The Treasury

Enforceability of financial services industry codes - Taking action on recommendation 1.15 of the Banking, Superannuation and Financial Services Royal Commission, Consultation Paper

Joint Submission – Code Compliance Committee Chairs

April 2019

Introduction

The independent Chairs[1] of four committees that monitor compliance with four industry Codes in the financial sector welcome the opportunity to make a joint submission[2] and provide information and feedback to Treasury's consultation paper into the enforceability of financial services industry codes released on 18 March 2019 (Consultation Paper).

A further submission will follow on behalf of the Insurance Brokers Code Compliance Committee (IBCCC) following the return to Australia from an overseas business trip by the Independent Chair of the IBCCC.

Commissioner Hayne's recommendation 1.15 in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Final Report)[3] could significantly change the current self-regulated Code model. Appropriate consideration must be given to the effect of enforceable provisions in Codes as this may have unforeseen and potentially negative outcomes for consumers, the industry and the reputational relevance of the Codes themselves.

In particular, the impact of carving out only certain sections of each Code to be enforceable would likely result in a degeneration of the 'non-enforceable' sections of each Code.

The role of Codes in the financial services industry

Codes of practice have never been intended to act as a de facto form of legislation. While Codes are designed to comply with the law, they are not the law and should not be confused with it. A self-regulatory Code is a set of rules that often reflect a higher standard than simple compliance with the law. They set out expected standards of conduct and disclosure for industry members who subscribe to the Code.

Consumer-focused Codes often fill a regulatory gap in areas that require flexibility and the ability to respond to changing expectations and circumstances. For example, the current review of the General Insurance Code is seeking to address matters such as mental health and family violence, flagged as key issues by consumer groups. The updated Banking Code of Practice also sets out an updated commitment for banks to proactively identify if someone is at risk of financial difficulty and requires the Bank to work with the customer to try to prevent the situation from worsening.

As at 12 April 2019, there were 281 entities who had subscribed to the four Codes covered by this submission.

The strength of an individual Code's power lies in its ability to influence continuous improvement within an individual member organisation or within the entire industry, where the member or the industry as a whole works collaboratively with the relevant Code Compliance Committee to effect change and fix problems.

If Codes were to become akin to a piece of prescriptive legislation, there is a real risk that they would become nothing more than minimum service standards. Effectively, such black letter law-like standards would not keep up with everyday changing consumer expectations. Self-regulatory Codes can and do deal with changing consumer sentiment and expectations.

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[1] The Chairs and their relevant Codes referred to in this report are listed in Appendix A.

[2] This submission has been prepared by the Code Compliance and Monitoring team (the Code team) at the Australian Financial Complaints Authority (AFCA) in its capacity as administrator and secretariat to code monitoring and compliance committees for the four industry Codes of practice listed in Appendix A.

[3] Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019 (FSRC Final Report).

The Role and functions of a Code Compliance Committee (CCC)

In the current structure of the Codes and in line with ASIC's guidance[4], the CCCs are independent of the industry Code owners and have clearly identified functions and powers to identify and address breaches of Code obligations.

Providing stewardship of the Code, CCCs help industry members to understand and comply with their Code obligations and identify areas of improvement. This results in better practices and continual improvement, both individually and across the industry. The CCCs are comprised of three members – an independent industry member, a consumer representative member and an Independent Chair. Together, the CCCs bring an enormous amount of experience and insight to the Codes enabling the CCCs to effectively discharge their many and varied obligations which include:

- Monitoring, reporting and enforcing Code compliance.
- Providing guidance on compliance.
- Collecting self-reported industry data and details of code breaches.
- Developing policies and guidelines in regard to administration of the Code.
- Agreeing to corrective measures and
- Undertaking targeted monitoring through own motion inquiries and desk-top audits.[5]

In addition to collecting self-reported industry and Code breach data, the CCCs also review possible code breach allegations that come directly from consumers, consumer advocates, AFCA or other external dispute resolution schemes or directly from the relevant industry association.

Robust governance arrangements and strong sanction powers are vital for the enforcement of all Codes. The CCCs support Commissioner Hayne's recommendation 4.10 that the sanctions power be extended to impose sanctions on a subscriber that has breached the applicable Code. As will be discussed later in this submission, this increase in sanctions power will ensure robust subscriber commitment and enable best practice and continuous improvement of the Codes.

The independent Chairs recognise the importance of their roles and that of their committees in providing both consumers and industry with a trusted monitoring program that aims to ensure compliance and applies appropriate sanctions when required. The Committees are committed to working with both industry and external stakeholders, including regulators and consumer advocates, on how best to implement the recommendations made by Commissioner Hayne so that changes work to lessen consumer confusion, meet best industry practice initiatives and continue to strengthen the self-regulatory Codes for the benefit of consumers and industry alike.

General Observations

As stated by Commissioner Hayne, for industry Codes to be more than mere public relations puffs, the promises made must be taken seriously[6]. The Chairs acknowledge the need for regular review and continual improvement of Codes to ensure they remain relevant and provide adequate protections for consumers. Robust governance arrangements that ensure independence and equip CCCs with appropriate powers to monitor the industry's compliance – and apply sanctions when necessary - are vital.

[4] ASIC Regulatory Guide 183, Approval of Financial Services Sector Codes of Conduct, March 2013.
[5] Recent Committee publications can be seen at Appendix B.
[6] FSRC Final Report, p. 12.

In summary, the Chairs' primary concerns are:

- The Codes currently hold subscribers to a higher standard than the law. The implementation of recommendation 1.15 may result in unintended, adverse consequences.
- In particular, carving out certain sections of each Code to be enforceable may result in degeneration of the worth of the 'non-enforceable' sections of each Code.
- The power of the Codes lies in influencing continuous improvement. The suggestion in recommendation 1.15 to pick some provisions that will be enforceable, and by implication to give lesser weight to non-enforceable provisions within the Codes, would threaten the benefits derived from that power.

The remainder of this submission references specific questions posed in the Consultation Paper.

What are the benefits of subscribing to an approved industry code?

Subscribing to an approved industry Code can bind subscribers to a higher set of standards than the law. As set out in ASIC's Regulatory Guide 183, Codes can deliver real benefits to both consumers and subscribers. As a living document, Codes can adapt over time to better reflect community standards and expectations and are able to be modified much more quickly than legislation.

From our knowledge and active experience, we highlight in particular the following benefits:

- Standards for subscribers are set by the industry itself and require more than compliance with the law.
- Clear promises are made between the subscriber and consumer representing real benefits to both parties.
- Gaps in the law can be addressed in a timely and flexible manner to better reflect community standards.
- The creation of greater fairness, honesty and transparency in dealings between the subscriber, consumers and small business.
- Codes can be updated faster in response to changing consumer expectations than is usually the case with financial services legislation.
- Continuous improvement is achieved through the monitoring and enforcement of the Code thereby ensuring subscribers are appropriately tested on and held to the Code standards and encouraged to adopt the necessary behaviours, either voluntarily or by use of Code sanctions.
- Increased consumer and small business confidence and trust in the industry sector through compliance with the Code.

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

The Chairs support the enforceability of all provisions in the Codes and do not believe that both enforceable and non-enforceable provisions should co-exist. The approach to enforceable Code provisions should be all or nothing.

However, should Ministers decide to implement only partial coverage of enforceable provisions, several issues arise that will need to be considered if industry codes are to contain some enforceable code provisions at the expense of others. These include:

1. The impact of enforceable provisions on the other non-enforceable provisions of the Codes.
2. The differences in the Codes.
3. Who will be responsible for the enforceable provisions?
4. What are the consequences of an enforceable code breach?

The impact of enforceable provisions on the other non-enforceable provisions of the Codes

It is our view that all sections of the Codes are equally important.

Effectively enacting some sections of the Code as legislation as opposed to others creates concern as to whether the non-enforceable sections become merely a desirable standard to be achieved if possible with no adverse consequences if that standard is not met. It is not apparent why one part of the Code should be more important than another. Indeed, dividing the various sections of the Codes into enforceable and non-enforceable provisions would demonstrably reduce the standards that are required to be met by some existing Codes.

This disparity around the importance of provisions may mean that basic consumer protections that may not be considered enforceable (for example, the compliance with claims timetables in relation to the general insurance industry) become difficult to enforce.

Commissioner Hayne puts the proposition that the provisions of the Codes that govern or are intended to govern the terms of the contract made between the customer and subscriber should become the enforceable provisions[7]. The entirety of the current Code of Banking Practice and the Customer Owned Banking Code of Practice are already contractually incorporated by reference into the written Terms and Conditions between the subscriber and the customer. Categorising the various provisions of these Codes into enforceable and non-enforceable would be a retrograde step.

Of concern is what will be lost in the spirit of the Codes if parts of the Codes become enforceable compared to others. It would not be unreasonable to anticipate that subscribers may adopt a legalistic 'black letter law' approach to both compliance and investigations which would go against the spirit of the Codes.

A further issue is the impact of enforceable provisions on a subscriber's willingness to self-report a breach. Subscribers may become less open to reporting any breaches of enforceable provisions or alternatively limit their focus and attention to only the enforceable provisions at the expense of other sections. This could result in poor outcomes for the consumer and not accurately reflect the actual breaches occurring in individual organisations or across the industry as a whole.

The differences in the Codes

Codes are specific to industry and can differ substantially.

For example, as indicated earlier, the entirety of the Banking and Customer Owned Banking Codes are already enforceable by reference in the contractual agreement between the customer and the subscriber. A customer can seek a remedy for a breach through internal dispute resolution (IDR), external dispute resolution (EDR) and taking a matter to court. If some provisions in either of those Codes were now to become non-enforceable, it would arguably be a backward step compared to what is currently in place.

In contrast to the Banking Code, the General Insurance Code of Practice 2014 expressly states that it is not incorporated into the contract of general insurance and does not create legal rights. Subscribers are, however, bound to comply with the Code obligations by way of a Deed of Adoption

[7] FSRC Final Report, p. 104.

entered into between the insurer, the Insurance Council and the independent Code Governance Committee.

Commissioner Hayne said that doubt occurs when trying to decipher which sections of the Codes can be relied on and subsequently enforced by individuals[8]. This doubt will only be exacerbated if some provisions become enforceable over others.

A preferable approach would be that the entirety of each Code becomes enforceable to ensure that a customer retains rights across all provisions of the Codes.

Who will be responsible for the enforceable provisions?

Consideration of the potential for confusion needs also to be given to which body would pursue the breach of an enforceable provision against a subscriber. It is not clear if this responsibility would fall to an oversight body (for example, the CCCs) or a regulator such as ASIC or some other body.

If this responsibility fell to the CCCs, the issue of resourcing would need to be explored. For example, if the CCCs were to impose a fine, it would need to be very large to influence a systemic offender. The CCCs do not have the resources to regularly litigate and large sanctions like this would be better placed with a regulator. Furthermore, turning CCCs into quasi-regulators would defeat the purpose of self-regulation designed to benefit consumers through driving industry improvements and voluntary industry best practice.

Recommendation 4.10 is relevant in this context. Extending the CCCs' sanctions powers may result in both ASIC and the CCCs having a shared responsibility to impose sanctions for a breach of the Code. How this would work in practice requires more understanding of what ASIC's role would be in relation to enforceable Code provisions.

Further, if the relevant body responsible for enforcing Code provisions is ASIC, how will ASIC know that a subscriber has breached an enforceable code provision?

A possible mechanism may be that it falls to the CCCs to investigate or determine if a subscriber has breached an enforceable provision in the first instance. If satisfied that the subscriber has done so (and the breach is significant), the CCCs could be required to report the matter to ASIC who may then seek enforcement and appropriate remediation for the affected customer or small business. Again, we do not encourage this as it is against the spirit of self-regulation and turns the CCCs into quasi-regulators.

Roles must be clearly set out to ensure all stakeholders are aware of their responsibilities and limitations in relation to the enforceable code provisions if they are created.

What are the consequences of an enforceable code breach?

It is not clear what the consequences of an enforceable code breach would involve.

In the Final Report, Commissioner Hayne stated that if a consumer was to elect to pursue a possible breach of the Code via EDR, they would be electing not to litigate through the courts, 'unless good cause is shown to the contrary[9]. Of relevance to this are what remedies will be available and whether these remedies differ depending on the section breached.

The size of the subscriber may also need to be taken into consideration when deciding on what remedy to apply. For example, industry participants vary widely and smaller subscribers will not have the same resources available within their organisations as exist in large subscriber organisations.

[8] FRSC Final Report, p.105.
[9] FSRC Final Report, p. 111.

What criteria should ASIC consider when approving voluntary codes?

The Chairs support in principle the approval of Codes by ASIC and strengthening the Codes through an approval process.

Consideration, however, must be given to the governance framework supporting a particular Code in addition to the provisions of the Code itself. This includes ensuring that members of an oversight body are independent and that the industry association provides an appropriate level of funding and resources to ensure that the oversight body and its secretariat (Code administrator) have the ability to discharge robust Code monitoring functions. To this end, ASIC should work cooperatively and closely with the relevant Committee to ascertain the level of resourcing required and ensure that the approval terms address these issues with the owner of the Code under consideration.

Industry and potential subscribers must be serious about the Code and value the independence of the CCC and the Code's administration. This must be demonstrated beyond just ASIC approval and extend to supporting the Code and its administration with adequate resourcing to support the ongoing effectiveness of the Code and not just the payment of lip service.

For the effective operation of each Code, the monitoring body should also be specifically required to provide ongoing feedback as to what areas are working well and any areas of the Code that require improvement. The monitoring body should also review implementation of agreed changes after an appropriate interval and, if these changes have not been made, subscribers should be required to account for their failure to make the agreed changes.

In addition to matters covered by RG 183, in the provision of approval, we consider that ASIC should also take into account the following matters:

- Whether approval of an annual work plan and required resources rests appropriately with the oversight body as opposed to the industry association.
- Whether the oversight body can recommend to the industry association termination of a subscriber's Code membership for serious misconduct or because of the imposition of a sanction. Further considerations would include what action the industry association would be required to take on receipt of this recommendation and further, how termination would work if membership is mandatory.
- Whether the oversight body is a contracting party to an organisation's proposed Deed of Adoption or a party to discussions with the industry association as to the suitability of the proposed subscriber.
- Whether the oversight body should be a contracting party to the outsourcing agreement between the code administrator (secretariat) and industry association.
- Whether the oversight body has the power to notify the industry association of gaps in the Code and areas that require improvement including governance arrangements.
- If the subscriber is an AFCA member, whether the oversight body can notify AFCA that the relevant subscriber (identified) has significantly breached the Code or that a sanction has been imposed. This information could be relevant to disputes coming before AFCA, given that AFCA can take into account codes of practice in decision making.
- Whether the oversight body should be able to report to ASIC on an identified basis those subscribers (who hold a relevant licence) that have significantly breached the relevant Code or were sanctioned.

- Whether each Code requires a subscriber, industry association and code oversight body to enter into a contractual agreement/deed of adoption to bind the subscriber to the terms of the Code and the oversight body's authority.

Should subscribing to certain approved codes be a condition of certain licences?

Yes. This would mean that participants who do not belong to the relevant industry association and/or do not currently subscribe to the code would be forced do so.

This approach would ensure consistency and fairness across the industry, benefit consumers and enable a fair and level playing field. It would also result in the effective monitoring of subscribers who may not previously have been subscribers to the Code.

What level of supervision and compliance monitoring for codes should there be?

We are of the view that a Committee that is independent from both the Code owner and Government should be responsible for the oversight and monitoring of Codes' compliance. The supervision and monitoring powers should be set out in the Codes.

To this end, each Committee should be appropriately resourced and recompensed to fully reflect the scope and responsibilities of the role – in particular, for the Codes covering the larger industry sectors, adequacy of resourcing to support and enhance compliance monitoring and investigations is key.

As is the current practice, information sharing should continue to occur between AFCA and ASIC.

The Committee should supervise the relevant industry's adherence to a Code, including:

- Investigating breach allegations reported by anyone (not just by a person who received the relevant services/product), including from AFCA and regulators (with a discretion resting with the oversight body whether to investigate).
- Working with a subscriber to identify and settle on appropriate corrective action to reduce the likelihood of a recurrence.
- Monitoring implementation of corrective actions in response to non-compliance.
- Conducting monitoring activities to assess the level of compliance, through various mechanisms (which should be at the discretion of the oversight body) including on-site visits.
- Possessing the authority to identify conduct as a significant breach.
- Identifying gaps in the Code or areas that require improvement.

The sanctions power as set out in recommendation 4.10 should be applied broadly and include the ability to publicly name a subscriber when appropriate. Remediation of breaches should also become binding on subscribers to prevent recurrence.

Should code provisions be monitored to ensure they remain relevant, adequate and appropriate? If so, how often should these reviews be conducted?

Should there be regular reviews of the codes? How often should these reviews be conducted?

Codes' provisions should be monitored to identify gaps in the Code and address any areas that require improvement, including in the governance framework. This monitoring role is different from an independent review and is a role the CCCs could conduct and in fact is currently part of the remit for some of them in their Code and Charter obligations.

As timeliness is an important factor to ensure prompt consumer protection offered by a Code, there should be a capacity to amend Codes in a timely way in response to emerging risks or the need to make improvements based on experience, as opposed to simply waiting for an independent review after, say, a number of years have passed.

We consider that all reviews, irrespective of their cause, should be conducted by an appropriately qualified and independent expert, with a specific remit to engage in genuine and deep consultation with all relevant stakeholders and to receive submissions from all interested parties.

Key stakeholders should include, for example:

- ASIC (or the appropriate regulator)
- The oversight body
- The industry association
- Subscribers and
- Consumer advocates or their representative bodies.

The Chairs support regular reviews of Codes to ensure they remain relevant and achieve their intended purpose. In the CCCs experience, three years is an appropriate time between reviews. Concerns in relation to the Code's effectiveness, however, should be communicated freely and openly to the owner of the Code and its Regulator at any time.

The timing of any review should otherwise be flexible according to need as specific issues may justify ad hoc reviews.

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

The Chairs agree that deterrence is a vital factor in ensuring a robust and trusted Code that includes effective enforcement and sanctions. More effective and timely sanctions should be built into the Codes and recommendation 4.10 goes a long way in achieving this.

Commissioner Hayne suggests that the enforcement provisions and remedies in Part VI of the CCA be used as a model for the enforceable code regime. The regime includes provisions relating to

- pecuniary penalties;
- injunctions;

- damages;
- non-punitive orders, including community service orders, probation orders, disclosure orders and corrective advertising orders;
- punitive orders relating to adverse publicity;
- disqualification from managing a corporation;
- other compensation orders; and
- enforceable undertakings.[10]

As stated in the Consultation Paper, some of the above remedies, such as damages, may be pursued by a consumer (or the ACCC on behalf of a consumer) and other orders may instead be pursued by the ACCC as part of a broader enforcement action, such as disqualification.

It can be difficult to compare the financial service industry to other industries due to its sheer size and nature. Consideration needs to be given to ASIC's approach in deciding what kind of enforcement action it will take when a contravention of an industry code occurs. For example, it should be clear what kind of code breach will result in a pecuniary penalty or an enforceable undertaking and whether individuals responsible for breaches will also be pursued.

It is also unclear as to how these enforceable provisions would operate in practice with the relevant Committees' new sanctions power under Recommendation 4.10.

The recommendation sets out that the Financial Services Council and the Insurance Council of Australia should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice respectively to empower (as the case requires) the Life Code Compliance Committee or the General Insurance Code Governance Committee to impose sanctions on a subscriber that has breached the applicable Code. Currently, Committees can only apply a sanction to a subscriber if the latter have failed to correct a Code breach.

The Chairs support this recommendation but are concerned that the remit of these new powers may be limited, or their purpose removed if it was to become ASIC's task to pursue and enforce Code breaches. Confusion is created as to whether it lies with the Committee, or ASIC, to apply sanctions and penalties to subscribers for a breach of an enforceable code provision.

The answers to these issues must be consistent with the nature of a Code, its role and ownership, the overall achievement of the Code's objectives and the avoidance of confusion.

Should only egregious, ongoing or systematic breaches of the enforceable provisions of an industry code attract a civil penalty?

The Consultation Paper poses that rather than providing for individual enforceable code provisions to be subject to a civil penalty, as is the case in the CCA model, it may instead be preferable that there be a general civil penalty where there are systemic or egregious breaches of a Code, and that this penalty would be consistent with the amount currently set out in the Corporations Act.

Given the practicality of litigating breaches and the time and resources required, the Chairs consider that the preferable approach appears to be to identify breaches that are egregious, ongoing or systemic in nature before they attract a civil penalty. This model could work in conjunction with their ability to apply sanctions for individual or systemic breaches in appropriate circumstances.

[10] CCA, ss 76, 80, 82, 86C, 86D, 86E, 87 and 87B respectively.

Conclusion

The Independent Chairs of the Committees support the continuation of industry self-regulation within a robust framework of effective enforcement and a range of sanctions that reflect the seriousness of particular individual or systemic breaches by Code subscribers.

As for the introduction of enforceable provisions within Codes, the Chairs are concerned that if some of the provisions of Codes are identified as enforceable, but others are not, then a real risk will arise that attention will be focussed by subscribers on the enforceable provisions at the expense of the non-enforceable provisions. This outcome would not be good for consumers, nor would it achieve the aim of driving better industry practice through compliance with all Code provisions. Accordingly, it is the view of the Chairs that the Codes should not have a mixture of enforceable and non-enforceable provisions.

In the same way that the Banking Code of Practice and the Customer Owned Banking Code create a contractual relationship between the subscribers and their customers, consideration could be given to having the same contractual relationship between subscribers and customers in all other Codes as an alternative to development of enforceable provisions in Codes.

Finally, the Chairs would welcome the opportunity to meet with the Department of Treasury representatives to discuss the issues raised in the Consultation Paper. With such a significant potential change to the Codes, the impact of recommendation 1.15 must be fully understood before deciding on whether or not to implement it.

If you have any questions about this submission or wish to make arrangements to meet, please contact the General Manager of Code Compliance and Monitoring, Sally Davis, on 03 9613 7341 or sdavis@codecompliance.org.au

Appendix A

List of current Chairs and the respective Codes.

Code of Practice	Owned By	Code Committee	Committee Chair
Banking	Australian Bankers' Association (ABA)	Banking Code Compliance Monitoring Committee (CCMC)	Mr Christopher Doogan AM – Independent Chair of the CCMC
General Insurance	Insurance Council of Australia (ICA)	General Insurance Code Governance Committee (CGC)	Ms Lynelle Briggs AO – Independent Chair of the CGC
Customer Owned Banking	Customer Owned Banking Association (COBA)	Customer Owned Banking Code Compliance Committee (COBCCC)	Ms Jocelyn Furlan – Independent Chair of the COBCCC
Life Insurance	Financial Services Council (FSC)	Life Insurance Code Compliance Committee (LCCC)	Ms Anne Brown – Independent Chair of the LCCC

Appendix B

List of recent publications of the Committees.

Code of Practice	Recent inquiries
Banking	Banking Code Compliance Monitoring Committee's Annual Report 2017-18 Year in Review (November 2018). Compliance with the Code of Banking Practice – Bank's Annual Compliance Statement Results 2017-18 (November 2018). Assisting customers in financial difficulty (2018).
General Insurance	General Insurance in Australia: 2017-18 and current insights (April 2019). General Insurance Code Governance Committee report 'How insurers handle consumer complaints' (January 2019).
Customer Owned Banking	Compliance with direct debit cancellation obligations disappointing (March 2019). Annual Compliance Report 2017-18 from the Customer Owned Banking Code Compliance Committee (November 2018).
Life Insurance	Annual Industry Data and Compliance Report 2017-18 (March 2019). Life Code Compliance Committee Annual Report 2017-18 (September 2018).