

Consultation Paper – Enforceability of financial services industry codes

Submissions to the Treasury

April 2019

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About Us

Slater and Gordon Limited is a leading consumer law firm in Australia. We employ over 800 people in 40 locations across Australia. Slater and Gordon's mission is to give people easier access to world class legal services.

As Australia's leading trade union and labour movement law firm, we also have a proud history of partnering with trade unions to defend workers' rights. The firm provides specialist legal and complementary services in a broad range of areas.

Our Superannuation and Disability Insurance practice has been dedicated to assisting claimants for more than 20 years. The area of disability insurance, whether through a group life policy within a superannuation scheme or retail policy, can be challenging and daunting for people suffering from an injury or illness.

The struggle to cope with the difficulties and frustrations that an illness or injury can bring to them and their families' drives us to support and guide them through this complex area both legally and through our dedicated in house social work services.

Introduction

Slater and Gordon welcome the opportunity to provide submissions to the Treasury on its consultation paper in relation to the enforceability of financial services industry codes.

We have advocated for prescription to the Codes of practice in relation to life insurance¹ to be a registration² and licensing condition with mandatory participation and be approval by ASIC.³

It is clear from the voluminous evidence and submissions provided to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and to other recent regulatory inquiries⁴ that the Codes of Practice in their current self-regulatory form are insufficient

¹ Financial Services Council Life Insurance Code of Practice ("FSC Code") and the Insurance in Superannuation Voluntary Code of Practice ("Super Code").

² *Life Insurance Act 1995* (Cth) s.21.

³ Slater and Gordon submissions to the Productivity Commission - Superannuation: Assessing Competitiveness and Efficiency (18 July 2018) (DR178); Slater and Gordon submissions to the Treasury - Extending Unfair Contract Terms Protections to Insurance Contracts Proposal Paper (August 2018); Slater and Gordon submissions to the Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry Final Report (25 October 2018) (POL.9006.2000.0012_0001); Slater and Gordon submissions on the FSC Consultation Draft – Life Insurance Code of Practice 2.0 (11 January 2019).

⁴ Parliamentary Joint Committee on Corporations and Financial Services - Report on the Life Insurance Industry (March 2018) "PJC Report on the Life Insurance Industry"; Productivity Commission Inquiry - Superannuation: Assessing Efficiency and Competitiveness – Draft Report (April 2018); Treasury Proposal Paper on Extending Unfair Contract Terms Protections to Insurance Contracts (June 2018) and FSC Consultation on Life Insurance Code of Practice 2.0.

to properly protect consumers or set minimum industry standards applicable to all relevant industry participants.

The Financial Services Council Code states that “[t]he Code is designed to protect you, the customer” and is “the life insurance industry’s commitment to mandatory customer service standards”.

The problem with the FSC Code is that it is only applicable to FSC members. Accordingly, many consumers are not protected by the ‘commitment to protect them’ as a customer, as they may be insured by a life insurer who is not members of the FSC. This not only results in inconsistency in the treatment of customers but is also confusing for consumers and the community.

The Parliamentary Joint Committees recommendation 4.3⁵ of its report on the Life Insurance Industry, stated that the FSC Code “must apply to all relevant industry participants, without exemption.”

Consistent with this finding, we strongly submit to the Treasury that Codes of Practice must apply to all industry participants, specifically those whose business is covered by the ambit of the relevant Code, including re-insurers and third-party agents.

Those who are members of the FSC, have agreed to be bound by a set of minimum standards. As it currently stands, the FSC Code of Practice is a good step in the right direction by the industry. However, it is clear from the FSC’s recent consultation in relation to version 2.0 of the Code, that further work still needs to be done.

Mandatory commitment to customer service standards through the implementation of a compulsory code of practice are of benefit to all parties involved. For consumers, it provides certainty and consistency across the industry, by virtue of a set minimum industry standard, and a clear complaints process.

By setting minimum industry standards of customer service, the industry will benefit from greater trust and engagement by consumers with the products they offer.

On the flip side of this, signatories must also be incentivised to comply by way of prescribed and enforceable consequences and sanctions for breach that have teeth.

⁵ PJC Report on the Life Insurance Industry page 64.

We are on record as supporting the Productivity Commission's Draft Recommendation 18, that an Insurance Code Taskforce be established to address and advance the benefits of the Code to insured consumer outcomes,⁶ and the recommendations of the ASIC Enforcement Review Taskforce Report of a co-regulatory model to enable consumers to pursue reparation through internal and external dispute resolution processes for non-compliance.⁷

Current consumer protections for insurance contracts fall far short of what is required to adequately protect consumer rights and entitlements. We consider that the amendment will enable this to be realised.

We strongly support the recommendations of the Royal Commission in relation to the enforceability of the Codes of Practice.

⁶ Productivity Commission Inquiry - Superannuation: Assessing Efficiency and Competitiveness – Draft Report (April 2018) page 63.

⁷ ASIC Enforcement Review Taskforce, Position and Consultation Paper 4 Industry Codes on the Financial Sector, 28 June 2017 pages xi, xv and Chapter 4.

RESPONSE TO CONSULTATION PAPER QUESTIONS

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

As noted in our introduction, we consider that there are benefits to industry participants and consumers by having approved compulsory financial industry codes of practice.

For consumers, it will ensure transparency, and enable an understanding of the processes and procedures for obtaining financial products, as well as what they can expect from their financial service provider, should claiming on them be required.

For industry participants, it enables the calling out of the behaviour of participants that taints the reputation of all and allows industry to consider what standard they wish their industry to set as a minimum requirement, and the consequences for those that fall below both industry and community expectations.

As observed by Lauren Wright in her paper on utmost good faith,⁸ *'consumer confidence is detrimentally affected where consumers and the community as a whole perceive systemic unfairness in financial products, or in dealing with financial service providers in respect of those products.'* This can be no truer a description of the current state of play between consumers and the financial industry, given the immense divide between consumer and community expectations and insurer conduct.

Approved industry codes of practice will go a long way to restoring community confidence in the financial industry and correcting some of the imbalance for consumers and small business with financial service providers.

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

As highlighted by the Royal Commission in its report, there may be some uncertainty about which provisions of an industry code can be relied upon and enforced by individual consumers, which remains, 'highly undesirable'.⁹

In its submission to the Royal Commission, ASIC noted that for a code of practice to benefit consumers, it "requires terms that make a real difference to outcomes for consumers and appropriate implementation of those terms throughout the industry."¹⁰

⁸ Utmost Good Faith and Fairness in Life Insurance: Restoring Consumer Confidence [2017] UNSWLawJlStud 3, page 1.

⁹ Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry Final Report (11 February 2019) page 311 ("Royal Commission Report").

¹⁰ ASIC Submissions to the Royal Commission Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry Final Report (25 October 2018) page 35 para 148.

Slater and Gordon support Commissioner Hayne's recommendation that financial service codes of practice contain enforceable code provisions.

Not all provisions of a code of practice warrant enforceable provisions that will constitute a breach of law. For those provisions that do, being provisions which govern the terms of the contract with consumers, consideration needs to be given to the enforceability of such provisions, whereby breach *is* deemed to be a breach at law.

The relevant issues that need to be considered are:

- Identification and agreement of which aspects of a code of practice ought to be enforceable by consultation with all relevant stakeholders;
- What aspects of the code mirrors regulation, and by virtue of this, having appropriate mechanisms to monitor compliance and facilitate consumer redress for lack of compliance;¹¹
- Appropriate infrastructure and resourcing for enforcement of a breach.

Section 912A of the *Corporations Act*¹² governs the general obligations for a financial services licensee, which includes the requirement for licences to have adequate resources to carry out supervisory arrangements. As such, a breach of an enforceable code provision should be a breach of the Act.

It is hoped that the removal of the current exemption on insurance claims handling from the definition of 'financial service' under the Corporations Regulations¹³ will enable enforceable code provisions in relation to these activities also.

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

*"The industry has also indicated to us that their intention is to submit the code for our approval. That doesn't necessarily mean that ASIC would enforce all the provisions, but we would only approve it if we were confident that the enforceability was robust."*¹⁴

The remarks of Mr Peter Kell, Deputy Chairman of ASIC in relation to the life insurance industry are relevant here both in terms of the criteria that ASIC should consider, as well as the industries willingness to be governed by an approved Code.

¹¹ <http://www.austlii.edu.au/au/journals/UNSWLawJI/2015/19.html>.

¹² Ss 912A(1)(d) *Corporations Act 2001* (Cth).

¹³ Regulation 7.1.33 of the Corporations Regulations 2001.

¹⁴ Mr Peter Kell, Deputy Chairman, Australian Securities and Investments Commission, Committee Hansard, 8 September 2017, p. 55, in the PJC Report on the Life Insurance Industry page 57.

The criteria that ASIC should consider when approving voluntary codes should consist of the following:

- Is the code comprehensive and reflective of consultation with *all* relevant stakeholders;
- The level of the industry participation and engagement with the code
 - i.e. Does it apply to the relevant industry participants so as to avoid consumer confusion as to when and who the code applies.
 - For example:
 - only members of the FSC are governed by the FSC Life Insurance Code of Practice
 - not all superannuation fund trustees have indicated their intention to be bound by the Super Code
- The appropriateness and effectiveness of mechanisms for review of alleged breaches and implementation of ramifications for breach
 - The Chair of the Life Code Compliance Committee (“LCCC”) indicated in submissions on the FSC Consultation Draft Code 2.0¹⁵ the FSC was “*yet to formally engage with the LCCC in relation to the apparent expectation that the LCCC will monitor and enforce subscriber compliance with the new Chapter 2...*”

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

We consider it preferential for a code to be enforceable rather than a government prescribed code.

Industry participants that are to be governed by a code need to ‘buy in’ to ensure there is a commitment to compliance with it. Relevant industry participation in the setting of minimum governance standards is essential to prescription and compliance.

Previous code of practice reviews have indicated that there is far greater net benefit of effective self-regulation than of government intervention.¹⁶ The reasoning behind this finding is based upon:

¹⁵ Life Code Compliance Committee Submissions on the FSC Consultation Draft Code 2.0 (11 January 2019) page 1.

¹⁶ The Treasury Paper on - Policy Guidelines on Prescribing Industry Codes under Part IVB of the Competition and Consumer Act 2010 (May 2011) page 2.

- Industry participants being best placed to tailor a code of practice to the business conditions in that industry;
- Lower compliance costs;
- Greater flexibility for amendment when required;
- Reduced costs on government for implementation, compliance monitoring and enforcement.

Having said that, if the industry continues to flounder in its ability to self-regulate, this may be the only option to ensure industry application and compliance, for enhanced consumer protection.

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

Yes. Not only is this necessary to ensure consistency for consumers and application across industry, but it ensures that any new industry participants are governed by the same code compliance conditions as existing licencees.

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

We refer to our response to question 3.

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?

No response to this question.

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

It is apparent from the released reports in relation to self-reporting of breaches, that there is a strong need and community desire for stricter supervision and monitoring of financial service codes.

The FSC Code

As at September 2018, the number of self-reported breaches by life insurers since the FSC Code took effect was 23. This is not a reflection of strict adherence by life insurers to the FSC Code but instead supports the conclusion that self-regulation is entirely inadequate. This is particularly so given, during the same period, 747 alleged breaches were referred to the Life Code Compliance Committee (“LCCC”).¹⁷

¹⁷ Life Code Compliance Committee Annual Report FY17 (18 September 2018) page 3.

The Annual Industry Data and Compliance Report¹⁸ indicated that subscribers to the FSC Code reported 164 breach events resulting in multiple breaches of a section of the Code, and almost 8000 isolated breaches affecting individual consumers. Of this:

- 60 per cent related to claims; and
- 99 per cent of breaches were caused by people-related issues.

The LCCC noted that there are limitations to the data, and that the quality of the data and reporting was not consistent across subscribers. It also found that not all subscribers have processes in place to enable full compliance and to detect, report on and remediate breaches.¹⁹

The Royal Commission witnessed significant breaches of statutory regulation by financial service providers, many with significant financial penalties for breach. By comparison, the ‘sanctions’ to be discretionally imposed for the FSC Code breaches as they stand would barely raise a blink let alone act as a ‘preventative’ or ‘deterrent’ measures. We note the Annual Data Report was silent on enforcement of sanctions.

The Super Code

The potential effectiveness of the Super Code is limited by virtue of the fact that:

- (a) It is voluntary in participation by industry;
- (b) There is no independent administrative oversight, monitoring or enforcement.

We note that the FSC is attempting to bolster the effectiveness of the Super Code by combining it with the current FSC Code, a move encouraged by the PJC.²⁰ This would be beneficial for consumers as it would reduce confusion and increase consistency. That being said, this is of limited assistance to consumers if it remains only applicable to those that have signed up as FSC members and does not apply to all industry participants.

It is clear that the regulatory framework of the life insurance codes must be enhanced, with breaches being regarded as contravention of the *Corporations Act*, and thereby attracting the appropriate enforceable penalties.

¹⁸ Life Insurance Code of Practice Annual Data and Compliance Report — 2017-18 (March 2019) page 6 (“Annual Data Report”).

¹⁹ Annual Data Report — 2017-18 (March 2019) page 27.

²⁰ Recommendation 4.4 of the PJC Report on the Life Insurance Industry, page xvii.

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, we consider that code provisions should be continuously monitored for relevance and adequacy.

Voluntary codes of practice are of limited value to either industry participants or consumers if they are not regularly monitored or reviewed to ensure that they remain relevant and appropriate.

A recent example of this was trauma policies, which the Commlnsure scandal revealed the significance of out-dated medical definitions in such policies. This was the experience of our client Mr Kurthi, whose claim was denied as his medically diagnosed heart attack did not align with his insurance policies restrictive definition.²¹ While thankfully, clause 3.2 obliges FSC members to review and update medical definitions at least every three years, it continues to remain silent on the standardisation of definitions across all types of policies, as recommended by the PJC.²²

The FSC Life Insurance Code of Practice clause 12.2 requires the code be formally and independently reviewed no less than every 3 years. Additionally, clause 12.3 provides that the FSC will consult with the LCCC, EDRs, consumer and industry representatives, relevant regulators and other stakeholders to develop the Code on an ongoing basis.

In the first instance, this is an appropriate form of monitoring. The LCCC formation includes a consumer representative, industry representative and an independent chair, which appropriately balances the Committee for transparency and effectiveness.

However, if it becomes apparent that this format of monitoring is not occurring, or appropriate industry consultation is not undertaken, then consideration of the composition of the overseeing committee would need to be reconsidered.

As noted in response to question 8, the Insurance in Superannuation Voluntary Code of Practice, by comparison, does not have an appropriate oversight or review committee for the purpose of monitoring or reviewing breaches of the Super Code, which is wholly inadequate. It therefore lacks an ability to not only set an agreed industry standard for members, but a complete inability to protect consumers or rebuild community trust.

²¹ <https://www.canberratimes.com.au/national/act/canberra-mornings-march-11-2016-20160310-gnfrbz.html>

²² Recommendation 10.60 of the PJC Report on the Life Insurance Industry page 167.

Slater and Gordon consider that independent and formal review of financial codes should occur at least every 4 years, but that Codes encompass provisions (similar to clause 12.3 of the FSC Code) for review and amendment at any earlier time to ensure any necessary amendment, addition or removal to a clause of the Code consistent with any change in the industry, occurs in a timely manner.

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

We refer to and repeat our response to question 9.

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?

For consistency with current legislation, Slater and Gordon agree with the findings of Commissioner Hayne that breaches of enforceable code provisions should mirror those currently set out in Part VI of the *Competition and Consumer Act 2010* (Cth).²³

We note that AFCA, pursuant to its rules, is currently able to award compensation for non-financial loss and indirect financial loss currently in relation to complaints against financial service providers in certain circumstances.

Further, while the FSC Code and Super Codes do not currently apply to all industry participants, AFCA can apply them in determining a consumer dispute²⁴ if the AFCA Decision Maker considers it fair in all the circumstances.

We consider that Commissioner Hayne's recommendation 4.10 should be contemplated by the FSC and Insurance Council of Australia in the intervening period.

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 response to this question

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

We refer to our response to question 2 above.

²³ Specifically, Pecuniary penalties (s 76), Injunctions (s.80), Actions for damages (s.82), Non-punitive orders (s.86C(2)(a)-(d)), Punitive orders - adverse publicity (s.86D), Other orders – as the Court thinks appropriate (s.87) and Enforcement Undertakings (s.87B).

²⁴ Clause A.14.2 b) of the Australian Financial Complaints Authority (AFCA) Complaint Resolution Scheme Rules (1 November 2018).

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

Slater and Gordon are of the view that there ought to be civil penalties for all breaches of enforceable provisions of a code of practice.

The form of the civil penalty should be proportionate to the significance of the breach, the ongoing or consistent nature of the breach, and the ease with which it is rectifiable (i.e. to put the consumer back in the position they ought to have been in).

We refer to the words of the Treasury that “[f]or codes to be meaningful rather than tokenistic, there needs to be reasonably effective mechanisms in place to ensure adherence”.²⁵

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

Slater and Gordon do not consider that there should be **any** circumstances that would result in a preclusion of a consumer from pursuing Court Proceedings.

The Australian Financial Complaints Authority (“AFCA”) is governed by its own rules, which consider and address the rights of parties to a dispute to take further action by way of court proceedings.

No further reform is therefore warranted or required, and we would be significantly concerned with any intention to do so.

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?

None. A court should consider the merits of a matter before it, irrespective of whether the matter has previously had an AFCA complaint.

Similar to that of a mediation in a litigated matter, the information or submissions made through such a process cannot be subsequently utilised in the court proceeding, the external dispute resolution process of AFCA runs on a “without prejudice” basis.

This process enables consumers to pursue a more cost effective and risk adverse method of dispute resolution prior to the formal, costly and riskier option of litigation.

²⁵ Treasury, Interim Report Submission, 12 [65] in the Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry Final Report (1 February 2019) page 107.

As it presently stands, for complaints against superannuation fund trustees, a consumer has a right of appeal against a determination of AFCA to the Federal Court on a question of law.²⁶ This entitlement does not extend to other dispute decisions of AFCA.

We would advocate for the extension of consumer rights of appeal through judicial review to all AFCA decisions, on points of law.

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

Such a scheme is designed to allow consumers access to assistance and consideration of the merit of their grievance with a financial provider, who is in a greater position of power, as a precursor to court proceedings. Such a scheme is cost and time efficient to all parties to a dispute.

An obvious issue which would therefore arise if consumers were not able to pursue their matter through a court following an AFCA determination would be a significant decline in the use of AFCA as an external and cost-effective dispute resolution body.

Conclusion

Slater and Gordon would welcome the opportunity to provide further clarification or submissions on any of the matters raised within our submissions, if it would be of assistance to the Treasury.

Yours faithfully



Sarah Snowden

SLATER AND GORDON LAWYERS

²⁶ S.1057 *Corporations Act 2001* (Cth).