

GUIDING PRINCIPLES ON FAIRNESS OF SERVICE CHARGES



**Consumer Protection Department
State Bank of Pakistan**

Introduction:

As a part of financial liberalization and deregulation, banks in the year 2003 were allowed to determine their own fee and charges against provision of various services subject to a disclosure requirement. The underlying idea was to create incentive for product diversification and bring improvement in product and services offered by the banks to the general public. It was expected that a competitive environment would ensure that the charges levied in respect of provision of services by banks would be fair and reasonable. While over the years, there has been significant improvement in products and services offered by the banks, however, the element of fairness has remained a challenge.

Accordingly, it has become imperative to inculcate fairness in determining services charges. In this backdrop without being prescriptive, the guidelines set forth overarching principles in the light of which all banks are required to develop/tailor their systems and processes for determining their schedule of charges.

Scope of Application:

These guidelines will apply on fee/charges relating to:

1. Consumer banking products and services.
2. Third Party Products sold directly or referred by the bank, to the extent of disclosure/dissemination.

These guiding principles will apply on fee/charges effective from 1st July, 2015. Banks are, therefore, advised to develop policies and procedures for determining their schedule of charges in the light of these principles well in time to ensure compliance.

Principles:

Principle 1: The charges should be disclosed in a manner which is simple and easy to understand. Banks should make adequate arrangements to ensure their fee or charges are effectively disseminated to the customer.

Most of the banks consider placement of schedule of charges on their website as sufficient dissemination. The fact, however, is that there are a few customers who have access to bank's website. Even if a person can access the information available on bank's website, it is difficult for a common man to extract and understand the desired information. It is a good practice to disclose the related charges along with the product or service offering. Banks are expected to make it part of their Standard Operating Procedures (SOPs) that a person approaching to avail a service is informed upfront about the related fees or charges. In case there is more than one type of charge or fee, the same should be disclosed separately and practice of informing lump sum charges should be avoided. Banks may use mediums like SMS alerts, emails, pop-up messages on ATM screens and e-banking user interface to disseminate new/revised charges.

While formulating schedule of charges the banks should consider the knowledge and wisdom of the clients. Fee and charges relating to retail banking services should be presented in simple manner to the possible extent. Further, besides publishing/printing in English language, the schedule of charges should be printed in Urdu language as well to facilitate their market segment.

With respect to non-interest charges, where permissible, bank should give 30 days prior notice before increasing charges and in case the revised charges are not acceptable to the customer, he or she should have the right to exit the contract without penalty, provided such right is exercised within the notice period. Non reply to the notice may be treated as implied consent while ensuring the delivery of notice. Similarly, the customers must also be informed about discontinuation of any product or services. While converting the discontinued service or product, it must be ensured that charges contained in the new offering are disclosed to the customer (in case he/she wants to continue the banking relationship) upfront.

Late payment penalties, if permitted, must be reflected in borrowers account/related notice well in time. The practice of informing the customer about the late payment charges at the time of maturity of loan must be avoided instead he/she should be informed about the late payment charges as and when accrued through mediums elicited above.

Principle 2: Charges should be reasonable, commensurate with the service being provided and fall within proximity of what other bank charge for the same service. There should be some empirical analysis which substantiates the fixation of charges.

Charges should be determined on the basis of cost of doing business plus a reasonable margin. The practice of fixing charges on expert judgment or a percentage rise over previous year charges should be avoided. Where a bank increases its fee by 25% or more for any service, it should document the reasons/justifications and make available the same to the SBP inspection team, when required.

For basic banking services rendered to individuals, banks should levy charges only if these are just and supported by cogent reasons. Basic Banking Services rendered to vulnerable person (pensioners, senior citizens or physically handicapped), should be provide either free or the bank should levy charges on more liberal/concessional terms.

Where there are regulatory restrictions on certain charges, banks must ensure that the same is observed in letter and spirit. Introduction of products with slight variation just to bypass regulatory restrictions must be avoided.

Principle 3: Bank must act fairly while recovering the charges. Where the bank has more than one option, the collection and appropriation of charges should be done in a manner which goes in favour of customer instead of bank.

Banks are advised not to take benefit of ignorance of any customer while appropriating the repayments. The underlying idea is to act in a manner as the customer would have desired if he had complete information.

For example, if a customer has multiple finance facilities from a bank, the repayments in absence of any instructions must be appropriated first against a loan which carries high Annual Percentage Rate (APR). Even if there are specific instructions from the customer which eventually result in high cost to the customer, it is bank's responsibility to provide guidance and avoid taking benefit of customer's ignorance.

Banks should establish effective controls to ensure that the payments are accounted in a manner intended by the customer even if SOPs have not been followed by the customer, e.g. if the customer has paid the total outstanding (early retirement /balloon payment), the loan must be appropriated accordingly rather than parking the paid amount for future installments. In order to save the customers from unreasonable charges banks must adopt substantial measures to educate them about the re payment procedures. The bank should also prepare a schedule indicating outstanding principal after repayment of each installment. If the customer has paid the total outstanding (early retirement /balloon payment), the loan must be appropriated first toward principal, mark-up and then other charges.

The billing cycle for consumer financing should be fixed in a manner that facilitates timely repayment by the borrower conveniently. For example, in case of a salaried person, the due date of payment may be fixed in accordance with the individual's salary disbursement date.

The banks are encouraged to provide banking services to their customers on standardized rates regardless of the fact that the services are acquired from parent branch or any other branch of his/her bank. Further, for services rendered through third parties like repossession of vehicles, valuation of property, credit reports, etc. banks are required to recover from customers the actual charges/cost incurred by them.

Principle 4: Banks need to ensure that the charges being recovered are not prohibited under the law, the underlying contract or any rules and regulation.

Issuance of tax certificate, collection of small denomination currency notes, etc. are legal obligations on the banks. Imposition of charges on provision of such services should be avoided. There may be circumstances where charges levied can be challenged on the ground that the underlying contract contains unfair /biased or contradictory terms rendering the whole contract null and void. Therefore, it is strictly advised that the banks take into consideration the legal enforceability of the charges while recovering the same. Similarly, banks should also ensure that the service charges do not contravene the regulatory instructions on service charges issued by the State Bank of Pakistan from time to time.

Further, the bank should obtain in-house legal/compliance opinion on legal/regulatory enforceability of charges. This opinion may be kept on bank's record and produced to SBP inspection teams, when required.

Principle 5: Customers should not be charged for the services rendered without consent.

The customer should not be charged for any unsolicited product or service provided due to human or system error or any other reason. It must be ensured that charges are levied only for the products or services for which the bank has written or verbal consent on record.

Banks need to exercise caution in case of products which are automatically rolled over upon expiry, e.g. personal loan, credit cards, etc. Unless there is an explicit consent of the customer to the contrary, banks are required to get written or verbal consent (on recorded lines) for every renewal.

Principle 6: Customer should not be charged for the services not rendered.

If a service is not rendered to the consumer due to system failure or other reasons on the part of bank, he/she should not be held liable to pay any charges for the same. Further, if a service provided does not meet the committed standards due to any fault on the part of the bank, it is fairly expected that the bank may treat the same as service not rendered and deal the customer accordingly.

Principle 7: Customer should not be charged twice for a service or a single breach of contract.

A typical example in this regard is late payment or a nonpayment charge on outstanding amount of a credit card despite the customer is levied normal financial charges. Duplication or compounding must be avoided and non payment charges may only be recovered on the unpaid amount for the overdue days. Similarly, the customer should not be charged for any reissuance of ATM, Debit/Credit cards if the same is required due to system/ human error on bank's end.

Further, penal charges on breach of limit in respect of credit cards or cash line facilities to consumer are prohibited, as the banks facilitate the same at their own end. However, banks shall acquire the consent of the customer at the inception that whether he/she needs overdraft facility and will charge the normal rate without any penal charges.

Principle 8: Right to recover/collect charges comes with the responsibility of providing the service.

In case of service arranged by the bank through a third party, the onus of provision of service to the satisfaction of the customer rests with the bank. The banks must ensure uninterrupted service provision to the customer by devising effective Service Level Agreements (SLAs) with the third party service providers. Further, the banks shall not force any customer to get insurance policy wherein the sum insured exceeds the exposure of the bank.

Principle 9: Banks undertake awareness campaigns to increase their customers' understanding of service charges

Banks are advised to formulate guidelines/policies regarding customer awareness campaigns and undertake the same periodically as approved under the policy. Banks must engage with their customers to educate them about the issues pertaining to service charges. Campaigns regarding malpractices like collection of uncalled for charges, rights for information, etc. shall be adopted to curb complaints arising out of unawareness of the customer. The banks shall carry out customer engagement/survey to gauge the reasonableness of their service charges. Banks may also share results of customer engagement/survey with Consumer Protection Department.