

**For information on
13 June 2002**

LegCo Panel on Financial Affairs

Consumer Protection in the Banking Sector

I. Purpose

This paper aims to update the Panel on the operation of the revised Code of Banking Practice, the latest complaint statistics, and the recent efforts taken by both the Hong Kong Monetary Authority (“HKMA”) and the banking industry to further enhance consumer protection in the banking sector. In view of these developments, the paper also examines the effectiveness of the current arrangements for the protection of bank customers.

II. Background

2. On 26 February 2002, the Panel held a special meeting to consider the existing consumer protection arrangements in the banking industry. Specific topics such as conduct regulation in the banking sector, the revised Code of Banking Practice and the respective roles of the HKMA and the industry Associations were discussed. In particular, the Administration was requested to review the operation of the revised Code of Banking Practice, the enforcement mechanism for the Code and the HKMA’s role in relation to consumer protection in the banking sector. It was agreed that a further meeting should be held in June to discuss these various issues.

III. A Brief Summary of the Existing Arrangements for Protection of Banking Consumers

3. A full account of the existing banking consumer protection arrangements has already been given in the HKMA’s previous papers prepared for the Panel.

4. Under the existing arrangements, the HKMA does not have an explicit statutory responsibility for consumer protection. However, in the absence of alternative arrangements, it has to some extent come to take on this role. It monitors and enforces compliance with the Code of Banking Practice as part of its regular supervision of authorized institutions (AIs). Where non-compliance with the Code is identified, it will follow up with the AI concerned to press for appropriate remedial action to be taken. In case of need, the use of “moral suasion” by the HKMA can be backed up by its formal powers under the Banking Ordinance where there is evidence of poor management or weak

internal controls. In addition, the HKMA receives complaints against AIs from the public with a view to checking that they are dealt with properly by the AIs involved. However, the HKMA does not generally arbitrate in customer disputes nor does it have any power to require AIs to pay compensation to customers.

5. The HKMA's role in consumer protection complements the banking industry's self-regulation. In an effort to take on a more proactive role in the future development of the Code of Banking Practice, the Hong Kong Association of Banks (HKAB) and the DTC Association (DTCA) have jointly established a Code of Banking Practice Committee (CoBP Committee), on which the HKMA is represented. The CoBP Committee is charged with the responsibilities of providing guidance on interpreting the Code and undertaking future review of the Code. It also provides a regular forum for the industry and the HKMA to address and respond to topical consumer issues which could have implications for the Code. However, the Committee does not monitor or enforce individual AIs' compliance with the Code.

IV. Recent Developments

6. The HKMA and the two industry Associations have continued to work under the above framework following the Panel's meeting in February. Recent developments relating to the operation of the Code are described below.

CoBP Committee

7. Since its inception in December 2001, the CoBP Committee has considered over 10 queries relating to the interpretation of specific provisions of the Code. The Committee's views in each case are circulated to all member institutions which are expected to implement the relevant provisions according to the Committee's interpretation. This arrangement has helped to promote consistency in the ways individual institutions adhere to the requirements of the Code.

8. During this period, the Committee also addressed a number of issues relating to how AIs' business practices should be reflected in the Code. These were brought to its attention by various parties including members of the Legislative Council, the Consumer Council and the HKMA. These issues have been dealt with promptly and some of them have already resulted in circular notices issued by the two industry Associations making recommendations to their members. The three cases summarised below are examples of how the Committee has enabled the banking industry to play a more proactive role in promoting good business practices amongst AIs.

(i) *Charges on foreign currency credit card transactions*

9. Early this year, some members of this Panel and the Consumer Council expressed concern about the transparency of charges on foreign currency credit card transactions. The CoBP Committee looked into this issue and identified room for improvement in respect of AIs' practices in this area. On the recommendation of the Committee, the two industry Associations subsequently issued a circular notice, recommending their members to disclose the margin they charge over the exchange rates charged by the credit card network operators on foreign currency credit card transactions. This new measure has improved the transparency of AIs' charges on credit card transactions in foreign currency.

(ii) *All-monies clause in mortgage documents*

10. At the February meeting of the Panel, some members raised the issue of "all monies" guarantees. Members considered that this practice was unfair to the guarantor whose liability could be extended, without his specific consent, to cover any additional loans granted by the AI to the borrower. They also commented that there was a lack of choice in the market as most AIs had included an "all-monies" clause in their mortgage documentation.

11. In April, the HKMA took up the Panel's concerns with the CoBP Committee. The CoBP Committee agreed that AIs' existing practice with regard to guarantors should be addressed in order to avoid the situation described by Members. To this end, members of the CoBP Committee have discussed new provisions to the Code of Banking Practice which would require AIs to seek the guarantor's specific consent before his liability can be extended to cover any further loans or facilities granted by the AI to the borrower. When the Committee has reached final agreement on the relevant provisions, they would need to be put to the industry Associations for their endorsement.

12. As regards the issue of choice in the documentation, the CoBP Committee noted that the HKMA has recommended the Hong Kong Mortgage Corporation, as part of its project to standardise mortgage origination documents in Hong Kong, to provide two options in the Model Mortgage Deed and Guarantee – one with an "all-monies" clause and one with a "loan specific" clause. The HKMC has already launched the "all-monies" Model Mortgage Deed and has been encouraged to launch the "fixed-amount" version as the next step. This initiative, when completed, will help to promote more choice in the market.

(iii) *Quotation of annualised percentage rates (APRs)*

13. Under the revised Code of Banking Practice, AIs are required to quote APRs on card products (one for retail purchase and one for cash advance) to facilitate comparison between different charging structures. Since this provision came into effect in January 2001, the HKMA noticed that AIs had adopted different practices. Some card issuers quoted the APRs in their application forms while others made reference to APRs in other documents which are provided to customers upon request.

14. To eliminate the above discrepancy in relation to the quoting of APRs, the industry Associations, on the recommendation of the CoBP Committee, have issued a circular notice to all member institutions clarifying that APRs, as a major term of credit card borrowing, should be highlighted in the application form. The clarification is conducive to further promoting the transparency of the cost of credit card borrowing.

15. It appears from the above cases that the CoBP Committee has so far been effective in achieving its objective – to enhance the role of the industry in self-regulation of market conduct. It has also responded effectively and promptly to public concerns about AIs' business practices.

Monitoring and enforcement of compliance with the Code

16. While the CoBP Committee provides guidance to AIs on the interpretation of the Code, the HKMA monitors and to the extent that it has power to do so enforces compliance with the Code.

17. As mentioned at the February meeting of the Panel, the HKMA has required the internal audit departments of AIs to carry out an annual self-assessment of their institution's compliance with the Code. The first of such reports should be submitted to the HKMA by September 2002.

18. The HKMA has recently designed a standard template to assist AIs in preparing the self-assessment report. The standard template requires the internal auditors to independently review the AI's compliance with the requirements under individual sections of the Code. Where non-compliance areas are identified during the assessment process, AIs are expected to provide full details of the non-compliance, as well as the remedial actions that they plan to take, or have already taken, to rectify the situation. The HKMA will then follow up with the AIs concerned to ensure that any non-compliance should be rectified in a satisfactory manner. This can be backed up by the HKMA's on-site examinations of the AIs where necessary.

19. Questions have previously been raised on whether statutory sanctions should be introduced to ensure the effectiveness of the Code of Banking Practice. The HKMA's experience so far has shown that moral suasion has been adequate in enforcing compliance with the Code. In general, once informed of a possible breach, the AIs concerned will promptly take remedial action. As noted above, the introduction of the proposed self-assessment system should help improve compliance further. The industry has also demonstrated its commitment to self-regulation of market conduct by taking more proactive ownership of the Code. In view of the above, it appears that the Code has been operating effectively so far. It does not seem necessary at this stage to put the Code on a statutory basis (with sanctions for non-compliance). However, this position should be reviewed regularly and would also depend on the more general issue of whether new arrangements for complaint handling and consumer protection should be introduced in Hong Kong (see paragraphs 34 to 42 below).

V. Customer Complaints received by the HKMA

20. The HKMA does not have any power to arbitrate or intervene in customer disputes under the existing framework. However, it has an interest in ensuring that customer complaints are properly handled by AIs, i.e. the process by which AIs investigate and deal with customer complaints should be fair, thorough and prompt, and be consistent with the requirements of the HKMA's Guideline on Complaint Handling Procedures.

21. In its role as prudential regulator the HKMA also has a direct interest in those customer complaints that raise doubts about the quality of an AI's internal controls or about the integrity of its management or staff or about compliance with regulatory rules or guidelines. However, the HKMA does not regard itself as being responsible for the handling of complaints such as those which relate solely to issues such as the cost or quality of banking services.

Increasing Number of Customer Complaints Received by the HKMA

22. At the last Panel meeting, the HKMA reported that the total number of complaints received by it increased by 42% to 880 complaints in 2001, from 618 in 2000. Of these, 449 were general complaints, and 431 were debt collection hotline complaints. The number continued to surge in the first quarter of 2002. The HKMA received a total of 479 complaints against AIs in that quarter alone, compared with 311 in the preceding quarter and 176 in the first quarter of last year (see Annex 1). In fact, the figure for Q1/2002 alone is already over 50% of last year's total of 880 complaints. Of the 479 complaints received in Q1/2002, 250 were debt collection complaints and 229 were general complaints.

23. On general complaints, the product types complained about most were consistent with last year's results. Credit card services had the highest incidence of complaints, representing close to 40% of the general complaints in the first quarter of 2002. These were followed by deposit/savings accounts (13%) and mortgage loan products (13%). Compared with the first quarter of last year, the most significant increase was in credit card complaints which rose over four fold, from 16 to 88 complaints, followed by unit trust and fund investment, and mortgage loans (see Annex 1 - Table C).

Reasons for the increase in complaints

24. The concentration of complaints in card services can be attributed to AIs' increasing shift into consumer finance business which has resulted in a rise in the number of credit card accounts in recent years. This has naturally led to more related complaints, such as regarding the quality of service or unauthorised transactions. Moreover, the number of such complaints has been exacerbated by the general deterioration in the economic environment which has led to growing repayment problems, higher rates of default amongst borrowers and the subsequent need for AIs to take debt recovery action. Complaints about the related levy of legal cost, finance charges and late charge have therefore increased.

25. It should also be noted that we have seen a general proliferation of more innovative and diversified products and services in the market which have contributed to the rise in customer complaints. Given the increasing intensity of competition and rapid advancement of technology in the banking sector, AIs are trying to attract customers with a wider product range. However, such new products are often more complex and sophisticated and are more likely to give rise to disputes. This is particularly the case for unit trust and investment fund products.

26. In addition, on the part of consumers, there seems to be a greater awareness of consumer rights and interests. Consumers are increasingly demanding a higher level of customer service and they consider that they have the right to lodge complaints when services or products fall short of their expectation. They have made increased use of various channels, including the HKMA, the media, LegCo, etc., to make complaints against AIs and try to seek redress. This is, of course, a positive development to the extent that it exerts greater pressure on AIs to improve the quality of their services.

Measures to address growing number of complaints

27. The number of complaints remains a very small proportion of the number of accounts of the various products (see Annex 1 – Table D). Moreover, the increase in the number of complaints is probably at least partly cyclical in nature, related to the general state of the economy. It can also be

regarded as healthy for consumers to exercise their right to complain. However, the rapid growth in the number of complaints is also a warning indicator of possible deterioration in banking services or of market practices that may need to be corrected. A high volume of complaints also imposes an additional burden on all those involved in dealing with the complaint (including the complainants themselves).

28. The recent trend in the number of complaints has therefore led both the HKMA and the industry Associations to take a number of measures to deal with the situation. Recently, the HKMA wrote to all AIs to draw their attention to the rapid rise in complaints (see Annex 2). In particular, it recommended AIs to step up the attention of their management on complaints received and to ensure that they have sufficient resources within their institution to handle the growing number of complaints. AIs were also reminded to comply with the requirements of the Guideline on Complaint Handling Procedures. Furthermore, AIs should ensure that there are adequate levels of transparency of their products and services and that they fully comply with the relevant provisions of the Code of Banking Practice.

29. As the increase in the number of complaints is to a large extent related to allegations of misconduct by debt collection agents, the HKMA has expressed to the CoBP Committee its concern on the rise in allegations of unscrupulous debt collection tactics. The CoBP Committee has recommended to the industry Associations to issue a circular to their member institutions to remind them to step up monitoring of the performance of the debt collection agents they employ and ensure compliance with all relevant provisions of the Code. In particular, AIs should ensure that debt collection agents do not employ harassment or improper debt collection tactics in debt collection, and they should discipline any malpractice of their debt collection agents. The HKMA has underpinned these industry efforts by strengthening its supervisory oversight of AIs' debt collection activities. It has required all institutions to submit a quarterly return on the number of complaints received against their debt collection agents. Institutions will be expected to explain to the HKMA what actions they would take in relation to those debt collection agents attracting frequent complaints.

30. Finally, for individual AIs which have given rise to a relatively large number of customer complaints, the HKMA is separately meeting with them to ensure that they review and, if necessary, tighten their policies and procedures in relation to specific problem areas identified.

VI. Potential gap in the existing arrangement and the role of the HKMA

31. The above-mentioned improvements should help address the current problem. Nevertheless, their effectiveness needs to be kept under close

monitoring, in particular with regard to the trend of bank customer complaints. The recent surge in complaints against AIs has already exerted immense pressure on the HKMA's resources. In response to that, the HKMA has substantially expanded its Complaint Unit by redeploying resources from other areas. However, there is obviously a limit to which this could be done given the reduction in the HKMA's overall headcount and the lack of an explicit mandate on consumer protection.

32. On some occasions, there are potential gaps between the expectation of bank customers and what the HKMA can do under the existing framework. As mentioned previously, the HKMA has no explicit mandate in consumer issues under the Banking Ordinance. Its involvement in promoting and encouraging proper standards of conduct and business practices is incidental to its primary function of promoting the stability of the banking system. In relation to complaints handling, the HKMA's role is limited to ensuring that the process by which the complaints are handled by AIs is fair and efficient. It has a very limited role in dispute resolution as it has no power to arbitrate in customer disputes, to adjudicate on the disputes or to award compensation to customers. Nor can it fine or reprimand AIs for wrong conduct. However, in the HKMA's experience in handling complaints, it is apparent that customers would expect it to be able to take actions against AIs to help them resolve disputes or recover financial losses. The HKMA's inability to do so has sometimes caused disappointment on the part of the complainants.

33. To address this issue, the HKMA is reviewing its workflow in order to cope with the substantial increase in the number of customer complaints against AIs. It might also help for the HKMA to clearly explain its role and procedures in complaint handling in a pamphlet to be distributed to all complainants to avoid any misunderstanding of the HKMA's functions and responsibilities. Among other things, this could address the issue of which complaints the HKMA should handle (e.g. not those involving complaints simply about the cost or quality of service). It could also be made clear to complainants that generally they should try so far as possible to resolve their disputes through banks' internal complaint handling procedures. The aim of such clarifications of the HKMA's role would be to enable it to focus on those complaints which are more serious in nature and raise questions about an AI's integrity or prudence.

The possible need for alternative arrangements

34. Despite the limitations in its legal powers, the HKMA has hitherto taken the view that the present arrangements for handling customer complaints are generally effective, and that the need for alternative arrangements, such as a banking ombudsman, is not proven. However, this judgement cannot be divorced from the number of complaints actually being received. While the present situation may be partly cyclical, continuation of

the current trend might well alter the cost-benefit argument in favour of a different set of arrangements. In considering other possibilities, we have to bear in mind the following principles of an effective complaint handling model:

- (a) The system must be impartial and transparent with well laid-down rules and procedures, disciplinary awards, and enforcement power;
- (b) The system must be credible so that both the complainant and the complained have a clear knowledge and expectation of the actions and decisions of the system; and
- (c) The system should be cost-effective.

Apart from setting up a fully fledged banking ombudsman scheme (as described in our previous paper for the Panel meeting on 26 February 2002) which will have substantial cost implications for the banking industry, there are basically two options to consider:

Option 1

35. The first option is an industry-based solution where the responsibility for investigating and resolving complaints would be passed to the industry associations. AIs would still need to find the resources to fulfil this role but the industry would be in a position to set and control its own budgets.

36. In this connection, it is relevant to note that the HKAB Ordinance already provides the Association with certain powers in relation to regulation of market conduct. For example, section 12(1) empowers the Association to make rules relating to the conduct of the business of banking. Such rules could, for example, be modelled on the Code of Banking Practice. Breach of these rules could render a member bank subject to disciplinary action by the Disciplinary Committee under section 21. Under this latter section, the Association may, following a recommendation by the Disciplinary Committee, impose the following penalties on a member bank:

- (a) a reprimand;
- (b) after consultation with the HKMA, the suspension of membership for any period not exceeding 3 months;
- (c) with the approval of the Financial Secretary, the suspension of facilities of the clearing of cheques and other instruments of a member for any period not exceeding 3 months;
- (d) with the approval of the HKMA, the expulsion of a member from membership of the Association.

As HKAB membership is a condition attached to the authorization of banks, the exercise of the disciplinary powers under (d) above could effectively lead to the revocation of a bank's authorization. It should be noted that the

disciplinary powers are backed up by the power to obtain evidence under section 18 of the Ordinance.

37. However, the above powers under the HKAB Ordinance appear to be confined to conduct regulation only. There are no provisions in the HKAB Ordinance that provide the Association with specific powers to resolve customer disputes with banks or to award compensation to those customers with legitimate complaints. So the mismatch mentioned in paragraph 32 above in relation to what customers expect to obtain in terms of dispute resolution might still exist even if HKAB were to take on a role in conduct regulation.

38. An industry-based solution has its attractions, but it does raise the question of whether an industry-run scheme would have the necessary credibility since AIs would effectively be policing themselves. This would depend on how committed the industry was to making the scheme work and building public confidence in it. It would also involve a substantial change in the way in which the associations have hitherto operated.

39. Finally, there would also be a particular issue for the deposit-taking companies sector. Unlike HKAB, the Deposit-Taking Companies Association is not a statutory body, and its membership is not mandatory. Therefore, it would be difficult to replicate the above arrangements for the DTC Association.

Option 2

40. Under this option, the role of investigating complaints would remain with the HKMA but would be formalised to a greater extent than at present. The HKMA might be given an explicit statutory role for consumer protection with enforcement powers tailored to this role (such as the power to “name and shame” or even fine AIs which have breached approved codes of practice). A further issue is whether the HKMA would be given the power to adjudicate and resolve disputes between banks and their customers, and perhaps to award compensation to customers who have suffered financial loss. If so, the HKMA would be taking on much the same role as a banking ombudsman.

41. Two main issues arise from this option. First, there may be a conflict between the HKMA’s role as prudential regulator and as consumer protector. However, other banking regulators fulfil this role to a greater or lesser degree (though this may not necessarily involve dispute resolution). The potential conflict could be reduced by suitable organisational arrangements, e.g. by locating the function of investigating (and perhaps resolving) complaints in a separate “complaints unit” within the HKMA, which would be separate from the banking supervisory departments.

42. The second issue is the resource implications. More HKMA staff are already having to be redeployed to handling complaints, and net additions to the HKMA's overall strength would be required to properly fulfil statutory obligations if these were given to HKMA. This comes at a time when the HKMA is trying to reduce its staff and cut its budget. Taking on a greater role in consumer protection would reverse this process, possibly to a significant extent. It is also likely that it would be necessary to make some form of cost recovery from the banking industry.

VII. The Way Forward

43. We will continue to work closely with the industry Associations to strengthen the mechanism for handling customer complaints and to enhance AIs' compliance with the Code of Banking Practice. We shall try to deal with the rapidly increasing customer complaints in the ways described in paragraphs 27 to 33 above. We shall also stress to the industry that the best solution would be to choke off the problem at source – through AIs being careful to avoid complaints arising in the first place and dealing with them promptly and fairly if they do arise.

44. Either of the options in paragraphs 35 to 42 would involve far-reaching changes in the current arrangements for banking consumer protection in Hong Kong. They would also incur additional costs, which could be substantial. Legislation of some form would probably be required. We should only proceed along any of these lines if there are full justifications. That need could become more evident if there is not an improvement in the current situation and the number of complaints continues to accelerate.

45. The HKMA would welcome the views of LegCo Members on the above options. We will also discuss the way forward with the Administration, and the industry, with a view to arriving at a decision on how the issue of consumer protection should be tackled.

*Hong Kong Monetary Authority
June 2002*

Customer Complaints Received by the HKMA

(A) *Number of complaints received*

Nature	Q1/2001	Q2/2001	Q3/2001	Q4/2001	Q1/2002	% increase over Q1/2001
Debt collection hotline complaints	93	92	78	168	250	168
General complaints	83	94	129	143	229	175
Total	176	186	207	311	479	172

(B) **Debt collection hotline complaints analysed by nature**

Nature	Q1/2001	Q2/2001	Q3/2001	Q4/2001	<i>Q1/2002</i>	% increase over Q1/2001
Intimidation	78	67	50	101	171	119
Nuisance	12	23	27	64	78	550
Violence	3	2	1	3	1	(66)
Total	93	92	78	168	250	168

(C) General complaints received analysed by Generic Product Type

Generic product type	Q1/2001	Q2/2001	Q3/2001	Q4/2001	Q1/2002	% increase over Q1/2001
Credit card	16	18	38	33	88	450
Deposit and Savings account	16	16	16	27	29	81
Mortgage loans	13	14	19	22	29	123
Securities accounts	4	14	5	5	6	50
Unit trust and fund investment	4	5	10	8	10	150
Current account	6	1	5	10	13	116
Remittance	3	1	1	4	4	33
Forex accounts	3	2	1	2	4	33
Insurance products	0	0	0	0	0	0
Other	18	23	34	32	46	155
Total	83	94	129	143	229	175

(D) Incidence of complaints in relation to number of accounts

2001	Deposit account (1)		Mortgage loan (2)		Credit Card (3)		Securities and Investment accounts (4)	
	<i>No. of complaints</i>	<i>Accounts</i>	<i>No. of complaints@</i>	<i>Accounts</i>	<i>No. of complaints@</i>	<i>Accounts</i>	<i>No. of complaints</i>	<i>Accounts</i>
	97	25,884,289	71	450,599	400	9,217,000	55	852,770
Incidence of complaints	<1 per 100K		<16 per 100K		<5 per 100K		<7 per 100K	

Q1/2002	Deposit account (1)		Mortgage loan (5)		Credit Card (6)		Securities and Investment accounts (4)	
	<i>No. of complaints</i>	<i>Accounts</i>	<i>No. of complaints@</i>	<i>Accounts</i>	<i>No. of complaints@</i>	<i>Accounts</i>	<i>No. of complaints</i>	<i>Accounts</i>
	42	25,884,289	31	458,115	259	9,376,000	16	852,770
Incidence of complaints	<1 per 100K		<7 per 100K		<3 per 100K		<2 per 100K	

2002 *	Deposit account (1)		Mortgage loan (5)		Credit Card (6)		Securities and Investment accounts (4)	
	<i>No. of complaints</i>	<i>Accounts</i>	<i>No. of complaints@</i>	<i>Accounts</i>	<i>No. of complaints@</i>	<i>Accounts</i>	<i>No. of complaints</i>	<i>Accounts</i>
	210	25,884,289	155	458,115	1,295	9,376,000	80	852,770
Projected incidence of complaints	<1 per 100K		<34 per 100K		<14 per 100K		<10 per 100K	

@ includes debt collection hotline complaints.

* projected no. of complaints in 2002 (based on growth trend in 2001). (Q1/2002 figures * 5).

(1) At end-March 2000, there was a total number of 25,884,289 deposit accounts (current and deposit & savings) in Hong Kong.

(2) At end-December 2001, there was a total number of 450,599 RML accounts outstanding.

(3) At end-December 2001, there was a total number of 9,217,000 credit card accounts.

(4) At end-December 2001, there was a total number of 852,770 securities accounts (including unit trust and fund investment) in and outside Hong Kong.

(5) At end-March 2002, there was a total number of 458,115 RML accounts outstanding.

(6) At end-March 2002, there was a total number of 9,376,000 credit card accounts.

(E) Number of second complaints arisen

	2001		Q1/2002	
	Received	2 nd complaint arisen	Received	2 nd complaint arisen
General complaints	449	55	229	38
Debt collection hotline complaints	431	20	250	3
Total	880	75	479¹	41²

(F) Outcome of second complaints handled in 2001*

	Cases closed ³		Remaining unresolved ⁴		Total
	General complaints	Debt collection hotline complaints	General complaints	Debt collection hotline complaints	
Supervisory concerns ⁵ identified	5	0	3	0	8
No supervisory concerns identified	31	20	16	0	67
Total	36	20	19	0	75

* Similar analysis for Q1/2002 is not yet available because it is too early to conclude the status of complaints for the first quarter.

¹ Already over 50% of last year's total.

² Already over 50% of last year's total.

³ Cases are regarded as closed if the complaint has been resolved to the complainant's satisfaction or if we have not received further response from the complainant after the AI's reply to his second complaint.

⁴ Cases are regarded as remaining unresolved if the complainant continued calling or writing to us to indicate his dissatisfaction with the AI's reply to his second complaint; or if the case is more suitably to be dealt with by other means such as through the court.

⁵ Supervisory concerns arise in cases where –

- (a) the complaint has raised doubts about the AI's operating procedures or about the integrity or prudence of its business;
- (b) the case has revealed weaknesses in the AI's complaint handling/investigation procedures; or
- (c) the case has revealed non-compliance of the Code of Banking Practice / Banking Ordinance by the AI.



D T R Carse JP
Deputy Chief Executive

簡達恆 JP
副總裁

Our Ref: B9/67C

30 May 2002

The Chief Executive
All authorized institutions

Dear Sir/Madam,

Rising number of customer complaints received by the HKMA

I write to draw your attention to the rapid rise in customer complaints against AIs received by the HKMA in recent months, and a number of suggested measures to address this issue.

In the first quarter of 2002, the HKMA received a total of **479** complaints against institutions, compared with 176 in the same period last year. Of these complaints, 250 were related to debt collection, and 229 were general complaints (compared with 93 and 83 respectively for the first quarter of last year). In fact, the total number of complaints in Q1/2002 alone is already over 50% of last year's total of 880 complaints. This rate of growth is unprecedented. Based on the current growth rate, the projected number of complaints for this year is likely to reach over 2000 cases.

A certain number of complaints is a healthy phenomenon. Moreover, relative to the number of accounts, the amount of complaints is not excessive. However, rapid growth in the number of complaints is a cause for concern. First, it could indicate that the quality of customer service is deteriorating or at least not keeping pace with customer expectations. Second, the handling of customer complaints is posing an increased administrative burden on all concerned (including the complainants themselves who have to go to the trouble of lodging complaints).

In view of this, the HKMA believes that AIs should give increased priority to ensuring, so far as they can, that complaints do not arise in the first place. And, to the extent that complaints do arise, they should ensure that the complaints are dealt with in a fair, thorough and prompt manner that is consistent with the requirements of the HKMA's Guideline on Complaint Handling Procedures.

The HKMA would like to draw institutions' attention to some of the important lessons learned from its recent handling of complaint cases –

- (a) the Code of Banking Practice must be strictly followed. It is, of course, important that AIs have adequate policies and procedures to ensure compliance with the provisions of the Code. But it is even more important that AIs achieve compliance not only in form but in substance as well. For example, in relation to debt collection practices, it is not enough that AIs have incorporated the relevant provisions of the Code into the service agreement with their debt collection agents. They should also proactively check that their agents are actually following these provisions in their collection activities. In the next three months, all AIs will need to conduct a comprehensive self-assessment of their compliance with the revised Code. The HKMA will issue a standard template to assist AIs in completing this exercise. AIs should take this opportunity to thoroughly review their business practices and operating procedures to ensure full compliance with the Code;
- (b) AIs must ensure that all complaints are dealt with fairly and thoroughly. Where a complaint is justified, AIs should be prepared to offer the complainant a full explanation of how the problem arose in the first place and what steps they will take to prevent recurrence of similar cases in the future. This is a point that we will stress to AIs in referring complaints to them in the future and we will check that this is done when reviewing AIs' replies to complainants; and
- (c) AIs must ensure adequate levels of transparency in the provision of banking products and services. Given the increasing competition in the banking sector, there has been a general proliferation of more innovative and diversified products and services in the retail banking market. Such new products and services are often more complex and sophisticated and are more likely to give rise to disputes between AIs and their customers. AIs should therefore ensure that all advertising and promotional materials are fair and reasonable and do not contain misleading information. This is in

fact a requirement under the Code with which all AIs should already be complying.

The increase in the number of complaints is to a large extent related to allegations of misconduct by debt collection agents (DCAs). We have already taken the matter up with the Code of Banking Practice Committee as an industry issue. Consequently, the industry Associations have issued a circular to all member institutions reminding them to step up monitoring of the performance of the DCAs they employ and ensure full compliance with all relevant provisions in the Code of Banking Practice. The HKMA fully endorses the industry Associations' advice given in their circular.

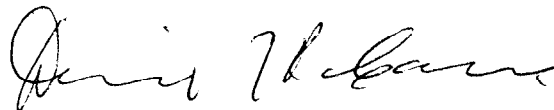
In addition to the general advice given by the Associations, the HKMA would like to draw institutions' attention to the following based on our recent handling of cases involving debt collection action taken against innocent third parties.

- (a) Institutions should put in place an effective mechanism for debt collection agents to report cases of apparent mistaken identity (e.g. cases of repeated denial of connection with the debtor) to the institution at an early stage. This would enable institutions to review the case and seek clarification of identity from the party who is being approached by the DCA;
- (b) In cases involving innocent third parties, institutions should be more sensitive about the feeling of the victims. Ceasing collection action alone, which the innocent third parties should not have been subject to anyway, is not enough. As noted above, institutions should give a full explanation of the reasons why the problem had occurred in the first place; and
- (c) While it may sometimes be difficult to establish whether improper tactics have been used by DCAs, institutions should not take the assurances of the DCAs at face value. Institutions should be prepared to listen to both sides and to discipline their agents if they are found to be in the wrong.¹ Bland statements to the complainant to the effect that no irregularities were found in the DCAs' reports are not sufficient.

¹ Section 37.12 of the Code of Banking Practice provides that institutions should consider whether to terminate the relationship with a debt collection agency if they are aware of unacceptable practices of that agency or breaches of its contractual undertakings.

In view of the rise in allegations of unscrupulous debt collection tactics, the HKMA has decided to reinforce its supervisory oversight of AIs' debt collection activities. All institutions will be required to submit a quarterly report (see Annex) on complaints received against the DCAs they use. The report should cover the number and nature of complaints received in relation to each of the DCAs engaged by the AI and what actions the institution will take in relation to those DCAs which attract frequent complaints. The report should be submitted to the HKMA within 2 weeks of the end of each quarter. The first such report, covering the second quarter of 2002, should be submitted to the HKMA by 15 July 2002. The soft copy of the reporting template will be emailed to your institution shortly. Should you have any questions on the report, please contact Ms Jocelyn Chan at 2878-1275.

Yours faithfully,

A handwritten signature in black ink, appearing to read "Denis T. Carse". The signature is fluid and cursive, with the first name "Denis" being more prominent and the last name "Carse" following in a similar style.

D T R Carse
Deputy Chief Executive

Encl.

**CONFIDENTIAL****HONG KONG MONETARY AUTHORITY****Quarterly Return on Debt Collection Related Complaints**For position as at: 30 June 2002

Name of Authorized Institution:

Please complete the report and return to the HKMA within 2 weeks from the end of each quarter.

Information of contact person in case of inquiry:

Name: _____

Department: _____

Post title: _____

Telephone: _____

Fax: _____

Email: _____

Debt collection related complaints

1. Please provide the total number of debt collection agents (DCAs) employed by the AI (including those which were terminated by the AI) during the reporting period: _____.
2. Please provide the following information on the number of complaints received against individual DCAs employed by the AI, the number of debt collection cases assigned to DCAs, the number of complaints where breach of the agency contract or the Code of Banking Practice (CoBP) was substantiated, and the nature of any disciplinary action taken against the individual DCAs. (Please list DCAs in descending order by column B).

(A) Name of DCA employed during the reporting period	(B) Total no. of complaints received against DCA during the quarter	(C) Total no. of collection cases assigned to DCA during the quarter	(D) Incidence of substantiated breach of agency contract or CoBP ¹	(E) Any disciplinary action taken against DCA (Enter [✓] in the appropriate box)				
				NO	YES			
					(a)	(b)	(c)	(d)
1.								
2.								
3.								
TOTAL	===== ²	=====	=====					

(a) issuance of warning letter; (b) suspension of contract; (c) termination of contract; (d) others (please provide details separately)

3. Amongst the total number of complaints received against DCAs employed by the AI, please provide information on the number of complaints received from the following categories of complainants.

Complaint lodged by ³	No. of complaints
Debtor	
Referee	
Family members/friends/relatives/employers etc.	
Innocent third party who has no connection with the debtor	
TOTAL	===== ²

¹ In this report, AIs are not required to provide the details of each incidence of substantiated breach of the agency contract or the CoBP. However, AIs should be prepared to provide such information if requested by the HKMA when necessary.

² Total number of complaints received by the AI against DCAs employed during the reporting period.

³ Complaints lodged by a third party (e.g. a family member) on behalf of the debtor should be regarded as a complaint from the debtor himself rather than the family member.