16 April 2019

Manager
Financial Services Reform Taskforce
The Treasury
PARKES ACT 2600

By email: enforceablecodes@treasury.gov.au

Dear Manager,

Enforceable code provisions

COBA appreciates the opportunity to contribute to the development of legislation to implement of Financial Services Royal Commission Recommendation 1.15 *Enforceable code provisions.*

Key points

Action on recommendation 1.15 should focus tightly on meeting the Royal Commission's objectives of:

- **clarity and certainty for customers about which provisions of industry codes can be enforced by individuals, and**
- **retaining the self-regulatory industry codes regime.**

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has $118 billion in assets, 10 per cent of the household deposits market and 4 million customers. Customer owned banking institutions account for around three quarters of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition, choice and market leading levels of customer satisfaction in the retail banking market.

Our sector's ownership model is a fundamental distinguishing feature for our member institutions compared to investor owned banks. Customer owned banking institutions are concerned with outcomes for customers rather than outcomes for a separate group of shareholders.

As noted by the Interim Report of the Royal Commission,

> "the interests of shareholders are not the same as the interests of customers. It may be that they are opposed. Shareholders will see what happens at the entity only through the lens of dividend and share price. Some shareholders will take a short term view of both dividends and share price, others may have a longer term view. But customers are concerned only with how the entity's conduct affects them in their dealings with the entity."

Customer-owned banking institutions have a different purpose than their listed bank peers but they are regulated in the same way, including under the Banking Act, the Australian Financial Services Licensing regime, the Australian Credit Licensing regime and the Anti Money Laundering regime.

Most customer-owned banking institutions are signatories to the Customer Owned Banking Code of Practice (COBCOP). There are 63 COBCOP subscribers. The COBCOP is currently under review by Phil Khoury, Principal of cameron.ralph.khoury.

The Customer Owned Banking Code Compliance Committee monitors compliance with the COBCOP, investigates allegations of breaches of the COBCOP and may impose sanctions on a code subscriber.

As Code owner, COBA may amend the Code from time to time. Before doing so, COBA will consult with Code subscribers, ASIC, the Code Compliance Committee, and other industry and external stakeholders as COBA determines.

Clarity and certainty

The Royal Commission was concerned that there may be doubt about the extent to which obligations contained in industry codes can be relied on and enforced by individuals. Uncertainty of this kind was "highly undesirable".

The Royal Commission saw it as necessary to give certainty and enforceability to key code provisions that govern the terms of the contract made between the financial services entity and the customer or guarantor. The Royal Commission wanted customers to be able to elect whether to enforce any breaches of these provisions through existing internal or external dispute resolution mechanisms or through the courts.

It is important to emphasise that the Royal Commission's focus is on the provisions that govern the terms of the contact between the bank and the customer.

The Royal Commission saw ASIC's role as to review the provisions put forward by industry to assess whether industry has identified the right provisions and whether those provisions are expressed clearly and unambiguously.

The Royal Commission does not recommend making ASIC the creator and enforcer of code provisions. The Royal Commission supports the banking industry continuing to develop self-regulatory codes over time.

It follows that remedies to breaches of enforceable provisions should be limited to those that relate to enforcing the contract, such as injunctions and damages.

Treasury's consultation paper notes that under the CCA, a code may contain a civil penalty provision, which is enforceable by the ACCC. COBA is strongly opposed to civil penalties applying to self-regulatory codes. Applying statutory penalties enforceable by ASIC to code provisions would utterly transform the current banking code regime and that is an outcome that is not envisaged or recommended by the Royal Commission.

Further detail in response to the questions in Treasury's consultation paper is provided in the Attachment.

Regulatory complexity

COBA supports Treasury's comment in the consultation paper that it is important that industry codes not allow existing industry participants to create barriers to entry for new industry participants, or otherwise hinder competition and efficiency in the market.

Policymakers should bear in mind that the implementation of recommendation 1.15 is one of a wide range of changes to the banking regulatory framework flowing from the Royal Commission and other processes.

As noted in the Royal Commission's Interim Report, regulatory complexity imposes burdens on business, existing law is labyrinthine and overly detailed, and adding any new layer of law or regulation will add a new layer of compliance cost and complexity.

Policymakers must recognise that excessive regulatory costs damage competition and consumers ultimately pay the price.

Legislative and regulatory responses to the Royal Commission should not go beyond what the Royal Commission recommended.

The RBA, in its latest Financial Stability Review[1], noted that the Royal Commission has laid out a path for fairer financial intermediation, which will contribute to a more resilient financial system.

> "But the large degree of change required by some institutions raises the significant challenge of managing the implementation in an effective and timely manner. Further, it raises the risk that the process of addressing these challenges distracts banks from managing other risks."

An egregious example of over-reach in responding to the Royal Commission is the decision by the Government and the Opposition to join forces to ram through Parliament a massive expansion of the financial product design and distribution obligations (DDO) regime.

Last minute amendments to the DDO regime broadened the scope of the DDO beyond products subject to specific disclosure requirements to all financial products regulated under the ASIC Act, including credit products. This means the DDO will apply to all deposit, investment and insurance products and also to credit products such as home loans, personal loans and credit cards.

Both the Government and the Opposition claimed the Royal Commission supported the DDO expansion but the Royal Commission made no such recommendation. The Government in its response to the Royal Commission said it would "carefully consider" how to implement expanding the DDO to credit but there has been no such public assessment or regulatory impact statement.

The original recommendation for the DDO regime was made by the 2014 Financial System Inquiry but the FSI did not recommend applying the regime to home loans and other consumer credit products. The FSI's recommendation for the introduction of a DDO regime called for a "targeted" obligation aimed at risky and complex financial products with different treatment for "simple, low-risk products such as basic banking products".

We refer to the DDO example to highlight the need to keep the response to Recommendation 1.15 tightly focused. If you wish to discuss any aspect of this submission please contact Luke Lawler on 02 8035 8448.

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer

[1] Financial Stability Review, RBA, 12 April 2019

ATTACHMENT: Consultation Paper Questions

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

   As noted in paragraphs 183.1-4 of ASIC Regulatory Guide 183 *Approval of financial services sector codes of conduct,* industry codes of conduct play an important part in how financial products and services are regulated in Australia. Codes should improve consumer confidence in a particular industry or industries. Where approval by ASIC is sought and obtained, it is a signal to consumers that this is a code they can have confidence in.

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

   The key issues that need to be considered are ensuring that customers have clarity and certainty about which provisions of industry codes are enforceable while retaining the voluntary codes regime which allows for self regulation, flexibility and evolution of codes.

   A further important issue is ensuring that implementing a regime where a breach of an enforceable code provision will constitute a breach of the law does not create confusion about, and overlap with, actual laws. A potential example of such overlap is the obligation imposed by the Corporations Act and the National Consumer Credit Protection Act on AFS and credit licensees to do all things necessary to ensure that financial services and credit activities are provided efficiently, honestly and fairly.

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

   The criteria outlined in sections C and D or ASIC Regulatory Guide 183. The Royal Commission also suggests that after receiving a proposal from industry, ASIC should review the proposed enforceable code provisions put forward by industry.

   > "ASIC's role must go beyond being the passive recipient of industry proposals. Rather, ASIC should assess whether industry has identified, from the provisions contained in the code, those provisions that should be made enforceable code provisions. In undertaking this task, ASIC should have particular regard to the need to ensure that all terms governing the contract made or to be made have been identified. ASIC should also assess whether the proposed enforceable code provisions are expressed clearly and unambiguously, so that they are capable of being enforced through the courts. ASIC should continue to engage with industry until any defects are remedied."

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

   No, this would overturn the principle of self regulation.

   Any consideration of a regime where the Government would be able to prescribe a voluntary financial services industry code should take into account:
   - the existing code environment (e.g. in banking there are two codes – BCOP and COBCOP)
   - whether or not there is a clear risk of significant consumer detriment, and
   - avoiding creating barriers to entry for new industry participants or otherwise hindering competition and efficiency in the market.

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

   See answer to Question 4.

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

   The Royal Commission says consideration of whether it is desirable to establish and impose a mandatory industry code should follow the failure of industry to put forward its proposed enforceable code provisions in a timely manner.

Importantly, the Royal Commission recommendation for legislation to provide for mandatory codes is not for standing mandatory codes but only as a contingency "so that the relevant mechanisms are in existence should they need to be exercised."

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?*

   The key factor is whether or not industry has failed to put forward proposed enforceable provisions in a timely manner.

   More broadly, factors to be considered are:
   - protecting the principle of self regulation.
   - protecting diversity in the market (e.g. in banking there are two codes – BCOP and COBCOP)
   - whether or not there is a clear risk of significant consumer detriment, and
   - avoiding creating barriers to entry for new industry participants or otherwise hindering competition and efficiency in the market.

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

   This is a matter to be determined in the context of regular reviews of industry codes, noting the Royal Commission's comment about the "force" of the ASIC Enforcement Review Taskforce recommendation that the code monitoring body, comprising a mix of industry, consumer and expert members, should be required to monitor the adequacy of the code and industry compliance with it over time, and periodically report to ASIC on these matters.

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. This should be done by the owner of the code, the code compliance committee and by periodic independent reviews of the code.

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

    Yes. ASIC Regulatory Guide 183 suggests an independent review every three years.

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?*

    Remedies to breaches of enforceable provisions should be limited to those that relate to enforcing the contract, such as injunctions and damages. Remedies should be reasonable and proportionate.

    In addition to a customer taking action to enforce a code provision, the COBCOP Code Compliance Committee may impose sanctions on a Code subscriber, including:
    - issuing a formal warning
    - requiring the Code Subscriber to train its staff on the Code
    - requiring the Code Subscriber to place corrective advertising
    - publicly naming the Code Subscriber as non-compliant with the Code, and
    - advising COBA of the Code Subscriber's non-compliant status, and/or failure to undertake a required course of action.

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 Royal Commission does not recommend making ASIC the creator or enforcer of code provisions. The Royal Commission supports the banking industry continuing to develop self-regulatory codes over time.

ASIC's role is to review the provisions put forward by industry to assess whether industry has identified the right provisions and whether those provisions are expressed clearly and unambiguously.

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

    See answer to Question 11.

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

    Civil penalties should not apply to self-regulatory codes. Applying statutory penalties enforceable by ASIC to code provisions would utterly transform the current banking code regime and that is an outcome that is not envisaged or recommended by the Royal Commission.

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

    The Royal Commission says enforceable code provisions should specify that resort to EDR "will be treated as an election not to pursue court remedies unless good cause is shown to the contrary."

    This contrasts with AFCA's Rule A.15.4: "If a Complainant does not accept a Determination, the Complainant is not bound by the Determination and may bring an action in the courts or take any other available action against the Financial Firm."

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 Royal Commission says "it should ultimately be left to the court to determine whether steps taken outside that forum should lead to the preclusion of court proceedings in any particular case."

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

    This would be a reduction in consumer rights compared to the current regime.