12 April 2019

Manager
Financial Services Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

Submitted by email: enforceablecodes@treasury.gov.au

Dear Sir/Madam

Enforceability of Financial Services Industry Codes

Thank you for providing the Insurance Council of Australia (ICA) with the opportunity to provide feedback on the Enforceability of Financial Services Industry Codes Consultation Paper (the Consultation Paper).

The ICA is the representative body of the general insurance industry in Australia. Our members represent more than 90 per cent of total premium income written by general insurers. ICA members, both insurers and reinsurers, are a significant part of the financial services system.

ICA members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property and directors and officers insurance).

The ICA understands that the Consultation Paper is the first step in establishing the legislation that will give effect to the recommendation from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) regarding enforceability of financial services industry codes.

The ICA is committed to working with its members to address the Royal Commission's recommendations in order to improve outcomes for consumers and we will take into account the Royal Commission recommendations as we seek to revise the General Insurance Code of Practice (the Code).

At its core, we believe the new approval regime and regulatory framework should strive to preserve the benefits of self-regulation; clarify the enforcement and remedy framework with regards to code breaches; clarify the code monitoring framework; and maintain the flexibility for industry codes to adapt to changing requirements. In essence, the new regime should seek to enhance consumer outcomes by simplifying, and not complicating, the framework within which industry codes operate.

The existing model of self-regulation has seen industry work in extensive consultation with, and be held accountable to, consumer representatives and regulators. For this reason the ICA also believes that the prescription of mandatory industry codes by Government should

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be a last resort measure where industry self-regulation has failed. Otherwise, as we detail later in our response, we consider such a step would fundamentally undermine the benefits of self-regulation.

The Consultation Paper sets out questions that go to the heart of a new approval regime for financial services industry codes. In this regard, the ICA strongly encourages Treasury to consider the consultation on insurance claims handling alongside the enforceability of industry codes. Together, they provide an opportunity to undertake a comprehensive review of the regulatory environment in which insurers will operate.

Both Government and industry have been presented with a chance to strengthen the role of financial services industry codes of practice and establish their place within the overall regulatory framework. We must be mindful to not create a duplicative and complex regime. We look forward to working with Treasury on this.

Attached are our responses to each of the questions posed in the Consultation Paper. If you wish to discuss any of the matters we have raised, please do not hesitate to contact Fiona Cameron, General Manager Policy, Consumer Outcomes on 02 9253 5132 or fcameron@insurancecouncil.com.au

Yours sincerely

Robert Whelan
Executive Director and CEO

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

The ICA has, as a condition of its membership, a requirement that members who provide products covered by the general insurance Code must become Code subscribers. Other industry participants may also subscribe and the ICA encourages all general insurers to do so. As the peak body for the general insurance industry, the ICA believes that it is vital for consumer confidence in our industry that our members agree to uphold a set of publically committed standards as provided for in the Code.

In February 2017 the ICA announced a review OF the Code. As part of the review process the ICA recommended that the Code be submitted to ASIC for its approval. It was the ICA's intention that having the Code approved by ASIC under its Regulatory Guide 183 - Approval of financial services sector codes of conduct (RG 183) could further enhance public confidence in our industry and ensure the Code remained a benchmark for industry self-regulation.

The ICA understands that the ASIC approval regime is now subject to change following the recommendations from the Royal Commission. We remain of the view that ASIC approval of codes could be beneficial in providing consumers with the assurance that the Code has met the approval of an independent authority. Nonetheless, the ICA submits that the new approval regime should not counteract the benefits of self-regulation, which include the ability to:

- respond quickly to issues as they arise;
- tailor provisions to specific industry and customer needs;
- encapsulate industry norms and standards in a way that a Government prescribed and mandated code would not be able to achieve;
- improve the provision of services above legal requirements;
- set behavioural standards for the industry; and
- reflect community expectations in a dynamic way that regulation and the law may not.

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

The ICA supports the views expressed by Commissioner Hayne that the promises made by industry participants in their codes must be made seriously.[1] It is the Commissioner's view that enforceability is the mechanism to provide for this.

In our response to this question we identify four key issues that need to be considered for financial services industry codes to contain enforceable code provisions. These are:

1. The implications of having a 'two-tiered' Code;
2. The rights of both consumers and regulators to enforce the existing Code;
3. The implications for drafting and presenting the Code in a consumer friendly format; and
4. The principles or requirements that will determine which provisions are enforceable.

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[1] Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019 (FSRC Final Report), pg 12

1. Two-tiered Code

A key issue for consideration is the practicality and implications of having both enforceable and non-enforceable Code provisions sit alongside each other. The Commissioner has proposed a regime whereby the onus is on the industry to identify enforceable provisions, that is provisions that the industry say govern the terms of the contract made between the financial services entity and the customer. However, there will still be a role for flexible 'non-enforceable' provisions, that is, provisions that reflect enhanced industry standards and changing community expectations but not identified as enforceable by statute. It is anticipated that these provisions will still form part of the Code which is overseen by the independent code governance body. As the Commissioner stated:

> *'I expect that the non-enforceable provisions of industry codes will continue to play an important role in setting standards of behaviour within those industries over time.'*[2]

The potential result could be a two tiered Code, with certain provisions deemed enforceable, and other provisions deemed non-enforceable. This has the potential to add a layer of complexity to the Code and may have broader ramifications when it becomes necessary for the Code to be updated. It may be that the enforceable provisions are not able to respond as quickly as the non-enforceable provisions, potentially resulting in parts of the Code unaligned with enhanced consumer expectations and standards.

A two-tiered Code also presents implications for the monitoring of the Code. It is important that the monitoring and enforcement framework does not lead to two bodies investigating the same matter. To prevent this, the ICA suggests that under the new regime the Code Governance Committee (CGC) maintains responsibility for monitoring compliance with the Code. However, in cases of systemic breaches, egregious offences or breaches of the enforceable code provisions the CGC should refer to ASIC for ASIC to investigate further.

2. Enforceability of the existing Code

The ICA also believes that careful consideration must be given to the existing legislative framework and the current rights that consumers and regulators have to enforce the Code. It is arguable that some aspects of the Code are already enforceable by ASIC, the Australian Financial Complaints Authority (AFCA) or the courts. For example, a significant breach of clause 4.4 of the Code which requires the insurer's sales process and the services of its employees and authorised representatives to be conducted in an efficient, honest, fair and transparent manner, could also be a significant breach of Section 912A (1) of the *Corporations Act 2001* which requires financial services to be conducted honestly, efficiently and fairly.

The ICA suggests that before the new code approval regime is established, further thought must be given to how provisions can be enforced at present by both consumers and regulators, with a view to ensuring duplicative regulatory regimes and penalties are not created. This will ensure that when the enforceable provisions are determined under the new

[2] FSRC Final Report, pg 11

approval regime, they will sit within a simple and clear regulatory framework that operates more efficiently.

3. Drafting enforceable code provisions

Commissioner Hayne commented that:

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.'[3]

While the ICA would seek to ensure that the enforceable Code provisions are expressed in this manner, it is likely that the enforceable Code provisions would need to be drafted with careful precision similar to how legislation is crafted, as a breach of these provisions will be a 'breach of the law'. This may cause some discrepancies in style between enforceable and non-enforceable code provisions.

4. Determining which provisions are enforceable

The ICA also believes there should be greater clarity around what ASIC will take into account when determining whether enforceable provisions have been correctly identified. Currently, the only indication is Commissioner Hayne's comments that ASIC:

> '*should have particular regard to the need to ensure that all terms governing the contract made or to be made have been identified.*'[4]

The ICA would welcome the development of a Regulatory Guideline so that industry and other stakeholders understand which types of provisions ASIC will expect to be enforceable. This would make the process of reviewing enforceable code provisions more efficient. ASIC should also give consideration as to whether or not it is more appropriate for a provision to sit within legislation as opposed to a code of practice.

A potential criteria for determining enforceable code provisions could require an assessment as to whether the identified provision governs the term of the contract, and whether a breach of the provision is likely to result in a significant level of harm to the consumer. While the criteria will need to be further refined, such a threshold should assist with identifying the type of provisions the Commissioner foreshadowed. Further, it would exclude those provisions that drive granularity of process.

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

Under the current regime RG 183 specifies the relevant criteria for codes to be approved. The ICA believes that these remain appropriate. Under the new regime, additional guidelines will be needed that give consideration to:

- the operation of both enforceable and non-enforceable provisions;
- existing legislation and enforceability mechanisms to ensure there is no unnecessary overlap; and

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[3] FSRC Final Report, pg 110
[4] FSRC Final Report, pg 110

- the mechanism for review and amendment of an approved code particularly when changes are needed outside of a formal review process.

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

As noted in the Consultation Paper, a voluntary code is only binding on the entities that have subscribed to it. A mandatory code is a compulsory subscription for members of the industry. Other than this difference, they are the same and both may contain enforceable provisions. With this in mind our points made in response to this question similarly apply to question 6 below.

A key concept for the ICA is that the Code maintains its status as an industry driven document that can harness the benefit of collective knowledge and drive positive change for consumers. The ICA firmly believes that self-regulation plays an important role within the broader regulatory landscape and that this must be preserved. The current process for drafting a Code is robust and involves extensive consultation with, and accountability to, a variety of stakeholders including consumer representatives and regulators. Phil Khoury noted this robust process in his independent oversight report which followed the release of the Interim Report into the Code Review. He stated that the:

> *'…ICA's approach to stakeholders in the early stages of the Review has been very open and supportive of obtaining broad input. I understand that the ICA was generous in providing information, answering questions and providing extensions of time.'*[5]

It is our view that for the general insurance industry, it would not be necessary for the Government to prescribe our Code. We have a well-tested process for working with all stakeholders to review and update the Code. We consider that it would only be necessary in the most extreme of situations for the Government to prescribe a voluntary financial services industry code. In such circumstances the Government should consider if an industry code is the most suitable mechanism for resolving the problem and whether the matter is best addressed through legislation.

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

The ICA agrees with the principle that participants of the same industry should subscribe to their relevant industry code. This encourages a level playing field and would ensure that all industry participants are required to meet the standards of their code and all would be subject to the penalties attached to a code breach.

There may however be unintended consequences by trying to achieve this principle through licence conditions. In the case of general insurance, the licence condition would have to be sufficiently restricted to prevent other insurers such as medical indemnity insurers being required to adopt the Code. The Code has not been written for such business models and would not be fit for purpose. In addition, consideration would have to be given to those entities that provide financial products under an arrangement with an AFS licensee or those that distribute wholesale products only. Such groups are not required to hold an AFS licence.

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[5] Phil Khoury Independent Oversight Report – General Insurance Code of Practice, February 2018, pg 3

If subscription to a code became a licence condition, it would also be important to clarify that a breach of the code would not automatically be considered a breach of licence. Except in the most egregious of circumstances, breaches of both enforceable and non-enforceable code provisions should be dealt with according to the appropriate remedy.

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

The points noted in response to question 4 are applicable here.

General insurance currently operates within a framework of consumer protection law which include the *Corporations Act 2001*, the *Insurance Contracts Act 1984*, the *Australian Securities and Investments Commission Act 2001* and the *Competition and Consumer Act 2010* (CCA). When it is apparent that the market has failed in a particular way, the ICA agrees that it is appropriate for the Government to intervene to change the law as required. While it is noted that mandatory codes are developed in consultation with industry, there is a real risk that Government prescribing a code could undermine the benefits of self-regulation.

In his comprehensive 2012 review into the Code, Dr Ian Enright noted in his Final Report several advantages to self-regulation. He wrote that:

> *'There is a good role for self-regulation in general insurance. It works best to join seamlessly the best legislation with the best market practice. It cannot substitute for either. Its benefits are harnessing the enthusiasm and pride of the industry to develop and test best practice and controls to produce agile, flexible, quick and cost-effective implementation within a framework of effective control, accountability and sanctions.'*[6]

The ICA is concerned that if the Government were to prescribe a mandatory, or voluntary, industry code, this would erode the benefits of self-regulation, as noted above, and blur the existing regulatory landscape.

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?

In order to preserve the benefits of self-regulation, the ICA believes that the Government should only impose a mandatory code on an industry in the most exceptional of circumstances. While important, the timely provision of enforceable code provisions to the regulator can not be the sole criteria. Optimally, the Code develops in an iterative and highly consultative environment. In addition to this, the approval regime will be new for both industry and the regulator. In this regard, other factors should be considered by Government when determining if a code should be imposed. It is the ICA's view that intervention would only be appropriate where there has been a complete failure by an industry to attempt to develop a code in good faith.

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[6] Dr Ian Enright, General Insurance Code of Practice Independent Review 2012-2013, Final Report, p46

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

Under the current Code, primary responsibility for supervision and compliance monitoring is undertaken by the CGC, with ICA members required to report compliance breaches to the CGC. In addition, any member of the public can report breaches of the Code to the CGC. The CGC is also empowered to report significant breaches of the Code to ASIC.

Under the new regime, ASIC may be empowered to undertake supervisory and compliance monitoring activities with regard to the approved enforceable provisions. The ICA's primary concern is that the delineation between the two supervisory bodies is clear, to avoid inefficient duplication. We suggest that the CGC maintains overall responsibility for monitoring compliance with the Code, however, where there is evidence of systemic or egregious breaches of the Code, the CGC should refer these matters to ASIC for their investigation. An investigation by ASIC should preclude a CGC investigation to prevent two enforcement bodies investigating the same matter.

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?

The ICA agrees that code provisions should be monitored to ensure they remain relevant, adequate and appropriate. Under the current Code, the CGC is empowered to provide quarterly reports to the board of the ICA which include recommendations for Code improvements as a result of its monitoring and enforcement activities. The new Code will also provide for independent reviews to occur every three years, which will mean that the Code is regularly reviewed to remain relevant. Additionally, the flexible nature of the Code means that the Code can be changed quickly, outside of the official Code review period, if urgent changes are needed. For example, after the 2010-11 season of natural disasters (most notably the Queensland floods and Cyclone Yasi) feedback from consumers was taken into account and the catastrophe provisions in the Code were improved and updated.

Under the new regime, while ASIC will be responsible for approving enforceable Code provisions, the ICA suggests that the CGC maintains responsibility for monitoring compliance with the Code.

As an industry owned document the ICA believes that, ultimately, it is the responsibility of the industry to seek and take into account feedback from ASIC, the CGC and consumer representatives on the effectiveness of the Code and to make changes to the Code as they are required.

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

RG 183 currently requires that codes be independently reviewed at maximum intervals of three years. The ICA agrees with the requirement for regular independent reviews. Since 1994 the Code has been reviewed four times, with a fifth review underway, and has had specific provisions updated outside of a formal review process.

The need for regular reviews must be balanced with the need for industry to implement new Code standards, and then for those standards to be monitored over time to ascertain their

effectiveness. In this regard the ICA suggests that the Code should be reviewed no less than three years after the adoption date of the previous changes or as required by industry.

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?

At this stage the ICA does not believe that remedies in addition to those proposed are required. Instead, as is discussed below, clarification of the existing enforcement provisions and remedies should be undertaken before additional measures are implemented.

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?

At present, a breach of the Code may constitute a breach of the law. For example the complaints standards within the Code must reflect ASIC's Regulatory Guide 165 which is mandatory for AFSL holders to comply with under the Corporations Act.

There currently exist remedies accessible by ASIC or determined by the courts or AFCA which include the ability to fine and award damages both compensatory and punitive. The ICA agrees that the remedies available for breach of enforceable code provisions should be made clear. In the first instance the existing legal arrangement should be clarified. Once this has been undertaken it can be determined if there are any gaps, and if a revised model is appropriate.

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

Currently, the provisions of the Code do not form part of the contract between the insurer and the customer. The ICA agrees with the Commissioner's recommendation that once ASIC has approved the enforceable Code provisions consumers will have the right to elect to pursue remedies via internal dispute resolution (IDR), external dispute resolution (EDR) or the courts but that an election to go to EDR precludes court action unless good cause is shown.

As a matter of fairness, the ICA agrees that its members should not be exposed to liability twice for the same breach of the Code - i.e. by the courts and by AFCA. In addition, ASIC should not seek to prosecute in respect of the same breach if a customer has commenced proceedings.

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

If civil penalties are to apply, the ICA agrees that only egregious, ongoing or systemic breaches of the enforceable provisions of an industry code should be punishable by civil penalty. These remedies would be targeted at the provisions deemed enforceable, and not available for procedural breaches, for example time frames.

If ASIC decides to commence proceedings for a civil penalty for an egregious or ongoing breach of an enforceable code provision, this should preclude the CGC from applying a

penalty for the same breach. In broader terms, consideration should also be given to the enforcement provision and remedies listed in Part VI of the CCA and whether they are appropriate for an industry code of practice – for example the utility of community service orders and probation orders.

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

The ICA supports the role of AFCA as an independent, impartial dispute resolution body. Currently, while financial service providers are bound by AFCA's decisions, consumers can choose to take the dispute to court.

The ICA agrees with the Commissioner's proposal that where there is a breach of an enforceable Code provision, the customer can choose to enforce the breach through existing IDR or EDR mechanisms or through the courts. While use of IDR would not constitute an election about future action, an EDR will be treated as an election not to pursue court action unless good cause is shown.

While in the majority of circumstances a determination from AFCA should preclude further court proceedings, there may be certain situations where further court proceedings are necessary. Such circumstances would have to be limited to cases of particular significance where an AFCA determination has far-reaching consequences and detriment for either the consumer or the financial service provider. For example, if an AFCA determination is a significant divergence from the law. In order to provide certainty to both consumers and financial service providers, court proceedings may be necessary. The court decision should have effect over the AFCA determination, including any compensation awarded from AFCA in the initial decision.

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 view expressed by the Commissioner suggests that for enforceable code provisions only, unless good cause is shown, electing an EDR mechanism should be treated as an election to not pursue court remedies. As an independent EDR body the ICA believes that, in general, a determination by AFCA should preclude further court proceedings unless in significant and highly consequential disputes. In particular, if there is a substantial increase in AFCA monetary limits, AFCA could be determining high value, complex matters. If there has been a significant divergence from the general rules of law then it may be appropriate for the court to decide to hear the dispute in order to provide certainty on the matter going forward. In such circumstances this ability should be available to both the consumer and to the financial service provider.

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

The ICA believes that AFCA plays a vital role in providing people with an accessible and less expensive alternative to court action. The ICA agrees with the Commissioner that the ordinary position is that a financial service provider should not need to defend an action twice and be liable twice as the result of a decision by AFCA and a court. However, the ICA

acknowledges that there may be certain situations where justice requires that a determination from AFCA should also be tested in court by either the consumer or the financial service provider (see Question 15 and 16).