18 April 2019

Manager
Financial Services Reform Taskforce
The Treasury
Langton Cres
Parkes ACT 2600

By email: enforeablecodes@treasury.gov.au

The Manager

Enforceability of financial services consumer industry codes

The Australian Financial Markets Association (AFMA) is making comment on the Consultation Paper entitled '*Enforceability of financial services industry codes*' (Consultation Paper). This takes up recommendation 1.15 of the '*Banking, Superannuation and Financial Services Royal Commission'* (Royal Commission).

In summary, AFMA considers that the Royal Commission highlighted the considerable confusion that surrounds what financial services consumer industry codes are and what should be enforceable in them. This is because they have been required to restate a considerable amount of statutory law, describe ethical principles underlying their application, provide general advice on rights in addition to the core promises they make about how an organisation will go about conduct its relationship with a customer in accordance with their contractual and statutory rights. To be effective the law should address this confusion and clearly ascribe clearly focused statutory rights to enable consumers to enforce their rights in respect of the promises made in industry codes, and give ASIC the authority to back the consumer up in enforcement of those legal rights.

AFMA as an industry association is not involved with financial services consumer industry codes and approaches implementation of the Royal Commission recommendation from an independent and objective conceptual point of view. AFMA's principle concern is with confused conceptual thinking affecting industry codes, which the Royal Commission opined upon. In part, this is because of a long evolution which has seen industry codes moving from setting novel industry norms to becoming a flexible adjunct to widening the

Australian Financial Markets Association
ABN 69 793 968 987
Level 25, Angel Place, 123 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7995 Email: dlove@afma.com.au

scope for consumers to pursue their legal rights, as statutory law has supplanted their norm setting role.

A key objective of law reform in this area is to be clear and precise on what elements of an industry code are enforceable by consumers, so they may understand the additional benefits they receive from a code as distinct to their rights arising under statutory law. In addition is should also make clear the supervisory role of ASIC with regard to industry codes and ensuring consumers may effectively pursue their rights. To this end the first part of this letter looks at defining industry codes and then turns to what aspects of the codes should be enforceable.

1. Defining 'industry codes'

Our starting premise, which is reflected in the Royal Commission's commentary, is that there is a lack of clarity about the nature of an industry code is and what it is meant to do. As we move forward with a greatly heightened regulation and compliance burden, we must be very clear in the law about what is required as we are extolled to do in the Royal Commission's commentary on the vague and problematic drafting of current financial services law. The proposed law reform must address this threshold problem. The term "codes of conduct" has a range of understandings in the community and the law. AFMA believes that it of fundamental importance in revising the law to be clear in the law what the nature of "financial services consumer industry code" is and define it in the law to give clarity to industry, investors and regulators about what is actually being regulated

Codes of conduct were first created by professional groups such as doctors and lawyers to bring together collected wisdom and establish standards for the profession. These rules or guidelines for behaviour are particularly useful for socialising new members into a profession. The code, in effect, alerts aspiring or new professionals to conflicts of interests, client protections, rights of the practitioner and so on. It also provides a benchmark for peers to determine when conduct does not meet professional standards.

This concept is commonly adopted by many industry associations to set out accepted norms of the professional behaviours when conducting business with peers. An example of this is AFMA's Code of Conduct, which is a set of ethical principles. This Code provides a framework to assist in making and judgments where there is no clearly articulated rule or legal requirement. It provides a sound ethical framework to determine how an organisation involved in financial markets should act in the conduct of their business affairs, taking account of responsibilities to their firm and the broader community. Ethical principles are socially normative and differ from values which are personal and subjective. Ethical principle codes commonly promote honesty, trustworthiness, loyalty, respect for others, adherence to the law, avoiding harm to others, and accountability.

Typically, the law tells us what we are prohibited from doing and what we are required to do. Although the law is increasingly prescriptive about behaviour, it normally does not tell us what to do in relation to many of the dilemmas and decisions we have to make in life. While we think obeying the law is an important basis for role models in our life, we consider other traits such as benevolence and empathy as more important in

characterising someone as a good person. Ethics engages our thinking and our feelings as social beings beyond rule based requirements.

Organisations have picked up the code concept for establishing internal organisational cultures. It is now accepted as part of current good corporate governance practice for a business organisation to have code of conduct that clarifies the organisation's mission, values and principles, linking them with standards of business conduct. Such a code articulates the values the organisation wishes to foster in its leaders and employees and, in doing so, defines desired behaviour. As a result, written codes of conduct or ethics can become benchmarks against which individual and organisational performance can be measured. Additionally, a code is a central guide and reference for employees to support day-to-day decision making. A code encourages discussions of ethics and compliance, empowering employees to handle ethical dilemmas they encounter in everyday work. It can also serve as a valuable reference, helping employees locate relevant documents, services and other resources related to ethics within the organisation.

In contrast to codes about ethical principles, we have law based codes which are designed to achieve public policy outcomes. The Royal Commission recommendation makes reference to the CCA Act industry codes regime. These provisions are designed as a micro-economic regulation tool to deal with identified market failure when there are problems with the operation of a market that prevents it producing optimal outcomes. In these situations resources cannot flow to their best use, to the detriment of industry participants and consumers. Examples of market failures that may lead to the establishment of prescribed industry codes are asymmetric information and imperfect competition. Under this regime the Government will only prescribe mandatory or voluntary codes in very limited circumstances — when it is absolutely necessary for supporting the efficient operation of markets or the welfare of consumers. This high threshold is reflected in the limited number of codes that have been prescribed over the years. Government intervention will only be considered where there is a demonstrable problem affecting industry participants or consumers which the market cannot or will not overcome, and where such intervention is likely to result in a net public benefit. This micro-economic regulatory purpose for codes differs from that for financial services industry codes.

When thinking about the nature of industry codes and how they should be defined it should be borne in mind that financial services industry codes have their origin as a complaints handling mechanism before the formal structures that we have in the law today were put place. In its 1991 report the Martin Committee Review[1] was concerned with the high cost of resolving disputes in the courts between banks and their customers. It recommended banks appoint independent monitors to ensure that complaints handling is a '*cheap, speedy, fair and accessible alternative to traditional Courts*'. It concluded that the banks should be required to establish a formal system of self-regulation based on a government approved Code of Banking Practice. It stressed the importance of an effective, low cost, complaints resolution procedure. As a result, the first 1993 Code of

[1] 1991 Martin Committee on Banking and Deregulation, *A pocket full of change: Banking and deregulation*. Parl Paper Number: 290/1991.

Banking Practice introduced an obligation for subscribing banks to provide access (at no charge) to internal complaints handling and external dispute resolution processes. At the time this was not an issue covered by legislation. The close connection between self-regulation expressed through the dispute resolution scheme, and self-regulation expressed through the Banking Code, was later mirrored in other parts of the financial services sector.

The current provisions of the Corporation Act 2001 are based on the policy conceptualisation set out in *'A consultation paper, Financial Products, Service Providers and Markets — An Integrated Framework'* (known as CLERP 6) [p62 ff]:

> *The role of codes of conduct is to establish best practice standards for meeting the requirements of the Law. In addition, codes that establish best practice in areas not covered by the Law may be developed. However, it will not be mandatory for an industry participant to be party to a code.*
>
> *ASIC will have power to approve a code as being consistent with the Law and should be consulted in the development or modification of codes of conduct. In exercising its powers, ASIC will be required to take account of the benefit of having codes of conduct harmonised to the greatest extent possible to reflect the regulation of the financial services industry.*
>
> *At the same time, however, where codes govern activities not covered by the regulatory framework, or where codes provide detail about how to meet regulatory requirements, the different characteristics of particular financial products or activities should be recognised.*
>
> *While ASIC will be empowered to approve codes, they should largely be administered by the industry. The objective of the Government's approach to codes is to provide flexibility to industry participants and foster an environment whereby industry works co-operatively with the regulator and consumer associations to establish best practice.*

In looking at this developmental history of the Banking Code of Practice over it various versions we see that much which was originally at the vanguard of consumer protection for deposit-taking and consumer credit services, and there areas dealt with like disclosure of the terms of the service, dispute resolution, and responsible lending have been largely been superseded by legislation. In these areas, the earlier versions of the Banking Code imposed standards on its subscribers that exceeded those imposed by law.

By contrast in 2019 we have the statutory structure supporting the Australian Financial Complaints Authority to deal with the large body of codified consumer protection provisions covering financial services, which seeks to mitigate consumer detriment from badly delivered financial services.

The role now of given to financial services industry code is to set out practice standards intended for meeting the requirements of statutory law, rather than establishing novel norms as they did in the past. Statutory law now generally codifies such norms.

In summary, a financial services industry code can be defined as a promise by an adherent organisation about how it will go about conforming to the law and meeting a customer's

legal rights. The 'how to do' is set out in practices which establish a particular standard of behaviour. On the other hand an industry code is not the ethical principles that may underlie it. The ethical principles go to informing how judgments may be made in applying standards of practice, they are not standards themselves.

Industry codes now commonly incorporate restatements of statutory law to assist the reader in understanding the context of practice standards. Being clear, about separating out what is required by law which is above and outside the law, from the practice standards which are about how to go about complying with the law and meeting a consumer's rights is important to the question of enforceability. Enforcing the practice standards is where the purpose of enforcement lies.

AFMA agrees with the proposal that responsible industry body identify which standards should be enforceable code provisions as the most practical way to achieve clarity on this point.

2. Enforceability

The question of enforceability is central to this consultation. The question of enforcement has caused confusion over time, a point which is eluded to in the Royal Commission's commentary. For this we must separate out the consumer centric purpose of enforceability from the question of supervisory compliance.

2.1. Consumer centric enforceability

The key issue that the Royal Commission recommended should be dealt with is, how can a consumer be assured that the promises made in an industry code will be fulfilled?

Industry codes relied on contract law for enforceability rights. As adherence by financial services organisations was voluntary and unilateral, the structure relied upon was to ask adherents to incorporate the industry code into their contracts with relevant customers. As is noted above, industry codes arose out of a need for low cost complaints handling which avoided the need for taking low value disputes through the expensive court enforcement of legal rights route. Once financial services law required external dispute resolution through mandatory membership of a complaints handling body enforcement became more formalised.

The purpose of statutory enforceability is to provide a consumer with a statutory legal right additional to rights based in contract law. Clarity on this matter is paramount in drafting the new law for it is here where so much confused thinking arises. AFMA agrees with recommendation of the Royal Commission that enforceable code provisions should be made subject to statutory remedies for breach of promise, as this is consistent with the legal construct on which codes are based though the EDR mechanism.

2.2. Clarity on what is enforceable

There should be clarity on what code provisions are enforceable. Firstly, enforcement is not relevant to statements of the ethical principles underlying a code. Ethics are different as we have pointed out to norms, as they are about how you tackle decision-making with regard to a norm. Secondly, in regard to norms much of what was formerly in codes regarding norms is now law rendering such norms as redundant. Code enforcement should not duplicate what is required by statutory law and merely restated in the code for reader guidance and contextual purposes. Enforcement of statutory requirements is fully dealt with in financial services regulation and ASIC is the proper and only arbiter on such matters.

What this leads us to is that code enforcement relates to the promises made regarding standards of conduct an organisation will apply in meeting its legal obligations to the customer and under law more generally. In essence, these are matters that could give rise to damage or loss to the customer and ensuring that a successful outcome for the customer will be complied with by the organisation at fault.

2.3. Supervisory enforcement powers

Given that the key purpose of code enforceability is to provide a consumer with a statutory legal right to pursue and ensure compliance with their legal rights under a code, the role of regulator supervision is to ensure this occurs. Therefore, the powers of enforcement given to the regulator are ancillary to empowering the consumer and should be directed to this objective.

AFMA is concerned with the direct read across that the Royal Commission makes from the enforcement and remedies in Part VI of the *Competition and Consumer Act* (CCA) which detracts from the primary consumer rights focus that ASIC should pursue. The code provisions in Part VI of the CCA are directed at micro-economic regulator objectives and go to the economic functioning and competition of industry sectors. Such codes are quite different in character because of their systemic nature. Financial service licensees are already subject to a whole body of law regulating the economic functioning of their services so it would be redundant to add more law and penalties to the same end.

Supervisory enforcement should ensure that an organisation fulfils the promises it makes to a consumer. ASIC has a role for monitoring and making organisations fulfil their promises and sanctions for deliberate failing or avoidance to do so are warranted. As noted in the Consultation Paper, ASIC already has wide powers in respect of financial services licensees, and failure to observe an industry code sits well within the organisational failings which may jeopardise a license and the ability to conduct a financial services business.

There is no role for the civil penalties regime here as it is government revenue only that is benefited. It is the aggrieved consumer who should receive compensation not the government for industry code failings. On the other hand, enforceable undertakings would seem to be a particularly suitable regulatory tool in this area.

3. Industry responsible for content and monitoring

AFMA agrees with the Royal Commission recommendation that the content of industry codes should remain a matter for the relevant industry sector to determine. This will preserve the value of industry sponsorship of industry codes as it keeps them close to consumer feedback and relevant to market developments.

Industry run code governing bodies should retain monitoring and frontline supervision in relation to both enforceable code provisions and other aspects of the code operation.

4. Mandating industry codes

The concept of mandating industry codes is borrowed from the CCA. As has already been pointed out this model is not fit for reading over given its micro-economic regulation objectives. CCA codes are tool for systemic regulation of an industry sector.

The idea of mandating the existence of a voluntary code is a contradiction in terms. The proliferation of existing industry codes demonstrates that this is unnecessary. In fact, this is a reason why the flexible voluntary approach is better. Determining whether an organisation should be subject to which code(s) is a complex matter depend on business mixes. Some associations do not compel members to be signatories to a code for this reason, as there may be several codes in the one industry sector.

In the case that ASIC considered a financial services licensee should adhere to an industry code, this can be simply achieved by making it a licences condition as occurs with many other aspects of the requirements placed on licensees.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

David Love
General Counsel & International Adviser