

APPENDIX B

ARRANGEMENTS TO PROTECT CLIENTS

AND

SOME COMMON MISUNDERSTANDINGS AS TO HOW BANKS FUNCTION

WHY DON'T BANKS DISCLOSE ALL THEIR CHARGES TO CONSUMERS?

The banks have a bewildering array and variety of products and services which they provide. These are complicated by variations for specific target markets, and then specific clients within those markets. The Banking Council has recently tried to prepare a comparison of the charges of the 4 major banks for a simple range of the most common products, and found it to be impossible!

However, the Board of Directors of the Banking Council have agreed that as a matter of principle all clients should:

- be notified of the most common charges for which they will be liable;
- be communicated with in a fashion which is readily understood; and
- be able to access information in the branches - i.e. information should be displayed.

They have also agreed that these principles should be enshrined in the Revised Banking Code at present under negotiation.

However, when it comes to information on charges on all products and services, the banks face the same challenge when dealing with their clients as the Banking Council did when trying to create a table. They would totally overwhelm the client with confusing and useless detail if they attempted to convey everything.

The same problem arises with notifying clients of changes in the various fees and charges. There is already consumer resistance to the perceived high banking charges. The costs associated with providing every client with details of every changed fee or charge, would be astronomical and make banking even more unaffordable. Clients are therefore currently advised of changes via the media and ATM and statement messages that the fees are changing, and that they can get more details from their branch. Some banks also print small brochures detailing the most common new fees.

WHY CAN'T BANKS GIVE ADVANCE NOTICE OF CHANGES IN INTEREST RATES?

The Board of Directors of the Banking Council have resolved that its members should give their clients as much notice as is reasonably possible. However, banks operate in extremely volatile international and local financial markets, with the majority of their deposits (which fund all loans) of a short term, wholesale nature. These deposits re-price almost immediately in line with local and international market pressures. So where they are vulnerable to sudden and major increases in their costs, they cannot expose themselves to fixed rates of revenue.

The Board of the Banking Council has agreed that the new Banking Code of Conduct should enshrine the principle that, at the very least, members should be obliged to give notice in the national media, on the day on which they vary the rates. This notice should also be communicated in writing to the client, whether in a statement or other document, at the first opportunity after this. In terms of the Usury Act, this notice should be sent within 90 days.

THE ROLE OF THE BANKING SECTOR OMBUDSMAN

The Banking Ombudsman is responsible for:

- Intermediating between banks and the clients of banks whenever the client feels that he or she has been treated "unfairly". The Ombudsman is guided in his intermediation by the Banking Code of Conduct.
- Making a recommendation if his intermediation is not successful. If the client does not like the recommendation, the client is free to go to court.
- Making public his recommendation (and the fact that the bank has declined to follow it) in cases where the bank does not accept the recommendation.

The Ombudsman is not a substitute for the courts. He is there in a complementary role, and he is meant to be guided by what is fair, rather than what is the strict law. Moreover he is meant to act quickly and with very little or no cost to the client.

Despite the fact that the Ombudsman enjoys absolute security of office, the Board resolved that, by the time the new Banking Code of Conduct is brought into operation - which must happen before the end of 1999 - an independent juristic entity must be brought into being to select the ombudsman and oversee the conduct of that office. The banks will only be permitted a minority voice on the board of that entity.

We are currently going through the process of defining the new entity and how it will function. There is a workshop of the Financial Services Board in this connection on the 9th March.

THE BANKING CODE OF CONDUCT

The Banking Code of Conduct is at present being radically revised, based in large part on the new banking code introduced in the UK in 1997. The new Code will be much more readable, and will spell out the responsibilities of both bank and client more clearly. The Banking Council, in conjunction with the Ombudsman, has already negotiated a number of major concessions from the banks. The process of discussing and negotiating the revised Banking Code with consumer representative groups will begin in March 1999.

There have been calls for Codes of Conduct to be given legally binding status. This would be a serious mistake, as a Code of Conduct is an aspirational document that reflects the intention of the banks to do better than the law prescribes. Any legalisation of this commitment introduces serious risk and cost elements, and would restrict the freedom of both bank and client to strive for "fair and just" behaviour outside of the narrower limits provided for in terms of the law.

SOME COMMON MISUNDERSTANDINGS AS TO HOW BANKS FUNCTION

There are many misunderstandings about how banks function. It is acknowledged that in many respects the banks themselves have failed to educate the public or their clients about these issues. But there are also clearly problems with the education system itself, for example where large numbers of people (who have been through twelve years of "privileged" education) have no understanding of the most basic legal principles relating to financial services.

DOES THE BANK "TAKE THE BENEFIT OF INTEREST" ON A CLIENT'S CHEQUE TRANSACTION?

No. When the client deposits a cheque, the bank undertakes to collect the money for the client by presenting the cheque for payment. But if the cheque "bounces" or is not paid for any reason, the collecting bank in which the client deposited the cheque has no further obligation. However, since most cheques are paid when presented, interest is calculated from the day that the deposit is made and credited to the client depositing the cheque. If the cheque is not paid the credit is reversed, together with any interest calculated and paid on the amount of the cheque.

It takes time for the physical cheque that was deposited to be processed through the cheque clearing system to the bank branch at which the account is held. Only then can value be transferred from the cheque account holder to the collecting bank (which has already given the depositor value in good faith). In order to balance the system, the debit in the account holder's account is backdated to the date of the original deposit. All related transactions between the 2 banks are similarly dated. In effect, therefore, this represents a simulated instantaneous deposit and withdrawal, with neither of the banks concerned being able to use the funds for their own "float" purposes.

The actual time to clear a cheque and pass value from one bank to the other varies, depending mainly on the geographic location of the banks concerned, and the arrangements used to process the cheques - e.g. collating them, transporting them, processing them. Cheques deposited in small rural branches, and from bank branches in Swaziland, Lesotho and Namibia - all part of the Common Monetary Area - take much longer to clear than local cheques deposited in the main urban areas.

Dishonest individuals, knowing that there is a time difference between crediting the account of the depositor of the cheque and the actual passing of value, or in the return of a

dishonoured cheque, deposit dud or stolen cheques. They then draw down on the credit in their account before the bank becomes aware that the deposited cheque will not be paid. This leaves the depositor bank with a debit on the account, which it cannot recover. Last year alone, 3.2 million cheques were "Returned to Drawer" (contributing substantially to the R150 million losses on cheque fraud).

Banks have therefore adopted a policy that (even though they have credited the account for interest earning purposes) they will not allow that credit to be accessed until they are confident that they will receive value for the credit that they made available to the depositor. This "holding period for un-cleared effects" varies between 7 and 14 days following the deposit and depends on the bank's experience with receiving value and returned unpaid cheques. This ensures that there is a reasonable chance that before the money is drawn down, the bank will have been advised as to whether the cheque will be paid or not.

In sum there are 3 distinctly different dates:

- The date from which the interest will be calculated. This is the date that the cheque is deposited on;
- The date from which the client will be allowed to withdraw the funds. This is usually between 7 and 14 days, unless the client has made special arrangements with the bank; and
- The date from which the funds actually belong to the client and no reversal can be made from the account. This is the date when, in terms of the cheque clearing rules between the banks, the drawer's bank may no longer dispute the validity of the cheque. This date will never be the day that the deposit is made, but it might be before or after the client is allowed to draw down on the funds.

WHY IS THE CLIENT CHARGED FOR PROCESSING THE CHEQUE AND FOR THE "VALUE" OF THE CHEQUE?

Banks have invested considerable resources in the cheque processing and clearing systems so that their clients can have the convenience of making and receiving payments without the disadvantages and risks of cash. These systems are also "on-line real-time" and the client can interface with account information and ATM systems 24 hours a day, 365 days a year. The client issuing a cheque pays for this facility.

As mentioned above, fraud is rife. Most of this fraud occurs when stolen or forged cheques are processed through the system, and the client has drawn down on the credit before it is discovered that the cheque is stolen or forged.

The reality is that every time the bank acts to collect or pay a cheque on behalf of a client, the bank is taking a risk. The greater the value of the cheque, the higher the risk for the bank. Losses from fraud are now so high that it has become common practice for the paying bank to phone and check with its client when cheques for large amounts are presented for payment.

This risk management system is expensive, and difficult to automate. In order to cover these additional costs and risks, clients are charged an "ad valorem" charge on their cheques, whereby the actual charge per cheque increases (to a certain maximum) according to the value of the cheque.

WHAT ARE THE GROUNDS FOR AN ADMINISTRATION CHARGE ON A CHEQUE ACCOUNT OR SAVINGS ACCOUNT?

There are a number of reasons for levying administrative charges:

- A bank incurs a number of ongoing expenses in relation to an account, even if no transactions are being conducted against the account. For example, even if the account is dormant and is generating no income, the bank has to maintain the computer systems and networks available nation-wide, 24 hours a day, 365 days a year, in case the client wants to access the account.
- A bank has to hold liquid assets and cash reserves in respect of an account. These compulsory investments in lower or non-paying government financial instruments or institutions are estimated to cost the banks between 0.5 and 0.6% per year on the funds involved.
- A bank has to render returns to the SA Revenue Services in respect of an account and therefore has to keep track of all interest credited to that account.
- Dormant accounts are an open invitation to the fraudsters to see what they can do to usurp the money. Considerable cost is therefore incurred in monitoring dormant accounts.

- For cheque accounts, the bank has to constantly monitor the account in relation to the facilities on the account. Other facilities (which vary regularly) such as the ATM and other withdrawal limits also have to be monitored.
- Every time the bank does anything on the computer system, including the debiting or crediting of an amount to any other account, the computer has to check across all the accounts. This has become such a problem that it takes as long as 8 hours for the major banks to run the month end processes, and at times they do not have enough time to complete those runs before the start of the next day's business.
- All records and information pertaining to the account have to be kept until at least 5 years after the account is closed (to facilitate possible money laundering investigations). Current legislation relating to what may be considered as evidence in a court limits much of this to expensive hard copy, which has to be stored in secure facilities.

In addition, a bank derives no benefit from an account with a small balance on it. It is therefore clear that there are significant costs associated with maintaining an account, and these costs continue even when the account is dormant.

WHY IS THERE SUCH A PROBLEM WHEN DEPOSITED CHEQUES ARE LOST?

Unfortunately lost cheques have become a major problem in our crime-ridden society. Last year 174,000 cheques were lost, many of them were stolen. Try as they might, the banks have not yet been able to come up with a solution which remotely satisfies all the conflicting interests.

The moment a cheque, which is being cleared is lost, the banks and their clients are at considerable risk and the banks dare not process the transaction further. If they do, and it subsequently transpires that the cheque was not lost but stolen, and the thief presents the cheque for payment and it is paid, the bank will bear the full loss.

Initially it was thought that the banks could continue to process the clearing transactions on the strength of the electronic details of the cheque (where these had already been captured), and leave it to the account holder to check the bank statement and advise the bank if the cheque concerned had been incorrectly processed.

There is now a realisation that this would have put an undue onus on the account holder, and in particular, many public sector bodies.

It would also have opened a major opportunity for fraud syndicates to perpetrate stolen cheque fraud in the knowledge that the transaction would be processed and not discovered for many months. The owner of the cheque account would be unlikely to pick up the false debit to his account before the fraudster had withdrawn the credit that had been processed and disappeared with the proceeds. The banks are now doing everything they can to minimise the risk, costs and inconvenience resulting from this problem.

WHO OWNS THE HOUSE THAT IS MORTGAGED TO THE BANK AS SECURITY FOR A HOME LOAN?

When a client buys a home with a loan from a bank, the property is usually mortgaged as security for the loan in case the borrower's disposable cash flow becomes too small to continue servicing the loan repayments. A mortgage is nothing other than a pledge that is registered formally through the Deeds Office, to protect the rights of the lender. This means that the homeowner cannot offer the same property as security to someone else without first disclosing that it has already been offered (or mortgaged) to the previous lender, and that he or she cannot sell the property and pocket the proceeds without first paying back the outstanding loan.

This being the case, the home belongs totally to the homeowner. He or she is responsible for maintaining it, and he or she will benefit from the capital appreciation of the property. The bank's sole interest in it is as security or collateral for the outstanding loan balance. There is therefore no justification for the claims that banks are the "owners" of these properties, and that they are therefore not entitled to change the interest rates on the grounds that they get the benefit of the capital appreciation.

WHY CAN THE BANK BUY BACK THE PROPERTY BONDED TO IT AT A SALE IN EXECUTION FOR A "RIDICULOUS" PRICE, AND STILL CLAIM THE BALANCE OF THE LOAN FROM THE CLIENT?

The client decides what property to buy and at what price. All he or she asks the bank to do is to grant a loan to finance the purchase. The property belongs to the client and not to the bank. All the bank does is look at the property to see if it is satisfied with the security that it will hold for the loan. It does not look at the property to decide if the client made a good purchase.

However, if the client fails to repay the loan the law prescribes that the only way that the bank may recover the loan is to get a court judgement and, in terms of that judgement, ask the Deputy Sheriff or Messenger of the Court to sell the property at a public auction to the highest bidder. The proceeds of the sale are then distributed in accordance with law relating to the preference rating of creditors. In most instances the first creditor to be paid is the Local Authority for arrear rates and charges. Should there still be any surplus after that it is applied to the outstanding balance on the home loan. Any proceeds still left after that are paid to the homeowner. Likewise, if the proceeds of the sale are not sufficient to cover the outstanding loan balance then the client still has an obligation to repay that outstanding amount to the bank.

The bank can go to the sale like anyone else, and the sale must be extensively advertised. At the sale the bank can take a decision like anyone else that it would like to buy that property as an investment, or to protect its interest as a creditor. Once that decision is taken all the risk of profit and loss in that investment is for the bank's account and has nothing to do with the client to whom the property belonged. This due process of law is as old as the Roman Empire, and applies equally in our law as it does in the law of all developed nations. Without it there would be no basis on which the banks could do the business of 20-30 year lending to the public for the purposes of home ownership.