

Joseph Yam: Consumer protection and the banking industry

Speech by Mr Joseph Yam, JP, Chief Executive of the Hong Kong Monetary Authority, at the Hong Kong Association of Banks' Half-Yearly Dinner, Hong Kong, 19 June 2001.

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Thank you very much for asking me to give the speech this evening. The last time I was invited to speak at an HKAB dinner was almost exactly two years ago, and the time before that was nearly nine years ago. Although I am not quite sure whether I could manage the pace if this rate of acceleration were to continue, it is a pleasure to be getting together with you more frequently. It is also most appropriate. The banking industry in Hong Kong is going through a period of rapid transformation. The regulatory system is in the middle of a programme of intensive reform. And the Hong Kong Association of Banks, now in its 20th year, is currently reviewing its role and aims in the light of these changes. As the banking sector's main representative body, HKAB has an important role to play: I shall suggest later on, that indeed it has an increasingly important role to play as the banking sector continues to evolve and adapt to changing conditions. Before I turn to that subject, I should like to address, very briefly, two broad interconnected subjects: first, the theme of competition, particularly in the context of the current programme of banking sector reform; and secondly, the question of consumer protection, in the light of increasing competition and other trends.

Competition and banking sector reform

We are now two years into our programme of extensive banking sector reform. In fact, the first measure under that programme was my clarification, at your dinner in June 1999, of the HKMA's policy on the question of Lender of Last Resort. It was a pretty heavy-going speech for an after-dinner occasion, and I still recall the drooping eyelids and stifled yawns. But at least those of you who sat through it can take satisfaction in the fact that you were witnessing a minor historical event.

Since then, the reform programme has made a great deal of progress. In 1999 we relaxed the "one building" condition on foreign banks licensed since 1978. Last year we expanded access to Real Time Gross Settlement and implemented the first phase in the deregulation of the remaining Interest Rate Rules. We also completed a study and a public consultation on the case for establishing a commercial credit reference agency. Earlier this year, a similar public consultation was completed on the case for a deposit insurance scheme. The general view in these consultations was that the two schemes should be pursued, although we fully recognise that there are dissenting opinions on the question of deposit insurance. We are now working out the details for both schemes, and we look forward to further consultations with HKAB and other bodies as the proposals progress.

The theme of the reform programme is facilitating greater competition in the banking sector while strengthening safety and soundness. Perhaps the single most important measure to remove barriers to competition will be the abolition early next month of the last remaining Interest Rate Rules, which involves removing the interest rate cap on savings accounts and ending the prohibition on interest on current accounts. There is, of course, much speculation about the immediate impact of this event: whether it will be a big bang that will change the face of banking services, or merely a quiet change of gear. Given the plentiful liquidity in the banking system, it is likely that it will be the latter. But there should be no doubt about its significance in bringing to an end restrictions that have been in existence for more than a third of a century. The restrictions, some of you may recall, were introduced in 1964 as a measure to prevent cut-throat competition among banks. They served their purpose, but they have now outlived their usefulness.

Why do we place so much stress on facilitating competition through regulatory reform? I use the term "facilitate" because it is not within the power of a government – and it is certainly not the policy of our government – to create competition, or to force competition to happen. Competition is a part of Hong Kong's free market ethos. It is already strong in the banking sector here. We have witnessed it in particular – and occasionally with some concern – in the mortgage war and in the provision of credit card and other consumer services. Competition is being sharpened and stimulated by globalisation, which opens up hitherto restricted markets to businesses that are able to export their strengths, and by technological advance, which puts a premium on innovation and ingenuity.

For the economy as a whole, competition promotes efficiency in the allocation of resources and strength and flexibility in the face of change or crisis. In the banking sector, greater competition strengthens both individual banks, by forcing them to focus on their own core competence, and the banking system as a whole, by weeding out inefficiencies. For the consumer, competition promotes choice, quality and efficiency in products and services, and more reasonable costs. But competition, by its very nature, produces winners and losers. It also complicates the relationship between banks and customers, as services and fee structures become more complex and more sophisticated products proliferate.

The general government policy on competition in Hong Kong is to adopt a sector-specific approach. We are not disposed to the idea of a general, overarching competition authority, since each sector of the economy has its own special needs and concerns. The banking sector, which has its own unique history, and which, for obvious reasons, is subject to more supervision than perhaps any other sector of the economy, requires a particularly focused approach. The approach here is a simple but proactive one. The main policy objectives are to remove barriers to competition, such as the Interest Rate Rules, and to maintain a level playing field, particularly with regard to access to infrastructure.

In addition to this proactive policy approach, there are two main subsidiary concerns. One of these is to watch out for signs of collusion or anti-competitive behaviour in the industry and to address these when they occur. I should note here that we do not see such signs at present, though we remain vigilant. The other is a general concern that the adjustments to fees and services, which form a necessary part of the competition and reallocation of resources resulting from deregulation, should not lead to the exclusion of certain groups in society from a basic level of banking services, and that they should be introduced in a transparent way. Again, I should make it clear that, despite the concerns expressed by a number of groups over the last few months, we believe that, in general, the banks are addressing this point. I should also add, for the avoidance of any doubt, that it is not the HKMA's policy to regulate fees and charges. This is something that is left to the market. It would hardly be consistent for us on the one hand to be promoting greater competition and on the other to seek to determine or influence fees and charges. However, the public concern about the effects of deregulation, coupled with the recognition of the importance of banking services to people's daily lives, suggest that we should be paying more attention than we have in the past to the question of consumer issues. This is the subject to which I should now like to turn.

Consumer protection

First, I think it needs to be understood that the changes now going on in banking services, including the restructuring of fees and charges, are not solely the result of interest rate deregulation. There are a number of factors – global as much as local – that are driving banks into refocusing their business. These include: increased competition from both within and outside the banking industry; pressure to increase shareholder value; the need to develop new income streams amid a shortage of conventional lending opportunities; and globalisation, which is inducing banks to specialise in forms of business in which they have a competitive advantage. These various factors are forcing banks to innovate – through new products and new technologies – in order to diversify their income. They are also forcing banks to become more cost-efficient: to scrutinise the profitability of their various services, and to rationalise cost structures. The result in many cases has been substantial changes in retail banking services: for example, the selling off of business units, the closing down of branches, the expansion into fee-based business, such as MPF and insurance services, the development of more cost-effective modes of service delivery, such as the ATM network and the Internet, and the imposition of specific fees and charges on services that did not incur fees and charges in the past.

Consumers also need to react to the changing environment – for example, through making use of delivery channels such as ATMs, telephone banking or the internet that reduce the cost of using banking services. Cost minimisation also provides the incentive for consumers to shop around, and new technology in the form of the Internet enhances the means of doing so. With the shopping around comes awareness of what else is on offer, and greater expectations on the part of the consumer. Less positively, there has been disruption and anxiety, which has been reflected in the steadily growing number of complaints and protests, and in the greater political attention being paid to this subject.

What is the stance of the HKMA? We do not, as I have already said, regulate fees and charges. But we seek to ensure that there is transparency in the provision of services, particularly in the setting out of fees and charges. The Code of Banking Practice, which is a non-statutory code issued jointly by HKAB and the DTC Association with our endorsement, is the main tool for achieving this end, and, as

you all know, the Code is currently being subjected to extensive revision and strengthening. This process is almost at an end and we believe that it will make the Code an even more effective tool. In addition to transparency, we hope that the banks, in making their decisions on fees and charges, will show some sensitivity to the needs of the more vulnerable members of society. We believe that, so far, banks are displaying such sensitivity. We also wish to ensure that there continues to be choice for customers. Again, we believe that there is choice, and that deregulation, new technology, new products are indeed combining with competition to provide a greater choice than ever before. We shall continue to monitor.

This is a reasonably healthy picture. But it is time also, I think, to look at the current arrangements for consumer protection in the banking industry, to see whether improvements are needed, and if so, what they should be. The HKMA already plays an informal role in addressing consumer complaints, though we have no powers to settle disputes. Should we – or should someone else – be given such powers? Should there be sanctions for banks that fail to comply with codes of practice? How does Hong Kong compare with other jurisdictions in this area?

It was with the intention of clarifying some of the issues surrounding banking consumer protection that we recently undertook a comparative study of the practices in the UK, Australia and Hong Kong. The report on this study has been presented to the LegCo Panel on Financial Affairs and has been made available to the general public, and, of course, to the banking sector. The study examines the different approaches to this subject in Australia and the UK, but it notes that, in contrast to Hong Kong, the regulators in both places have been given a specific mandate in relation to the protection of consumers of financial and banking services. Two further major differences between Hong Kong and the overseas regimes are highlighted: first, in the setting, monitoring and enforcement of standards of business practice; and, secondly, in the investigation, resolution, and arbitration of customer complaints. With regard to the former, Australia and the UK both, like Hong Kong, have a non-statutory Code of Banking Practice, which sets the standards. But both Australia and the UK take this a stage further, with the formal monitoring of compliance by a specialist agency, which, in the UK case at least, has the power to impose sanctions against institutions that breach the Code. For the resolution of customer complaints, both the UK and Australia have a formalised Ombudsman scheme, with powers to arbitrate in disputes.

These two key features of the British and Australian systems illustrate how the arrangements in Hong Kong do not go as far as, or are less formalised than, those in other jurisdictions. This may have something to do with different philosophical approaches: in Hong Kong the tradition has been a free-market one, which entails a very low level of government involvement in business relationships. But as the Hong Kong market becomes more sophisticated and more competitive, and as consumer issues are coming more to the fore, it may be useful to consider whether Hong Kong should follow the path of other jurisdictions.

At this early stage of discussion, there seem to be three broad options, which are not necessarily mutually exclusive. The first is some form of self-regulation by the banking industry. The second is to provide a specific mandate to the regulator, that is the HKMA. The third is to place the responsibility in the hands of an Ombudsman. There are a number of issues – some philosophical, some practical – that will need to be taken into account in deciding in the fullness of time where the responsibility would lie. As far as the HKMA is concerned, the arguments for and against are, I suggest, finely balanced. One argument holds that a more formal role for the HKMA in this area might create a conflict of interest between our prudential regulation and consumer protection roles. The other point of view is that the two roles can co-exist if there are sufficiently high and thick Chinese walls between them, and that, furthermore, there are synergies between the two roles, and cost benefits to be achieved. The HKMA has an open mind on this issue, and we are hoping to receive views on the way forward, from the industry, from Legislative Councillors, and from the community at large. And I should stress, before the charge of empire building is raised, that this is not necessarily one of the functions that the HKMA would wish to add to its already onerous responsibilities.

There is, of course, the parallel question of whether HKAB, as the main industry organisation, and as the traditional vehicle for self-regulation, should play a role in consumer protection. Here again the arguments seem to be evenly balanced. On the one hand, the knowledge and proximity to the industry would place HKAB at an advantage in handling complaints. On the other hand, there could be the perception of a conflict of interest. I note that it is not HKAB's wish to take on the formal role of consumer protection, and I respect that. But, whichever organisation takes on the formal role, HKAB will almost certainly have a part to play in shaping policies and practices in this area.

The future role of HKAB

Quite apart from consumer protection, the larger question remains of what the industry, the HKMA, and not least the community might expect from HKAB in the future, after one of its principal responsibilities – the weekly setting of interest rates – has been taken away. It is this subject that I should like briefly to address in the final section of this speech.

It is, perhaps, something of an irony that, at a time when HKAB's formal powers are diminishing, its public profile has never been higher. We know from the television and the press that it has become almost a weekly tradition for your Chairman to appear down in Statue Square to receive petitions, banners, and all kinds of symbolic objects from concern groups. I think this says something about the reputation that HKAB has established as the industry body. It also says something about public expectations of its role. It is therefore timely, during a period of deregulation and rising expectations, that there should be a reconsideration of how HKAB's role could be developed.

I should stress that the decision on how that role should be developed is ultimately a matter for HKAB itself. HKAB has, in fact, already commissioned a consultant to examine this subject, and you have now published the Report for consultation with member banks. The HKMA has read the Report, and from our point of view the recommendations in it are sensible and realistic. Taking into account the Report, and how we see the banking sector developing, we see scope for developing HKAB's role in four broad areas.

First, and perhaps most important, the Report recommends that HKAB could take further its function as the voice of the industry. We support this recommendation. HKAB already fulfils this role to a great extent, particularly in its submissions on policy proposals and in its regular meetings with us on a variety of operational issues. But this role could be deepened, particularly in developing a more unified position on major policy issues, and in achieving a position that broadly reflects the views of the whole of the banking industry. I would even suggest that there is scope for HKAB to become not just the spokesperson for the banking industry, but also a lobbyist for the industry. This is not an easy task, because the banking industry in Hong Kong is diverse and not always able to come to a single view on issues that affect it. Nor is there any reason why it should do so on every issue. However, HKAB could develop its profile and gain strength as a representative organisation if it were to work on developing its role as the clear industry voice.

The second main recommendation in the Report concerns HKAB's role in the development of the Code of Banking Practice. The Code, which sets the standards for banking services, is jointly issued by HKAB and the DTC Association, with the endorsement of, and involvement of, the HKMA. It is a non-statutory code, although compliance with it is expected of all AIs. It is monitored by the HKMA as part of its regular supervision, although, as I mentioned earlier, we have no formal, statutory mandate in this project. There is, I think, scope, as the Report advocates, for HKAB to take greater ownership of this code, particularly in the setting of standards – and in ensuring that these are high standards – and in monitoring and enforcing compliance. This would be consistent with the practice of banking associations in other jurisdictions, and it would be a logical development of HKAB's role.

A third area highlighted in the Consultant's Report is consumer education in the field of banking services. This is a neglected subject in Hong Kong. The question of which organisation should take the lead in this is, of course, tied to the question of who should take on consumer protection. But, whatever the answer to the second question, it seems clear that HKAB would need to be involved in some form or another. This, in fact, reflects the practice among industry organisations in other jurisdictions, many of which have a strong tradition of producing plain-language factsheets, webpages and other resources on running personal finances, protecting one's financial interests, and making the most of new forms of financial services.

Moving away from the recommendations in the Consultant's Report, there is, I think, a fourth area in which HKAB could become more involved. This is in the development of Hong Kong's financial infrastructure. This is one of the HKMA's key policy objectives, but it is also an area in which HKAB has a keen and constructive interest. In particular, HKAB, together with the HKMA, is joint owner of Hong Kong Interbank Clearing Ltd, which operates one of the key features of Hong Kong's financial infrastructure, the Real Time Gross Settlement System. One other project on which HKAB can work closely with the HKMA is in the development of a Commercial Credit Reference Agency. Some of your members are already participating in the Working Group that is now engaged in thrashing out the details of how the CCRA would work. An issue which has been raised in the deliberations of the Working Group is whether HKAB should participate in the ownership of the CCRA, as it does in HKICL. This was not an idea that found much favour when we consulted the industry on the CCRA

scheme last year. But perhaps, now that it seems likely that such a scheme will go ahead, it is an idea which should be revisited at some stage in the future. That is a matter for HKAB and it is one that I leave you to think about. Even if you were to confirm the earlier view not to participate directly in this particular project, it would not undermine the general principle that the HKMA and HKAB should, wherever feasible, work hand in hand in developing important pieces of the financial infrastructure.

Conclusion

To summarise, deregulation will bring greater competition to the banking industry, which should enable banks to exercise a great deal more freedom in the nature of business they pursue and in the form of services they offer. Ideally, this freedom should also provide greater choice for the consumer, greater efficiency in the delivery of services, and better value for money. In practice, however, the transitional period in which we now find ourselves will also give rise to misunderstandings, disputes, and dissatisfaction among many consumers that will need to be resolved. To approach these problems and to find practical ways of resolving them, we need to develop a more sophisticated and better organised system of consumer protection. We have now placed the subject on the table for discussion. I hope that the community and its representatives, and the industry, through your organisation, will take up the debate and help shape an effective solution.