



## ASIC Enforcement Review

### Industry codes in the financial sector

Submission by Financial Ombudsman Service Australia

August 2017



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## Executive summary

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The Financial Ombudsman Service (FOS) Australia<sup>1</sup> is an ASIC-approved independent external dispute resolution (EDR) scheme that covers disputes across the financial sector.<sup>2</sup>

As well as its role in dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. We also provide secretariat services to code monitoring and compliance committees for five industry codes of practice.<sup>3</sup>

We welcome the opportunity to provide feedback on *Position and Consultation Paper 4 – Industry Codes in the Financial Sector*, released by Treasury on 28 June 2017 (Consultation Paper).

FOS considers that industry codes can play a crucial role in the financial sector by strengthening consumer confidence. We support initiatives to make codes operate more effectively by improving their coverage, content, consistency and enforceability. For this reason, we broadly support the general approach outlined in Positions 1 to 5 in the Consultation Paper. Our particular interest is to ensure the reforms reinforce arrangements to allow consumers to access EDR easily when they seek redress for code breaches.

This submission<sup>4</sup> highlights the importance of the role industry codes play in the financial sector and comments on the following issues:

### **Service standards set in industry codes**

Industry codes complement legislation by filling gaps and setting standards higher than the legislation. At present the codes set minimum standards of good practice and aspire to go further and establish best practice. Moving to a position where codes set 'base level' service standards, as suggested in the Consultation Paper, would be a retrograde step.

FOS considers that the model should require codes to continue to set good, or best, industry practice service standards so that:

- codes continue to benefit consumers through EDR decisions and continuous improvement, and
- improvements in industry standards achieved through codes to date are not undermined.

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<sup>1</sup> Information about FOS is set out in full on our website at [www.fos.org.au](http://www.fos.org.au). The Appendix to this document summarises key points.

<sup>2</sup> FOS is approved by ASIC under its [Regulatory Guide 139 Approval and Oversight of External Dispute Resolution Schemes](#).

<sup>3</sup> See the Appendix for more detail.

<sup>4</sup> This submission has been prepared by the office of the Chief Ombudsman and does not necessarily represent the views of the board of FOS. It draws on experience of FOS and its predecessors in the resolution of disputes about financial services.

### **Code coverage**

In the financial sector, we support broader coverage of industry codes as appropriate to complement relevant legislative and regulatory standards. Where the pre-conditions for an effective co-regulatory approach are not currently strong, standards of conduct based on clear legislated minimum standards with robust enforcement by the regulator may be required in the first instance.

In areas where a co-regulatory approach is appropriate, FOS considers that coverage by ASIC-approved codes should be comprehensive. To assist the transition to approved codes, the model should include step by step guides and other measures to help industry to develop codes in areas without codes or with codes that require substantial enhancement.

If code coverage is to be aligned with AFCA's jurisdiction, several issues would need to be addressed including:

- whether particular restrictions on the jurisdiction of AFCA should be replicated when setting code coverage
- how changes in AFCA's jurisdiction or membership should change code coverage and
- whether code coverage should have scope to develop independently of AFCA's jurisdiction.

### **Code enforceability**

FOS considers that provisions of an industry code should form part of the contracts between subscribers and consumers.

In our view, strict compliance with certain code provisions should be required. A code should set out a remedy other than a contractual remedy to apply if strict compliance provisions are not followed.

### **ASIC approval**

FOS supports the approach of requiring industry codes to be approved by ASIC.

The design and contents of an industry code should meet key requirements set out in this submission. We plan to provide further input when amendments to ASIC's Regulatory Guide 183 are developed.

## ePayments Code

If a modified version of the model is devised to apply in relation to the ePayments Code, it should in our view include these features of the model as presented in the Consultation Paper:

- Positions 1 and 2, to address the key issues stated in paragraph 1 on page 7 and
- Position 4, to ensure consumers have adequate access to redress where code breaches occur.

As the Consultation Paper acknowledges, a single EDR scheme – to be called the Australian Financial Complaints Authority (AFCA) – will soon be established to replace FOS and the other two dispute resolution schemes operating at present in the financial sector<sup>5</sup>. This change, recommended by the Ramsay Review<sup>6</sup>, is expected to take place on 1 July 2018.

Please contact FOS if you would like us to clarify any aspect of this submission or provide further information.

## 1 Role of industry codes

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FOS supports the development of strong industry codes that include robust and transparent governance arrangements. Through a code, financial services providers can make commitments to consumers over and above requirements imposed by law.

A code should include guiding principles that subscribers need to observe to ensure they treat consumers fairly and consistently through the whole life cycle of a financial product or service.

Financial services providers should put the interests of consumers first in a way that keeps pace with consumer needs and expectations, which continue to change, and may change rapidly. This includes meeting standards of good practice as well as meeting all relevant minimum legal requirements.

Principles in a code can be applied to take into account changes in practice, technology and other developments such as those that may impact on the interpretation of insurance policy definitions. This allows a code in theory to be more flexible and agile than legislation or case law.

Part 2 of this submission explains that industry codes can benefit consumers through continuous improvement of industry standards and as a basis of good industry practice taken into account in EDR decisions. As explained in our second submission to the recent Senate inquiry into the scrutiny of financial advice, code

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<sup>5</sup> The three schemes operating at present are FOS, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal.

<sup>6</sup> The Treasury website sets out information about the [Review into the Financial System's EDR and Complaints Framework](#) chaired by Professor Ian Ramsay.

provisions can also improve consumer protection in specific areas such as definitions in life insurance policies.<sup>7</sup>

FOS considers that industry codes can strengthen consumer confidence in the financial sector. We support initiatives to make codes operate more effectively by improving their coverage, content, consistency and enforceability. For this reason, we broadly support the general approach outlined in Positions 1 to 5 in the Consultation Paper.

Industry codes complement legislation by filling gaps and setting standards higher than the legislation. At present the codes set minimum standards of good practice and in some cases aspire to go further and establish best practice. Moving to a position where codes set base or minimum level service standards, as suggested in the Consultation Paper, would be a retrograde step.

## **2 Service standards set in industry codes**

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### **2.1 EDR decisions**

When deciding a dispute, FOS does what it considers fair in all the circumstances, having regard to factors including good industry practice and applicable codes. Industry codes help us to determine what constitutes good industry practice in particular situations.

Through this approach, decisions of FOS taking codes into account require financial services providers to meet good practice, or best practice, service standards. FOS decision makers would not be able to do so if the standards in the codes were reduced to minimum or base level

### **2.2 Continuous improvement**

Codes play an important role by raising industry standards. Improvements occur when a code sets standards at a higher level standard of service or conduct than applicable law or regulatory guidance. Raising standards benefits consumers directly. It can also assist EDR as improved standards can be expected to result in fewer disputes, more effective internal dispute resolution and less need for EDR. Allowing standards in codes to fall from best practice to base level would threaten to reverse improvements already achieved through codes and make continuous improvement in future more difficult.

### **2.3 Proposed model**

The Consultation Paper indicates that, in the proposed model, industry codes should set a base level for service standards. As this would be a retrograde step, we disagree with this aspect of the proposed model.

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<sup>7</sup> [FOS submission](#) to the Inquiry by the Senate Economics References Committee into the Scrutiny of Financial Advice, April 2016.

We consider the model should require codes to continue to set good, or best, industry practice service standards so that:

- codes continue to benefit consumers through EDR decisions and continuous improvement and
- improvements in industry standards achieved through codes to date are not undermined.

In our view, industry codes should continue to play their current role of lifting standards above minimum levels set by legislation and other regulatory measures.

### **3 Code enforceability**

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In the proposed model, Position 3 requires ASIC-approved codes to be binding on and enforceable against subscribers by contractual arrangements with a code monitoring body. FOS considers that code provisions should also form part of the contracts between subscribers and consumers.

Given that the purpose of a code is to set standards of industry practice, contractual remedies are not sufficient in relation to some code provisions. One example is the clause dealing with guarantees in the Code of Banking Practice<sup>8</sup>, which provides that a subscriber will not accept a guarantee unless certain steps are taken.

The courts have taken the approach that, if the consumer would still have signed the guarantee, it will be enforceable even if the required steps were not taken. This means that compliance with code provisions becomes optional in some circumstances.

In our view, certain provisions in a code should be identified as provisions that require strict compliance. The code should set out a remedy, other than a contractual remedy, to apply if strict compliance provisions are not followed. For example, if the steps to be taken before a guarantee is signed are not completed, the guarantee should be unenforceable even if the consumer would still have signed it.

### **4 Code coverage**

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#### **4.1 Financial services provided to retail clients**

The Consultation Paper highlights that the proposed model may not be appropriate for all activities conducted in the financial sector. It explains that some areas may not be ready to develop and manage a code meeting the standards for ASIC approval.

A risk in this context is that the model could foster improvement in the areas covered by codes at present and leave standards in other areas further behind, without plans

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<sup>8</sup> Clause 31 of the [Code of Banking Practice](#).

for improvement. Areas with codes that require substantial enhancement to obtain ASIC approval could also be at risk of being left behind.

In the financial sector, we support broader coverage of industry codes as appropriate to complement relevant legislative and regulatory standards. Where the pre-conditions for an effective co-regulatory approach are not currently strong, standards of conduct based on clear legislated minimum standards with robust enforcement by the regulator may be required in the first instance.

In areas where a co-regulatory approach is appropriate, we consider that coverage by ASIC-approved codes should be comprehensive. To assist the transition to approved codes, the model should in our view include step by step guides and other measures to help industry to develop codes in areas without codes or with codes that require substantial enhancement.

Financial services not covered by codes at present include superannuation, traditional trustee services, managed investments and derivatives trading.

We note that the list of codes on page 5 of the Consultation Paper does not refer to all of the codes operating in the financial sector at present. Other codes include:

- the Association of Financial Advisers' Code of Conduct
- the Australian Timeshare Holiday Ownership Council Code of Practice
- APES 230 Financial Planning Services issued by Accounting and Professional Standards Board Ltd and
- the National Credit Providers Association Code of Conduct.

## **4.2 Alignment with AFCA jurisdiction**

The Consultation Paper suggests that code coverage should ideally align with the jurisdiction of AFCA. It may be appropriate for code coverage to be set so that, broadly speaking, it aligns with AFCA's jurisdiction. However, when determining the precise boundaries of the coverage, decisions would need to be made about several issues, including:

- Should restrictions on the jurisdiction of AFCA, such as the monetary limits on claims, be replicated when setting code coverage?

The jurisdiction of AFCA is expected to be subject to monetary limits on claims (higher than, but corresponding with, the current monetary limits on claims that can be made to FOS). The application of industry codes is not subject to monetary limits of this type at present.

The exclusions from the jurisdiction of FOS are stated in our Terms of Reference and explained in the [Operational Guidelines](#) published on our website. The jurisdiction of AFCA is expected to have comparable exclusions.



- If the jurisdiction or membership of AFCA changes, how should code coverage change?

Changes to the jurisdiction or membership of AFCA may occur. For example, debt management firms may in future be required to become members of AFCA. These firms may need a separate industry code.

- Should there be any scope to change code coverage arrangements when no corresponding change to AFCA's jurisdiction occurs?

An approach to maintain alignment strictly may not allow code coverage to develop separately from the development of AFCA's jurisdiction.

## 5 ASIC approval

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FOS supports the approach of requiring industry codes to be approved by ASIC, which the proposed model addresses in Position 1. It will be important to ensure that the approval process does not cause delays in code enhancements.

The Consultation Paper indicates that RG 183<sup>9</sup> may require amendment, but does not discuss possible amendments. FOS plans to provide further input when details of the amendments are developed.

In recent public submissions, FOS has commented on how industry codes should be designed. For example, we have indicated that an effective code of practice should:

- be developed through a transparent, consultative process
- be well known and supported widely across the industry
- build upon rather than replicate mandatory minimum standards – whether by setting higher standards, covering additional issues or supporting compliance with practical elaboration and guidance
- have an effective governance structure that allows for meaningful independent monitoring of code compliance
- provide consumers with access to a clear, simple mechanism for raising code breach concerns and
- be subject to independent review at regular intervals.

Our dispute resolution experience indicates that, to meet the expectations of all stakeholders, a code of practice should be framed against a set of clear benchmarks.<sup>10</sup> These benchmarks would need to deal with key matters such as:

- code application

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<sup>9</sup> ASIC's Regulatory Guide 183 *Approval of financial services sector codes of conduct*.

<sup>10</sup> The approach we recommend corresponds closely with the approach taken at present in RG 183.

In our experience, codes with limited application are less clear. Consumers tend to find it more difficult to access these codes and understand how they apply.

- focus on consumers

A code should set good industry practice consistent with community and stakeholder expectations.

- accessibility

A code should use plain English and speak to the consumer simply. A code should concisely state each standard set, how the subscriber should meet the standards in practice and what happens if standards are not met.

- fairness

A code should commit subscribers to fair service and treatment of consumers throughout the life cycle of the financial products or services provided.

- openness and transparency

A code should commit subscribers to transparency in decision making and conduct at all stages from sales and marketing to complaints handling.

- accountability

A code should set out clear compliance obligations for subscribers and an effective framework for oversight, monitoring and enforcement.

## 6 ePayments Code

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The Consultation Paper indicates that it may be difficult to bring the ePayments Code within the proposed model. For example, the paper notes on page 4 that no single industry body has been able to take responsibility for administering or monitoring compliance with the code.

If a modified version of the model is devised to apply in relation to the ePayments Code, it should in our view include these features of the model as presented in the Consultation Paper:

- Positions 1 and 2, to address the key issues stated in paragraph 1 on page 7 of the paper and
- Position 4, to ensure consumers have adequate access to redress where code breaches occur.

## Appendix - About FOS

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FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines. The original participants were:

- the Banking and Financial Services Ombudsman
- the Insurance Ombudsman Service and
- the Financial Industry Complaints Service.

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre and
- Insurance Brokers Disputes Ltd.

FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector. Our service is free to consumers and is funded through a combination of levies and case fees paid by our members, which are financial services providers.

Our operations are governed by our Terms of Reference that form a contract with our members. The Terms of Reference are available on our website.

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector. FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as:

- banking
- credit
- loans
- general insurance
- life insurance
- financial planning
- investments
- stock broking
- managed funds and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC.

FOS also provides secretariat services to committees that monitor financial services providers' compliance with these industry codes of practice:

- the General Insurance Code of Practice
- the Code of Banking Practice
- the Customer Owned Banking Code of Practice
- the Insurance Brokers Code of Practice and
- the Life Insurance Code of Practice.

FOS is governed by a board with an independent chair and:

- four 'industry directors' appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry and
- four 'consumer directors' appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.