

OFT response to Banking Codes Review 2007

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OFT903

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2007 BANKING CODES REVIEW

Your letter of 4 December 2006 invited views on the Banking Code, Business Banking Code and guidance documents to feed into the triennial review. I welcome the opportunity to contribute.

There have been a number of significant developments since the last codes review. Not least of these are two major new pieces of consumer protection legislation, the Unfair Commercial Practices Directive and the Consumer Credit Act 2006. The Banking Code has scope to play a key role in clarifying steps subscribers need to take to comply with this new legislation.

However in addition to this, recent work by the OFT and others has raised concerns across a broad spectrum of issues, suggesting that subscribers are not treating customers fairly.

This is, for example, evident from the OFT's enforcement work under the Unfair Terms in Consumer Contracts Regulations (UTCCRs) and Consumer Credit (Advertisements) Regulations 2004, as well as OFT studies into payment protection insurance, banking services for small firms, and the Competition Commission's investigation into personal current accounts in Northern Ireland.

These interventions demonstrate that the codes need to do more to help ensure that markets work well for consumers. Significant change in subscriber behaviour is required, particularly to address the lack of transparency that pervades the retail



banking sector. The current framework will be working effectively when subscribers are treating customers fairly across the board, without the need for regulatory intervention. In this context, aligning the codes with the criteria set out in the OFT's Consumer Codes Approval Scheme (CCAS) would be a significant step forwards.

The role of the Banking Code Standards Board (BCSB) is clearly critical to the success of the codes. The more independent and transparent the BCSB can be when monitoring and enforcing the codes, the greater both our and consumers' confidence in the codes will be. We will be exploring with the BCSB practical ways in which greater transparency could be delivered, drawing on the expertise that the OFT has developed through CCAS. We will also be discussing the evidence gathered through the OFT's enforcement work, which suggests that subscribers are failing to meet their key commitment to provide "clear and not misleading" advertising and promotional literature. I very much welcome the BCSB's recent interest in closer working on these and other issues.

John Fingleton
Chief Executive

Office of Fair Trading response to Banking Codes Review 2007

1. The Banking Code and Business Banking Code play a key role in influencing the way subscribers treat their customers. Past experience suggests that they can bring real improvements, and the work of the Payment Systems Task Force also highlights the benefits that a collaborative, non-regulatory approach can bring.
2. However the high level of OFT and CC intervention in retail banking over the last few years demonstrates that the codes need to do more to help ensure that markets work well for consumers. The codes need to be revised in line with the criteria set out in the OFT's Consumer Codes Approval Scheme,¹ so that subscribers treat their customers fairly and significant regulatory interventions are no longer necessary. The OFT criteria include the ready availability of effective redress procedures,² and in this area the Banking Code Standards Board needs to ensure that it collaborates effectively with the Financial Ombudsman's Service.
3. The rest of the OFT's response highlights a number of specific areas where the current Banking Code, Business Banking Code and guidance should be revised. These relate to the following issues:
 - transparency
 - pre-notification of charges
 - new consumer protection legislation
 - Payment Systems Task Force recommendations
 - small and medium-sized enterprise (SME) banking services
 - other issues.

Transparency

4. There is a fundamental lack of transparency in retail banking, particularly in relation to prices. This encompasses the charging structure that firms use (in particular the reliance placed on hidden charges and the complexities that can arise when calculating interest),

¹ OFT *Consumer Codes Approval Scheme Core Criteria and Guidance* November 2006.

² See in particular 4d of the OFT's guidance.

as well as the quality of information³ they give customers, both existing and prospective. Concerns about these issues have been raised in a wide range of contexts, and these are outlined briefly at Annexe A.

5. Poor transparency makes it difficult for consumers to assess the price they pay for existing products and to make comparisons across other products. It contributes to the significant customer inertia found in both the personal consumer and SME current account sectors.⁴ It drives concerns about weak competition and lack of fair treatment of customers in the sector.
6. In light of these concerns, the OFT recommends that there is a substantive review of the codes' role in promoting transparency and that concrete steps are taken to give customers relevant information on costs (including foregone interest).
7. The Competition Commission's (CC's) remedies in relation to personal current accounts in Northern Ireland are likely to be relevant to the UK as a whole. The codes review should build on the CC's findings and incorporate its remedies. The OFT would welcome the opportunity to provide a supplementary submission on transparency issues in the light of the CC's proposed remedies, which are due to be published shortly.

Pre-notification of charges

8. At present the codes' subscribers only commit to give customers prior notification before standard charges or interest are taken from current or savings accounts (paragraph 5.5 of the Banking Code and 5.6 of the Business Banking Code). In addition, the guidance accompanying the Banking Code explicitly states that subscribers do not need to provide prior notification before taking fees in relation to unauthorised

³ Quality of information encompasses when and how information is provided as well as whether it is clear and readily comprehensible.

⁴ For example, a study by Warwick Business School found that the annual rate of bank switching by SME's with a current account was just above 2 per cent for all businesses, and 5 per cent for businesses with a turnover in the range £250,000 - £499,999. See Centre for Small and Medium-Sized Enterprises, Warwick Business School *Finance for Small and Medium-Sized Enterprises A Report on the 2004 UK survey of SME finances* May 2005.

overdrafts.

9. In the context of personal current accounts in Northern Ireland, the CC found that 'customers are not usually advised of most charges prior to their being debited from their account, making it difficult to take appropriate action to ensure that sufficient funds (or an appropriate overdraft facility) are available to pay for the charges, or to confirm that the charges are correct, prior to their being debited.'⁵ This is a particularly significant issue in light of the OFT's current concerns about unauthorised overdraft charges.
10. The OFT therefore recommends that both the codes and guidance are amended so that at least 14 days notification is given before all charges and interest are taken from customers' accounts. All notifications should be clear and readily comprehensible.

New consumer protection legislation

11. There are two significant new pieces of legislation that need to be reflected in the revised Banking Code and accompanying guidance:
 - the Unfair Commercial Practices Directive, and
 - the Consumer Credit Act 2006.
12. These are discussed in turn.

Unfair Commercial Practices Directive (UCPD)

13. The UCPD will be implemented on 12 December 2007 by the Unfair Trading (Consumer Protection) Regulations 2007 ('the UTCP Regulations'). These prohibit unfair commercial practices that harm consumers' economic interests and will apply to all business to consumer financial transactions.⁶ In particular, they contain a general duty not to trade unfairly. The OFT recommends that the revised Banking Code specify what constitutes fair practice in retail banking to enable subscribers to meet (or exceed) their new legal obligation. It

⁵ Paragraph 4.122(d) Competition Commission *Market investigation into personal current account banking services in Northern Ireland Provisional Findings* October 2006.

⁶ The only scope for derogation is for EU Member States to impose more restrictive or prescriptive requirements than the UCPD requires.

should also reflect the UTCP Regulations more generally by including a broader, over-arching commitment to fairness and citing these regulations in the relevant section of the accompanying guidance.

14. The UTCP Regulations will oblige all businesses not to mislead consumers through acts or omissions, or to subject them to aggressive commercial practices. Of these, the provisions relating to misleading omissions will represent the most significant change since the Banking Code was last reviewed. They will require traders to ensure they have identified the information that the average consumer needs to take an informed transactional decision. A failure to provide sufficient pre-contractual information will constitute a misleading omission.
15. In light of this substantive change, the revised Banking Code should clearly identify (i) what constitutes material pre-contractual information that should be provided to consumers to enable them to make informed transactional decisions, and (ii) when that information should be provided to ensure that consumers have proper opportunity to take it into account.
16. In this context the OFT recommends that you review the following paragraphs of the Banking Code to ensure that they are in line with the new legislation and the OFT's Consumer Codes Approval Scheme guidance:⁷ paragraphs 3.1, 4.2, 5.1, 6.1 and 10.8.
17. You should also be aware that the UCPD enables Member States to provide for enforcers to take legal action against 'code owners' where a code of practice promotes non-compliance with the legal requirements. If the UTCP Regulations contain such a provision, the OFT would be able to take the enforcement action against the owners to the Banking Code if, for example, it promoted the provision of pre-contractual information that was less than is necessary under the UTCP Regulations.

Consumer Credit Act 2006 (CCA 06)

18. The CCA 06 makes significant changes to the consumer credit licensing system to enable the OFT to target both unfit applicants and

⁷ See section 3d of the OFT's core criteria and guidance in particular.

unfit licencees more effectively. Of particular relevance here is the explicit inclusion of 'irresponsible lending' as an unfair or improper practice that the OFT can take into account when assessing or reviewing fitness to hold a consumer credit licence.⁸ This will come into force in April 2008 and the OFT will issue general fitness guidance by December 2007. The OFT considers that sections 10 and 13 of the Banking Code need to be revised, in particular to set out the factors that need to be taken into account when assessing a customer's ability to repay,⁹ and to address concerns about the automatic raising of credit limits.¹⁰

19. Subscribers will also need to ensure that their procedures and processes are not liable to challenge under the new 'unfair relationships' test, which will enable consumers to challenge unfair credit agreements more effectively through the courts¹¹. This test will come into force in April 2007.
20. The OFT therefore recommends that you revise the Banking Code and guidance in light of CCA 06 to ensure that Banking Code subscribers more readily comply with its requirements.

⁸ This is through a new section 25(2B) of the Consumer Credit Act 1974.

⁹ When assessing customers' ability to repay, account should be taken of all relevant information and circumstances, where practical, and the guidance to section 13 should reflect this. The guidance to section 10.9 should clarify that the assessment needs to be in terms of the borrowers' ability to repay the loan in full by the due date as well as making periodic repayments when they fall due.

¹⁰ This issue has been raised by TSC, alongside concerns about inadequate credit checking in its reports *Transparency of credit card charges* December 2003 and *Credit card charges and marketing* February 2005. The APACS guidelines and Code need to be strengthened so that consumers have stronger and clearer opt-out rights, and to ensure that a broader set of criteria are used when assessing whether credit limits should be increased or not.

¹¹ See sections 19 to 22 of the Consumer Credit Act 2006.

Payment Systems Task Force recommendations

21. Since the last codes review, the Payment Systems Task Force has successfully secured agreement to a number of key improvements to clearing times.¹² Industry has agreed the following standard maximum clearing times for current and basic bank accounts, and savings accounts:

- a maximum time limit of T¹³ + 2 on clearing for 'value'¹⁴
- a maximum time limit of the start of business¹⁵ on T + 4 on clearing for 'withdrawal'¹⁶
- a maximum time limit of T + 6 for withdrawal will apply to savings accounts
- a maximum time limit of the end of T + 6 on clearing for 'fate'.¹⁷

22. These need to be reflected in the codes and guidance. In addition, it was agreed that standard, plain English terms would be used to describe all aspects of the cheque clearing process and that these terms would be incorporated into the Banking Code.

SME banking services

23. In January 2006 the OFT launched a review of undertakings given by clearing banks in relation to the provision of SME banking services.¹⁸ The OFT has now advised the Competition Commission on whether there are grounds to vary, release or supersede any of the existing undertakings of the banks. The OFT intends to publish a non-

¹² See Payment Systems Task Force *Cheques Working Group Report* November 2006.

¹³ Where T is the day of transaction. The precise definition of 'T' will need to take account of branch cut-off times, deposits at ATMs, post offices or by post, and will need to be made clear in each account's terms and conditions. All references are to clearing days, excluding bank holidays and weekends. All of the proposals may be suspended under certain defined 'force majeure' circumstances (for example if a non-clearing day has had to be declared).

¹⁴ Value is when customers start to earn interest on money deposited via a cheque or reduce the amount of overdraft and any consequent interest applied.

¹⁵ The definition of 'start of business' differs between individual financial institutions and also depends on the channel by which the money is accessed.

¹⁶ Withdrawal is when customers are able to withdraw money which has been deposited by cheque.

¹⁷ Fate is when customers know that money paid to them by cheque cannot be taken out of their account as a result of the cheque being dishonoured, provided they are not a knowing party to fraud.

¹⁸ See www.of.gov.uk/News/Press+releases/2006/14-06.htm

confidential version of its advice once the Competition Commission has reached a provisional decision later in the year.

24. In addition to its statutory advice to the Competition Commission, the OFT has identified ways in which the Business Banking Code should be improved. The most important of these is a commitment to give SMEs information on their transaction volumes as part of their monthly statements. This information is essential for customers to assess value for money and the potential benefits of switching. The OFT understands that the four main banks in England and Wales already provide this information.
25. As noted at paragraph 5, switching is currently very low in this sector and the OFT believes there is scope to improve confidence in the switching process. In particular, the Business Banking Code should include a commitment to nominate a single identified individual to be responsible for overseeing the switching process, so that customers know who to go to if something goes wrong. Furthermore, under the behavioural undertakings agreed following the 2002 CC report into SME banking, the nine largest clearing banks in the UK are required to provide compensation when switching targets are not met. The Code should specify that these banks provide customers with more details on compensation arrangements, including at the point when they are considering switching.

Other points

26. **Switching and personal consumers:** The CC has examined switching in the context of its investigation into personal current accounts in Northern Ireland. It is considering whether the switching process could be improved to reduce delays and mistakes in applying direct debit and standing order instructions.¹⁹ The review should incorporate into the revised Banking Code any relevant proposed remedies that the CC makes.
27. **Pressure to purchase insurance products** (paragraph 8.6 of the Banking Code): The OFT's study of payment protection insurance (PPI) found that although PPI providers did not necessarily insist that

¹⁹ See paragraph 32 of CC *Notice of Possible Remedies under Rule 11 of the Competition Commission Rules of Procedure*.

consumers buy PPI, there was evidence of consumers being told or given the impression that taking out PPI would help their application for credit²⁰. The OFT therefore recommends that the wording of paragraph 8.6 is revised to ensure that product information is presented in a more balanced way, so that there is no undue pressure to purchase PPI or any other product.

28. **Credit cards:** The OFT welcomes the fact that APACS has produced guidelines for the use of summary boxes on credit card statements²¹. These should be incorporated into the Banking Code. However the guidance for paragraph 10.11 of the Banking Code needs to go beyond APACS best practice guidelines to clarify how interest rates and APRs should be quoted, and to ensure subscribers provide clear explanations of how interest rate charging practices and procedures for allocating payments operate in practice.
29. **Credit card cheques:** The OFT has had a number of concerns about the way in which credit card cheques have been promoted²². The OFT welcomes the APACS credit card cheques guidelines²³, which should also be incorporated into the Banking Code. However in addition the Banking Code should ensure that subscribers provide a clear explanation of the key differences between payments made by credit card and by credit card cheque. Further reminders should feature on cheques, cheque book or counterfoil as well. Paragraph 9.9 of the Banking Code should include a commitment to advise consumers how to dispose of unwanted cheques safely.
30. **Account closures:** The OFT has some concerns about paragraph 7.5 of the Banking Code, particularly when taken in conjunction with paragraphs 14.6 and 14.7. Our concern is that the Banking Code does not appear to provide consumers with sufficient protection from unreasonable closure of accounts and sale of debt to a debt collector. The Banking Code should include a commitment not to use the threat

²⁰ See page 2 of OFT *Payment Protection Insurance Report on the market study and proposed decision to make a market investigation reference* October 2006.

²¹ See www.apacs.org.uk/resources_publications/documents/BPG2006Section02-CardholderStatementSummaryBox.pdf

²² These were outlined in our response to the DTI's consultation on credit card cheques, available at www.offt.gov.uk/NR/rdonlyres/DAD278B2-02B0-442A-B1AF-9E68A471471C/0/oft835.pdf

²³ www.apacs.org.uk/resources_publications/documents/BPG2006Section03-Creditcardchequesguidelinesandsummarybox.pdf

of bank account closure to deter customers from exercising any rights they have as a matter of contract or under the Banking Code.

31. **OFT guidance:** Section 13 of the guidance accompanying the Banking Code should refer to relevant OFT guidance including the OFT's Non-Status Lending Guidelines.²⁴ However please note that the guidance to section 13.1 refers to an OFT guide to credit scoring, when this is in fact an industry guide.²⁵
32. The OFT would like to draw the reviewer's attention to section 12 of the Banking Code and Business Banking Code. The focus of these sections should be on setting out the steps subscribers will take to help protect customers' accounts, rather than telling customers what steps they should take to protect their accounts.

²⁴ See www.ofg.gov.uk/NR/rdonlyres/56CF50D1-0728-47FF-89D4-069484DE7EED/0/oft192v2.pdf

²⁵ See www.bba.org.uk/bba/jsp/polopoly.jsp?d=135&a=6612

Transparency concerns in retail banking

- A1. Since the last Banking Codes review, a number of reports have identified significant concerns about the lack of transparency in retail banking in the UK. These include the following:
- The **Competition Commission's (CC's) market investigation into personal current accounts in Northern Ireland**. The CC has provisionally found that the banks have unduly complex charging structures and practices, and do not fully or sufficiently explain their charging structures or practices.²⁶ The CC is currently considering a range of potential remedies to improve transparency for consumers that are likely to be of relevance to the UK as a whole.
 - The OFT's action under the **Unfair Terms in Consumer Contracts Regulations (UTCCRs)** in relation to credit card default charges, and the OFT's current work on the application of the disciplines of the UTCCRs to charges for unauthorised overdrafts. In relation to unauthorised overdrafts, the OFT also has concerns about the potential for consumers to incur multiple charges within a very short space of time.
 - The **OFT's market study on payment protection insurance (PPI)**. The OFT found that the information firms provided to consumers was poor, despite the Financial Services Authority's rules requiring consumers to be provided with key information about PPI policies in good time before the contract is concluded.²⁷
 - The **OFT's credit card advertising programme**. This has revealed substantial levels of non-compliance with the Consumer Credit (Advertisements) Regulations 2004 with respect to the advertising of credit cards and other credit products. For example failure to inform customers about balance transfer fees or the interest incurred on such fees.

²⁶ Paragraph 58 Competition Commission *Market investigation into personal current account banking services in Northern Ireland Provisional Findings* October 2006.

²⁷ Paragraphs 6.18 – 6.21 OFT *Payment Protection Insurance Report on the market study and proposed decision to make a market investigation reference* October 2006.

- The **Treasury Select Committee's reports on credit cards**. These have raised major concerns about the lack of clarity in relation to interest rates and charges for credit cards.^{28 29}
- **The OFT's response to DTI's consultation on credit card cheques.**³⁰ This emphasised the need for consumers to have clear information about the interest rate applicable to credit card cheques, the fact that interest is charged from the date of the transaction and that there are additional fees. Consumers also need to know about their right to opt-out and how this can be exercised. All such information needs to be prominent, readily comprehensible and timely. The OFT also argued that consumers need to be reminded of the key features of credit card cheques with each mailing of cheques, on statements and that there should also be key information on the cheques themselves.

A2. The OFT also considered transparency issues as part of its recent review of undertakings in SME banking. The OFT expects to be able to provide the review with a non-confidential copy of its findings when the CC reaches a provisional view. This is likely to be before the 2007 Banking Codes review has been completed.

²⁸ House of Commons Treasury Committee *Transparency of Credit Card Charges* December 2003, and *Credit card charges and marketing* January 2005.

²⁹ The OFT's responses to these reports are included as part of the Government response at www.publications.parliament.uk/pa/cm200405/cmselect/cmtreasy/508/508.pdf and www.publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/431/431.pdf

³⁰ See www.offt.gov.uk/NR/rdonlyres/DAD278B2-02B0-442A-B1AF-9E68A471471C/0/oft835.pdf