Review of the Code of Banking Practice

RESULTS OF THE FIRST COMPREHENSIVE REVIEW OF THE CODE OF BANKING PRACTICE

BACKGROUND

The Code of Banking Practice is a voluntary Code issued jointly by the Hong Kong Association of Banks (HKAB) and the DTC Association (DTCA), and endorsed by the Hong Kong Monetary Authority (HKMA). Issued in July 1997, the Code seeks to promote good banking practices and a fair and transparent relationship between authorized institutions and their personal customers. Its coverage includes banking services such as current accounts, savings and other deposit accounts, loans and overdrafts, and card services.

In July 2000, the HKMA convened an Informal Working Group (IWG), comprising representatives of HKAB and DTCA, to conduct the first comprehensive review of the Code since it was issued in 1997. The objective of the Review was to strengthen the provisions of the Code in light of its operation in the past three years and to keep it up to date with the latest developments in the banking industry, including the rapid developments in the area of electronic banking.

SCOPE OF REVIEW

The scope of the Review covered card services, accounts and loan services, debt collection practices of authorized institutions, electronic banking services, and other miscellaneous items such as stored value cards, mortgage refinancing and remittance services etc. The IWG held four meetings and produced five sets of recommended practices in relation to these banking services.

CONSULTATION

Consultation was an essential part of the Review exercise. The IWG consulted the two industry Associations and the Consumer Council extensively on its recommendations during the Review. The IWG has endeavoured to ensure that the recommendations put forward strike a reasonable balance between consumer rights on the one hand and efficiency of banking operations on the other.

MAJOR IMPROVEMENTS TO THE CODE

Major improvements to the Code include:

Terms and conditions of banking services

These provisions aim to make the terms and conditions of banking services more transparent and more consumer-friendly:

- *Institutions should make readily available to customers and prospective customers written terms and conditions of a banking service. They should be prepared to answer any queries of customers or prospective customers relating to terms and conditions.*

- *In drawing up terms and conditions for banking services, institutions should have due regard to applicable laws in Hong Kong, including, in particular, consumer protection legislation*[1].

Annualised percentage rates (APRs)

These provisions aim to facilitate customers to compare different charging structures of institutions and ensure that institutions do not charge customers extortionate interest rates:

- *Institutions should quote the APRs of credit card borrowing and personal loans which are revolving in nature in accordance with a standard method which is based on a set of assumptions regarding the typical behaviour of borrowers.*

- *For personal loans with a specified maturity date, institutions should quote the APRs for different tenors which are commonly selected by customers.*

- *While institutions are exempt from the Money Lenders Ordinance to allow them free scope to set interest rates under the Currency Board arrangement in Hong Kong, they should not charge customers extortionate interest rates*[2].

Notification of changes to fees and charges

These provisions aim to enhance the transparency of the setting and revision of fees and charges by institutions.

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[1] This provision was first proposed for card services only. However, since the same principle applies to other types of banking services, the application of this provision has been extended to cover other types of banking services.

[2] Same as footnote 1.

- *Institutions should give at least 30 days' notice to affected customers before any change in the level of fees and charges (including any change in the basis on which fees and charges are determined) takes effect. Institutions should adopt effective means of notification which would provide reasonable assurance that their customers will be informed of the change and which do not rely unduly on the customers' own initiative, such as by individual notification, press advertisement, prominent display of notice in banking halls, display of notice on ATM sites/screens, phone-banking messages, and notice posted on the website of the institution.*

- *Institutions should inform customers of the basis on which fees and charges on deposit accounts will be determined.*

Card services

These provisions aim to bring card services in Hong Kong more in line with practices in other financial centres:

- *Cardholders' maximum liability for unauthorised transactions should not exceed HK$500, provided that cardholders have not acted fraudulently or with gross negligence or have not otherwise failed to inform the card issuer as soon as reasonably practicable after having found that their cards have been lost or stolen.*

- *Card issuers should not hold subsidiary cardholders liable for the debts of the primary cardholders or other subsidiary cardholders.*

Debt recovery practices and expenses

These provisions aim to promote the proper use of debt collection agencies by institutions and good debt collection practices by their agencies:

- *Institutions should have proper systems and procedures in place for the selection of debt collection agencies and the monitoring of their performance. These systems and procedures should be subject to regular review.*

- *Institutions should require their debt collection agencies not to employ harassment or improper debt collection tactics.*

- *Any cost indemnity provision contained in the terms and conditions should only provide for the recovery of costs and expenses which are of reasonable amount and were reasonably incurred[3].*

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[3] Same as footnote 1.

- *Institutions should evaluate on a regular basis whether the charges of the debt collection agencies employed by them are reasonable having regard to the prevailing market practices. They should assess the reasonableness of any charge before passing it on to the customer concerned.*

- *At the request of debtors, institutions should provide a detailed breakdown of the costs and expenses for which debtors are required to indemnify the institution.*

<u>Electronic Banking Services</u>

While the general provisions of the Code are applicable to all types of banking services regardless of the delivery channel, new provisions have been developed in order to provide specific guidelines to institutions that are particularly pertinent to the provision of banking services through electronic channels. These include:

- *When a customer enters into an agreement for an e-banking service, institutions should make clear and prominent disclosure covering issues such as a customer's liability for unauthorized transactions, all fees and charges applicable to e-banking services, and customer obligations relating to security of e-banking services, etc.*

- *Unless customers have acted fraudulently or with gross negligence, they should not be responsible for any direct loss suffered as a result of unauthorised transactions conducted through their accounts.*

<u>Stored Value Cards</u>

In view of the increasing popularity of stored value cards, new provisions have been developed to promote good practices in the provision of stored value card services. These include:

- *Issuers of stored value cards should provide customers with general descriptive information relating to the use of stored value cards, including all fees and charges, any deposit payable by customers, the refund procedures, and any expiry date of the card, etc.*

- *In case customers do not agree to any significant variation of the terms and conditions of a stored value card, they should be entitled to the full refund of the deposit and any residual value in the card.*

The above highlights some of the main improvements to the Code. Institutions should refer to the discussion papers for other provisions and further details. These papers explain the background to the formulation of the provisions and therefore contain useful guidance to institutions on the interpretation of the revised provisions. Institutions should make reference to the guidance provided in these discussion papers in complying with the revised Code. The discussion papers are organised in the following sequence:

Paper 1 - Card Services
Paper 2 - Accounts and Loans Services
Paper 3 - Recovery of Loans and Advances
Paper 4 - Electronic Banking Services
Paper 5 - Miscellaneous Proposals

IMPLEMENTATION

The desired objectives of the Review cannot be accomplished without the full commitment of all institutions to adopt the new or revised provisions of the Code. The revised Code is effective from 1 December 2001. The industry Associations and the HKMA expect all institutions to take active steps to implement the recommended practices of the IWG as quickly as possible. Institutions should endeavour to achieve full compliance within 6 months of the effective date of the Code. However, a further 6 months is allowed for compliance with those revised provisions which require system changes.

It should be noted that certain provisions in the revised Code have become effective earlier than the effective date of the Code. These include the recommended practices relating to card services, which were effective from 15 January 2001. Two other recommended practices relating to notification of fees and charges were effective from 15 June 2001.

MONITORING COMPLIANCE WITH THE CODE

The HKMA will continue to monitor institutions' compliance with the Code. In addition, all institutions will be required to commission their compliance officers, internal audit departments or other equivalent units to carry out an annual assessment of the institution's compliance with the Code. The first such assessment report should be submitted to the HKMA within three months of the latest date for achieving full compliance with the revised provisions of the Code which do not involve system changes (i.e. 1 September 2002). These measures will enhance the effectiveness of the Code and make it a more effective tool to promote good banking practices.

ROLE OF INDUSTRY ASSOCIATIONS

Going forward, HKAB, jointly with the DTCA, will assume greater ownership of the Code. A Code of Banking Practice Committee comprising representatives of HKMA, HKAB and DTCA has been established and this will take on the role of developing and drafting future changes to the Code. It will also provide guidance on the application and interpretation of the Code. The HKMA welcomes this initiative, and will continue to work closely with the Associations on the future development of the Code.

Hong Kong Monetary Authority
November 2001

PAPER 1 – CARD SERVICES

1. PURPOSE

1.1 This paper sets out the business practices recommended by the Informal Working Group on the Review of the Code of Banking Practice (IWG) in relation to the provision of cards services[1] by authorized institutions either directly or indirectly through their subsidiaries or affiliated companies controlled by them (reference to authorised institutions below includes their subsidiaries and affiliated companies controlled by them).

1.2 These recommended practices are aimed at addressing the issues highlighted by the Court of First Instance in its ruling on 10 July 2000 and a survey published by the Consumer Council in its Choice Magazine in August 2000. Both of these incidents reveal that there is a need to improve the business practices of institutions in respect of credit cards.

2. RECOMMENDED PRACTICES

2.1 In drawing up the terms and conditions for card services, institutions should have due regard to applicable laws in Hong Kong, including, in particular, consumer protection legislation.

The IWG notes that credit card services, as well as other personal finance products, are offered to a large number of customers. It would not be realistic for institutions to negotiate with each customer about the terms and conditions. Therefore, the relevant agreements are standard forms drafted by the institutions themselves. This is precisely why customers of personal finance are generally considered as "dealing as consumer[2]" and are therefore protected under various legislation relating to consumer protection (including the Unconscionable Contracts Ordinance).

Although there does not appear to be any practical means of addressing the issues that institutions are usually in a stronger bargaining position than customers and that customers do not have the power to negotiate the terms and

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1 Although this paper focuses on credit card services, the IWG considers that many of the principles contained in this paper are also applicable to other types of card services and unsecured consumer lending.

2 Section 3 of the Unconscionable Contracts Ordinance provides that a party to a contract "deals as consumer" in relation to another party if –
(a) he neither makes the contract in the course of a business nor holds himself out as doing so;
(b) the other party does make the contract in the course of a business; and
(c) the goods passing or services provided under or in pursuance of the contract are of a type ordinarily supplied or provided for private use, consumption or benefit.

conditions for card services, this does not excuse institutions from the obligation to ensure that the relevant terms and conditions are “fair” to customers. This is indeed one of the most important principles contained in the Code of Banking Practice (see clause 5.2 of the Code). In case of doubt, it is always a good practice for institutions to seek advice from their legal counsel as to whether a term is fair and reasonable to customers.

In considering whether a term is reasonable to customers, institutions should pay particular attention to all legislation relating to consumer protection. This is necessary not only to protect the interests of customers but also those of the institutions themselves, as any terms and conditions which infringe upon the statutory rights of consumers could be void and unenforceable.

2.2 A copy of the written terms and conditions should be provided at the request of customers (or prospective customers).

Given that the credit card agreements are prepared by the institutions, it is reasonable that consumers, who may not yet be customers of the institutions, are given the opportunity to review the terms and conditions. This will allow consumers to compare the different card services available in the market and hence enable them to select the service which is most competitive and most suitable for them. Above all, providing customers with a copy of the terms and conditions is one way to safeguard the enforceability of the pertinent terms and conditions, which can only be in institutions’ own interests.

The IWG has considered whether institutions should provide a full copy of the terms and conditions to customers at the time of application for credit cards. It is noted that this may not be the most effective way to promote transparency as most customers would not actually read the detailed terms and conditions. It may be more appropriate to think of other more effective ways to enhance transparency (see recommended practice below). Nevertheless, in order to provide customers with the opportunity to review the full terms and conditions, institutions should provide a copy of the written terms and conditions at the request of customers or prospective customers.

2.3 Customers’ attention should be drawn to the major terms and conditions which impose significant liabilities or obligations on their part. These terms and conditions should be described or highlighted in plain language (both in English and Chinese) in the application forms for card services. The description should be printed in clear and legible type and in a font size that facilitates easy reading.

Making a copy of the terms and conditions readily available to consumers is not sufficient to enhance transparency. A more important issue is whether consumers understand the implications of the terms and conditions of credit card services, particularly those which would impose significant liabilities or obligations on them. To this end, institutions should take reasonable steps to draw consumers' attention to these provisions and explain to them their potential liabilities under these provisions. This can be done by means of the application forms for card services, which can be enhanced to contain a concise but clear description of the major terms and conditions which impose significant liabilities or obligations on the part of customers. The description of these terms and conditions should be printed in clear and legible type and in a font size that facilitates easy reading. Plain language (both English and Chinese) should be used to the extent that it is consistent with the need for legal certainty.

Nevertheless, institutions should still advise customers to read the whole terms and conditions. Given that terms and conditions of different institutions may be different, individual institutions should exercise their own judgment in determining which term or condition would impose significant liabilities and obligations on customers and hence should be highlighted in the application forms. However, the following terms and conditions should generally be included.

(i) the responsibility of the cardholder to sign on the card immediately if the card is accepted;
(ii) the obligation to handle with due care any personal identification number provided and the liability for failing to do so;
(iii) the obligation to repay the outstanding balance on time and the liability to pay penalty charges if the required minimum payment is not made;
(iv) in case of default, the liability to indemnify the institution for costs and expenses reasonably incurred by the institution in recovering the debt;
(v) the liability for all losses suffered by the institution if the cardholder has acted fraudulently or with gross negligence;
(vi) the maximum liability for unauthorised transactions before a card loss is reported to the institution;
(vii) the right of the institution to regard a statement of account as conclusive if the cardholder fails to report any unauthorised transaction within 60 days from the statement date or any longer period specified by the institution[3];
(viii) the right of the institution to set off any credit balance maintained by the cardholder with the institution (if there is any such right);
(ix) the respective liabilities of the principal and supplementary cardholders for sums owed to the institution;
(x) the right of the institution to demand immediate repayment; and
(xi) the right of the cardholder to terminate the card service if he or she does not accept any amendment to the terms and conditions proposed by the institution.

[3] In accordance with section 27.1 of the Code, card issuers should give customers at least 60 days (from the statement date) to report any unauthorised transaction included in their statements.

2.4 Institutions should be prepared to answer any queries of customers (or prospective customers) relating to the terms and conditions for card services.

To further ensure that customers understand the terms and conditions, institutions should be ready and able to answer any queries of consumers relating to the terms and conditions. It is recommended that institutions make use of their existing customer service hotlines to answer queries of consumers in this respect. Appropriate training should therefore be provided to the relevant staff.

2.5 Any cost indemnity provision contained in the terms and conditions of banking services should only provide for the recovery of costs and expenses which are of reasonable amount and were reasonably incurred.

Institutions should review their terms and conditions to ensure that the indemnity cost provisions only provide for the recovery of costs and expenses that are of reasonable amount and were reasonably incurred. This means that institutions should not only assess whether an item of expense ought to be incurred, but also evaluate whether the amount incurred is “reasonable”. Whether an item of expense is “reasonable” would need to be assessed on its own merits. However, the following practices should help institutions to assess the reasonableness of such charges and should be implemented by institutions:

(i) institutions should have in place a system to evaluate on a regular basis whether the charges of their agents or advisers are reasonable having regard to factors such as the prevailing market practices, the reputation of these agents or advisers and the institution’s past experience in dealing with them;

(ii) in the case of variable charges, institutions should require their agents and advisers to give detailed account for the charges (e.g. the time spent in debt collection efforts) in order for them to assess the reasonableness of such charges;

(iii) institutions should ensure that their own administrative procedures keep such costs and expenses to a reasonable amount; and

(iv) any legal proceedings taken by institutions should be instituted in the appropriate court.

2.6 At the request of debtors, institutions should provide a detailed breakdown of the costs and expenses for which debtors are required to indemnify the institution.

To enhance the clarity of the costs and expenses for which debtors are required to indemnify the institution, institutions should, at the request of debtors, provide a detailed breakdown of the amount of such costs and expenses.

2.7 Institutions should quote the annualised percentage rate of interest (APR) for credit card products, together with the annual card fee, to facilitate comparison between different charging structures. The APR of interest should be calculated in accordance with the standard method set out in the Annex, which is based on a set of assumptions[4] regarding the behaviour of cardholders. The APR and the annual card fee should be shown with equal prominence whenever interest rates on credit card products are quoted.

The IWG considers that standardising the method used by institutions to calculate APRs of credit card lending would help to promote the transparency of credit card products. This will, however, require the banking industry to agree to a set of assumptions regarding the "typical" behaviour of cardholders (e.g. their usual repayment pattern). Save for certain adaptations to suit the local environment, the IWG believes that it is desirable to follow the approach set out in the guideline, "Credit Charges and APR", issued by the Office of Fair Trading in the U.K. A detailed paper on APR calculation is enclosed at the **Annex**.

It is recommended that all institutions should quote APRs of credit card advances calculated in accordance with the standard method. Customers or prospective customers should be advised of the prevailing APRs (one for retail purchase and one for cash advance) and the annual card fee in all advertising materials whenever interest rates of credit card products are quoted. The APRs and the annual card fee should be shown with equal prominence.

2.8 While institutions are exempt from the Money Lenders Ordinance to allow them free scope to set interest rates under the Currency Board arrangement in Hong Kong, the APR[5] of interest charged by them in respect of credit card lending and calculated in accordance with the standard method and assumptions set out in the Annex should not, unless justified by exceptional monetary conditions, exceed the legal limit as stated in the Money Lenders Ordinance.

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4 It should be noted that the APRs required to be provided will be "typical" APRs calculated on the basis of "typical" assumptions. This will enable better comparisons to be made between different issuers.

5 It should be noted that the APR of interest used for comparison here is based on the "typical" assumptions. Alternative calculations may produce an annualised figure which is higher than the maximum rate depending on the behaviour pattern or assumptions used. (e.g. when cash advances are drawn and repaid within a short period of time, the cash advance fees can be translated into a very high annualised rate).

Institutions are exempt from the Money Lenders Ordinance in order to allow them free scope to set interest rates under the Currency Board arrangement in Hong Kong. However, this is no justification for charging consumers extortionate interest rates and they should observe the spirit of the Money Lenders Ordinance, which sets out the level of interest rate which is considered as extortionate under law. If the APR of interest calculated in accordance with the standard method and assumptions set out in the Annex would be higher than the level presumed to be extortionate by virtue of section 25 of the Money Lenders Ordinance (i.e. 48% per annum), the institution concerned should be able to justify why such a high interest rate is not unreasonable or unfair (e.g. a high interest rate is required to compensate the institution for a high loan loss ratio). In any case, the APR charged by institutions and calculated in accordance with the standard method and assumptions should not exceed the legal limit stated in the Money Lenders Ordinance (i.e. 60% per annum) except under exceptional monetary conditions.

2.9 Provided that cardholders have not acted fraudulently or with gross negligence or have not otherwise failed to inform the card issuer as soon as reasonably practicable after having found that their cards have been lost or stolen, their maximum liability for unauthorised transactions before the card loss is reported should not be higher than HK$500.

Section 29 of the Code states that provided that cardholders have not acted fraudulently or with gross negligence, their maximum liability for credit card loss should be confined to a limit specified by the card issuer, which should be "reasonable". The industry practice, however, is that this limit is usually set at the prevailing credit limit of the cardholders, which would normally exceed HK$10,000. This is not the usual practice in other comparable financial centres. Consistent with international standards (e.g. US$50 in the U.S., NZ$50 in New Zealand and GBP50 in the U.K.), the IWG recommends that this limit should be set at a level not higher than HK$500.

2.10 While principal cardholders are held liable for the debts of supplementary cardholders, supplementary cardholders should not be held liable for the debts of the principal cardholders and other supplementary cardholders.

Some card issuers hold the principal and supplementary cardholders jointly and severally liable for the sums owed to the institutions. They will pursue a supplementary cardholder for the debts of the related principal cardholder if the principal cardholder defaults. In some cases where there is more than one supplementary cardholder, the debt of the principal cardholder may even include debts of a second supplementary cardholder accumulated under that principal cardholder. The IWG considers that this practice is unreasonable. In granting a card to a supplementary cardholder, institutions rely only on the credit standing of the principal cardholder. Moreover, supplementary cardholders do not have their own credit limits but share the limits of the principal cardholders. For this reason, it is unfair that supplementary cardholders are held liable for the debts of the principal cardholders or other supplementary cardholders, over which they have no control.

It is acknowledged that institutions may need to segregate the debts of principal and supplementary cardholders and devise a method to apportion repayments between the accounts of the principal and supplementary cardholders. System changes may also be required. Therefore, a longer period will be allowed for compliance with this recommended practice.

Like other recommended practices, this recommendation should be viewed as the minimum practice. It does not restrict card issuers from exempting supplementary cardholders from all debts accumulated under both the supplementary or principal cards. However, principal and supplementary cardholders should be advised of such arrangements at the time the supplementary card is applied for. In the case of joint cardholders, they should be advised that they will be held jointly and severally liable.

3. IMPLEMENTATION

3.1 The above recommended practices are effective from 15 January 2001. Institutions should adopt these recommended practices as quickly as practicable, and should achieve full compliance within 6 months at the very latest (although a further 6 months will be allowed for compliance with the recommended practice in paragraph 2.10, which may involve system changes).

3.2 Institutions which provide card services, directly or through their subsidiaries or affiliated companies should commission their internal audit department to conduct an assessment in relation to the institution’s compliance with the above recommended practices. The assessment report should be submitted to the HKMA on or before 15 August 2001.

Hong Kong Monetary Authority
January 2001

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Annex

Calculation of Annualised Percentage Rate of Interest in relation to Credit Card Products

This paper sets out a standard method for the calculation of annualised percentage rates (APRs) of interest in relation to credit card products.

Background

Lack of a standard calculation method

2. Section 11 of the Code of Banking Practice provides that institutions should quote APRs on deposits, loans and credit card products to facilitate comparison between different charging structures. It further provides that the formula set out in guidelines issued by the industry Associations should be followed in the computation of APRs.

3. The guidelines issued by the industry Associations in 1997 provide specific recommendations on the method that should be used to calculate APRs for advances such as personal and mortgage loans. It is provided that the “Net Present Value” (NPV) method specified in the UK Consumer Credit Act (see “The Proposed Framework” below for details) should be adopted and the APRs should include interest on loans as well as any other fees and charges to reflect the total cost of credit. If a different formula is adopted, disclosure to this effect should be made.

4. However, in respect of credit card products, the guidelines only give general suggestions that annual fees for the use of cards should not be included in calculating APRs, and that the APRs should reflect the rate charged on outstanding debit balances. Hong Kong Association of Banks (HKAB) attempted to standardize the methods used by member banks to calculate APRs of credit cards in 1998 but concluded that a standard computation method was problematic.

5. A small-scale survey conducted by the HKMA in February 1999 revealed that the methods used by the industry to calculate APRs varied amongst institutions. It was found that some card issuers simply multiplied the monthly rate by twelve. Obviously, this simple calculation method is not suitable for card issuers which charge compound interest on credit card outstanding. Moreover, there was not a consistent way to deal with fees and charges related to credit card products.

Need for greater transparency and standardization

6. The Consumer Council released in August 2000 a survey on the cost of credit card borrowing. The survey was critical of the lack of transparency as regards the calculation of interest and other charges on credit card debts. It highlighted that consumers may not easily understand the different calculation methods and thus the true cost of borrowing in relation to credit cards.

7. To enable consumers to make an informed choice in their use of credit cards and to facilitate greater competition amongst institutions, it is considered desirable that the methods for calculating APRs of credit cards should be standardized. The following paragraphs set out a standard method for calculating APRs of credit cards advances.

<u>The Framework</u>

8. Since the UK method is already used to calculate APRs of personal and mortgage loans in Hong Kong, as a natural extension of the current practice, the method for computing APRs of credit cards in the UK should also be adopted.

The formula

9. In the UK, the Consumer Credit Act prescribes that the NPV method should be used to calculate APR:

$$A = \sum_{k=1}^{n} \frac{X}{(1+i)^{t_k}} \quad \text{where}$$

A = original loan amount
n = number of instalments
X = monthly instalment amount
t_k = time interval, expressed in years, between the relevant date and the date of the k^{th} instalment
k = number identifying a particular instalment
i = unknown APR

The assumptions

10. Since the APRs calculated would depend on the behaviour of the cardholders (e.g. the repayment patterns), a set of assumptions must be made so as to provide a consistent basis for calculation. The guideline, “Credit Charges and APR”, issued by the Office of Fair Trading in the UK sets out the assumptions

which should be made and the types of fees and charges which should be included for calculating APRs.

11. The assumptions provided for in the UK guideline should be largely followed. However, certain adaptations are necessary to cater for the local practices. These assumptions are:

(i) The retail purchase is made or the cash advance is withdrawn at the earliest time possible (consistent with the UK guideline);

(ii) The amount of credit used is HK$50,000;

(This assumption is necessary because most card issuers levy fixed charges. If the amount of credit used is not specified, these fixed charges can translate into different APRs. Industry representatives in the Informal Working Group on Review of Code of Banking Practice (IWG) consider that a limit of HK$50,000 is reasonable in the context of Hong Kong's credit card market.)

(iii) All fees and charges related to the provision of credit should be taken into account in the calculation of the APR, with the exception of the annual card fee, or fees and charges which are payable as a result of the failure of the cardholder to carry out his obligations under the agreement (e.g. default charges) or which are payable upon the provision of additional services by the card issuer (e.g. charges for temporary over limit);

(*This assumption is slightly different from that adopted in the UK where all fees and charges are included. Annual card fees are excluded because they do not form part of the cost of credit, since a cardholder will need to pay the annual card fee regardless of whether or not he makes use of the credit facility. Moreover, the annual card fee can be considered as the cost of the convenience or benefits associated with the use of the card, such as the convenience of using the card as a means of payment and the benefits of any insurance coverage or bonus scheme provided by the card. In addition, in Hong Kong it is quite common for the annual card fee to be waived by the issuer. To include the fee in the calculation of the APR would, therefore, - for most customers – be misleading.)*

(iv) The cardholder continues to make the minimum payments until the balance on the account falls to zero (consistent with the UK guideline);

(Under this assumption, the outstanding balance (including the cash advance fee) would be repaid over an extended period. The IWG considers this assumption more appropriate because it is consistent with the UK guideline and it reflects the typical repayment behaviour of cardholders more accurately than other assumptions such as cardholders repaying the outstanding balance within a stated period of time, e.g. six months or one year.)

(v) If the transaction requires a repayment to be made no later than a specified date, that date should be used as the time of repayment (consistent with the UK guideline);

(vi) If there are repayments of credit or payments of charges which are to be paid before the relevant date (i.e. the end of the relevant period), it is assumed that they are paid on the relevant date (consistent with the UK guideline); and

(vii) Bonus schemes and cash rebates are ignored since it is too difficult to translate such benefits into pecuniary terms (consistent with the UK guideline).

12. Illustrative examples of APR calculation for cash advance and retail purchase based on the above assumptions can be found in the relevant guidelines issued by the industry Associations.

Hong Kong Monetary Authority
January 2001

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PAPER 2 – ACCOUNTS AND LOANS

1. PURPOSE

1.1 This paper sets out the changes recommended by the Informal Working Group (IWG) to strengthen the provisions contained in the Code of Banking Practice in relation to accounts and loans services provided by authorized institutions.

2. BACKGROUND

2.1 In 1999, the HKMA undertook to deregulate the remaining interest rate rules (IRRs) of the Hong Kong Association of Banks (HKAB) by two phases. The first phase of deregulation covering time deposits with a maturity of under 7 days was implemented in July 2000. The second and final phase covering current and savings account deposits is scheduled to take place in July 2001.

2.2 After the second phase of deregulation, all HK$ deposits will no longer be subject to interest rate caps. It is likely that the IRRs issued by HKAB will be dispensed with substantially or entirely. Given that the IRRs contain a number of requirements on member banks to observe certain best practices, it is desirable that these rules are incorporated into the Code and therefore retained.

2.3 From a self-assessment exercise conducted by 44 major retail banks last year, it is envisaged that banks may react to deregulation by increasing fees and charges (Indeed, some banks have already announced changes to their fees and charges). This is partly in anticipation of the forthcoming deregulation, but also a response to increasing pressure on interest margins as a result of intensified competition in the banking industry. To prepare for these changes, there is a need to enhance the relevant provisions contained in the Code to provide more detailed guidance to banks in relation to the setting and revision of fees and charges.

2.4 The opportunity is also taken to amend certain provisions pertaining to the operation of deposit and loan accounts.

3. RECOMMENDED PRACTICES

3.1 Institutions should advise customers of the interest rate, if any, that will apply on time deposits which have matured but have not been renewed or withdrawn.

3.2 If the date of maturity of a time deposit falls on a day which is not a business day, the deposit shall be deemed to mature on the succeeding business day.

3.3 Institutions should provide customers with a contemporaneous receipt or advice for deposits at call or notice or fixed deposits which should show the date of deposit, the rate of interest, and, in the case of fixed deposits, a single date of maturity.

The IWG considers that the above best practices set out in the IRRs of HKAB should be incorporated into the Code in anticipation of the second phase of deregulation. The retention of these rules can help to minimise any potential dispute between institutions and their customers in the taking of time deposits. Institutions are expected to follow these practices insofar as they are applicable to them (e.g. since DTCs are only allowed to take deposits with a maturity of 3 months or above, the third recommendation is only partially applicable to them).

3.4 Institutions should give at least 30 days' notice to affected customers before any change in the level of fees and charges (including any change in the basis on which fees and charges are determined) takes effect, unless such changes are not within their control. Institutions should adopt effective means of notification which would provide reasonable assurance that their customers will be informed of the change and which do not rely unduly on the customers' own initiative. Individual notification of customers (whether by written notice, statement insert or email message) is likely to be effective in achieving these objectives. But where this is not appropriate on grounds of disproportionate costs or likely ineffectiveness (e.g. in the case of passbook savings accounts where the latest address of the customers may not be known to the institution), institutions may adopt other means of notification, such as one or more of the following:

(i) press advertisement;
(ii) prominent display of notice in banking halls;
(iii) display of notice on ATM sites/screens;
(iv) phone-banking message; and
(v) notice posted on the website of the institution.

In accordance with section 6.3 of the Code, institutions should give 30 days' notice to affected customers before any change in fees and charges takes effect. The Code, however, does not specify how such notice should be given to affected customers.

To meet this requirement, it is noted that institutions usually display an updated list of all fees and charges at their branches 30 days before adjustments to their fees and charges take effect. However, not all customers may visit branches.

Simply displaying an updated list of fees and charges at the branches is therefore not a sufficient way to draw customers' attention to the fee adjustment.

To enhance the transparency of fee adjustment, it is important that institutions should first of all give affected customers a notice of fee adjustment showing clearly the variation, rather than just an updated list of fees and charges. In addition, the notice should indicate how affected customers can seek assistance from institutions if they do not agree to the change (e.g. how they can terminate the relevant service if they so decide).

Regarding the way through which the notice of fee adjustment should be disseminated, the IWG believes that institutions should make their best endeavours to inform affected customers of the impending revisions in fees and charges. It is considered that sending an individual notice to each affected customer is an effective means of notification. Many account holders already receive regular monthly statements from institutions, and the notice can simply be provided by means of a letter or a statement insert mailed to the affected customers.

However, this means of notification may not be appropriate in the case of passbook savings accounts. Since a large number of these accounts were opened years ago, institutions may not have the current address of the account holders. The lack of the latest address of the account holders will affect the effectiveness of this means of notification. Moreover, the requirement of individual notification may increase the cost of providing passbook savings accounts, which might eventually be passed onto the account holders. The IWG therefore considers that other means of notification such as a newspaper advertisement is more likely to be read by an affected customer than a letter with an incorrect address.

In view of the above, it is considered that, where individual notification is not appropriate on grounds of disproportionate costs or is unlikely to be effective, institutions should be given some flexibility in determining which means of notification is most appropriate in informing customers of the fee adjustments. They should adopt other means of notification that provide reasonable assurance that customers will be informed of the change and that do not rely unduly on the affected customers' own initiative to know of the change. Effective notification may require a combination of the measures set out in paragraph 3.4.

3.5 Institutions should inform customers of the basis on which fees and charges on deposit accounts will be determined.

After the final phase of deregulation, institutions may introduce different types of charges on deposit accounts. The level of these charges may vary depending on the profitability of individual customers to the banks and the nature of banking services offered. For example, savings and current account holders may be required to pay a charge if the average monthly balance of their accounts falls below a predetermined minimum amount, or the number of cheques issued by them exceeds a specified level. While there is a provision in the Code which requires institutions to inform customers of the basis on which interest will be determined (see section 17.2(b) of the Code), there is currently no similar provision in respect of fees and charges. The IWG considers that the above provision should be incorporated into the Code after section 17.2(b).

3.6 The number of days used as the basis of interest calculation for loans and deposits should be consistent.[1]

At present, there is no standard practice in respect of the bases on which interest for loans and deposits is calculated. Some institutions calculate interest on a monthly basis and some on a daily basis, some using 365 days for ordinary years and 366 for leap years as the basis of interest computation, and others simply using 365 days for any year (see formula below).

Interest for the relevant month
= Outstanding balance at the end of preceding month X interest rate X number of days in the relevant month / 365 or 366 days (depending on whether it is a leap year and the method of calculation adopted)

The Consumer Council has pointed out that institutions which use 365 days as the basis for calculating <u>mortgage</u> interest could have charged their customers one extra day of interest during leap years (because the total number of days in the numerator is 366 whereas that in the denominator is 365 only).[2] Some mortgagors complained that this calculation method is unfair to them and therefore should not be used.

In this connection, it should be noted that it is a market convention to assume 365 days in all years in calculating interest for HKD interbank borrowing or lending. A significant number of institutions, particularly those which rely on interbank borrowing for funding, also follow this basis to calculate interest for deposits and loans in order to avoid interest mismatch on their asset and

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1 This provision will not apply to mortgage loans retrospectively. It is noted that the basis of interest calculation is usually stated in mortgage deeds and a change in the basis for interest calculation would entail amendments to these legal documents which would incur extra costs to either the customer or the institution. To avoid these unnecessary costs, institutions should be allowed to continue to use the calculation method stipulated in the mortgage deeds of existing customers.

2 This provision does not affect loans where interest is calculated on a monthly basis. The problem of charging customers an extra day of interest during leap years does not arise as the formula for interest computation is unaffected by the leap year problem:-

Interest for the relevant month = Outstanding balance X interest rate X 1/12 liability sides. Therefore, it may be unreasonable to require institutions not to use 365 days as the basis of interest calculation in leap years.

Nevertheless, it is agreed that institutions should not take advantage of this technicality of interest calculation (i.e. by using a different number of days in relation to deposits and loans). In accordance with sections 17.2 and 18.2 of the Code, they should inform customers of the basis on which interest will be determined, including the numbers of days in both ordinary and leap years that are used as the basis of calculation. Moreover, those institutions which use the 365-day year method to calculate interest on deposits should use the same basis to calculate interest on loans.

3.7 Institutions should give 14 days' prior notice to customers when a charge accrues on dormant accounts for the first time.

Section 6.5 of the Code states that institutions should inform customers of the nature and amount of any charges debited to their accounts promptly after such charges are debited. Many institutions, however, notify customers of dormant accounts (i.e. accounts which have not been operated for at least 6 months) before charges are debited from these accounts. This is considered to be a good practice which can avoid potential disputes between institutions and customers of dormant accounts and should be followed by all institutions.

The IWG has considered whether institutions should be required to give a prior notice to customers whenever a charge is debited from dormant accounts. In this connection, it is noted that some institutions may charge dormant accounts on a more regular basis (e.g. monthly). If they are required to give a prior notice to customers whenever a charge is debited from dormant accounts, this may incur significant costs to them. These costs would likely be passed onto the holders of the dormant accounts. Moreover, such a requirement would also defeat the purpose of imposing a service charge on dormant accounts to encourage customers to use account services in a more efficient manner (e.g. closing unused accounts) so as to promote the efficiency of account operations.

3.8 Institutions should set out in their terms and conditions the circumstances under which they would exercise their right of set-off.

Section 16.3 of the Code provides that institutions should inform customers promptly after exercising any right of set-off. To provide greater transparency of the operation of the right of set-off, institutions should set out in their terms and conditions the circumstances under which they would normally exercise their right of set-off.

4. IMPLEMENTATION

4.1 Recommended practices 3.4 and 3.5 are effective from 15 June 2001 in view of the impending deregulation of the remaining IRRs in early July 2001. Institutions should adopt these recommended practices as quickly as possible but in any event not later than the effective date. Other recommended practices in this paper will become effective on a date to be specified later upon completion of review of the Code.

Hong Kong Monetary Authority
May 2001

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PAPER 3 - RECOVERY OF LOANS AND ADVANCES

1. PURPOSE

1.1 This paper sets out the changes recommended by the Informal Working Group (IWG) on how the guidelines contained in the Code of Banking Practice in relation to the use of debt collection agencies (DCAs) by authorized institutions can be strengthened.

2. BACKGROUND

2.1 From time to time, there are media reports about the improper, or even unlawful, tactics employed by debt collectors. The number of complaints received by the Police – and indeed the HKMA – against the malpractices of DCAs is on a rapidly rising trend[1]. While there is no direct evidence that the increased number of complaints is attributable to the conduct of the DCAs employed by institutions, it is advisable for the banking industry, being the major provider of credit, to work together to identify ways to keep such bad publicity at bay.

2.2 Meanwhile, the Sub-committee on Debt Collection of the Law Reform Commission issued in July 2000 a consultation paper on regulation of debt collection practices. The Consultation Paper contains a succinct portrayal of the debt collection industry in Hong Kong, as well as a series of recommendations to regulate abusive debt collection practices. References have been made to the Consultation Paper where appropriate in drawing up the following proposals, which are aimed at further promoting the proper use of DCAs by institutions.

3. RECOMMENDED PRACTICES

3.1 Institutions should have proper systems and procedures in place for the selection of DCAs and the monitoring of their performance. These systems and procedures should be subject to regular review.

The Sub-committee on Debt Collection of the Law Reform Commission recognises that debt collection is a legitimate and necessary business activity. It is beneficial to the community at large as debts are usually repaid more expediently without immediate recourse to the judicial system. It is

[1] In 1997, there were 447 cases of criminal complaints relating to debt collection activities. The figures rose to 1,672 in 1998 and 3,323 in 1999.

unreasonable to impose an outright requirement on institutions not to employ specialist agents to collect debts on their behalf, particularly when other creditors are allowed to do so.

However, as mentioned in the Consultation Paper, the debt collection industry in Hong Kong comprises a wide spectrum of market operators, including large reputable international and local agencies, as well as some which may be less well managed and scrupulous. It is important that institutions should exercise extra caution in their use of DCAs in order to protect their corporate goodwill. They should employ only those DCAs which are run in a professional and ethical manner.

To this end, institutions should have proper systems and procedures in place for the selection of DCAs. These systems and procedures should be subject to regular review and should consist of the following essential elements:

(i) A review of the background information of the DCA including a company search to identify the owners and directors of the DCAs;

(ii) A basic assessment of the financial soundness of the DCA;

(iii) A site visit to ascertain the business address of the DCA;

(iv) An evaluation of the operation of the DCA to assess whether:

    (a) the DCA has a vetting process in place to ensure that only honest and ethical individuals are employed as collectors;
    (b) the tape recording system to record conversations between collectors and debtors is functioning properly and reasonably secured to protect it from any tampering by individual collectors;
    (c) there are adequate monitoring systems to make sure that collectors adhere to pre-established procedures and duly record their actions taken in respect of each debtor;
    (d) there are detailed codes of practice covering different aspects of debt collection including the manner in which telephone calls and personal visits should be conducted and the obtaining and handling of personal data;
    (e) there are established policies to handle complaints of debtors in a prompt and responsible manner; and
    (f) there is a disciplinary system (including termination of employment) to penalise collectors for misconduct or breach of established operation guidelines or codes of practice; and

(v) A procedure to obtain references from at least <u>two</u> of the existing clients (preferably authorized institutions) of the DCA.

After a DCA is engaged, its performance should be regularly monitored. A comprehensive review should be conducted at least on an annual basis. The procedures set out in (i) to (iv) above should be repeated during the review. The initial selection process and any subsequent review of the DCA should be properly documented to facilitate inspection by the internal audit department of the institution or by the external auditors or examiners of the HKMA.

3.2 Institutions should have established procedures to handle complaints received from debtors. They should carry out a careful and diligent inquiry into the complaint to check whether there is any misconduct on the part of the DCA and whether there is any violation of the requirements contained in the Code. Appropriate remedial actions should be taken if necessary.

Every now and then, institutions may receive complaints from debtors relating to the misconduct of the DCAs employed by them. These complaints may or may not be valid. Nevertheless, institutions should initiate a careful and diligent inquiry into the complaint in accordance with their established procedures.

At a minimum, the DCA involved should be required to provide within a reasonably short period of time (e.g. within 1-2 working days) a detailed report on the history of actions taken to date, together with all relevant telephone recordings and correspondence with the complainant to the institutions. The institution should examine these records vigilantly (and ask for more detailed information if considered necessary) to see if the complaint can be corroborated. In the course of the review, the institution should check for any breach of the requirements contained in the Code (which should have been incorporated into its contract with the DCA).

If misconduct or breach of the requirements of the Code is found, the institution should require the DCA to take appropriate remedial action, which should include taking necessary disciplinary action in respect of the collector involved. In the event of repeated breaches or serious misconduct (e.g. involving illegal collection tactics), the institution should consider termination of the relationship with the DCA. Proper documentation of the inquiry should be maintained.

3.3 Institutions should evaluate on a regular basis whether the charges of the DCAs employed by them are reasonable having regard to the prevailing market practices. They should assess the reasonableness of any charge before passing it on to the customer concerned.

This follows from the recommended practice that institutions should only recover from debtors costs and expenses which are of reasonable amount and which were reasonably incurred during the debt recovery process.

The prevailing market practice in the debt collection industry is that DCAs charge their clients on a "no collection, no pay" contingency basis. In the event that a debt is successfully collected, a DCA will charge its clients a commission rate in terms of a percentage of the amount recovered. By virtue of the cost indemnity provision contained in credit card and personal loan agreements, default debtors are generally held responsible for such charges. This charging method is not peculiar to Hong Kong. It is understood that it is also commonly used in other countries including the U.S., the U.K., Canada, New Zealand, Singapore and Malaysia.

The commission rate of DCAs depends on the age of the accounts and the value of the business between the agency and the client, but typically ranges from 20% - 35%. There is no evidence to indicate that such a level of charge is out of line with the levels in other countries.[2] It appears that the debt collection industry in Hong Kong is quite competitive, with an unofficially estimated number of about 30 active players.

The IWG is aware that concern has been expressed about this contingency based charging method on the grounds that it may be unreasonable to those debtors who repay within a short period of time after their accounts are assigned to DCAs. In particular, there would appear to be some element of cross-subsidisation between debtors who repay early and those who repay late or do not repay at all.

The IWG has considered two possible options to address this issue. The first one is to try to change the present charging method such that DCAs would be paid on a cost reimbursement basis plus a margin for their profits. This option, however, is likely to entail considerable expense on the part of both the DCAs and the institutions in terms of keeping and reviewing the expenses incurred in respect of each account (e.g. how many phone calls made by the collectors) and therefore appears to be unrealistic and impracticable. Another disadvantage is that this could encourage DCAs to adopt less proactive tactics in recovering debts in order to increase their charges. A further drawback is that the total expenses accumulated could reach a very high level disproportionate to the amount of debt outstanding.

An alternative option is that a lower commission rate would be applied on the amount of debt repaid earlier. For example, the applicable commission rate could be one-third of the pre-agreed commission rate within, say, 20 days after

[2] According to the promotional materials of some overseas DCAs, the commission rate of DCAs ranges from 15-40% in the U.S., 20-35% in Canada, 15-25% in U.K., and 20-30% in New Zealand.

the DCA is appointed, two-third of the pre-agreed commission rate between the 21st day and 40th day, and thereafter capped at the pre-agreed level. The merits of this modified charging method would be that it would appear to be fairer to those debtors who repay earlier and therefore the collection charges to be reimbursed by these debtors would perhaps be more likely to be considered by the courts as reasonable. Moreover, it provides an added incentive for debtors to repay earlier. However, it is questionable whether this modified charging method would be very worthwhile. Institutions do not usually refer accounts to DCAs unless they have already exhausted their own means of collection and it is therefore most unlikely that such accounts would be repaid within a short period of time after they have been assigned to a DCA. Furthermore, this charging method could also have implications for the operation and income of DCAs, which might ask for a higher commission rate to compensate for their potential loss of income. There is also the possibility that some DCAs may delay their collection efforts until the commission rate reaches the pre-agreed level. In view of the above, the IWG considers that there does not appear to be any immediately obvious viable alternative to the existing charging structure.

It should not be the case, however, that the fee charged by the DCA is automatically passed on to the debtor. On a case by case basis, the institution should assess the reasonableness of passing on the charge. It may be that in some cases institutions will determine that they should not pass on the full charge.

3.4 Institutions should require their DCAs not to employ the following improper debt collection tactics.

Sections 36.1 and 36.2 of the Code already stipulate that institutions should specify either in the contract or by means of written instructions that their DCAs should refrain from illegal, intimidation or harassment type collection tactics. The Consultation Paper has provided a number of examples of improper collection practices which can be incorporated into the Code to provide clearer guidance on what are commonly considered as undesirable collection practices. These examples include:

Harassment type tactics

- putting up posters or writing on the walls of the debtor's residence;
- disclosing or in any way revealing the indebtedness of the debtor to any third party;
- pestering the debtor with persistent phone calls;
- making telephone calls at unreasonable hours; and
- pestering the debtor's referees, family members and friends for information about the debtor's whereabouts.

Other improper tactics

- using false names (e.g. the name of another DCA) to communicate with the debtor;
- making anonymous calls and sending unidentifiable notes to the debtor to avoid being traced by police;
- making abusive or threatening remarks to the debtor after switching off the tape recorder or when calling the debtor by phones without tape-recording facilities (e.g. mobile phones); and
- making false or misleading representation with an intent to induce the debtor to make a payment (e.g. telling the debtor that he will be imprisoned if he fails to repay his debt).

3.5 Institutions should stop their debt collection activities on a debtor once they become aware that a bankruptcy order has been issued in relation to the debtor.

This provision ensures that institutions will comply with section 42 of the Bankruptcy Ordinance which stipulates that any asset movement after a debtor has presented a petition for bankruptcy order is void.

Hong Kong Monetary Authority
May 2001

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PAPER 4 - ELECTRONIC BANKING SERVICES

1. PURPOSE

1.1 This paper sets out the recommended practices of the Informal Working Group (IWG) in relation to the provision of electronic banking (e-banking) services[1].

2. BACKGROUND

2.1 The majority of the retail banks in Hong Kong (over 20 banks or banking groups) have already introduced internet banking services for personal customers, and some are offering or planning to offer banking services over wireless networks (mainly through mobile phones). Latest statistics suggest that an increasing number of consumers are using these emerging electronic channels.

2.2 These emerging e-banking services raise a number of customer protection issues. For instance, the ability to collect personal information of a customer through an open network (e.g. the internet) raises privacy issues. Moreover, the open or public nature of the network and the involvement of different parties in the transmission of information through the network may increase the risk of unauthorized transactions. A fair allocation of liabilities between banks and customers for unauthorized transactions is therefore important.

2.3 As the general principles and recommendations of the Code are applicable to all banking services irrespective of the channels used for delivering the services, this paper will not repeat these principles and recommendations in the context of providing these services over electronic channels. Rather, this paper proposes specific guidelines that are pertinent to the use of electronic channels for providing banking services to personal customers.

3. RECOMMENDED PRACTICES

Disclosure for e-banking services

3.1 Institutions should make clear and prominent disclosure covering the following issues when a customer enters into an agreement for an e-banking service –

[1] In this paper, electronic banking (e-banking) services refer to banking services delivered over the internet, wireless network, automatic teller machines (ATMs), fixed telephone network or other electronic terminals or devices.

(a) the customer's liability for unauthorized transactions;

(b) all fees and charges which will apply to the e-banking service;

(c) relevant statement(s) in relation to protection of customers' personal data as required by the Personal Data (Privacy) Ordinance;

(d) customer obligations in relation to security for the e-banking service;

(e) means for reporting security incidents or complaints.

3.2 Institutions should provide, where appropriate, a facility for customers to confirm that they have read such disclosures before they sign up for the service, e.g., a confirmation facility may be provided on a web page containing the disclosures to allow customers to declare, by clicking on the facility, that they have read the disclosures therein.

In order to enhance the understanding of customers of what they can reasonably expect of e-banking services, it is important that institutions make adequate disclosures about certain crucial aspects of the relevant delivery channel before the customers sign up for the services.

In the US, the Fed's Regulation E on electronic fund transfers imposes a requirement for providers of electronic fund transfer services to make certain disclosures at the time a consumer contracts for such service or before the first electronic fund transfer is made involving the consumer's account. Separately, PricewaterhouseCoopers (PWC) has launched a core set of disclosure principles to boost consumers' confidence in online transactions. The SFC has also issued guidelines that include disclosure requirements for the provision of online trading services.

Drawing references from these materials, the following disclosures are recommended for e-banking services:

(a) The liability of customers for unauthorised transactions should be clearly mentioned (Please refer to paragraphs 3.5 and 3.6 below). Moreover, institutions should clearly specify the applicable law if the e-banking service can also be accessible electronically outside Hong Kong (e.g. through the internet).

(b) All fees and charges – Any additional fees and charges as compared with similar services provided in other channels (e.g., physical branches) or for the provision and maintenance of any device (e.g., ATM cards, smart cards that store digital certificates) for accessing the e-banking services should be clearly highlighted. It should be noted that, according to a survey by the Consumer Council, only 7 out of 15 banks with internet banking services surveyed have posted their service charges on the web sites. The Consumer Council has therefore proposed that banks should be more transparent about the charges for internet banking transactions, which should be available on their web sites. The Consumer Council also recommends banks to consider more interactive ways to notify customers of such fees on the internet.

(c) Relevant statement(s) in relation to protection of customers' personal data as required by the Personal Data (Privacy) Ordinance (PDPO) – The Privacy Commissioner for Personal Data has issued a guide to assist data users to comply with the PDPO when they are collecting, displaying and transmitting personal data over the internet. For instance, in line with the guide, an institution with a web site should have its privacy policy statement either accessible or downloadable by its customers or prospective customers. Moreover, the institution should inform its customers if the electronic channel (particularly the internet) for its e-banking service will collect the customers' personal information without their knowledge, such as through the use of "cookies[2]". Moreover, the institution should disclose whether its web site allows access by any customer who does not accept cookies, and if it does, what functionality will be lost as a result.

(d) Security obligations – Institutions should provide relevant information to customers about their security obligations in the use of the e-banking service.

(e) Means for reporting security incidents or complaints – Institutions should notify customers of the means by which they can report actual or suspected security incidents and lodge complaints.

<u>Customer obligations in relation to security</u>

3.3 Institutions should warn customers of the obligation to take reasonable steps to keep any device (e.g., ATM cards, smart cards that store digital certificates) or secret code (e.g., PIN) used for accessing e-banking services secure and secret.

[2] A "cookie" is a mechanism that can be used by a web site to keep track of personal information of an internet user visiting the web site without his or her being aware of it. The information that can be tracked includes web site addresses accessed by the user and the operating system of the user's computer, which can be used to analyze the preference of the user.

3.4 Where customers are provided with an opportunity to select their own secret codes or user identification for accessing e-banking services, institutions should advise customers on how to select such items in a way that maintains adequate security. In particular, they should advise customers not to select secret codes incorporating such information as birthday, telephone number or recognisable part of the customer's name. Customers should also be advised to avoid using the same user identification and secret code for accessing other services (e.g., for connection to the internet or accessing other web sites).

Similar to Section 25.2 of the Code, institutions should warn customers of their duties in maintaining the security of e-banking services, especially in relation to the protection of devices and secret codes (e.g., PINs) for accessing the services. This would be relevant to the question of liability in the event of unauthorized transactions as discussed in paragraphs 3.5 and 3.6 below.

Liability for loss

3.5 Unless a customer acts fraudulently or with gross negligence such as failing to properly safeguard his device(s) or secret code(s) for accessing the e-banking service, he should not be responsible for any direct loss suffered by him as a result of unauthorized transactions conducted through his account. This provision does not apply to unauthorized transactions conducted through cards which are covered under Section 29 of the Code.

This principle has already been set out in the Guideline on Authorization of Virtual Banks which is a statutory guideline issued under Section 16(10) of the Banking Ordinance. The IWG considers that this principle should be incorporated in the Code.

The above principle should represent a fair division of liabilities between the customer and the institution for unauthorized transactions. Except for unauthorized transactions conducted through cards (which are governed by Section 29 of the Code), an institution will bear the direct loss of customers incurred in using its e-banking service, caused by, for example, a computer crime that is not prevented by the institution's system.

Moreover, an institution which provides an e-banking service over an electronic network controlled or provided by a third-party service provider (e.g., telecommunication operator) should not avoid liability to a customer in respect of any direct loss caused or contributed by the service provider.

3.6 Customers should be warned, through clear and prominent notice, that they will be liable for all losses if they have acted fraudulently. Customers

may also be held liable for all losses if they have acted with gross negligence (this may include cases where customers knowingly allow the use by others of their device or secret code). Customers should be warned that this may apply if they fail to follow the safeguards set out in paragraph 3.3 if such failure has caused the losses.

Section 29.4 of the Code states a similar principle for card services such as credit card, debit card and cash card (ATM card). It is reasonable that customers should be given warning about their potential liability if they act fraudulently or with gross negligence. As a result, the same principle should also be applicable for e-banking services in general.

The security obligations in paragraph 3.3 are to be distinguished from the advice on security precautions in paragraph 3.4. Failure to comply with the safeguards in paragraph 3.3 would more easily compromise the security of the transactions for e-banking services. As such, in line with Section 29.4 of the Code, it is considered sufficient to relate only those safeguards in paragraph 3.3, the breach of which would be more likely due to the negligence of customers, to the question of liability for unauthorized transactions.

Reporting of actual or suspected security incidents

3.7 **Customers should be advised that they must inform institutions as soon as reasonably practicable after they find or believe that their secret codes or devices if any for accessing the e-banking services have been compromised, lost or stolen, or that unauthorized transactions have been conducted over their accounts.**

3.8 **Customers should be advised that they may be held liable for the losses if they have failed to comply with paragraph 3.7.**

3.9 **Institutions should provide an effective and convenient means by which customers can notify the institution of security incidents; facilities such as a telephone hot-line should be available at all times, which will provide for logging and acknowledgement of notifications from customers.**

3.10 **When such facilities are not made available by institutions during particular periods, institutions should be liable for any losses due to non-notification, provided the customer notifies the institution within a reasonable time after the facilities have become available again.**

3.11 **Institutions, on being advised of a loss, theft or possible compromise of a secret code or a device, should take action to prevent further use of the secret code or the device.**

Sections 28.1 to 28.5 and 29.3 of the Code contain similar principles for card services such as credit card, debit card and cash card (ATM card). It is considered reasonable to apply the same principles to e-banking services in general.

3.12 Institutions should ensure that transactions of their e-banking services can be traced and checked as long as they are received by their systems.

In line with Section 25.4 of the Code and given the fact that certain e-banking services (e.g., telephone banking, internet banking) may not normally generate paper-based records for customers' retention when the transactions take place, institutions should maintain adequate audit trails of their e-banking transactions. Recognising that e-banking transactions (particularly internet banking transactions) may pass through various parties or networks before they are processed by institutions' systems, this guideline focuses mainly on audit trails of the transactions received by institutions' systems.

Hong Kong Monetary Authority
June 2001

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PAPER 5 - MISCELLANEOUS PROPOSALS

1. PURPOSE

1.1 This paper contains recommended practices of the Informal Working Group (IWG) in respect of the following areas:

(a) Stored value cards;
(b) Annualised percentage rates (APRs) for personal loans and revolving lines of credit;
(c) Release of mortgage documents;
(d) Cross-border payment services;
(e) Equal opportunity;
(f) Administrative charges for handling bulk cash deposits;
(g) Introduction of new or enhanced services;
(h) Promotion of fair competition;
(i) Customer identification in card issuance;
(j) Issuance of credit cards to university students; and
(k) Application of the Code to employees of authorized institutions.

2. RECOMMENDED PRACTICES

Stored Value Cards

2.1 Card issuers should draw the attention of customers or prospective customers to the major terms and conditions of stored value cards (e.g. by describing or highlighting such terms and conditions in the application forms or promotional leaflets where no application is required for card issuance. The description should be printed in clear and legible type and in a font size that facilitates easy reading).

2.2 Card issuers should provide customers with general descriptive information relating to the use of the stored value card. Such information should include:

(a) All fees and charges which will apply, including any annual fee and the basis of determining the relevant fees and charges;
(b) Any deposit payable by customers and the refund procedures;
(c) Any expiry date of the card;
(d) The procedures for stopping the use of the card;
(e) The refund policy in respect of any residual value when the use of the card has been suspended or stopped (including where the card has expired or has become dormant);

(f) The potential loss that may be suffered by customers in the case of card loss (e.g. all the remaining value in the card) and the procedures for reporting a card loss;
(g) Customers' liability for card damage;
(h) The customer service hotline provided by the card issuer;
(i) Security of the cards and personal identification numbers; and
(j) The range of use of the card (e.g. transport services, fast food restaurants);
(k) Any other services to which cardholder may have access (e.g. ATM).

2.3 Card issuers should not automatically renew a card without giving the cardholder at least 30 days commencing from the date of renewal to cancel the card without having to pay the renewal fee.

2.4 Card issuers should give customers at least 30 days' notice before any significant variation of the terms and conditions or any change in the level of fees and charges takes effect. The notice should show clearly the variation and the ways in which customers may seek assistance if they do not agree to the change. Institutions should adopt effective means of notification which would provide reasonable assurance that their customers will be informed of the change and which do not rely unduly on the customers' own initiative. Individual notification of customers (whether by written notice, statement insert or email message) is likely to be effective in achieving these objectives. But where this is not appropriate on grounds of disproportionate costs or likely ineffectiveness, institutions may adopt other means of notification, such as one or more of the following:

(i) press advertisement;
(ii) prominent display of notice in banking halls or major points of card issue and usage; and/or
(iii) notice posted on the website of the institution

2.5 A copy of the revised terms and conditions should be provided to customers upon their request.

2.6 In case customers do not agree to any significant variation of the terms and conditions, they should be entitled to the full refund of the deposit and any residual value in the card.

2.7 Where a stored value card malfunctions due to no fault on the part of customers, they should be given the choice either to request a replacement free of charge or to cancel the card and seek full refund of the deposit and any residual value in the card.

2.8 Any expiry date of the stored value card should be printed on the card.

2.9 Card issuers should comply with the provisions of Chapter 1 where relevant.

2.10 For stored value cards which can operate as an ATM card, card issuers should comply with the relevant provisions in Chapter 3 and Chapter 5.

At present, there are three main stored value card schemes in the market, namely Octopus, Mondex and VisaCash. The former scheme is issued by Creative Star Ltd, a deposit-taking company owned by a consortium of transport companies. The remaining two schemes are provided by banks in conjunction with card companies.

A variety of stored value cards have been issued under these schemes. They are principally used to facilitate retail payments and have a high degree of "moneyness". Some cards are "disposable" and contain an expiry date. Some cards are "reloadable" and can be used continuously subject to payment of periodic fees. Some cards are "personalised" and are used in conjunction with the card holder's other bank accounts (e.g. some stored value cards can be used as an ATM card and some stored value cards can be automatically reloaded by debiting the card holder's other bank accounts).

Given the wide variety of cards in use, it may not be practicable for the Code to prescribe in very specific terms the manner in which stored value card services are provided. Nevertheless, the general principles that terms and conditions should be fair and transparent to customers should still be applicable.

To promote the transparency of stored value card services, institutions should draw the attention of customers or prospective customers to the major terms and conditions of stored value cards, for example, by means of the application forms, or promotional leaflets where no application is required for card issuance (these promotional leaflets should be given to customers when they purchase the cards). Institutions should also provide cardholders with general descriptive information relating to the use of the card. These requirements are consistent with those in respect of credit cards.

In addition, customers should be given 30 days' prior notice before any significant variation to the terms and conditions or any change in the level of fees and charges. Taking into account the different modes of operation of the existing stored value card schemes (e.g. some card issuers may not collect the mailing address of individual cardholders), it is necessary to give card issuers some flexibility in determining which means of notification is most appropriate in informing customers of the revision.

Some customers have complained that the residual value of some disposable stored value cards will not be refunded at the expiry date of the card. In this respect, it has been considered whether it is appropriate to standardise the refund policies of different stored value card schemes (e.g. to require institutions to adopt a policy of refunding any residual value to customers upon their request). It is noted that whilst institutions would generally refund any unused value to customers, they may reserve the discretion of not doing so. This is important for fund management (e.g. it is not possible for institutions to redeem a large number of cards issued at the same time). It is further noted that some cards are issued for commemorative purposes and are therefore valid only within a specified period. For these cards, it may also be inappropriate to require the issuers to refund any unused value in the cards. In consideration of the above, it is considered that there should not be an across-the-board requirement on institutions to refund any unused value in stored value cards. However, institutions should still have a clear refund policy in place and customers' attention should be drawn to the refund policy e.g. through the application forms.

The other recommended practices are self-explanatory.

<u>Annualised Percentage Rates (APRs)</u>

2.11 Institutions should where relevant quote APRs of banking products to facilitate comparison between different charging structures. Where interest rates for the product are commonly quoted in terms of annualised floating rates (e.g. deposits, overdrafts and mortgage loans), institutions are not obliged to quote the corresponding APRs, but they should show all fees and charges related to the product in a clear and prominent manner.

At present, section 11.1 of the Code requires institutions to quote APRs on deposit, loan or credit card products to facilitate comparison between different charging structures. However, most institutions do not in practice quote APRs for banking products such as deposits, overdrafts and mortgages. The interest rates of these banking products are commonly quoted in terms of annualised floating rates (e.g. best lending rate + x% per annum).

The IWG has assessed whether it is desirable to require institutions to strictly adhere to this provision and therefore quote APRs for these floating rate products. Since customers are already accustomed to the existing practice of institutions and they can compare the relative interest or cost of these banking products simply by comparing the annualised floating rates provided, it is considered not necessary to require institutions to quote APRs for these floating rate products. Moreover, there is also a concern that the provision of two different interest rates might cause unnecessary confusion to customers.

In view of the above, section 11.1 of the Code will be amended so that institutions will not be required to quote APRs for banking products the interest rates of which are commonly quoted in terms of annualised floating rates. However, they must show any fees and charges related to these products in a clear and prominent manner. For example, in respect of overdrafts, institutions should inform customers of the interest cost (e.g. prime + x% per annum), the facility fee (e.g. x% per annum on the approved limit) and any other charges related to the provision of the overdraft.

2.12 For personal loans with a specified maturity date, institutions should quote the APRs for different tenors which are commonly selected by customers. Where there is more than one applicable interest rate during the loan period, institutions should follow the Net Present Value Method and quote the effective APRs for the relevant tenors (see Annex 1 for an example).

2.13 For personal loans which are revolving in nature (excluding overdrafts), institutions should quote the APR calculated in accordance with the standard method set out in Annex 2, which is based on a set of assumptions regarding the behaviour of borrowers, together with the annual fee. The APR and the annual fee should be shown with equal prominence whenever interest rates are quoted.

The industry Associations have issued guidelines on APRs and borrowing charges recommending that wherever institutions quote the flat rate of interest in promotional materials relating to personal loans, they should also quote the corresponding APR. In addition, wherever different tenors for flat rates are featured, the APR for each tenor should also be supplied.

In practice, it is noted that whilst most institutions provide APRs for a comprehensive range of tenors, a few institutions may intentionally quote APRs only for shorter tenors (e.g. 3 months and 6 months) for marketing reasons[1]. Moreover some institutions may quote different APRs for different periods of the loan (e.g. a low introductory rate for the first 3 months and a regular rate for the rest of the tenor of the loan). These diverse practices of quoting APRs of personal loans have made it difficult for customers to compare between different charging structures.

To facilitate customers to compare different personal loan products, institutions are required to quote APRs of personal loans for tenors which are commonly selected by customers. Institutions should exercise their judgement in determining what tenors of APRs they should quote taking into account the type of personal loan being offered and the prevailing market practice (e.g. for

[1] For example, it was found in one case that an institution, which offered a fixed amount of cash rebate to customers, only quoted 6-month APRs in its advertisements. This is because the effect of the cash rebate on APRs of shorter tenors is more prominent.

general personal loans, it is a good practice to quote the 6-month, 12-month and 24-month APRs, but for hire purchase loans, institutions will need to quote APRs for longer maturities). Though institutions are given the discretion to determine the tenors of APRs which should be quoted, they should be able to justify why their choice of tenors is appropriate in light of their experience. Where there is more than one interest rate during the loan period, institutions should follow the Net Present Value Method and quote the effective APR for the relevant total period. If floating rates are offered, institutions should use the prevailing rate in the APR calculation.

For personal loans which are revolving in nature (excluding overdrafts), institutions should follow the standard method set out in Annex 2 in calculating APRs. This standard method is largely the same as the one for credit card lending except that it does not specify a typical credit limit for personal loans in view of the fact that institutions may apply tiered interest rates for different sizes of loans.

It is impossible for the Code to set out the way that institutions should quote interest rates under different circumstances, particularly when new products continue to emerge in the market. However, the overriding principle is that institutions should ensure that the charging structure of their products is transparent to customers. They should abide by section 10.2 of the Code and ensure that all advertising and promotional materials are fair and reasonable. In case of need, institutions should consult their respective industry Associations.

Release of Mortgage Documents

2.14 On receipt of a request from customers for discharge of a mortgage, institutions should as soon as reasonably practicable release title deeds and any relevant documents (other than the mortgage itself) to the solicitor representing the customer against the solicitor's undertaking to return the documents on demand as appropriate. Unless institutions encounter any practical difficulties, this process should normally be completed within 21 days. If institutions are unable to meet this industry standard, they should promptly inform the customer.

There have been some complaints suggesting that banks may have deliberately withheld documents such as title deeds for an unreasonable period of time when customers try to switch to another bank for refinancing their mortgages. It would be useful if the industry can agree to a common standard for the release of mortgage documents.

In a recent survey conducted by the HKMA, it was found that five out of the six active providers of mortgage loans surveyed have an internal policy of releasing mortgage documents within a period of less than 21 days. Based on the survey findings, it appears both reasonable and practicable that the industry standard for the release of title deeds to be set at 21 days. However, there should be an appropriate carve out in the proposed provision to cater for unexpected events (e.g. when the institution has other types of lending to the customer secured on the same property, which have been overdue)

Cross-border Payment Services

2.15 Institutions should inform customers of their practice regarding when interest payable on inward remittance will begin to accrue (e.g. interest will only accrue after the remitted funds are credited to the customers' account).

2.16 For incoming cross-border payments, unless otherwise instructed by the remitting bank, institutions should promptly credit the remitted funds to the beneficiary's account after receipt of the funds is confirmed and any necessary checking is completed. If institutions are unable to do so, they should notify the beneficiary and provide an appropriate explanation, unless there are strong justifications not to do so (e.g. where the identity of the beneficiary cannot be confirmed).

There have been customer disputes and queries from Legislators in the past regarding the handling of cross-border payments, in particular in relation to the payment of interest on inward remittances. HKAB set up a working group in 1999 to review the existing practices and consider whether there was a need to issue any best practice guide to banks. A survey on banks' practice in this area was subsequently conducted which revealed that most banks, as a standard practice, did not pay interest on inward remitted funds before they are actually credited to the beneficiary's account. In view of the survey findings, HKAB issued a circular in May 2000 recommending banks to appropriately advise their customers of their practice in this regard, for example by including suitable provisions in their terms and conditions governing the operation of accounts or inward remittances.

It is considered that a similar provision to this effect should be included in the Code. It is also considered desirable to make clear the general principle that institutions should follow in handling inward remittances. To provide better service to customers and to promote the transparency of remittance operations, the above provisions will be added to section 34 of the Code.

Equal Opportunity

2.17 Institutions should at all times comply with the relevant Ordinances for the promotion of equal opportunity and any codes issued under these Ordinances (section 9.1)

In considering amendments to the Code in respect of credit card services, it was already acknowledged that customers of personal finance are protected under various legislation relating to consumer protection. Therefore, it is not necessary to include in the Code references to specific Ordinances relating to consumer protection (e.g. Unconscionable Contracts Ordinance). Consistent with this treatment, it is recommended that references to specific Ordinances relating to the promotion of equal opportunity in section 9.1 of the Code be removed. This amendment would also obviate the need to update the Code to reflect the enactment of the Family Status Discrimination Ordinance, which is also related to the promotion of equal opportunity.

Administrative Charges for Handling Bulk Cash Deposits

2.18 Institutions should not impose administrative charges for handling cash deposits in Hong Kong dollars, except those in large quantities.

Before January 1994, banknote transactions between note-issuing banks and other banks was for US dollar value at the fixed rate of HK$7.80 to US$1. When the exchange rate was on the strong side of the link, banks receiving banknotes from customers and redeeming them with note-issuing banks would incur an exchange rate loss. In response, some banks imposed banknotes handling charges on customers to recoup such losses. These charges were unpopular with customers.

On 24 January 1994, the note-issuing banks agreed that all banknote transactions between themselves and other licensed banks would be for Hong Kong dollar value. As from that date, banks agreed to stop charging banknote handling fees. Section 6.4 of the Code, which provides that institutions should not impose administrative charges for handling retail cash deposits in Hong Kong dollars, was intended to formalise this voluntary agreement among the banks.

However, this provision should not be construed to restrict the imposition of administrative charges for handling "bulk" cash deposits in Hong Kong dollars (i.e. cash deposits in large quantities regardless of whether such deposits are in the form of banknotes, coins or a mixture of both) in recognition of the labour intensive nature of the service. Section 6.4 of the Code will be replaced by the above paragraph to clarify its meaning.

Promotion of New or Enhanced Services

2.19 **When introducing a new or enhanced service or product to customers which involves a cost or potential liability to them, institutions should not automatically enrol customers into the service or product, i.e. should not enrol them without the prescribed consent[2] of the customers. In cases where the new or enhanced service or product does not involve an additional cost or potential liability to customers, institutions should allow a period of at least 14 days for customers to decline acceptance of the service or product, and provide a convenient channel for customers to indicate that they decline acceptance.**

At present, section 32 of the Code provides that institutions should not, without the prescribed consent of the customers (in respect of card services only), automatically enrol them into new services or products which involve a cost to them. However, the existing provision does not specify whether institutions can adopt an opt-out practice for promoting new products and services which are free of charge. Examples of such practice include:

- Enrolling customers to a short-dated insurance policy if they do not give a negative reply to the institution;
- Automatically upgrading the products or services offered to existing customers; or
- Automatically increasing the credit limits of existing customers.

It is acknowledged that such practices may cause an element of inconvenience to some customers as they have to go to the trouble of rejecting such products and services. On the other hand, it is also noted that the majority of customers would find these free services or automatic upgrades in services or products desirable as they would regard them as extra benefits at no additional cost.

On balance, it is considered that institutions should be allowed to adopt an opt-out practice in promoting new services or product which do not involve an additional cost or potential liability to customers. However, they should allow a period of at least 14 days for customers to decline acceptance of the new service or product, and provide a convenient channel (e.g. a telephone hotline) for customers to indicate that they decline acceptance. This would allow the majority of customers to continue to enjoy such benefits while keeping any inconvenience to other customers to a minimum.

The above best practice should apply to all types of banking services. An exception to the general principle that an opt-out practice may be used when no additional cost or liability is involved is the issue of credit cards to customers

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2 Prescribed consent is defined in the Code as the express consent of a customer given voluntarily.

without having been requested by them to do so (see section 22.2 of the Code), notwithstanding that the cards may be offered to these customers free of charge. Institutions may however upgrade cards (e.g. replacing a gold card by a platinum card) that have already been issued to existing customers, provided that the cards are offered with no additional charge and there is a convenient channel for customers uninterested in the upgraded service to decline acceptance. Section 22.2 of the Code will be appropriately amended to reflect this.

Promotion of Fair Competition

The Consumer Council issued in 1999 a "Benchmark Code of Practice" which outlines general principles and practical examples of code rules that can form the basis for an industry association to construct or amend an existing code of practice. The Council considers that the Code of Banking Practice is in general in line with the principles set out in the Benchmark Code except that it does not contain a broad reference to the Government's Statement on Competition Policy. The industry Associations have agreed to consider this issue in this review of the Code.

The IWG has considered incorporating a general statement on competition in the Code with some reference to the Government's statement on Competition Policy. It is noted that the Code of Banking Practice applies to bank/customer relationships, setting standards in respect of banks' business practices in dealing with personal customers. As such, the Code may not be the most appropriate medium to carry a statement on competition (e.g. the competition statement should also apply to institutions' business practices in dealing with other types of customers).

Nevertheless, the IWG recommends the industry Associations to consider the merits of issuing a statement to its members to encourage them to comply with the principles of free competition and refrain from adopting restrictive practices which impair economic efficiency or free trade.

Customer Identification in Issuance of Cards

From time to time, there are fraud cases involving the use of stolen identities in credit card applications. Section 22.3 of the Code states that institutions should satisfy themselves about the identity of a person applying for a card. One option to achieve this objective would be to amend section 22.3 to require cardholders to collect their cards in person. This would enable institutions to verify the identity of the cardholders face to face and would be an effective means to prevent fraud cases involving the use of stolen identities. However, such a requirement may be unwelcome to customers as this would cause significant inconvenience to card applicants (who may find it a nuisance to have to visit bank branches to collect their cards). This proposal would also disadvantage those card issuers without an extensive branch network, and may inhibit competition in favour of larger institutions. The IWG further notes that at present card issuers already have established procedures for card issuance (e.g. requiring applicants to input certain personal particulars before the card can be activated) that help to minimise the number of fraud cases of this nature. In view of the above, the proposal of requiring cardholders to collect their cards in person is not favoured.

Issuance of Credit Cards to University Students

There has been some criticism regarding the issuance of credit cards to university students. Some institutions have been criticised for using marketing tactics which are too aggressive, such as inundating students with attractive gifts upon applications, and for approving credit cards indiscriminately.

The IWG has considered a number of ways to address these concerns. In particular, it has considered whether there should be a cap on the number of cards that are issued to university students. The major problem with this proposal is that this would be difficult to verify, given that information on the number of cards that a person holds is not available from the credit reference agencies[3], nor is voluntary disclosure by an applicant likely to be effective.

Another proposal considered by the IWG is whether it would be desirable to provide some practical guidance to institutions on what is meant by "acting responsibly" in the context of issue of student cards[4]. For example, section 22.1 might be enhanced to require institutions to avoid aggressive inducements to attract university students to apply for credit cards. There is also a suggestion that institutions should consider the need to request university students to provide confirmation that their parents have been notified of the application.

In the IWG's opinion, such practical guidance may not be of much help to institutions. In particular, it would be difficult to define what types of or what amount of inducements would generally be regarded as "aggressive". The requirement that students should seek consent from their parents before they apply for cards would likely be objectionable to some university students.

It appears to the IWG that the main concern of the community is that some university students, if given access to credit cards, may not be able to handle their personal finance in a prudent manner. In this regard, the IWG believes that the most effective means to prevent university students from using cards in an imprudent fashion is better education. It recommends the two industry Associations to encourage their

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3 To protect the interests of consumers, the Code of Practice on Consumer Credit Data issued by the Privacy Commissioner does not permit the sharing of positive credit data amongst credit providers (including the number of credit cards that a person currently holds).

4 Section 22.1 of the Code states that institutions should act responsibly in the issue and marketing of credit cards, in particular to person who may not have independent financial means, such as students.

members to take active measures to educate university students on prudent financial management, for example, by means of an education package provided to university students when the cards are issued to them.

Application of the Code to Employees of Institutions

Some banks have previously questioned whether the Code is applicable to the employees of institutions. In this regard, it can be argued that in providing banking services to its employees, the relationship between an institution and its staff remains one of banker and customer. Therefore, the Code should cover institutions' dealing with their staff.

On the other hand, it should also be noted that some banking services are offered to employees on preferential terms. Institutions may encounter practical difficulties in adhering to certain provisions of the Code. For example, when an employee wishes to terminate his employment with the institution with immediate effect, it is not reasonable to expect the institution to give 30 days' prior notice to the employee before the fees and charges applicable to the preferential banking services currently offered to the employee are adjusted to regular levels.

Taking the above into account, it is considered not useful to state explicitly whether the provisions of the Code would apply to institutions' dealing with their employees. However, institutions are expected to treat their staff in a fair and reasonable manner.

Hong Kong Monetary Authority
August 2001

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Annex 1

Use of Net Present Value Method to Calculate Annualised Percentage Rate of Personal Loans with Fixed Maturity

Example

Assume the following tax loan is offered by the institution

Loan amount	Applicable interest rate
10,000 - 49,999	0.35% (flat rate per month)
50,000 – 149,999	0.32%
150,000 – 599,999	0.24%
600,000 – 1,000,000	0.20%

Arrangement fee: 1% per annum (to be collected from the monthly repayments)
An initial flat rate of 0.15% per month (for the first three months only) is offered to all customers irrespective of the loan amount

The APRs that should be quoted by the institution are:

			Equivalent APR (including arrangement fee)		
Loan amount	Mid-value	Flat rate per month	6-month	12-month	24-month
10,000 - 49,999	30,000	0.35%	7.04%	8.72%	9.57%
50,000 – 149,999	100,000	0.32%	6.72%	8.19%	8.92%
150,000 – 599,999	375,000	0.24%	5.86%	6.80%	7.26%
600,000 – 1,000,000	800,000	0.20%	5.43%	6.11%	6.44%

(See enclosed spreadsheet for detailed calculation)

Example (Personal Loan)

Personal loan

(a) Loan amount	(b) Flat rate p.m.	(c) Initial flat rate p.m. (for the first 3m)	(d) Arrangement fee p.a.	Tenor (months) - (t) 6 Required monthly repayment	 6 APR	 12 Required monthly repayment	 12 APR	 24 Required monthly repayment	 24 APR
30,000	0.35%	0.15%	1%	5,100 (1)	7.04% (2)	2,615	8.72%	1,373	9.57%
100,000	0.32%	0.15%	1%	16,985	6.72%	8,694	8.19%	4,549	8.92%
375,000	0.24%	0.15%	1%	63,544	5.86%	32,378	6.80%	16,795	7.26%
800,000	0.20%	0.15%	1%	135,400	5.43%	68,833	6.11%	35,550	6.44%

Note: (1) Required monthly repayment = [a + a*c*3 + a*b*(t-3) + a*d*t/12] / t

(2) The APRs are calculated using the NPV method. Some examples are shown below.

6 month	12-month	24-month
7.04%	8.19%	7.26%
- 30,000	- 100,000	- 375,000
5,100	8,694	16,795
5,100	8,694	16,795
5,100	8,694	16,795
5,100	8,694	16,795
5,100	8,694	16,795
5,100	8,694	16,795
	8,694	16,795
	8,694	16,795
	8,694	16,795
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		16,795
		16,795
		16,795
		16,795

Annex 2

Calculation of Annualised Percentage Rate for Revolving Credit Facilities (Other than Credit Card Advances and Overdrafts)

Institutions should adopt the following assumptions in calculating the annualised percentage rate (APR) for revolving credit facilities other than credit card advances and overdrafts.

APR formula

2. Institutions should use the following "Net Present Value" (NPV) method specified in the UK Consumer Credit Act regulations to calculate the annualised percentage rate.

The formula:

$$A = \sum_{k=1}^{n} \frac{X}{(1+i)^{t_k}} \quad \text{where}$$

A = original loan amount
n = number of instalments
X = monthly instalment amount
t_k = time interval, expressed in years, between the relevant date and the date of the k^{th} instalment
k = number identifying a particular instalment
i = unknown APR

Rules and assumptions

3. To provide a consistent basis for calculation, the following rules and assumptions should be adopted:

(i) The credit is drawn up to the maximum limit at the earliest time possible;

(ii) All fees and charges related to the provision of credit should be taken into account in the calculation of the APR, with the exception of the annual fee, or fees and charges which are payable as a result of the failure of the borrower to carry out his obligations under the agreement (e.g. default charges) or which are payable upon the provision of additional services by the institution (e.g. charges for temporary over limit);

(iii) The borrower continues to make the minimum payments until the balance on the account falls to zero;

(iv) If the transaction requires a repayment to be made no later than a specified date, that date should be used as the time of repayment; and

(v) If there are repayments of credit or payments of charges which are to be paid before the relevant date (i.e. the end of the relevant period), it is assumed that they are paid on the relevant date.

4. Illustrative examples of APR calculation for revolving credit facilities based on the above rules and assumptions are shown in the Appendix.

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Revolving Credit Facilities

Assume the following revolving credit facility is offered by the institution:

Credit limit	Applicable interest rate
0 - $30,000	1% monthly compound
$30,000 or above	0.8% monthly compound

Annual fee: HK$300
Minimum repayment required: 3% of outstanding balance or $50, whichever is the higher

The APRs and the annual fee that should be quoted by the institution are:

Credit limit	Applicable APR	
0 - $30,000	12.68%	(see enclosed spreadsheets
$30,000 or above	10.03%	for detailed calculation)

Annual fee HK$300

Revolving credits

Credit limit:	30,000	
Annual fee	300	Annual fee not included in APR calculation
Interest rate:	1%	Monthly compound
Minimum repayment:	3%	or $50 whichever is higher until full repayment

Date	Credit used	Fees	Payment	Principal Repaid	Interest Accrued during the Month	Balance	Cash Flow	APR
31/08/00	30,000.00	0.00	0.00	0.00	0.00	30,000.00	-30,000.00	12.68%
30/09/00	0.00	0.00	900.00	600.00	300.00	29,400.00	900.00	
31/10/00	0.00	0.00	882.00	588.00	294.00	28,812.00	882.00	
30/11/00	0.00	0.00	864.36	576.24	288.12	28,235.76	864.36	
31/12/00	0.00	0.00	847.07	564.72	282.36	27,671.04	847.07	
31/01/01	0.00	0.00	830.13	553.42	276.71	27,117.62	830.13	
28/02/01	0.00	0.00	813.53	542.35	271.18	26,575.27	813.53	
31/03/01	0.00	0.00	797.26	531.51	265.75	26,043.77	797.26	
30/04/01	0.00	0.00	781.31	520.88	260.44	25,522.89	781.31	
31/05/01	0.00	0.00	765.69	510.46	255.23	25,012.43	765.69	
30/06/01	0.00	0.00	750.37	500.25	250.12	24,512.18	750.37	
31/07/01	0.00	0.00	735.37	490.24	245.12	24,021.94	735.37	
31/08/01	0.00	0.00	720.66	480.44	240.22	23,541.50	720.66	
30/09/01	0.00	0.00	706.25	470.83	235.42	23,070.67	706.25	Some rows not displayed
30/06/15	0.00	0.00	50.00	46.72	3.28	281.16	50.00	
31/07/15	0.00	0.00	50.00	47.19	2.81	233.98	50.00	
31/08/15	0.00	0.00	50.00	47.66	2.34	186.32	50.00	
30/09/15	0.00	0.00	50.00	48.14	1.86	138.18	50.00	
31/10/15	0.00	0.00	50.00	48.62	1.38	89.56	50.00	
30/11/15	0.00	0.00	50.00	49.10	0.90	40.46	50.00	
31/12/15	0.00	0.00	40.86	40.46	0.40	0.00	40.86	
Total	30,000.00	0.00	44,537.47	30,000.00	14,537.47			

Revolving credits

Credit limit:	30,000	
Annual fee	300	Annual fee not included in APR calculation
Interest rate:	0.8%	Monthly compound
Minimum repayment:	3%	or $50 whichever is higher until full repayment

Date	Credit used	Fees	Payment	Principal Repaid	Interest Accrued during the Month	Balance	Cash Flow	APR
31/08/00	30,000.00	0.00	0.00	0.00	0.00	30,000.00	-30,000.00	10.03%
30/09/00	0.00	0.00	900.00	660.00	240.00	29,340.00	900.00	
31/10/00	0.00	0.00	880.20	645.48	234.72	28,694.52	880.20	
30/11/00	0.00	0.00	860.84	631.28	229.56	28,063.24	860.84	
31/12/00	0.00	0.00	841.90	617.39	224.51	27,445.85	841.90	
31/01/01	0.00	0.00	823.38	603.81	219.57	26,842.04	823.38	
28/02/01	0.00	0.00	805.26	590.52	214.74	26,251.52	805.26	
31/03/01	0.00	0.00	787.55	577.53	210.01	25,673.98	787.55	
30/04/01	0.00	0.00	770.22	564.83	205.39	25,109.15	770.22	
31/05/01	0.00	0.00	753.27	552.40	200.87	24,556.75	753.27	
30/06/01	0.00	0.00	736.70	540.25	196.45	24,016.50	736.70	
31/07/01	0.00	0.00	720.50	528.36	192.13	23,488.14	720.50	
31/08/01	0.00	0.00	704.64	516.74	187.91	22,971.40	704.64	
30/09/01	0.00	0.00	689.14	505.37	183.77	22,466.03	689.14	Some rows not displayed
30/04/14	0.00	0.00	50.00	47.72	2.28	237.08	50.00	
31/05/14	0.00	0.00	50.00	48.10	1.90	188.98	50.00	
30/06/14	0.00	0.00	50.00	48.49	1.51	140.49	50.00	
31/07/14	0.00	0.00	50.00	48.88	1.12	91.62	50.00	
31/08/14	0.00	0.00	50.00	49.27	0.73	42.35	50.00	
30/09/14	0.00	0.00	42.69	42.35	0.34	0.00	42.69	
Total	30,000.00	0.00	40,582.59	30,000.00	10,582.59			