

Consumer Council**Submission to LegCo Panel on Financial Affairs
'Consumer protection in the banking sector'****Introduction**

1. The Consumer Council is pleased to provide comments to the Panel on the issues it has identified relating to consumer protection issues in the banking sector. Some of the issues have been the subject of public debate over the past few years and the Council has provided substantial responses to various consultation papers and requests for comments from industry and government. The Council would be happy to elaborate on the information provided below in more detail, should members wish.

Consumer Protection Policy

2. As noted in the research material, both the UK and the US have placed much emphasis on the protection of consumer rights through the creation of both sector specific and general consumer protection agencies, and through enshrining detailed consumer protection objectives and principles in legislation.
3. The LegCo duty visit report has observed that 'Industries are often under the impression that by ensuring the protection of customers' interests, the rights and interests of the industries are forgone', a view which is not shared in the LegCo report. The Council also considers that this attitude by industry misconstrues the purpose behind having a strong consumer protection environment. This is primarily to do with maintaining consumer confidence, which is vitally important to economic growth, and which cannot be simply left for market forces to deliver.
4. The approach taken in the UK, for example, correctly recognizes this importance. As noted in the LegCo report, the 'concept of consumer protection has been very comprehensively implemented in the Financial Services and Markets Act which links the protection of consumers to the wider interest of maintaining the international competitive position of the financial markets.'

Regulatory Framework for the banking sector

5. The comparative study undertaken by HKMA has discussed regulatory arrangements for the financial sector in other jurisdictions where sector specific arrangements for consumer protection sit relatively comfortably with the existence of general consumer protection agencies. For example, the Australian Competition and Consumer Commission, which has amongst other things a nationwide consumer protection role, operates in cooperation with several financial regulatory authorities that also have consumer protection functions. Similarly the UK Office of Fair Trading works in cooperation with the Financial Services Authority.
6. Notwithstanding the fact that the Consumer Council lacks an enforcement responsibility, the Council speaks for the consumer interest, drawing its views from the extensive contact it has with the wider community, and from its contact with other international consumer bodies.
7. The Council supports the work of the HKMA in promoting the cause of consumer protection in the finance sector. As such, it would welcome any organizational

arrangements within the HKMA, with necessary safeguards as noted in its study, that support that cause.

Consumer consultation on banking related legislation and policies

8. As far as consumer consultation mechanisms are concerned, the Council notes the existence of the Financial Services Consumer Panel in the United Kingdom which was established by the Financial Services Authority to provide advice on the interests and concerns of consumers. Whilst the Consumer Council is performing a generally similar function now, it would welcome initiatives to refine the framework within which industry seeks representations from a wider consumer audience, through a consumer representative panel, **provided that:**

(a) The panel must have independent view and not be dominated by the relevant industry or liable to capture by industry.

(b) The panel needs to be provided with necessary support to analyze issues, conduct studies, and facilitate meaningful responses from members.

9. The choices available to Legco Members and government, as to an appropriate system for consumer protection that is best for the Hong Kong banking industry, or the economy in general are varied. Moreover, the very nature of the existing Consumer Council is in fact one such model of a consumer advisory panel.

10. In the absence of any other structures that exist in Hong Kong, the Consumer Council will continue to study issues and speak for consumers' interest. This is illustrated by the following example:

11. In July 2000 the Court of First Instance made a ruling on an action brought under the *Unconscionable Contracts Ordinance* by consumers who were subjected to onerous debt collection practices, set out in the terms and conditions of credit card contracts, by banks in Hong Kong. The fact that this dispute arose, and was the subject of a highly contested and expensive court case illustrates a common attitude in Hong Kong, i.e. that the interests of industry should reign supreme over that of consumers. This attitude is in contrast to the prevailing more balanced approach that can be found in other comparable advanced economies.

12. In this particular case, the Council was asked for assistance by the court in its deliberation of the dispute, which was eventually resolved in the consumers' favour. The success of the case has brought about some changes in banks' behavior that recognizes consumer interests, not solely those of the banks. This has come about due to the very positive reaction to the court's decision by the HKMA in its efforts to persuade industry to review the Code of Banking Practice. The Council was also subsequently involved in providing comments to the industry working group conducting the review, after the group had developed various draft proposals. These covered a wide range of issues, including the following:

(a) How representations on the terms and conditions for banking services should be made available to consumers.

- (b) The quotation of interest rates. The Council fully supports the HKMA in taking a definite decision requesting all banks to use a common formula to disclose the 'true' cost of credit card borrowing to customers. The Council has long urged the banking industry to use a common method for calculating the Annualized Percentage Rate (APR) of credit card advances and that all relevant fees and charges should be taken into account in the calculation of APR.
- (c) Clear and prominent disclosure of crucial information to customers before they enter into an agreement for an electronic banking service at the point of service within the web site when a customer contracts for such service.
- (d) Requirements to disclose relevant statements in relation to protection of customers' personal data when using an electronic banking service.

Mechanism for handling complaints from bank customers

13. The Council encourages consumers to make their complaints against banks and similar financial service providers directly at the corporate level, through banks 'in house' complaints handling mechanisms. The Council also plays a role, either when there has been dissatisfaction with the in house mechanism, or if the consumer has chosen to do so, directly to the Council in the first instance. In the case of the latter, the Council has to rely on its persuasive capacity to effect a remedy, directly with the institution concerned. As a last resort, if it considers warranted, it may give support to consumers through its Consumer Legal Action Fund to take legal action under appropriate consumer protection legislation.
14. The Council does not seek direct assistance from the HKMA on individual complaints by consumers against banks. However, in circumstances where a systemic problem is identified, discussions are held to ascertain whether it should be involved in finding a solution.
15. There are a number of options available in regard to a dispute resolution framework, such as creating a Banking Ombudsman or retaining and/or improving the current system. The Council suggests that the Government set up a task force to examine the options.
16. The Council considers that whatever mechanism is introduced to resolve disputes between consumers and members of the banking industry (or the economy generally) there are core principles that need to be applied to ensure that the mechanism is effective and fair. Those principles are as follows.

Independence/Impartiality: A dispute resolution mechanism will be neither credible nor effective unless it is conducted by individuals who are truly independent and impartial with respect to the disputing parties.

Transparency: An essential criteria is that information on all aspects of the service be readily available to potential users of the service. Such transparency is also needed so that outside researchers, as well as potential users, can assess the independence and effectiveness of the service on an ongoing basis. Publication of past rulings is important in this respect.

Availability: A dispute resolution mechanism should be as widely available as possible, in that any customer of the party being complained of, regardless of the customer's geographic location, should be given access to the mechanism.

Visibility: The dispute resolution mechanism, to be useful, should be well-publicised, such that interested consumers and businesses can become aware of it when the need arises.

Affordability: The mechanism should, optimally, be free to the consumer. Any consumer charge, or a "loser pays" rule will deter consumers from using the mechanism.

Speed/Timeliness: Dispute resolution mechanisms should be made available to disputants in a timely fashion, and should resolve disputes quickly.

Competence of Complaints Officers: Those conducting the dispute resolution must have sufficient skills and training to fulfil the function in a satisfactory manner.

Accessibility/Ease of use: The dispute resolution mechanism should be easily accessible, non-intimidating, and convenient to use. For example, there should be guidance for customers in filling in and filing submissions. The mechanism should be available in both Chinese and English, and all information on aspects of the service should be available in that language.

Security: Any confidential communications in the context of dispute resolution should be appropriately secure from unauthorised access.

Enforceability: It would be expected that failure by a business member to comply with a decision under the dispute resolution mechanism should have appropriate sanctions to make non compliance undesirable.

Due Process: The mechanism should provide both parties with a reasonable opportunity to make their case, and to hear and respond to the opposing party's arguments. Ideally, the average consumer should not need legal representation in order to use the process effectively, but should not be precluded from being represented.

Legality/Liberty: Where a dispute resolution mechanism is provided as an alternative to legal process, the option of using the mechanism for consumers and should not impinge in any way on their right to legal redress if dissatisfied with the results of the mechanism.

Marketing practices of credit providers

17. The Council has expressed a concern with HKMA on the manner in which credit is marketed by financial institutions arising from the concern of increased bankruptcies
18. Notwithstanding the results of HKMA's findings that authorised institutions were generally in line HKMA's expectations, the Council has a concern that the marketing practices of many credit providers may contribute to the problem of unsustainable indebtedness by unwary consumers.

19. The Council recognizes that the HKMA's jurisdiction is limited, in that it does not have supervisory power over all credit providers particularly those who may have engaged in questionable marketing practices, and there is high reliance on industry self regulation. The marketing problems that the Council has concerns with exist across all institutions that provide credit in the community. In considering the means to resolve the debt problems that are arising in the community, the dispersed nature of regulatory supervision in the credit sector is a factor that government must consider in the immediate future.
20. The issue of marketing practices also needs to be viewed in an evolutionary perspective, in that the marketing practices used by institutions to entice consumers into borrowing vary and change over time.
21. For instance, a common advertising feature that the Council has become aware of, through complaints and inquiries from consumers, is that credit providers represent to consumers that they only need to pay minimum monthly payments to secure access to large amounts of readily available funds. However, the advertisements fail to inform consumers of the compounding effect of interest on the debt. Needless to say, the full costs of repayment in terms of the number of years required to pay off the amount owing is the reason why many consumers have sunk deeply into unsustainable debt.
22. Another marketing tactic that the Council feels is exacerbating the problem is the practice of encouraging customers to, in effect, take out an overdraft in the first weeks of obtaining a credit card, and repaying the minimum balance in the first three months in order to obtain a prize. The Council believes that if the problem of unsustainable indebtedness is a major problem, then credit providers should not be engaging in conduct that encourages cardholders to develop a habit of taking on overdrafts, and only paying a minimum balance, with the ultimate consequence of a high and prolonged period of indebtedness.
23. It might be argued by credit providers that they are under no obligation to inform consumers of the downside in taking on large amounts of debt. However, from what industry and government have publicly stated on the extent of the problem, the Council believes there is an obligation on the part of the industry not to exacerbate the problem by exaggerating the benefits of their credit products, or by omitting important facts in their marketing tactics.
24. The Council is devoting its resources to educate and inform consumers of the pitfalls in promises made in advertisements that portray only the favorable side of a product. However, the resources available to the Council are no match when compared to those devoted to the promotion of credit in the marketplace; as demonstrated by the barrage of media advertising, junk mail, and cold calling that the industry devotes to promote debt. The Council considers that there is a need to tighten the regulation of these marketing practices in Hong Kong.
25. Hong Kong needs a solution to adequately address problems of consumer concern with various marketing practices.
26. The Council has published survey findings on banking services through its Choice magazine for public information. Topics have included fees and charges levied by

banks and charge back policies of credit card companies. The Council's findings were extensively covered in the media.

27. The Council has also conducted consumer education workshops at elderly homes on the issue of low-balance account bank fees.

Access to credit reference

28. The Council has been in dialogue with HKMA and industry on the proposal to extend the current credit reference data base of information kept on consumers. The Council is willing to support government and industry policies that work to the benefit of consumers and the economy generally, through reducing the extent to which consumers take on unsustainable levels of debt. However, the Council considers that a number of issues need to be addressed before there is any further action taken to extend the sharing of credit data as proposed by industry. In particular, the issue of privacy safeguards.
29. Apparently there is only a minority of borrowers who either fall victim to an inability to understand the implications of getting into debt, or who actually cause a problem through planned bankruptcies. The Council understands from discussions with industry that approximately two thirds of credit card holders pay their monthly balances in full, and therefore would not come within the ambit of the problem.
30. The Council has informed HKMA of its concern that mandatory sharing of credit information to include substantial information is exposing a majority of consumers to unnecessary detailed scrutiny. Given the problems that have arisen in the past with leakage of personal information that is used for marketing purposes, the Council is concerned with the potential risk of unauthorised disclosure.
31. In this regard the Council will continue to liaise with the Privacy Commissioner, the HKMA and industry to resolve lingering concerns.

Fees and charges for basic banking services

32. The Council is concerned that low-income consumers, or others at a disadvantage, will suffer from the imposition of fees for failing to maintain a particular account balance. For low-income earners especially, maintenance of a minimum balance at a level set by some banks may be an unreasonable task and could be an added burden.
33. There are some banks that do not presently levy these charges, and there appear to be competitive choices available to those low-income earners who are unable to maintain balances above the minimum levels currently in existence although these banks may not be easily accessible in terms of geographic location. The Council trusts that where banks choose to levy fees on minimum balances, prior notice would be given to consumers on the imposition of the fees so that they may opt not to maintain the account and choose another bank. This is in line with the requirement of the Code of Banking Practice that banks would give advance notice to affected consumers before any change in fees and charges takes effect.
34. Nevertheless, the Council is concerned of the long-term trend in the industry that all banks will eventually levy charges on accounts below certain minimum levels. There

are of course, cost considerations in relation to maintaining bank accounts, and the Council is not seeking to deny banks recovering those costs.

35. An option for HKMA and industry to consider is the example of 'Basic Bank Accounts' or 'Lifeline Accounts' as found in the UK and USA (sections 17 and 35 of the LegCo Secretariat research paper refers). In the meantime, due to the length of time necessary to introduce the legislative support necessary for such safeguards, HKAB members could give consideration to providing some targeted assistance to those in our community who may warrant special attention, and for whom the competitive process might leave behind. For example, granting concessions or waiving low balance charges for low-income and other disadvantaged classes of consumers. In considering which consumers fall into relevant categories that have special needs, there are similar schemes operating in other service industries. For example, China Light and Power Company (CLP) provides a concessionary tariff for the elderly (aged 60 or over) who are receiving or eligible for Comprehensive Social Security Assistance. Reference could also be made to the concept of a Universal Service Obligation similar to that which operates in the telecommunications industry.

Protection for bank depositors

36. The Council has previously submitted during the public consultation exercise, that it considers a deposit insurance scheme to be the best option for Hong Kong. In summary, the Council's views are that a deposit insurance scheme would best serve the interests of consumers for the following reasons.
- (a) It would contribute to a stable banking system, as a reasonable assumption can be made that such a scheme would provide an element of confidence in the industry and that depositors, particularly smaller ones, may be less inclined to act on rumors in the market, thereby reducing the possibility of runs on the banking system;
 - (b) In the event of a bank failure, a deposit insurance scheme would ensure that small depositors are guaranteed of receiving funds (in that they would not have to worry about a failed bank having sufficient assets to meet their claims);
 - (c) Even if a failed bank was eventually found to have sufficient assets, the payments would be much more promptly made under an insurance scheme, rather than would be the case under a priority payment scheme, because they would not have to wait for the full process of administration of assets, and recognition of creditor priority, to run its course; and
 - (d) There is a strong argument that having a deposit insurance scheme is consistent with the protection that is already in place for investors in the stock and futures markets, and the proposed improvements to that protection through amendments to the Securities and Futures Bill. It could be argued that it is equally, if not more important, that depositors' funds should have similar insurance protection, given that they could represent the life savings, and a major source of liquidity for many consumers.
37. A number of arguments have been made against introducing such a scheme. For example, that insurance-based systems promote moral hazard and lead to "commoditization" of covered deposits because depositors have less reason to

discriminate between banks on grounds of risk. It is also noted that prudent banks might claim they are subsidising riskier banks in the sense that the prudent banks are helping to pay for a system which they themselves do not need and are unlikely to use. Also, there are concerns that the costs of the insurance scheme will be directly passed on to consumers.

38. The Council considers that the answer to the issue of moral hazard is through competent regulatory supervision. The Council notes the good work of the HKMA and that it is already in the process of enhancing its supervisory regime to make it more risk-based. With regard to the arguments of cross-subsidisation, an element of subsidy is inherent in any form of insurance, particularly mandatory insurance. It is considered that deposit insurance would help promote competition in the market for banking services, and that as a result, strong competition between banks will play its part in reducing the extent of costs being passed on to consumers.

39. As noted, the Council appreciates the work done by HKMA in assessing the conduct of industry, and in furthering consumers' interests generally. We welcome this cooperation, and stand willing to assist government and industry, through making our resources available, to address the various problems that arise in the finance sector.

Consumer Council
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