant obligations and incentives to comply with the Code."* Overview of Code, p3

The decision to waive a contractual obligation on subscribing institutions is out of step with the general direction of self-regulatory codes in this industry. We note that Australian Bankers Association (ABA) requires subscribing members to include the Code of Banking



Practice as part of its contractual arrangement with customers. This practice has, in our view, contributed to the robustness of the ABA Code. While we appreciate the differences between ABACUS and the ABA, and their respective members, there are not significant differences between the two groups in the contractual rights expected by customers.

The *Draft Code* states “This Code goes beyond our legal obligations, offering our members and customers additional protections and benefits” (Draft Code p1). The *Draft Code* does move beyond minimum legal requirements to establish minimum best practice in the Australian mutuals sector. However, in the absence of a contractual obligation it is confusing and potentially misleading to state that this amounts to additional protections. Protections are commonly understood to be rights that are protected in law, such as under contract.

The *Overview Document* explains that ABACUS expects misleading and deceptive conduct provisions of the *Trade Practices Act* to be the legal instrument through which compliance with the Code is legally enforced. While a customer may take legal action based on these provisions we question 1) the cost risk and uncertainty borne by the individual customer in lodging such a claim, and 2) the extent to which the remote risk of a law suit with an uncertain outcome would act as a deterrent to potential violations of the code. Further, the reliance on these legal provisions contravenes the intent of self-regulatory mechanisms. It transfers risk to individual consumers and establishes industry practice that can’t achieve minimum best practice in compliance and enforcement. For these reasons CHOICE believes it is unacceptable to rely on this legal provision to justify waiving contractual obligations on subscribing members.

CHOICE considers that the failure to insist on a contractual commitment to the Code may create confusion for consumers and undermines the intent of the self-regulatory model. We urge ABACUS to reverse this decision, or at the very least make it possible for subscribing members to adopt the Code as a contractual obligation and strongly encourage them to do so.

#### External Dispute Resolution (EDR)

Lastly we note that the *Draft Code* proposes that a dispute only proceed to EDR after either a formal response or 45 days. The timeframe for the banking sector included in the Banking Code of Practice is substantially less at 21 days. Given banking disputes often involve high stress to the individual customer it is unreasonable to extend the timeframe unnecessarily. The ABACUS Code should reflect best practice to resolve disputes and 45 days is, in our view, excessive. We urge ABACUS to adopt the 21 day standard already established in the banking industry.

For further information, or to discuss any of the issues raised in this letter, please feel free to contact me on (02) 9577 3349 or [efreeman@choice.com.au](mailto:efreeman@choice.com.au) .

Kindest regards

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