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Making industry codes work
Submission to the Treasury

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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The Superannuation Consumers' Centre was formed in 2013 as a not-for-profit to advance and protect the interests of superannuation consumers. The SCC aims to educate, advocate on behalf of and directly assist superannuation consumers to improve the standard of living for people of retirement age.

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INTRODUCTION

The Royal Commission has shown that self-regulation in financial services has failed. Industry codes have consistently proved to be inadequate in addressing widespread consumer harm. The persistent problem that plagues codes, from their development to enforcement, is that industry has little interest in addressing problems it is currently profiting from.

The best example of this inadequacy is the failure of the Insurance in Superannuation Voluntary Code of Practice to solve clearly identified consumer harm. Industry delay and self-interest in the sector blocked reforms that have cost Australians, particularly those on low incomes, billions in balance erosion. This behaviour is typical of every self-regulatory process - when proposed consumer protections threaten profit, the industry delays or prevents reforms.

The scandals of the Royal Commission dictate that we need a shift in thinking about the way financial services industry codes work in Australia. We need to take the rule development part of codes out of industry hands. Instead, we need our finance regulator, ASIC, to take a leading role in the development of industry codes. The Federal Government should grant ASIC rule-making powers to author and administer mandatory financial services industry codes. This will guarantee that ASIC will be in charge of steering discussions about reform, and will ensure that the interests of Australians, not industry, are prioritised.

If the government continues to leave code development in the hands of industry, it will allow the sector to continue to frame reform to their own commercial advantage. This will continue to result in weak and ineffective codes.

Key points:

- Industry codes have consistently failed to protect Australians from harm.
- Even if significantly reformed, industry codes written by and for industry will still fail to protect many consumers.
- The Federal Government should legislate to give ASIC rule-making powers to author and administer mandatory industry codes.
- To ensure compliance, these ASIC-authored codes should come with strong penalties and be rigorously enforced by an independent and well-resourced code monitoring body.

Summary of recommendations

1. The Federal Government should legislate that ASIC be granted rule-making powers to draft and administer industry codes.
2. The Federal Government should grant ASIC broad rule-making powers, similar to the Financial Conduct Authority in the United Kingdom.
3. Entire industry codes, not specific provisions, should be enforceable and mandated by ASIC.
4. Civil penalties should be attached to individual breaches of industry codes. Breaches of a civil penalty provision should have a maximum penalty the greater of:
    - 300 penalty units; or
    - Three times the benefit derived or detriment avoided.
5. Breaches of industry codes that are 'egregious or systematic in nature' should be considered breaches of the general obligations 912A(1) of the Corporations Act.
6. To ensure compliance with industry codes, we need strong and independent code monitoring bodies. As a minimum, these bodies should:
    - Be independent from industry
    - Be well-funded and resourced to ensure compliance
    - Have adequate powers to guarantee compliance
    - Have a balance of ASIC-appointed consumer advocates, industry members, and independent experts on its panel
7. The code monitoring body should:
    - publicly report breaches of industry codes;
    - name companies that breach the code; and
    - provide specific reasoning for breaches of the code, to guide future policy making.
8. Existing consumer protections need to be upheld to ensure that ACFA's decisions are non-binding so individuals are free to pursue the decision in a court or tribunal.

1. Consumer harm caused by failed self-regulation

Newcastle mother, Alyson, came to CHOICE in late 2018 angry that she had seen her daughter's superannuation balance eroded almost to zero. Trying to do the right thing by her daughter, Alyson had deposited $200 and later another $1,000 to kickstart her savings. Her daughter had just begun a casual job while finishing her HSC and was earning about $80 a week.

After returning from a holiday Alyson was shocked to find mail from the super fund announcing that within a year her daughter's balance had reduced to just $34.22. On top of administration fees the main culprit was the nearly $80 a month her daughter was being charged for various types of life insurance.

"They had been taking out $79 a month for total death and disability and income protection (intended for) someone earning $80,000 a year, for a kid that was doing casual work and going to university full-time,"[1] said Alyson.

This was the 'exam problem' set for the superannuation industry when it was designing the Life Insurance in Superannuation Code. The industry knew it needed to ensure young people and those on low incomes could receive appropriate insurance without eroding their retirement savings. Due to sheer self-interest and greed, it was a problem the Code failed to answer.

In 2017 CHOICE was involved in the self-regulatory efforts of the industry in developing the Code of Practice. Our experience in this process is typical of our involvement in most self-regulatory endeavours. The industry had reached crisis point after a string of public cases of consumer harm. Government had indicated it was likely to legislate unless the industry acted.

The industry embarked on more than a year long process with multiple meetings per week of all the major stakeholders, including each of the four major industry lobby groups, interested funds, life insurers and a single consumer representative from CHOICE.

The group was able to determine the headline problems, which were all evident based on public reporting, including:

[1] News.com.au, 2018, 'Mum's horror find in 17-year-old daughter's mail', available at: https://www.news.com.au/finance/superannuation/mums-horror-find-in-17yearold-daughters-mail/news-story/3a35bcdbeccf00bff4f8019b75874a09

- Improving cost impacts on account balances for consumers, including the right cover for young people
- Addressing multiple default insurance policies
- Providing better assistance to consumers during claims
- Improving superannuation fund member communications on insurance

Despite a clear assessment of areas of consumer harm in the industry, what was delivered was a weak and unenforceable code.The code evolved in the drafting process from targeting erosion by putting a hard, albeit generous cap on insurance premiums, to giving full discretion to the funds about how they chose to comply. It paid lip service to the needs of younger people and those on lower incomes. Again it failed to implement effective measures to stop balance erosion for these two cohorts. Instead funds were only directed to "consider" the needs of younger members in insurance design.[2] This in no way solved the problem of Alyson Gearing's daughter or millions of other younger Australians or people with low balances. As a result, many people's first experience of superannuation continues to be discovering their balance has been entirely eroded by insurance premiums.

The Productivity Commission also found that too few industry players were making use of data to understand the needs of their members:

> *"Finding 4.5: Superannuation funds make insufficient use of their own (or imputed) data to develop and price products (including insurance). This is particularly problematic for designing products for the retirement and transition to retirement stages, because this is when different strategies can have the biggest payoffs for members."* [3]

Only two funds collected information on all ten of the PC's relevant trait information for the design and price of products. As an example, only about 20% of funds knew if members had dependents. This is a crucial piece of information in insurance product design, yet most funds collect no information from their members on need. This also indicates funds have been freely breaching or at least applying no good faith in their code obligation to "consider" the needs of different cohorts. As there is no way to consider the needs of someone you don't seek to understand the needs of in the first place.

Helpfully Treasury has quantified the cost of not making insurance appropriate for young people and those with low balances. Making insurance in superannuation opt in for under 25s and those with balances below $6,000 would return $3 billion in

[2] Insurance in Superannuation Voluntary Code of Practice, clause 4.10
[3] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.240

insurance premiums back to around 5 million Australians.[4] In the context of a $9 billion a year industry, the self-interest in keeping this rent-seeking behaviour going is clear.[5] It would be completely at odds with the profit motive of the insurance industry to ensure that people have appropriate insurance. Instead the industry has consistently pursued a policy of selling insurance to people who either do not require insurance or would be better served by other policy measures. The sector has done this by creating a weak, unenforceable code and consistently undermining the Government's attempts to reform the sector through legislative means.[6]

The entire Life Insurance in Superannuation code was only accepted by industry on an "if not, why not basis".[7] This means funds can breach any clause so long as they have a reason, however there is no authority to check whether the reason is justified or based on evidence of any kind. Earlier versions of the code included a code compliance body, that could have been responsible for this kind of basic checking. This was removed from the final version of the code, in a clear sign that the industry did not want to be held accountable for any breaches.

The failure of this code to achieve meaningful reforms is typical of our experience in self-regulatory processes; once consumer protections threaten profit, the industry waters them down.

2. Taking code development out of the hands of industry

Code development is currently run by industry, for industry. While consumer groups may be consulted, their capacity to influence is constrained, sometimes deliberately so. Industry are still making primary decisions about what is covered in codes and how it will be addressed. Even if significantly reformed, industry codes written by and for industry will still fail to protect consumers.

The proposal that industry identify and nominate to ASIC which specific provision of codes they want to be enforceable is fraught. This model still leaves key decisions and processes in the hands of industry groups, typically the parties that commercially benefit from current practices and have little incentive to support change. The industry will be incentivised to select only provisions that don't conflict with their profit motive to be approved as enforceable by ASIC.

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[4] Kelly O'Dwyer, 2018, Media release: 'Encouraging and rewarding Austrlaians by protecting your superannuation', available at: http://kmo.ministers.treasury.gov.au/media-release/050-2018/
[5] Productivity Commission, 2018, 'Superannuation: Assessing Efficiency and Competitiveness', p.363
[6] The Australian, 2019, 'Move to end $3bn superannuation gouge set to sink', available at: https://www.theaustralian.com.au/nation/move-to-end-3bn-superannuation-gouge-set-to-sink/news-story/46506854389aeb2cea57c42fa00ec031
[7] Insurance in Superannuation Voluntary Code of Practice, clause 1.1

This approach also elevates industry-written codes to the effective status of law. It is problematic that an industry that has systematically taken advantage of countless Australians, especially vulnerable Australians, should be afforded the power to define the rules of what effectively will be turned into law. The code development process needs greater independence to actually address industry-wide problems.

The Royal Commission has identified four overarching principles that should govern industry codes. They are:

- Codes should have mandatory coverage;
- Consumers should be able to rely on codes and they should have enforceability;
- Breaches of the code need to have meaningful sanctions; and
- ASIC needs to play a leading role in code development, approval, and enforcement.

These four principles will ensure that Australians can trust that promises made in the code are taken seriously and are not mere 'public relations puffs'.[8] These four principles can be best achieved by the Federal Government granting ASIC legislated rule-making powers to author and administer mandatory industry codes.

3. ASIC rule-making powers as a means to guarantee consumer protections

We strongly support the Federal Government granting ASIC rule-making powers to author and administer enforceable and mandatory financial services industry codes. In line with the Royal Commission's recommendation, this rule-making power should be extended to include all APRA-regulated institutions and Australian Credit Licence holders.

This will shift the way that financial services codes are developed in Australia. Under the ASIC-led model, code development will seek to maximise consumer wellbeing as a starting premise. Whereas under the existing model, the starting premise is how can industry write a code that will not threaten their profitability or can achieve the bare minimum to avoid more enforceable legislative reform. The ASIC-led process will ensure the development of the code will be truly consulatitive. The process should include engagement with consumer advocates, financial counsellors, community legal centres and industry to determine the scope and nature of each code.

[8] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, p.12

There is precedent for ASIC's rule-making powers. ASIC already has rule-making powers for Market Integrity Rules under Pt 7.2A and Derivative Transaction Rules under Pt 7.5A of the *Corporations Act 2001* (Cth) (the Corporations Act). APRA also has rule-making powers to make standards pertaining to 'prudential matters'.[9]

Although not within the scope of the consultation, we also support granting ASIC broad rule-making powers. In its submission to the Royal Commission's Interim Report, ASIC called for these powers, stating that rule-making powers, 'would directly assist it to address potential and actual misconduct in the financial services and credit sector.'[10] ASIC explained that:

'*such a power would build flexibility into the regulatory regime, allowing the setting of standards of conduct in response to the changing regulatory environment of new regulatory issues.*'[11]

The Financial Conduct Authority in the United Kingdom has broad rule-making powers which allows them to make general rules that are "necessary or expedient for advancing one or more of its operational objectives".[12] These powers allow the conduct regulator to be adaptable and responsive in addressing emerging regulatory concerns.

It is important to acknowledge that with ASIC's enhanced role, the corporate regulator will require additional funding and resourcing to consult widely and write strong and effective codes.

Recommendations 1 and 2

1. The Federal Government should legislate that ASIC be granted rule-making powers to draft and administer industry codes.
2. The Federal Government should grant ASIC broad rule-making powers, similar to the Financial Conduct Authority in the United Kingdom.

[9] Banking Act 1959, s11AF
[10] ASIC 2018, Submission to Interim Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, p. 18
[11] ASIC 2018, Submission to Interim Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, p. 18
[12] Financial Services and Markets Act 2000 (UK) s 137A

4. Enforceability of industry codes

An entire industry code, not just certain provisions, should be enforceable. This is to ensure that individuals are able to rely on all promises made by financial services providers in industry codes. We do not support individual provisions being nominated as enforceable, leaving others unenforceable.

ASIC has also raised concerns that allowing only certain provisions to be enforceable would mean that industry are less likely to engage constructively in the code development process. ASIC noted that:

"A key risk of making codes directly enforceable by regulators on a provision-by-provision basis is a reduction in industry willingness to commit to measures which go beyond strict legal requirement."

Further, uncertainty around what provisions one can rely on creates unnecessary confusion and complexity for consumers. We support Commissioner Hayne's assertion that, 'uncertainty of this kind is highly undesirable.' The solution to this uncertainty is to ensure that the entirety of the code is enforceable. Codes should be authored by ASIC in a clear and concise manner that makes every provision enforceable. Further, ASIC should establish that adherence to a code is mandatory, and is a condition of licensee to operate in Australia.

Recommendation 3

- Entire industry codes, not specific provisions, should be enforceable and mandated by ASIC.

5. Ensuring compliance with industry codes

Financial services firms currently view penalties for breaching existing codes as non-existent at best and a slap on the wrist at worst. Strong penalties and enforcement are essential. We strongly support attaching civil penalties to individual breaches of ASIC-authored industry codes. The Royal Commission has shown that many financial services flagrantly breached both the law and industry codes, and viewed penalties as simply the 'cost of doing business'. Penalties must be onerous enough to deter businesses from poor conduct. A full suite of compliance measures should be available to the code monitoring body and the corporate regulator for breaches of the code.

Breaches of financial services codes should mirror the civil penalties regime in the *Competition and Consumer Act 2010* (Cth) (the CCA). Breaches of a civil penalty provision of a code should attract a maximum penalty of 300 penalty units ($63,000) or three times the benefit derived or detriment avoided, whichever is highest. This determination should be at the discretion of the code-monitoring body.

For breaches of the code that are 'systemic or egregious in nature' we encourage the corporate regulator to prosecute firms under the new 912A(1) Corporations Act general penalty regime. Under the new regime, if entities breach general obligations of acting 'efficiently, honestly, fairly', they face a maximum penalty the greater of $10.5m, 3 times the benefits or detriment avoided, or 10% annual turnover (capped at $525m).

A code is only effective if it adequately monitored and enforced. Many of the existing industry-led code monitoring bodies have proven inadequate and ineffective in fulfilling their role. It is clear code monitoring bodies have ineffective and conflicted roles. For example, evidence from the Royal Commission showed that the General Insurance Code Governance Committee received 13,000 self-reported breaches of the Code.[13] Despite this, the Committee had never used its sanction powers to punish an insurance company.

To ensure compliance with industry codes, we need strong and independent code monitoring bodies. As a minimum, these bodies should:

- Be independent from industry;
- Be well-funded and resourced to ensure compliance;
- Have adequate powers to guarantee compliance;and
- Have a balance of ASIC-appointed consumer advocates, industry members, and independent experts on its panel.

A possible solution is the creation of a single code monitoring body that monitors compliance with all industry codes in financial services. The code monitoring body should be regularly required to report to ASIC breaches of the code that are 'systemic or egregious in nature'. In order to ensure transparency in the industry, the code monitoring body should also publically name companies who breach the codes and provide specific reasoning for breaches of the code to assist with future policy making.

Recommendations 4 to 7

4. Civil penalties should be attached to individual breaches of industry codes. Breaches of a civil penalty provision should have a maximum penalty the greater of:

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[13] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, Final Report, p.315

- 300 penalty units; or
- Three times the benefit derived or detriment avoided.

5. Breaches of industry codes that are 'egregious or systematic in nature' should be considered breaches of the general obligations 912A(1) of the Corporations Act.

6. To ensure compliance with industry codes, we need strong and independent code monitoring bodies. As a minimum, these bodies should:
   - Be independent from industry
   - Be well-funded and resourced to ensure compliance
   - Have adequate powers to guarantee compliance
   - Have a balance of ASIC-appointed consumer advocates, industry members, and independent experts on its panel

7. The code monitoring body should:
   - publicly report breaches of industry codes;
   - name companies that breach the code; and
   - provide specific reasoning for breaches of the code, to assist future policy making.

6. Assessing ACCC regulation-making powers

We acknowledge that an alternative method of mandating enforceable codes could be achieved by mirroring the regulations-making powers of the CCA. Part IVB of the CCA establishes that the Federal Government can prescribe regulations to enforce a mandatory industry code upon participants.[14] This regulation-making power would be preferable to industry writing their own codes and submitting it to ASIC for review. However, granting ASIC rule-making powers will be a stronger safeguard of Australians' financial wellbeing.

ASIC is better suited to address emerging consumer issues in the financial services industry. Compared with government-led regulation-making powers, rules-making powers would allow ASIC to be more flexible and adaptive in responding to consumer harm in a timely and effective manner. The code creation process would also be lead by ASIC, whose experience as a conduct regulator and investigative powers will ensure that areas of consumer harm are covered in the Code. ASIC already has extensive processes established to identify consumer harm and is connected to consumer representatives through its Consumer Advisory Panel.

[14] Section 51AE, Competition and Consumer Act 2010

7. Maintaining existing consumer protections for dispute resolution

We support Financial Rights Legal Centre and Consumer Action Law Centre's submission that a determination of AFCA is non-binding on the individual and that individuals are free to pursue the decision in a court or tribunal. It would be a significant weakening of existing consumer protections if individuals wishing to take action for breach of code had to choose between internal or external dispute resolution or going through the courts. The current dispute resolution process is a fair and just system, which allows for cheap, timely, and flexible resolutions. It is imperative that existing consumer protections are upheld.

Recommendation 8

Existing consumer protections need to be upheld to ensure that ACFA's decisions are non-binding so individuals are free to pursue the decision in a court or tribunal.

For further information please contact CHOICE on pveyret@choice.com.au