Australian Banking Association

28 February 2020

Manager,
Financial Services Reform Taskforce
The Treasury Langton Crescent
PARKES ACT 2600
By email: FSRCconsultations@treasury.gov.au

Dear Mr Namgyal

Recommendation 1.15 - Enforceability of financial services industry codes

At the release of the Final Report of the Royal Commission last year, the banking industry committed to learning the lessons, fixing the problems and making things right.

One year on from the Royal Commission the banking industry has tougher rules imposed by the Government and regulators, a back to basics approach to banking which is squarely centred on the customer and a renewed focus on fixing culture.

The banking industry strongly supports the Government acting on the recommendations of the Royal Commission and is committed to working together to see recommendations 1.15, 1.16 and 4.9 of the Royal Commission are effectively implemented.

The ABA's position

As has been endorsed by Commissioner Hayne and the Treasury[1], self regulation through industry codes is a speedy and flexible way for an industry to change behaviour and introduce new customer rights.

The effective implementation of the Royal Commission recommendations on enforceable code provisions should be guided by two key objectives:

1. The preservation of the fundamental character of industry codes as primarily self-regulatory; and
2. The continuation of industry participation in the development and enforcement of industry codes.

The criteria for ASIC to identify enforceable code provisions are too broad and unspecific and could result in a large number of code provisions being deemed enforceable under this regime. This will undermine the ability of the industry to change behaviour in a speedy and flexible way and reduces the incentive to set better practice standards and introduce new rights for customers.

Key points

- To ensure that the regime preserves the self-regulatory character of industry codes and avoids duplicating existing rights and legal obligations, the Bill should require ASIC to have regard to the following criteria when considering whether to designate provisions as enforceable:
    1. The existing enforceability of the provision in question – including, for example, whether the provision is incorporated into code subscribers' contracts with customers, and

[1] p7, Explanatory Memorandum.

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whether impediments to contractual enforcement of the provisions have been demonstrated in the past; and

2. The extent to which conduct that would be in breach of the provision is already subject to a statutory enforcement regime (for example, under the National Consumer Credit Act).

- Further, the scope of enforceability provisions should be expressly limited, in addition to the criteria outlined in the draft, to provisions that satisfy all of the following:
    a) Provisions that set out specific obligations, rather than those that record guiding statements or principles;
    b) Provisions that provide a clear and specific extra protection beyond the existing laws, and not provisions that duplicate existing laws; and
    c) Provisions dealing with matters already within ASIC's regulatory jurisdiction (and not those already the subject of an enforcement regime, for example within the remit of APRA, AUSTRAC, or the Office of the Australian Information Commissioner).
- The sanctions for breaches of enforceable code provisions should not include community service or probation orders.
- The requirement to report breaches of enforceable code provisions to ASIC should be subject to a significance threshold.

We would be pleased to discuss any of the issues raised above.

Yours sincerely,

Jerome Davidson

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About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers.

We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

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ABA response to the Enforceability of financial services industry codes: Exposure draft legislation

Background

The ABA supports a robust enforcement framework for financial sector codes. ABA member subscribers to the Banking Code of Practice (Banking Code) have led the field in fostering industry engagement with regulators on industry codes and best-practice self-regulation. The Banking Code is the first substantial Australian financial sector code to be approved by ASIC under the Corporations Act. The ABA has also implemented recommendations of the Royal Commission on the Code's content, and obtained ASIC approval, and ACCC authorisation for these changes, which commence 1 March 2020. Both of these processes involved lengthy and in-depth consultation with regulators, as well as comprehensive input from community stakeholders.

The Banking Code is also the only such code to expressly state that the relevant terms of the code form part of a customer's contract with their bank. This provides a sound foundation for code enforceability. A breach of a Banking Code relevant provision is a breach of contract and so a remedy can be sought by the customer through the courts, as well as through the Australian Financial Complaints Authority (AFCA). Under its mandate, AFCA can take into account applicable industry codes to determine what is fair in all the circumstances, as well as relying on contractual enforceability.

While it is clear that the Royal Commission concluded that there should be an additional layer of enforceability for some clauses of industry codes, it is also clear from the broader discussion of codes in the Final Report, that Commissioner Hayne both recognises, and seeks to preserve, the benefits of self-regulation in the financial sector:

> "I do not intend to interfere with the broader development of, or operation of, industry codes. Nor do I intend to modify or limit ASIC's powers to approve the non-enforceable provisions of industry codes….I draw attention to this point because I consider it important that the banking industry, and (as I will come to) the insurance industry, continue to develop their industry codes over time. 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."

It is against that background that the ABA provides the following comments and recommendations on the draft legislation.

Approval of voluntary industry codes

We support the general provisions that set out the approval process.

Enforceable code provisions

The success or failure of this regime in implementing the Royal Commission recommendations yet preserving, per Hayne's intention, the fundamental characteristics of self-regulation, depends to a large extent on the proportion of code provisions that will be designated as enforceable. If most or all of the provisions of codes are captured, then codes will be akin to legislation. ASIC would be effectively the primary monitor of enforcement, and the collector of self-reports regarding breaches of the codes.

In addition, such a high degree of ASIC involvement in the process would tend to crowd out the role of the Code monitoring bodies such as the Banking Code Compliance Committee (BCCC), which have been a fundamental pillar of the self-regulatory regime to date, and the incentive for establishing and funding such bodies removed. In short, the self-regulatory regime would be undermined.

Implementation of the regime in a way that remains true to the intent of the Royal Commission requires, we submit, that the enabling legislation set clear limits on the scope of provisions that should be included. The draft Bill does not set such limits. Rather, section 1101A(2) outlines criteria for ASIC's consideration that are broad enough to be interpreted as being effectively unlimited in scope:

In the approval, ASIC may identify a provision of the code of conduct as an enforceable code provision if ASIC considers that:

a) the provision represents:

i. 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

ii. a commitment to a person by a subscriber to the code; and

b) either:

i. a breach of the provision could result in significant detriment to the person; or

ii. 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.

Another concern of the Royal Commission was that its recommendations not unduly complicate the law. The Commissioner was clear that the regulatory regime is already overly complex, and that his recommendations were not intended to create a new and separate layer of regulation:

> "Treasury, and many of the entities that made submissions, urged the need for caution before recommending change. This is undeniably right.
>
> As I said in the Interim Report, adding a new layer of regulation will not assist. It will add to what is already a complex regulatory regime."

Consistent with that sentiment, the enforceable codes regime should not have the result of duplicating existing regulation.

In light of the above, a more appropriate scope for the use of the designation power could be achieved by acting on the recommendations set out below.

ABA recommendations:

ASIC should, in considering whether to designate provisions as enforceable, have regard to:

1. **The existing enforceability of the provision in question – including, for example, whether the provision is incorporated into code subscribers' contracts with customers, and whether impediments to contractual enforcement of the provisions have been demonstrated in the past; and**
2. **The extent to which conduct that would be in breach of the provision is already subject to a statutory enforcement regime (for example, under the National Consumer Credit Act).**

The scope of enforceability provisions should be expressly limited, in addition to the criteria outlined in the draft, to:

a) Provisions that set out specific obligations, rather than those that record guiding statements or principles;

b) Provisions that provide a clear and specific extra protection to customers beyond the existing laws, and not provisions that duplicate existing laws;

c) Provisions dealing with matters already within ASIC's regulatory jurisdiction (and not those already the subject of an enforcement regime, for example within the remit of APRA, AUSTRAC, or the Office of the Australian Information Commissioner).

Monitoring and oversight of approved industry codes

Monitoring bodies

We start by reiterating the point made above regarding the role of monitoring bodies such as the Banking Code Compliance Committee (BCCC), and the importance of the parameters of the broader regime in preserving this role. If most or all of the provisions of codes are captured, then codes will be akin to legislation. ASIC would be effectively the primary monitor of enforcement, and the collector of self-reports regarding breaches of the codes. Code monitoring bodies would be largely redundant, and the incentive for establishing and funding such bodies removed. In short, the self-regulatory regime would be undermined and potentially obsolete.

Sanctions

We note that the draft includes a (new) proposal that courts be empowered, on the breach of an enforceable code provision, to make community service or probation orders. A probation order may be ordered by the Court for the purpose of ensuring that a person who contravened an enforceable code provision in an approved code of conduct or a civil penalty provision in a mandatory code of conduct does not engage in the conduct, similar conduct or related conduct, for a period of no longer than three years. Under this new order, the Court can make an order directing the person:

- to establish a compliance program for employees or other persons involved in the person's business, being a program designed to ensure awareness of the responsibilities and obligations in relation to such conduct; and
- to establish an education and training program for employees or other persons involved in the person's business, being a program designed to ensure their awareness of the responsibilities and obligations in relation to such conduct; and
- an order directing the person to revise the internal operations of the person's business which led to the person engaging in such conduct.

While we note that this power is drawn from Part VI of the Competition and Consumer Act, in our view, its inclusion is not appropriate for this regime. Such sanctions are traditionally more criminal than civil in nature and are not appropriate for a self-regulatory regime (and we note that breach of such an order would constitute an offence[2]). Further, the inclusion of these sanctions would add a layer of complexity over and above customer remediation and civil penalties, for code breaches.

Moreover, the proposal overlooks the fact that ASIC has (or will have) other powers that could be used to achieve largely same ends – such as the product intervention power, the ability to apply licence conditions, the Corporations Act modifications power, and the planned directions power (from the ASIC Enforcement Review) which is also being implemented in this broader package of reforms. Recalling Commissioner Hayne's view on complexity of the law and the ineffectiveness of adding new layers of regulation, we question the need for the proposed sanctions' inclusion.

ABA recommendation: The sanctions for breaches of enforceable code provisions should not include community service or probation orders.

Breach reporting

The requirement to report breaches of enforceable code provisions to ASIC should be subject to a significance threshold. While the proposed new (breach reporting) regime will deem breaches of 'civil penalty provisions' to be significant, the ASIC Enforcement Review Taskforce recommendation to that effect contemplated these to be breaches of civil penalty provisions under the Corporations Act, which are subject to much higher penalties than those proposed under the enforceable codes regime.

[2] See ss. 1101B(10), 1311

ABA recommendation: Reporting obligations for breaches of enforceable code provisions should be subject to the general significance threshold under the proposed new breach reporting regime.