



FINANCIAL
SERVICES
COUNCIL

Royal Commission Recommendation 1.15 – Enforceable Code Provisions

FSC Submission

February 2020



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1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing \$3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC supports recommendation 1.15 of the Financial Services Royal Commission (**FSRC**) which provides ASIC with the power to approve industry codes of conduct and to deem certain provisions as “enforceable code provisions”.

In his final report, Commissioner Hayne recommended that:

The law should be amended to provide:

- *that ASIC’s power to approve codes of conduct extends to codes relating to all APRA-regulated institutions and ACL holders;*
- *that industry codes of conduct approved by ASIC may include ‘enforceable code provisions’, which are provisions in respect of which a contravention will constitute a breach of the law;*
- *that ASIC may take into consideration whether particular provisions of an industry code of conduct have been designated as ‘enforceable code provisions’ in determining whether to approve a code;*
- *for remedies, modelled on those now set out in Part VI of the Competition and Consumer Act, for breach of an ‘enforceable code provision’; and*
- *for the establishment and imposition of mandatory financial services industry codes.*

The FSC believes that industry codes play an important role in setting high standards and norms for industry participants. Codes of conduct can go above and beyond the requirements of law and can set industry standards where there is a gap in the law.

Indeed, the Royal Commission highlighted the value of industry codes, with Commissioner Hayne noting the improvements that the Life Insurance Code of Practice (**Life Code**) has already had on the industry.¹ The FSC agrees with Commissioner Hayne that the industry should take the lead in identifying and driving areas for improvement.

We note that Commissioner Hayne recognised the benefits of self-regulation and sought to preserve these. He also stated that “non-enforceable provisions of industry codes will continue to play an important role in setting standards of behaviour within those industries over time”.² However, the FSC believes that the current drafting of the proposed legislation goes beyond Commissioner Hayne’s recommendation in its scope of what is captured as an enforceable code provision. This is explained in our detailed feedback.

The financial services sector is undergoing significant reforms. The enforceable industry code regime must be placed within this broader context. A code must enjoy full industry support to maximise the benefits delivered to both consumers and the code subscribers. Under the enforceable industry code regime, breaches of enforceable code provisions will be subject to significant civil penalties as well infringement notices. It is important to strike the

¹ Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (2019), vol 1, 314 (FSRC Final Report).

² FSRC Final Report, 111.

appropriate regulatory balance which delivers industry-wide consumer protections whilst encouraging progressive and continuous improvements to the code.

The FSC makes a number of recommendations which aims to strikes this balance. In making these recommendations, we have taken into account their broad applicability across a wide cross-section of the financial services industry.

2.1. Recommendations

The FSC considers the following recommendations should be implemented to enhance the enforceable codes regime.³

Recommendation 1: Section 1101A(2) be amended to ensure provisions captured represent “the terms of the contract made or to be made between the financial services entity and the customer or guarantor” as stated in the FSRC Final Report. Alternatively, that section 1101A(2) be amended so that it only includes provisions which the consumer does not have a “line of sight” to (and breach of which could result in significant detriment as set out in section 1101A(b)(i)), and which therefore would not be able to seek a remedy through IDR, EDR or the courts.

Recommendation 2: The EM should be clearer in outlining that there is a materiality threshold for significant detriment. Furthermore, paragraph 1.71 of the EM should not include non-financial detriment.

Recommendation 3: The term “could” in section 1101A(2)(b)(i) and (ii) be amended to “has resulted in or is likely to result in”.

Recommendation 4: ASIC’s ability to identify a code provision as an enforceable provision should be based on what ASIC *reasonably* considers meets the criteria.

We also recommend the following suggestions to the EM and ED which we believe will assist with clarity.

Recommendation 4: The EM should be amended to make clear or provide examples of provisions which would not be considered enforceable code provisions, such as:

- Where a provision is a guiding statement or principle;
- Where a provision restates the law or a contractual term for the purposes of providing information to a customer; and
- Where it is not sufficiently certain, objective and definitive to constitute a provision which is appropriately enforceable as the law and subject to public law sanctions.

Recommendation 5: That the ED make clear that the penalty for a breach of an approved code is a *maximum* of 300 penalty units, in line with the wording of the EM.

Recommendation 6: That the EM make clear that ASIC may only vary a code at the request of the code owner and cannot unilaterally vary a code.

³ The FSC considers that the recommendations would not require Treasury to seek additional policy authority.

3. Detailed Feedback

3.1. Approved Codes of Conduct

Under section 1101A(2)⁴ of the exposure draft (**ED**), ASIC may identify a provision of the code as an enforceable code provision if ASIC considers the provision represents:

- A commitment by a subscriber to the code to act in a particular way or in a manner consistent with attaining the objectives of the code; or
- A commitment to a person by a subscriber to the code; and

either:

- A breach of the provision could result in significant detriment to the person; or
- A breach of the provision could significantly undermine the confidence of the Australian public, or a section of the Australian public, in the provision of financial services in this jurisdiction or those who provide financial services in this jurisdiction.

The criteria around a “commitment” is extremely broad. Commissioner Hayne was clear in his final report that those provisions which are enforceable should be those that govern “the terms of the contract made or to be made between the financial services entity and the customer or guarantor”.⁵

The FSC strongly believes that the ED does not reflect the wording of the FSRC recommendation. A commitment by a subscriber to act in a particular way could include a number of factors, not necessarily those which relate to the terms of the contract between the insurer and the customer. As currently drafted however, the use of the term “commitment” would arguably capture the entire Life Code⁶ and therefore, captures provisions beyond the Royal Commission’s recommendation which is limited to the terms of the contract between the insurer and the customer.

It was not Commissioner Hayne’s intent to deem all provisions of an industry code as enforceable. This is clear in recommendation 1.15 that an industry code “may include” enforceable code provisions and in Commissioner Hayne’s articulation of what type of provisions ought to be identified as enforceable code provisions (namely provisions which govern the terms of the contract). Commissioner Hayne envisages a mechanism in which industry, in consultation with ASIC, undertakes a process to identify those provisions which are enforceable.

⁴ The ED proposes to amend both the Corporations Act 2001 and the National Consumer Credit Protection Act 2009. Where recommendations in this submission refer to the Corporations Act, they should be reflected in the relevant provision of the National Consumer Credit Protection Act.

⁵ FSRC Final Report, 104.

⁶ The Life Code states that, “the Code is the life insurance industry’s *commitment* to mandatory customer service standards”.

Given this, we believe it is not appropriate to use the term “commitment” as one of the criteria for determining what may constitute an enforceable code provision, and that Treasury should amend the ED to reflect the FSRC Final Report.

Commissioner Hayne also stated that:

Finally, if financial services entities breach an enforceable code provision, customers and guarantors should be able to elect whether to enforce that breach through existing internal or external dispute resolution mechanisms, or through the courts. As I have said above, to effect this outcome, the law should be amended to provide that breach of an enforceable code provision will constitute a breach of the law.⁷

It is clear from the FSRC Final Report that a consumer should be able to elect the method through which they may enforce a breach of an enforceable code provision. As a direct result, those provisions which are enforceable should only be those which govern the terms of the contract and are included in the relevant code.

A. Scope of “commitment”

Alternatively, if Treasury is minded to retain the current drafting and the use of the term “commitment”, the FSC suggests that it be further clarified that only those provisions of which the consumer has no direct “line of sight” (and breach of which could result in significant detriment as set out in section 1101A(b)(i)) should be captured. These are provisions which would result in significant harm if breached and a consumer would not be able to seek an alternative remedy to.

While FSC’s submission is that enforceable code provisions should be confined to those recommended by Commissioner Hayne (namely, terms of the contract made or to be made between the financial services entity and the customer), if the Government intends to extend this recommendation further, then under the FSC’s proposal, a customer has “line of sight” to a provision if they are able to seek a remedy through Internal Dispute Resolution (**IDR**), External Dispute Resolution (**EDR**) or the courts. In most cases, these will be the provisions which govern the terms of the contract that was envisaged by Commissioner Hayne. In these instances, if such obligations were breached, a consumer would be able to seek remedy through several pathways.

However, there may be provisions within a code which provide additional consumer protections that the contract does not provide. For example, this could include provisions which prohibit the payment of bonuses based on declined claims. Such a provision is likely to cause a consumer significant harm and result in detriment but would not be a term of the contract between the consumer and the insurer and as a result a consumer would not have the usual IDR, EDR or court remedies.

The FSC believes that this alternative would seek to capture the “spirit” of the recommendation and offer further protections than envisaged by Commissioner Hayne. It seeks to clarify and refine the current drafting which captures provisions not envisaged by

⁷ FSRC Final Report, 110-111.

Commissioner Hayne. This framework allows for provisions which govern the terms of the contract to be enforced by the consumer through existing IDR or EDR mechanisms, or through courts.⁸ However, this alternative would also ensure that there is an enforcement mechanism for breaches of enforceable code provisions which the industry has offered up as preventing consumer harm.

FSC Recommendation 1: Section 1101A(2) be amended to ensure provisions captured represent “the terms of the contract made or to be made between the financial services entity and the customer or guarantor” as stated in the FSRC Final Report. Alternatively, that section 1101A(2) be amended so that it only includes provisions which the consumer does not have a “line of sight” to (and breach of which could result in significant detriment as set out in section 1101A(b)(i)), and which therefore would not be able to seek a remedy through IDR, EDR or the courts.

B. Significant detriment

The FSC notes that the use of the term “significant detriment” is extremely vague and undefined. The term “significant detriment” was introduced with the Product Intervention Powers (**PIP**). The PIP explanatory memorandum (**EM**) states that both “significant” and “detriment” are not defined under the law.⁹ It notes that that the detriment must be sufficiently great to justify an intervention. We appreciate that the term is not intended to be defined under law however, we believe that further clarification could be made to the EM and in additional regulatory guidance released by ASIC to clarify that there must be a materiality threshold for significant detriment.

The FSC believes that there is an inconsistency in the use of “significant detriment” in the EM with other legislation. The draft enforceable codes EM outlines what factors that ASIC might consider as causing “significant detriment” in paragraph 1.71. The EM outlines that ASIC may consider factors including non-financial detriment. This differs from the definition of significant detriment (noting that this is non-exhaustive) under section 1023E(1) of the *Corporations Act 2001* and section 301E(1) of the *National Consumer Credit Protection Act 2009*.

For example, the Life Code commits insurers to treat customers with empathy, compassion and respect.¹⁰ This is a clear commitment by a code subscriber to act in a particular way. Potentially a breach of such a commitment *could* cause non-financial detriment to an individual customer resulting in a civil penalty and/or infringement notices issued by ASIC. It is desirable that such guiding statements should be included within codes of conduct to inform customers how they should expect to be treated but these obligations are merely principles and would not be appropriate to be considered an enforceable code provision subject to state law sanctions in the form civil penalties and/or infringement notices.

⁸ FSRC Final Report, 109.

⁹ Explanatory Memorandum, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2918 (Cth) 2.32-2.35.

¹⁰ Financial Services Council, *Life Insurance Code of Practice* (at 1 July 2017) para 8.24 (Life Code).

Furthermore, the use of the term “could” in the ED is broad and is subjective in nature. In determining if a provision is enforceable, the test should be more objective that a breach “has resulted in or is likely to result in” significant detriment. Code owners should be encouraged to include provisions which provide guiding statements or principles that seek to improve industry standards but where determining detriment may be subjective.

Finally, we submit that ASIC’s ability to identify a code provision as an enforceable provision should be based on what ASIC *reasonably* considers to meet the criteria in section 1101A(2).

FSC Recommendation 2: The EM should be clearer in outlining that there is a materiality threshold for significant detriment. Furthermore, paragraph 1.71 of the EM should not include non-financial detriment.

FSC Recommendation 3: The term “could” in section 1101A(2)(b)(i) and (ii) be amended to “has resulted in or is likely to result in”.

FSC Recommendation 4: ASIC’s ability to identify a code provision as an enforceable provision should be based on what ASIC *reasonably* considers to meet the criteria.

C. Provisions to inform or provide information

Other provisions which may be included in a code of conduct might inform the customer of their rights under existing laws or replicate, reflect or paraphrase existing laws. We note that paragraph 1.33 and 1.64 of the EM states that a code of conduct should do more than restate existing laws. While we agree with this statement, there is value in restating an existing law in a consumer facing document for the purposes of consumer education. Similarly, a code may restate the rights the consumer has under a standard contract. However, if a code subscriber inadvertently breached a provision which restated the law or contract, this could result in both a breach of the original law or contract and a breach of an enforceable code provision (and potential civil penalties and infringement notices).

The FSC believes that code subscribers should not be penalised for seeking to inform consumers of their existing legal or contractual rights, apart from those which meet the criteria outlined in the FSRC Final Report governing the terms of the contract between the financial services provider and the customer.

D. Provisions should be definitive and objective

An enforceable code provision has a heightened status in law, which is not afforded to most contractual terms. Contractual terms are subject to private law rights (e.g.: a breach of contract). Enforceable code provisions could not only be contractual terms and subject to private law remedies but are also enforceable by public law sanctions in the form of civil penalties and infringement notices. Infringement notices issued by ASIC are not provable in court if ASIC believes (in its view) on reasonable grounds that an enforceable code provision has been breached.

Therefore, as for any law punishable by the state (and consistent with the *AGD Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*)

(September 2011)) the enforceable code provision should be sufficiently clear and objective.¹¹

FSC Recommendation 4: The EM should be amended to make clear or provide examples of provisions which would not be considered enforceable code provisions, such as:

- Where a provision is a guiding statement or principle;
- Where a provision restates the law or a contractual term for the purposes of providing information to a customer; and
- Where it is not sufficiently certain, objective and definitive to constitute a provision which is appropriately enforceable as the law and subject to public law sanctions.

3.2. Sanctions and Enforcement

We note the inconsistency in the drafting of penalties between enforceable codes (s 1101AC) and mandatory codes (s 1101AD). Where a code has been mandated, the ED stipulates that penalties “not exceed[ing] 1000 penalty units”. The EM states that a contravention of an enforceable code provision may attract a penalty of up to 300 penalty units. We recommend that section 1101AC reflect the wording of the EM and is drafted consistently with section 1101AD.

The FSC submits that the penalty should be a maximum of 300 penalty units, depending on the nature and severity of the breach. We do not think that it is appropriate that a pecuniary penalty is set at a fixed 300 penalty units, regardless of the nature of the breach.

We note that the EM uses the term “up to” in reference to both approved codes and mandatory codes.

FSC Recommendation 5: That the ED make clear that the penalty for a breach of an approved code is a *maximum* of 300 penalty units, in line with the wording of the EM.

3.3. Code Review

The ED and EM outline the process through which ASIC can identify and approve enforceable codes of conduct. The EM outlines in paragraph 1.62 a process through which industry and ASIC can work together to identify provisions in a code which may be considered enforceable code provisions.

Similarly, ASIC may vary a code at the request of the applicant. The EM should make clear that ASIC is not able to unilaterally vary a provision of the code and that any variation to the code must also be subject to agreement of the applicant (in addition to the usual consultation

¹¹ In the context of Infringement Notices, the AGD Guide (page 58) states: *The efficacy of an infringement notice scheme depends on the reliability of the assessments made by the enforcement officers as to whether an offence has occurred. To ensure accuracy, these assessments should be based on straightforward and **objective** criteria rather than complex legal distinctions.* [Our emphasis]

process for material variations to an industry code). It is important, where codes are enforceable with civil penalties and infringement notices, that there is certainty provided to industry that any previously agreed code provisions cannot unilaterally be amended.

FSC Recommendation 6: That the EM make clear that ASIC may only vary a code at the request of the code owner and cannot unilaterally vary a code.

3.4. Update to RG183

We expect that ASIC is likely to need to update Regulatory Guide 183 (**RG183**) following the passage of final legislation. While we understand that this process may take some time and be subject to public consultation, we would request that ASIC release an Information Sheet in the interim to provide further clarity to code owners highlighted in recommendation 4.9.

The FSC considers that whilst RG183 is currently broadly appropriate, areas where initial ASIC guidance may be helpful relate to approval process of codes with enforceable code provisions:

- What specific criteria might ASIC take into consideration for a provision to be considered an enforceable code provision?
- What does ASIC consider to cause significant detriment?
- During the code approval process, how will ASIC outline the reasons it believes a provision would result in significant detriment (for example, will it be required to prove significant detriment as it is currently required to do when using the PIPs).
- How will ASIC consider provisions under ASIC RG's (and similar regulatory guidance) where they are part of the code?

Otherwise we support Commissioner Hayne's vision of the process by which industry would identify and ASIC review those provisions identified as proposed enforceable code provisions:

"I anticipate that the process of identifying and rendering enforceable the enforceable code provisions will proceed in four steps:

- *industry should identify the provisions that it says govern the terms of the contract made or to be made between the financial services entity and the customer or guarantor;*
- *industry should seek ASIC's approval of those provisions;*
- *ASIC should review the provisions put forward by industry; and*
- *once ASIC has approved the enforceable code provisions, they will be enforceable by statute. Customers will be able to elect whether to enforce any breaches of those provisions through existing internal or external dispute resolution mechanisms or through the courts."*¹²

¹² FSRC Final Report, 108.