Parliamentary joint Committee on Corporations and Financial Services

Oversight of ASIC, the Takeovers Panel and the Corporations Legislation, 20 October 2023

Australian Financial Complaints Authority

QoN no. 5

Mr Locke: We do have concerns that there are proposals currently from the Australian Banking Association as part of a review they've undertaken into the banking code to make changes to the banking code. One of those proposals is to remove from the banking code the obligation on banks to act as a diligent and prudent lender with regard to retail consumers. We have made representations to the ABA about the revised banking code. Some of those representations have been taken onboard, some have not.

The one of most concern to us is the removal of the diligent and prudent lender obligation. The ABA's position is that this is a simplification matter and that, because the banks are required as ADIs to act in a way that is efficient, honest and fair under the national consumer credit act, this is duplication. We do not accept that position. We've made our position on this clear, as has the banking code committee. The ABA has submitted the revised banking code to ASIC, and we understand that ASIC will be running a public consultation on this soon, but it really is down to ASIC as to whether they approve these changes to the banking code. This is an area where we are seeing, we believe, some parts of industry are pulling back some of the commitments made post the Hayne royal commission. It is a concern for us. We also have a concern with insurance brokers, the National Association of Insurance Brokers. Only in the last couple of weeks it has announced it is changing its code to remove the obligation to be transparent about commissions.

CHAIR: …..and perhaps if I could ask you to make a submission to the committee on all of your concerns with regard to code changes and the notion that they're being described as simplifications, which is at odds with what you've described as an erosion of the necessary improvements that came from the Hayne royal commission, which was multilaterally accepted here in the parliament.

AFCA's submission regarding proposed changes to Industry Codes of Practice

Role of Codes

Industry codes play an important role in the financial system. They set standards for financial firms about how to comply with, and surpass, various aspects of the law. Codes therefore contain commitments that at times are higher than regulatory requirements and they can also fill gaps where the law is silent. They also play a critical role in confirming good industry practice against which AFCA can resolve complaints against financial firms by making recommendations and decisions.

Codes of practice set standards of good industry practice for financial firms when dealing with individual or small business customers in areas relating to:

- service provision
- standards of professional conduct
- practice standards
- ethical behaviour.

Effective codes should improve consumer confidence in a particular industry or industries.

Industry Codes of Practice and AFCA

AFCA's interest in Codes arises in two key ways:

- from the direct application of code standards to the resolution of individual disputes (as provided for in our Rules), and
- in our role as Code administrator for several Codes.

The Code Compliance and Monitoring Team is a separately operated and funded business unit of AFCA. The Code Team supports independent Committees to monitor compliance with codes of practice in the Australian Financial Services Industry to achieve service standards people can trust.

The Code Team administers the following Codes:

- Banking Code of Practice
- General Insurance Code of Practice
- Insurance Brokers Code of Practice
- Customer Owned Banking Code of Practice
- Life Insurance Code of Practice

As Code administrator, AFCA is committed to ensuring codes remain a progressive conduct model, extending above the minimum standards required by the law. This is also consistent with the Australian Securities and Investments Commission (ASIC) regulatory guidance (Regulatory Guide 183 – Approval of financial services sector codes) which states that an effective code should elaborate on legislation to deliver additional benefits to consumers.

ASIC has a formal approval power in relation to industry codes. Currently only one of the codes the Code Team administers has sought and obtained approval from ASIC – the Banking Code of Practice. This Code is subject to all the requirements set out in RG 183 including about consultation.

Banking Code of Practice

The Australian Banking Association (ABA) has run a targeted consultation with a select group of stakeholders, including AFCA, on proposed changes to the Banking Code of Practice (the Code). According to the ABA, the proposed changes are consistent with principles agreed by the ABA Council for the Code review, including to remove legislative and regulatory duplication and simplify the structure to avoid unnecessary complexity.

The ABA's consultation on the Code has now been completed and changes to the Code have been submitted to ASIC for consideration and approval, in accordance with RG183. We understand that ASIC will be running a separate, public consultation process, before finalising its decision about whether to approve the Code with the new changes.

While we appreciate that the ABA has made several amendments to what was originally proposed in its initial consultation process, we remain concerned that the remaining changes will have an adverse impact on both AFCA's decision making and consumers more broadly. We believe there needs to be a greater balance between the ABA's stated objective of simplification and ensuring consumer protections are not reduced.

Removal of coverage for NCCP Act-regulated loans to individuals

Responsible lending laws under the National Consumer Credit Protection (NCCP) Act apply to consumer lending. The Banking Code of Practice has, since its inception, included a broad obligation to act diligently and prudently and AFCA currently assesses whether banks have met this broad standard as part of our assessment of whether banks acted reasonably, as required by the responsible lending laws.

The ABA notes the Code refers to both compliance with law and to a diligent and prudent banker obligation. They believe this causes confusion for consumers. The ABA also says the diligent and prudent banker test may be a lower standard than the standard of conduct required under the NCCP Act. The ABA is now proposing to remove the diligent and prudent banker obligation in paragraph 49 of the Code for consumer lending, and to retain it for unregulated lending (including small business lending) for which no other legal standard applies.

We disagree with the ABA's assessment. In our view, the spectrum of what is 'reasonable' conduct (which is covered in the law) can be broad, and when the diligent and prudent banker requirement is overlaid, it can indicate additional or more specific steps the bank should have taken which effectively creates a higher standard for banks than what generally applies to credit providers under the NCCP Act.

For example, we may consider the diligent and prudent requirement creates a higher standard of conduct in assessing whether a loan is unsuitable where:

- a borrower applies for a loan to purchase a property in which they will not have a legal interest (such as a property to be purchased by an adult child)
- a borrower seeks a loan to purchase a property to construct a dwelling and there is debate about whether the bank ought to have considered the repayments on a future construction loan when assessing the earlier purchase loan
- a bank has internal policies about verifying genuine savings or acceptable forms of income in credit assessments (e.g. excluding certain unreliable income sources) and AFCA is considering whether related conduct is a breach of the Code, and
- a broker provides information about a proposed loan that appears on its face to be unreliable.

Although the responsible lending obligations are broad and principles-based, the obligation in paragraph 49 of the Code, in our view, creates a higher (and better) standard for banks within the spectrum of reasonable conduct. We also consider subscribing banks' compliance with their own policies as part of our consideration of whether they acted diligently and prudently when assessing a loan application.

The standard in the Code has existed alongside the responsible lending obligations since they were enacted in 2009 and we do not believe there is evidence of confusion or duplication to warrant its removal. To the contrary, AFCA relies on the diligent and prudent banker test in its decision making and it would be detrimental to lose a meaningful, simple touch-point phrase that consumers and industry can understand. While it is a positive that the Code will include this terminology for small business, omitting it for consumer credit suggests that such a requirement does not exist to protect consumers.

In our view, removing this core standard and expectation changes the nature and tone of the Code, and in our view will not achieve what the ABA was seeking to achieve when it first introduced the Code. This would be a backward step on the good work done by banks over the last four years to rebuild trust and improve practice in dispute resolution.

Removal of protection for guarantors

The removal of paragraph 49 for loans to individuals will substantially lower protections for guarantors. In the Victorian Supreme Court of Appeal decision of *Doggett v CBA*, the Court found the Code obligation in paragraph 49 is incorporated into Code subscribers' guarantee contracts. This means guarantors also benefit from the protection in paragraph 49.

If a bank does not act diligently and prudently when assessing the borrower's capacity to repay the secured loan, the guarantor may be released from liability under the guarantee where AFCA finds the bank's error led it to provide a loan it otherwise would not have provided.

Unlike individual borrowers, who have the protection of the responsible lending obligations, guarantors do not have the same legislative affordability assessment protections, so are more reliant on the protections in the Code. It is paragraphs 49 and 50 of the Code (and their incorporation into guaranteed contracts under paragraph 2 of the Code) that effectively extend the responsible lending and diligent and prudent obligations to cover guarantors.

The removal of the 'diligent and prudent banker' requirement in paragraph 49 of the Code would remove this protection for guarantors of loans to individuals and substantially weaken guarantor protections.

Simplification of complaints handling obligations

The existing Chapters 47 and 48 have been significantly reduced to a single paragraph, essentially stating that the bank will comply with ASIC Regulatory Guide (RG) 271. The ABA has advised it does not believe it is necessary to duplicate the contents of RG271.

RG271 is a 57-page document written for financial firms and it is unreasonable to expect customers to refer to this guide to understand a bank's complaints handling obligations. The Code plays a key role in clarifying these requirements in a clear and accessible way.

The ABA advised it will prepare a separate, customer focused companion document that complements the Code to explain a customer's key rights and protections. However, we are not satisfied that this will achieve the objective to provide accessible and clear information to help customers navigate and understand legislative protections.

Further, there are particular obligations in the current Code that are not duplicated in RG 271, and streamlining these obligations in this manner is a loss of consumer protections.

Insurance Brokers Code of Practice

Proposed changes

The March 2022 Code approved by the National Insurance Brokers Association (NIBA) Board required insurance brokers to disclose all remuneration and commissions to retail and small business clients.

NIBA has now communicated to AFCA and its stakeholders that it will be limiting disclosures to only retail clients as defined by the *Corporations Act* 2001 (Cth).

Under this definition the remuneration and commissions to retail clients is limited to a narrow set of low value product types. In particular, these statutory definitions do not include commonly held small business insurance products, and we are concerned that small business customers will therefore be particularly disadvantaged.

Disclosure of insurance broker commissions and remuneration is in AFCA's view critical as it helps customers assess whether the advice and insurance products recommended are in their best interest and to understand the real cost of using brokers' services. Transparency is critical to reducing the risk of insurance broker conflicts of interest and consumers purchasing unsuitable or unnecessary insurance policies.

We know insurance brokers can disclose this information and some already do. This is good industry practice. NIBA has an important opportunity to drive improved practice across the sector, by ensuring the standard extends above and beyond the minimum legal standards.

NIBA's own submission to the recent Quality of Advice Review relied on its Code promises and emphasised, at multiple points, the fact insurance brokers were required to disclose all commissions and remuneration to retail and small business clients.

Page 1 of NIBA's submission to the Quality of Advice Review in June 2022 stated:

> ".. community expectations continue to evolve, to meet those expectations and raise standards of professionalism, the industry has responded by introducing a new Code of Practice that sets standards above the Law, which further increases the transparency and disclosure of broker remuneration and conflicts of interest."

What we now see is NIBA stepping back from this commitment, on the basis that the changes will reduce complexity and align with the minimum standard proposed by the Quality of Advice Review.

AFCA strongly opposes these changes. As noted, codes play an important part in AFCA's external dispute resolution work and decision making, particularly where they expound on what is good industry practice. We directly apply these standards when resolving individual disputes, so the proposed changes to the Code do have a direct impact on complaint outcomes for insurance broker clients who bring a complaint to AFCA.

Where industry fails to keep in step with community expectations, more formal regulation will likely fill the gap. In the absence of broad disclosure provisions in the Code, mandatory disclosure provisions for brokers would need in our view to be considered.

Consultation processes for changes on both Codes

We are concerned about the level of consultation on changes to both the Banking Code of Practice and the Insurance Brokers Code of Practice. Consultation on the Banking Code of Practice was limited. We are unaware of any consultation with stakeholders on the changes to the Insurance Brokers Code of Practice and AFCA was not consulted.

Given the important role of Industry Codes, and their primary role to raise standards and to complement the legislative requirements that already set out how product issuers and licensed firms (and their representatives) deal with consumers, it is critical that consultation on any changes are appropriately carried out, so issues can be identified and worked through. This is also to ensure Codes continue to play an important role in improving consumer confidence in financial services.

Moreover, consultation is a key criterion set out in ASIC's Regulatory Guide 183: Approval of financial services sector codes of conduct. RG 183.19-20 states that (emphasis added):

RG 183.19 *We consider a code to be a body of rules that sets enforceable standards across an industry (or part of an industry) and delivers measurable consumer benefits.*

RG 183.20 *As such, a code should satisfy the following criteria:*

(a) the rules contained in the code must be binding on (and enforceable against) subscribers through contractual arrangements;

(b) ***the code must be developed and reviewed in a transparent manner, which involves consulting with relevant stakeholders including consumer representatives****; and*

(c) the code must have effective administration and compliance mechanisms.

The regulatory guide sets out ASIC's expectations about effective consultation and transparent procedures in developing an industry code.

The NIBA Code says that "the Code was developed following close consultation with key stakeholders, including consumer groups, regulatory bodies and the broader intermediated insurance industry".

We are concerned that the level of consultation on recently proposed changes to the NIBA Code are not aligned with the expectations in RG 183, or the representations made in the actual Code. While RG 183 currently only applies to the Banking Code of Practice, it provides a useful best practice model for all Codes.