

Draft Code of Practice – Mutual building societies and Credit Unions

Submission by the Credit Union Dispute Resolution Centre--

The Draft Code of Practice – Mutual building societies and Credit Unions (“**the Code**”) has much to commend it. It is detailed, comprehensive and reflects positively on a sector of the industry which seeks to set itself apart by emphasising its commitment to its members and customers and to “high standards of practice, conduct and service”¹. We are impressed with the rigorous approach which has been taken to the drafting of the Code and the leadership shown by mutual building societies and credit unions in going beyond the requirements of the law and the standards set by other industry Codes in many areas. Overwhelmingly, we regard the implementation of the Code as a positive and constructive step for consumers and industry participants alike. However, there are a few aspects of the Code we feel could be strengthened or improved and it is those areas we have focused on in our submission.

Key Issues

Enforceability

The lack of contractual enforceability weakens the impact and effect of the Code. We strongly recommend that the Code be a contractually binding document which individual or small business members or customers can enforce by pursuing a dispute with an external dispute resolution (“EDR”) scheme or at law.

Making the Code contractually enforceable will:

- enable CUDRC, as an alternative dispute resolution scheme applying the Code in its decision making, to determine appropriate compensation for breaches of the Code;
- remove any doubt that mutual building societies and credit unions are genuinely committed to meeting the standards set out in the Code; and

¹ *Draft Code of Practice*, 2007, p. 4.

- ensure that the Code, which exceeds current industry practice in some of its provisions, is a truly 'best practice' document setting the standard for other sectors of the financial services industry.

Current undertakings to comply with the Code

Currently, the Code includes two statements to the effect that Code subscribers undertake to comply with the Code:

- In the section entitled 'Coverage, Commitment to Comply, Other matters', the Code states "we undertake to comply with this Code in our dealings with you"²; and
- Clause 4.1 of the Code states that "the standard Terms and Conditions Standard Agreements ("Terms and Conditions") applying to our products and facilities will be consistent with this Code"³.

Given these undertakings, it comes as a surprise to read in the *Abacus Australian Mutuals – Code of Practice – Public Consultation Discussion Paper* ("**Discussion Paper**") that there is no intention that the Code be contractually binding. The Discussion Paper explains that Abacus has not sought to require subscribing institutions to give consumers contractual rights in terms of the Code's commitments because:

*"making the commitments of the Code contract terms (in effect) would be at odds with the non-technical and aspirational style of drafting of the Code."*⁴

In our view, making the Code contractually binding, in the same way that section 10.3 of the Code of Banking Practice ("**CBP**") gives the CBP contractual force, would not require changes to the current language or terminology (which, in any event, needs to be sufficiently clear for CUDRC and other dispute resolution bodies to interpret and apply the Code).

We also don't believe making the Code contractually enforceable would undermine the aspirational style of drafting of the Code. The CBP, for example, includes broad statements in Part B which set out its Key Commitments and General Obligations. The Banking and Financial Services Ombudsman ("**BFSO**"), which routinely applies the CBP in its

² *Draft Code of Practice*, 2007, p. 5.

³ However, footnote 10 provides that "this section does not apply to individual contract arrangements or to terms specifying the cost or price of a product or facility". We discuss this exclusion further on pp. 5-6.

⁴ *Discussion Paper*, 2007, p. 3.

decision making, interprets these key commitments, such as the promise to “act fairly and reasonably towards you, in a consistent and ethical manner”⁵, in light of the specific and more detailed commitments outlined in the remainder of the document. Abacus might include a provision in the Code explaining that its Code should be interpreted in this manner although, given the structure of the Code, it is likely that the ‘Key Promises’ section will be read down in light of the more detailed provisions in the section entitled ‘Delivering on Our Key Promises’.

Alternative means of redress

The Discussion Paper also suggests that consumers unable to pursue a contractual remedy for breaches of the Code will have other alternative means of redress. It states that “arguably an entity that consistently failed to comply with a provision of a Code of Practice to which it purported to subscribe would risk breaching legal prohibitions against misleading and deceptive conduct.”⁶

In some circumstances, there may be scope for a consumer to argue that a Code subscriber which breaches the Code, despite having made an explicit commitment to comply with it, has engaged in misleading or deceptive conduct in breach of section 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (“**the ASIC Act**”) (although regular or repeated breaches of the Code are only likely to be detected and pursued by an EDR scheme or the Code Monitoring Committee). However, the Courts have determined that it is the domain of contract law to enforce promises or make representations good and, consequently, the damages that will flow for misleading or deceptive conduct are likely to be lower than the damages a consumer will receive for a breach of contract.⁷

Application by EDR schemes

In addition, the Discussion Paper points out that “the Code will be applied by the external dispute resolution schemes to which Abacus members belong.” This suggests that lack of contractual enforceability will be remedied by the fact that consumers will be able to take disputes to the appropriate EDR scheme which will apply the Code in its decision making.

⁵ Clause 2.2, *Code of Banking Practice*, 2004, p. 1.

⁶ *Discussion Paper*, 2007, p. 3.

⁷ See *BFSO Bulletin 52*, 2006, p. 3 for a discussion about compensation for misleading conduct.

This comment seems to be based on the erroneous assumption that EDR schemes, under their Terms of Reference, can apply the Code as if it were contractually binding even though it does not, in fact, form part of the contract between a member or customer and their mutual building society/credit union. In CUDRC's case, it is entitled to "have regard to applicable industry codes including the Credit Union Code of Practice"⁸⁹ but this does not extend to awarding compensation as if a breach of the Code represented a breach of contract.

In fact, in order to determine compensation for a breach of the Code, CUDRC will need to determine whether the breach amounts to:

- misleading or deceptive conduct under the ASIC Act;
- an actionable misrepresentation;
- promissory estoppel; or
- breach of another legislative or common law obligation.

To avoid confusion about the action a breach of the Code gives rise to, and to ensure that compensation is determined in a consistent manner (no matter which EDR scheme or legal forum the member or customer pursues the dispute in), we strongly recommended that Abacus make the provisions of the Code contractually binding on its members. This will be of considerable benefit to CUDRC in its role as a decision maker.

Section 4: Fair products and fees

Section 4 of the Code, entitled 'Fair products and fees' includes a number of important provisions about fees. The Discussion Paper identifies the provisions in this section as one area "where, we believe the Code goes further than other codes in providing consumer benefit"¹⁰ and we agree.

⁸ Clause 2.1 of the *CUDRC Terms of Reference* defines the Credit Union Code of Practice as the 'Credit Union Code of Practice published on 21 July 1994 as amended, supplemented or replaced from time to time'. Therefore, this will include the new Code of Practice when it is introduced.

⁹ Clause 7.2(b) of the *CUDRC Terms of Reference*.

¹⁰ *Discussion Paper*, 2007, p. 3.

However, the consumer benefits which this section provides are limited by an important exclusion set out in footnote 10 which states that:

this section... does not apply to terms specific to individual contractual arrangements, or to terms specifying the cost or price of a product or facility (including interest rates, applicable fees and charges, repayment amounts and periods, available credit, credit limit or overdraft amount, etc).

We understand from our discussions with Michael Funston that the intent of this exclusion was to ensure that the operation of this section did not impinge on the right of a mutual building society or credit union to itself determine the appropriate fees to charge for its products and services. However, in its current form, the exclusion has the effect of excluding from the operation of this section all terms which “[specify] the cost or price of a product of facility”. This means that these provisions, will not, for example, have to meet the requirements of clause 4.3 which specifies, among other things, that terms and conditions will be “clear, unambiguous, and not misleading”. It even appears to exclude clause 4.4 which relates directly to fees and charges.

The current wording of the exclusion is clearly too broad but we question whether the exclusion is really necessary. On our reading of the provisions in this section they would not impinge on the right of a Code subscriber to set its fees and charges at its own discretion. Similarly, ensuring that the standard Terms and Conditions are consistent with the Code would not in any way hinder the setting of fees and charges. The reference in clause 4.1 to “[striking] a fair balance between your legitimate needs and interests... and our interests and obligations” would surely include a Code subscriber’s commercial interest in running a viable business. We suggest that the exclusion is removed.

At any rate, the exception, in its current form, is too important to be included in a footnote. If it is retained it should be moved up into the section itself and made a clause of the Code.

Section 5: Responsible lending practices

Relying on member or customer information

Clause 5.1 states that Code subscribers will:

base our lending decisions, including decisions to extend existing credit facilities, on a careful and prudent assessment of your financial position and capacity to repay.

Clause 5.2 goes on to explain that Code subscribers will:

only lend amounts to you that we believe, on the information available to us, you can reasonably afford to repay. In making this commitment, we are entitled to rely on your honesty and the accuracy of the information you provide to us (although we may undertake our own independent checks as well).

In our view, relying on the customer to provide honest and accurate information without independently verifying the information may not be compatible with the commitment in clause 5.1 to act in a “careful and prudent” manner. In some circumstances it may be careful and prudent to rely on the information provided by a member or customer - for a standard credit card application, for instance, which does not, on its face, appear incorrect or inaccurate.¹¹ In other circumstances, such as a personal loan or home loan, it may well not be considered careful and prudent practice to rely on information provided without independently verifying the information.¹² We believe the clause should be reworded as follows:

We will only lend amounts to you that we believe, on the information available to us, you can reasonably afford to repay. In making this commitment, we expect that you will provide honest and accurate information to us. Where it is prudent to do so we will also undertake our own independent checks as well.

Unsolicited credit card increases

Clause 5.3 states that “we will not send you an unsolicited offer to increase your credit limit if you have a recent poor repayment history, or regularly make only minimum monthly repayments on the facility.” The wording of this clause suggests that if you don’t have a recent poor repayment history or you pay more than your minimum monthly repayment you may receive an unsolicited offer to increase your credit limit.

Our experience with maladministration disputes shows that payment history is not always a reliable indicator of capacity to meet repayments on an increased credit limit.¹³ In our view, failure to make enquiry of the cardholder to reveal current income levels and other credit commitments may lead to an inappropriate offer of credit despite a member or customer being otherwise able to meet their current payments. We suggest that a training manual to accompany the Code include information about the limitations of ‘credit scoring’ (or making decisions about a customer’s

¹¹ For further discussion see *BFSO Bulletin 50*, 2006, p. 5.

¹² For further discussion see *BFSO Bulletin 50*, 2006, p. 7.

¹³ For further discussion see *BFSO Bulletin 45*, 2005, p. 8.

capacity to make repayments without making direct enquiry of their current circumstances) to ensure that Code subscribers don't believe that merely complying with the requirements of clause 5.3 is sufficient to meet their obligations as a lender.

In addition, clause 5.4 provides that any unsolicited offer to increase a customer's credit limit will include information on "rejecting the offer if you are currently having difficulties meeting your repayments, or your financial circumstances are likely to deteriorate in the near future." We believe this should be expanded to include information about rejecting the offer because you can't afford an increased credit limit (even if your current circumstances remain the same).

Comments on Specific Provisions

Clause 7.2

The wording of this provision could give the impression that a cardholder must destroy a subsidiary card or return it to the subscribing institution in order to avoid liability for unauthorised use of the card following cancellation.

We suggest that the clause is amended to as follows:

If you cancel a subsidiary card, you will not be liable for any losses resulting from continuing (unauthorised) use of the subsidiary card following cancellation, provided you:

- (a) *take all reasonable steps to ensure the card is destroyed or returned to us;*
and
- (b) *do not act fraudulently or otherwise cause those losses.*

Clause 8.2

This clause suggests that a Code subscriber can avoid liability under this provision by turning a blind eye as to whether a co-borrower is receiving a benefit under a loan or facility. We suggest this clause is amended as follows:

We will not accept you as a co-borrower if we are aware, or ought to be aware, that you will not receive a direct benefit from the loan or facility.

Clause 9.9

We suggest that this provision is amended as follows:

We will ensure you have a minimum of 24 hours before signing the documentation to consider and/or obtain advice on the documents and information we provide to you. At our discretion, we may agree to a short period if you (the guarantor) request this provided that you have obtained independent legal advice.

This amendment will protect the guarantor from pressure from the borrower to sign the documentation quickly. The 24 hour waiting period is an important protective mechanism for the guarantor and should not be waived on his or her request unless they have received independent legal advice about the consequences and risks of signing the document. It also reduces the possibility of a challenge to the validity of the guarantee on the grounds of undue pressure.

Clause 10.1

We see a lot of disputes about whether a mortgage or finance broker is an agent of the member/customer or the financial institution whose products they are distributing. We envisage that this clause, which refers to the 'engagement' of a mortgage or finance broker, may give rise to similar disputes. To avoid this complication, we recommend that the clause is amended as follows:

If we allow mortgage or finance brokers to distribute our products, we will require that the brokers belong to the Mortgage and Finance Association of Australia and are members of an ASIC-approved external dispute resolution scheme.

The distinction between a mortgage or finance broker acting as an agent of a Code subscriber, as opposed to an independent operator, is nonetheless important in terms of referral of disputes to the correct EDR scheme.

Where a mortgage or finance broker is acting as the agent of a Code subscriber, any disputes which arise in relation to the mortgage or finance broker's conduct should be referred to the EDR scheme of which the Code subscriber is a member (because the Code subscriber is responsible for its agent's conduct). However, where a mortgage or finance broker is acting independently, the dispute should be referred to the scheme to which the mortgage or finance broker belongs.

Clause 22.2

This clause requires that Code subscribers have procedures in place to ensure that they do “not have your default listed on your credit file while [they] are considering your application or request.” This is subject to footnote 23 which states “that [they] may not be able to have a reference removed once it is listed.”

We are not aware of any circumstances in which the institution which made the listing would not be entitled to subsequently withdraw the listing. If this clause was breached, CUDRC would usually require that the listing be removed. We suggest this footnote is removed.

Clause 28 – Complaints about breaches of this Code

This provision provides that claims involving financial loss should be referred to an EDR scheme, which has the power to award compensation, whereas disputes which do not involve financial loss should be referred to the Code Compliance Manager.

We are concerned that disputes involving non-financial loss, for which a member or customer is nonetheless entitled to compensation (such as dispute involving a breach of a member or customer’s privacy), may not be eligible for referral to an EDR scheme. We suggest that this clause is amended to just refer to “loss” rather than “financial loss”.

Appendix – Publicising the Code

We suggest that in addition to making copies of the Code available in each branch Code subscribers also have copies of the Code on display in each branch. We believe this is an important aspect of publicising the existence of the Code.