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Financial Services Reform Taskforce

12 April 2019

The Treasury

Langton Crescent

Parkes ACT 2600

By email: [enforceablecodes@treasury.gov.au](mailto:enforceablecodes@treasury.gov.au)

Dear Sir / Madam

### **Enforceability of Financial Services Industry Codes**

The Australian Finance Industry Association (AFIA) welcomes the opportunity to provide feedback on Treasury's Consultation Paper – Enforceability of Financial Services Industry Codes (the Paper).

#### **AFIA Background**

AFIA is the voice of a diverse Australian finance industry. AFIA supports our members to ensure a fair, equitable and competitive market for customers through representation, insights and connectivity.

AFIA is uniquely placed to respond given our broad and diverse membership of over 100 financiers operating in the consumer and commercial markets (including small-medium business and agri-finance). AFIA members:

- include banks (major<sup>1</sup>, regional and mutual/community-owned) and non-banks;
- range from ASX-listed public companies through to small businesses providing finance;
- operate via a range of distribution channels including bricks and mortar premises, intermediaries (finance brokers, dealerships, suppliers) through to online / digital access
- collectively operate across all states and territories in Australia in capital cities through to regional and remote areas: the majority operating across at least one border;
- have customers from all demographics, all age groups (legally able to borrow) in support of Australia's diverse and multi-cultural community with

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<sup>1</sup> While AFIA's membership includes the major banks, we note the Australian Banking Association represents their views for components of their business (other than asset/equipment/receivables finance).

- commercial entities range from sole traders and partnerships through to the more complex corporates (e.g. trusts, corporate group) and government-entities some with no employees through to others with hundreds (if not thousands) of employees
- consumers range from high-income through to low-income earners (including some whose main income source may be government welfare); many with substantial assets, others with minimal; single borrowers through to blended families; covering the whole range of employment scenarios, full-time, part-time, seasonal or casual employment.
- provide a broad range of finance products:
  - consumer: from personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), loans secured by land or personal property; consumer leases of assets (including household/electrical/IT or cars)
  - commercial: asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); working capital solutions (online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards) together with more sophisticated and complex finance solutions.
- AFIA has demonstrated capability in the development, design and implementation of Codes. Of most relevance in the context of this submission is the AFIA Online Small Business Code of Lending Practice (see [here](#)) and the AFIA Car Rental Code (which is currently under a review and update process) (see [here](#)).

### **AFIA's Position on Self-Regulation + Enforceability of Code Provisions**

Our submission consists of two parts; general comments follow and more detailed responses to the specific questions are included in the attachment.

At a macro level, our members:

- support self-regulation as a means of facilitating provider-differentiation enabling providers that self-regulate to demonstrate to customers a level of service, product design and distribution capability that gives an operational context and commitment to the law or sets a standard of agreed behaviour that exceeds it.

- want to preserve the value of industry ownership of Codes and therefore responsibility and accountability around compliance and brand-risk
- appreciate the complexity of the issues being addressed through Treasury's Consultation Paper
- acknowledge the complexities of drafting amendments (e.g. to the Corporations Act s. 1101A) to implement recommendations in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (RC) relating to mandating legal enforceability of Code provisions given broader statements around not intruding on how those provisions currently work for ASIC's ability to approve the non-legally enforceable provisions of a Code sought to be endorsed by ASIC
- seek greater clarity of the underlying problem that is being solved through this process to facilitate our offering potential solutions designed to specifically address that problem
- recommend the enforceable Code-provision regime should not include civil penalties as remedies for breach on the basis that this creates compliance risk and uncertainty that may outweigh any customer/market differentiation benefit for a provide to commit to an enhanced industry standard reflected in the Code
- recommend remedies should be limited to a right to compensation for damage suffered as a result of breach, reflecting the principles-based nature of Code commitments for the same reason as outlined in the above dot point.

We provide further detail against the specific questions raised by Treasury in attachment 1.

### **Proposed Treasury / FICA round table**

As part of Treasury's consideration of these responses and to facilitate a process that maximises values from impacted key stakeholders in the financial services industry to inform the Government's next steps, we suggest that Treasury consider:

- inviting members of the FICA Code Enforcement Working Group (covering members of the ABA, AFIA, AFMA, ASF, COBA, FSC and ICA) to join with Treasury (and ASIC) at a Roundtable to enable further detail and discussion on these issues (or relevant others). The FICA Working Group has been recently established to consider a potential whole of financial services solution to this issue

- through this FICA Working Group Treasury could:
  - shape elements of a cross financial services framework that could apply to the development and design of a solution to implement the legal enforceability of provisions of Codes (e.g. identification of key provisions that should be legally enforceable in any Code by Code-developers- such provisions should be limited to those which have clear boundaries like process or disclosure requirements and consequently will have factual evidence available to easily assess whether there has been a breach and should not include those which are of a general or aspirational nature)
  - consider the treatment of Code provisions that reflect, partly or wholly, existing requirements under the law and therefore are already enforceable
  - potentially remove duplication and reduce the potential for overlapping enforcement regimes.
- this process could enable a fit for purpose solution that optimises the outcome for customers in a way that appropriately balances the needs of financial services providers to operate prudently and commercially
- such an approach would provide greater clarity on these 'corner stone aspects' leading to a more consistent and smoother transition towards execution of any final recommendations.

### **Next steps**

AFIA welcomes the opportunity to discuss our feedback further, or to provide additional information. Please contact me at [helen@afia.asn.au](mailto:helen@afia.asn.au) or Karl Turner, Executive Director, Policy and Risk Management at [karl@afia.asn.au](mailto:karl@afia.asn.au) or both via 02 9231 5877.

Kind regards



Helen Gordon  
Chief Executive Officer

## **ATTACHMENT 1**

### **Responses to Specific questions**

#### **1. What are the benefits of subscribing to an approved industry code?**

There are many benefits. An industry code:

- it is better to lead, than be led; through self-regulation Industry can visibly show commitment to customers to a standard of behaviour above what strict legal compliance would warrant and designed to be implemented in an operationally efficient and effective manner shaped to fit against a particular product or market group
- provides greater clarity to customers on the level of service, product design and distribution practices that they can expect when interacting with a code compliant member (CCM)
- clarifies the elements that at least meet and in specified circumstances establish a standard of commitment above the law
- reduces competitive arbitrage and provides a level playing field for consumers and industry participants by lifting of standards across potentially a wide and diverse set of market participants
- encourages less 'mature' financial services providers (who still comply with the law) to potentially lift their compliance standards early to the level of more mature players who also operate over the legal minimum requirements
- reduces the need for formal legislation
- reduces the work load on government regulatory bodies
- assists External Dispute Resolution schemes (such as AFCA) by providing an agreed benchmark from which to assess and review complaints made by customers against a CCM.

## **2. What issues need to be considered for financial services industry codes to contain 'enforceable code provisions'?**

There are many issues that need to be considered:

- clear articulation of the problem statement that is being addressed through the inclusion of enforceable provisions would be a good starting point
- the additional value that is expected to be generated over and above existing statutory remedies
- the interplay with current legal provisions – for example, how would remedies of breach of the Competition and Consumer Act or ASIC Act, for example in the area of misleading and deceptive conduct, interact with potential enforceable Code provisions
- the definition of such provisions
- The process for determining there has been a breach
- the potential remedies that could be imposed on a CCM ahead of any formal sanction
- how wholesale funders may react if their smaller financial services clients have to include such provisions in a contract either with an industry body or with a customer directly as this will potentially vary assumptions around risk and return that underpin such agreements and consequently the availability or cost of this funding and therefore competition in the market
- the assessment of quantum of any 'detriment' or damage or loss to a customer including for example, assessing:
  - the number of customers impacted
  - the impact of any customer detriment
  - the relative impact of any customer detriment e.g. an action of a CCM which led to a customer inadvertently losing their house vs the action of a CCM led to a customer

being inappropriately default listed

- the position the customer may have already been put into through the outcome of the CCM's internal or external dispute resolution schemes
- a materiality threshold to avoid capturing all Code provisions as potentially legally enforceable
- the interdependency of enforceable with non-enforceable provisions within a Code
- The impact this interdependency has on customer, AFCA or regulator understanding
- Who will be covered by such provisions:
  - Australian financial services (AFS) licensees
  - Australian Credit Licensees
  - authorised representatives of AFS licensees
  - issuers of financial consumer products
  - issuers of financial consumer and small business products
  - issuers of any financial product
  - members of which Associations – noting that the current arrangements:
    - encourage broader and multiple memberships
    - allow a targeted, member needs approach to be met
    - do not limit choice which could impact on competition
    - accommodate members who are still very much customer centric but may not necessarily want to be signatories to a Code.

Members of the FICA Working Group are considering engaging an external legal firm to help clarify some of these definitional elements. We welcome the inclusion of Treasury in this process as part of a post submission ongoing dialogue on how the RC recommendations can be implemented.

### **3. What criteria should ASIC consider when approving voluntary codes?**

At this stage, members support the current process namely:

- apply to ASIC who may consult with other key stakeholders, including industry and consumer representatives, and other government agencies and regulators on the decision to approve a code
- follow regulatory guidance (RG) 183
- meet the ASIC threshold for any Code namely it must:
  - require subscribers to be contractually bound by the code (either by contracting with the enforcement body or with consumers or both)
  - have an independent person or body that is empowered to administer and enforce the code, including imposing any appropriate sanctions
  - provide that consumers have access to internal dispute resolution and an appropriate external dispute resolution scheme for any code breaches resulting in direct financial loss
  - give consumers broad standing to complain about any other code breach to the independent body.

AFIA has found ASIC and the ACCC to be very pragmatic in their feedback on AFIA Codes – for example, with ASIC, the Online Small Business Lenders Code was not material in the scheme of the Australian financial services market but delivered important benefits to on-line small business customers through an innovative, unique pricing tool, the Smartbox™.



At a macro level, Members support the option of the development of Codes without the need for agreed sign-off and implementation being contingent on ASIC approval. In this, we are not saying that ASIC would not be a key stakeholder involved in the consultation process. In short, any Industry Code should as a minimum:

- be developing following regulatory guidance eg ASIC RG 183
- clearly articulate the objective sought to be addressed by the Code
- analyse whether the problem can / should be addressed using existing laws or regulations?
- consider whether any other form of industry self-regulation has already been developed that would address the problem (or any gaps in it that may need to be addressed)
- consider whether an industry code is the most suitable mechanism for resolving the problem
- ensure there is likely to be a net public benefit flowing from the development and implementation of an industry Code.

#### **4. Should the Government be able to prescribe a voluntary financial services industry code?**

Members are a little unclear what is intended by this question – it would be good to explore:

- the circumstances in which government would want to use this mechanism vs say implement formal legislation
- how or if potentially mandatory codes could interact with voluntary codes driven by Associations and voluntary codes developed by the Government.

#### **5. Should subscribing to certain approved codes be a condition of certain licences?**

There are potential advantages and disadvantages from this proposal:

- on the one hand it could:
  - increase customer certainty
  - drive consistency

- reduce competitive arbitrage
  
- on the other hand, it could:
  - reduce competition
  - reduce innovation
  - create more barriers to entry.

An alternate approach, which Members believe will drive a more nuanced and potentially better customer outcome, is the development of product specific rather than licence specific Code.

For example, when the Online Small Business Lenders Code was implemented, because it was product focused, CCMs agreed on the inclusion of a unique pricing tool, which was materially over and above legislative requirements - the Smartbox<sup>tm</sup>, allows customers to quickly and easily compare key pricing metrics of on-line small business loans in a standardised format used by each of the CCM providers.

It would not have been possible or appropriate, at this stage, to leverage this tool say across all the products of a licence holder.

When looking at such product specific Codes, members believe that there should be minimum elements. Using RG183, this could be as simple as every product Code should:

- require subscribers to be contractually bound by the Code (either by contracting with the enforcement body or with consumers or both)
  
- have an independent person or body that is empowered to administer and enforce the Code, including imposing any appropriate sanctions
  
- provide that consumers have access to internal dispute resolution and an appropriate external dispute resolution scheme for any Code breaches resulting in direct financial loss
  
- give consumers broad standing to complain about any other Code breach to the independent body.

## **6. When should the Government prescribe a mandatory financial services industry Code?**

Currently, members:

- do not believe there is a need for a mandatory code - such Codes should only be considered as a last resort where evidence of consumer risk or market failure clearly warrant that government intervention
- would only support the notion that it may be appropriate to impose a mandatory code if an industry did not put forward its proposed enforceable code provisions in a timely manner – noting that they would welcome the opportunity to discuss with Treasury or ASIC potential criteria when this could occur.

## **7. What are the appropriate factors to be considered in deciding whether a mandatory code ought to be imposed on a particular part of the financial sector by Government?**

- currently, Members believe a mandatory code should only be considered as a last resort
- while the RC report highlighted examples of misconduct, Members believe that a mandatory code would only be necessary when dealing with extreme systemic failure – as highlighted say during the Global Financial Crisis when governments in the UK and US had to intervene and nationalise a solution to address some financial services provider behaviour.

## **8. What level of supervision and compliance monitoring for Codes should there be?**

For ASIC endorsed Codes, members:

- support recommendation 22 of the Final Report of the ASIC ERT namely the establishment of a Code monitoring body, comprising a mix of industry, consumer and expert members, to monitor the adequacy of a Code and industry compliance
- suggest existing Code governing bodies should retain monitoring and enforcement powers in relation to both enforceable and all other Code provisions. Systemic or serious breaches could potentially be referred to ASIC, but this should only give rise to enforcement action where it constitutes breaches of other provisions – for example, license obligations
- would like clarity to ensure the boundaries between ASIC and any Code monitoring body are clear and not duplicated.

For non-ASIC endorsed Codes:

- there should still be the establishment of a Code monitoring body, comprising a mix of members with relevant skills/competencies to be able to adequately monitor the adequacy of a code and industry compliance
- the Code governing bodies should retain monitoring and enforcement powers in relation to their Codes
- there should be clarity to ensure the boundaries between ASIC and any Code monitoring body are clear and not duplicated
- supervision and monitoring could mirror some of the content that AFIA has adopted in the [Terms of Reference](#) (ToR) or our Code Compliance Committee for the Online Small Business Lenders Code of Lending Practice, these ToR highlight that for this product specific Code, the Code monitoring body consists of:
  - three independent representatives with relevant experience at a senior level in finance in Australia appointed by the Board
  - an independent chairperson appointed jointly by the Chief Executive Officer and the Chairperson of the Board

and may:

- make reasonable requests for a CCM to provide them with access to information, documents and systems which they consider necessary or appropriate to carry out its functions and responsibilities
- seek independent professional legal, accounting, industry or other advice
- conduct enquiries on its own initiative and conduct audits of any CCM's compliance with a relevant Code provided that any such audit is limited to (as applicable) an issue which relates to a complaint being investigated by the body or a specific issue which they believe is of sufficient concern to warrant an audit request each CCM
- ask a CCM to lodge an annual attestation on its compliance with its relevant Code

- in all cases, there needs to be a balance of appropriate supervision and compliance in order to ensure quality candidates apply for potential compliance monitoring roles and financial services members benefit from the insights these experienced personnel can provide.

**9. Should code provisions be monitored to ensure they remain relevant, adequate and appropriate? If so, how should this be done and what entity should be responsible?**

- Yes – as highlighted above, the use of a Code compliance committee for ASIC approved and non- approved Codes is an important element to ensure Codes remain relevant, adequate and appropriate.
- As above, there needs to be a balance of appropriate supervision and compliance in order to ensure quality candidates apply for potential compliance monitoring roles and financial services members benefit from the insights these experienced personnel can provide.

**10. Should there be regular reviews of Codes? How often should these reviews be conducted?**

- Yes – ongoing review of Code content is very important given changing regulations and development in community expectations.
- Again, the process adopted for the Online Small Business Lender’s Codes could be used as a template namely that:

The Board may, after consultation with, and seeking comments and suggestions from:

- the then members of the Code Compliance Committee
- the then CCM
- such other organisations or people as it considers appropriate

review and amend the Code at any time it considers it appropriate to do so.

**11. Aside from those proposed by the Commissioner, are there other remedies that should be available in relation to breaches of enforceable code provisions in financial service codes?**

- Members would like clarity on some of the Commissioner’s suggestions – for example, they suggest the following should not be applicable:
  - non punitive orders, including community service orders, probation orders

- disqualification from managing a corporation.
- As highlighted under question 2, considerable clarity is sought in relation to the definition of, and process associated with, enforceable Code provisions.
- Members believe the enforceable Code regime should not include civil penalties as a remedy and suggest:
  - remedies should be limited to a statutory right to compensation for damages or loss flowing from breach, reflecting the principle-based nature of Code commitments.

**12. Should ASIC have similar enforcement powers to the Australian Competition and Consumer Commission (ACCC) in Part IVB of the Competition and Consumer Act in relation to financial services industry codes?**

- No, the enforceable Code regime should not include civil penalties as a remedy.
- There should be a statutory right to damages to compensate for loss to the customer from a breach of an enforceable Code provisions – see 11 above.
- If implemented as proposed, the potential impact could be to:
  - deter the industry from wanting to self-regulate and set industry standards above the law
  - cause various members to review their appetite to remain part of industry bodies and / or
  - review the need to potentially continue to provide funding in the Australian market, potentially limiting access to products for consumers.

**13. How should the available statutory remedies for an enforceable code provision interact with consumers' contractual rights?**

- There is no easy answer to this question. The complexity warrants significant consideration informed by a clear articulation of what is the underlying problem sought to be addressed by this solution.

**14. Should only egregious, ongoing or systemic breaches of the enforceable provisions of an industry code attract a civil penalty?**

- As stated above, Members do not support a civil penalty regime for breaches of industry codes.
- If this position is not adopted then, yes – this is important so as to not detract from our Members desire to self-regulate as a means of setting benchmarks at least in line and in many situations above the law.
- However, as part of this, greater clarity is sought on the definition of systemic breaches.
- The interaction with ASIC's and AFCA's definition of systemic breaches will also be important so as to drive consistency in terms of understanding and application.

**15. In what circumstances should the result of an external dispute resolution (EDR) process preclude further court proceedings?**

- The EDR process was meant as an alternative to court proceedings.
- AFCA's mandate is increasing. Members have appreciated the opportunity to continue to educate AFCA personnel on the nuances of lending to non-consumer markets, supported by non-ABA Codes of Conduct.
- With its increasing mandate, Members would welcome a discussion with AFCA and other key stakeholders on the boundaries of its jurisdiction and future interactions with the courts to ensure greater clarity from a customer's and financier's perspective.

**16. To what matters should courts give consideration in determining whether they can hear a dispute following an Australian Financial Complaint Authority (AFCA) EDR process?**

The following matters maybe relevant when determining whether a court can hear a dispute following an AFCA EDR process. Whether:

- the customer or financier believes due process has not been followed
- the customer or financier has new evidence that leads to the outcome of the complaint being questioned
- the financier believes AFCA has not appropriately considered any legal and contractual arrangements in arriving at its determination
- an industry association or affiliated body sees merit in running the determination as a test case due to the potential ramifications it could have across an industry or product set.

**17. What issues may arise if consumers are not able to pursue matters through a court following a determination from AFCA?**

The following issues should be considered:

- lack of confidence in the process
- continuation of potential asymmetry
- lack of clarity on areas of ambiguity.