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Mr James Kelly
Division Head, Financial Services Reform Taskforce
Treasury
Langton Crescent
PARKES ACT 2600

By email: FSRCconsultations@treasury.gov.au

Dear Mr Kelly

Financial Services Royal Commission – Enhancing consumer protections and strengthening regulators

The Australian Finance Industry Association (AFIA) welcomes the opportunity to provide a response to Treasury's consultation on its exposure draft legislation in relation to its response to the recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission).

AFIA is committed to ensuring that all Australians have continued access to finance and is also committed to enhancing consumer protection and this commitment informs our responses to the draft legislation.

AFIA Background

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia including retail banks, finance companies, credit card issuers, and Fintechs, such as buy now pay later providers. For more information about AFIA, please see **Annexure A to** this submission.

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self-regulation through industry codes, and to work with the Federal Government, financial regulators and other stakeholders to promote a supportive environment for industry.

Our guiding principles seek to build the settings to:

- Promote simple, convenient, innovative and affordable credit to finance Australia's future, including maximising access to credit for customers able and willing to service their commitments and minimising the likelihood or incidence of customers entering into unsuitable credit contracts
- Foster competition and innovation in Australia's financial services industry, which enables our members to grow, expand and thrive as key participants in lending and other markets, and
- Generate greater financial and economic participation by consumers and small businesses in Australia's financial system and economy and improve social participation as a means to create financial wellbeing.

To do so, we focus on the key drivers that provide positive customer outcomes, foster competition and innovation within industry, and facilitate financial, economic and social engagement by both customers and industry.

Our Submissions

We note that while members have contributed to our submission, the position being put by AFIA may not reflect a particular member's organisationally-specific position on all of the issues. These will get captured through a submission from that organisation.

In principle, we support Treasury and the Government in its plans to deliver on the recommendations of the Financial Services Royal Commission. It will be very important to ensure implementation of these recommendations it done in a manner that does not negatively impact on the broader economy, limit access to credit, or reduce innovation and competition.

In relation to ASIC's Directions Power, we note that the Commissioner Hayne did not specifically recommend that the Government implement the ASIC Enforcement Review Taskforce's (ERT) recommendation to give ASIC a directions power. Our Members believe strongly that only the courts should be able to impose penalties on a business after hearing suitable evidence, and therefore we ask that the *Financial Sector Reform (Hayne Royal Commission Response – Stronger Regulators (2020 Measures) Bill 2020*: *FSRC Recommendation 7.2 (ASIC directions)* is not passed.

We will not be providing feedback on all proposed Royal Commission-related draft exposure legislation released by the Government for public comment, but only those that will affect our members and their businesses and customers.

As a result, we have summarised below key recommendations and provided more detailed responses to each of these pieces of draft exposure legislation as follows:

- ASIC directions power (the additional commitment in response to recommendation 7.2) – **Annexure B**
- Strengthening of breach reporting (Royal Commission Recommendations 1.6, 2.7, 2.8, 2.9 and 7.2) – **Annexure C**
- Enforceability of financial services industry codes (Royal Commission Recommendation 1.15) – **Annexure D**
- Deferred sales model for add-on insurance (Royal Commission Recommendation 4.3) – **Annexure E**, and
- Cap on vehicle dealer commissions (Royal Commission Recommendation 4.4) - **Annexure F**.

Key recommendations

All our key recommendations are built off the guiding principle that a 'one size fits all' approach to regulation is not going to be appropriate as it would adversely impact innovation and competition, reduce customer choice and potentially impact access to finance:

In relation to ASIC's directions powers:

1. Do not proceed with the Bill, and

2. If this does not occur, ensure there are qualifications when ASIC may make a direction and remove their power to make directions based on suspicion of a possible breach.

In relation to strengthening breach reporting:

3. Hold a roundtable with Treasury and AFIA to explore further the outcomes of the 20 February 2020 meeting and subsequent discussions on:
    a. The definition of a 'significant' breach – including the impact the current proposal would have on both ASIC and AFCA's resourcing capacity and financiers' reputations if left unamended
    b. The definition of an 'investigation'
    c. ASIC's proposed ability to publish breach report data to address reputational and privacy concerns, and
    d. An enhanced solution for reference checking.
4. Provide at least an 18 month transition timeframe to manage implementation and minimise compliance complexities and costs.

In relation to Enforceability of Codes:

5. Ensure the ABA's Banking Code of Practice does not become quasi-law through becoming legally enforceable code provisions. The ABA's Banking Code of Practice was designed for large, prudentially regulated financial institutions, and is not suitable for all financial institutions. Specifically, clauses relating to responsible lending and small business lending and fairness, as defined by AFCA, should not be legally enforceable and/or deemed the minimum standard across the financial services industry.
6. Ensure the scope of enforceable code provisions is limited, in addition to the 'significant detriment' criterion outlined in the draft, to provisions that:
    a. Set out specific obligations, rather than those that record guiding statements or principles
    b. Provide a clear and specific extra protection to customers beyond the existing laws, and not provisions that duplicate existing laws, and
    c. Deal 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).
7. Implement a materiality threshold for breach reporting of enforceable code provisions.

In relation to the deferred sales model for add-on insurance:

8. ASIC to delay its proposed use of its Product Intervention Power (PIP) for the motor dealer channel until and if such time that it is satisfied that there remains the risk of consumer detriment after full implementation and assessment of the Treasury Model.
9. Make the sale of a car rental damage waiver product for rental car operators exempt from the deferred sales model.

In relation to vehicle dealer commissions:

10. Align the cap currently imposed by section 145 of the National Credit Code to the cap on consumer credit insurance (CCI).
11. Have a thorough consultation prior to enactment of legislative instrument.

Should you wish to discuss our feedback further, or require additional information, please contact Karl Turner, Executive Director, Policy & Chief Operating Officer at karl@afia.asn.au or 02 9231 5877.

Kind regards

Diane Tate
Chief Executive Officer

Annexure A

The Australian Finance Industry Association (AFIA) is the voice of a diverse Australian finance sector. AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia which includes:

- major, regional and mutual/community owned banks
- providers of consumer finance, including home loans, personal loans, consumer leases, credit cards, buy now pay later services, and debt purchasers
- providers of land finance, including residential and commercial mortgages and bridging finance;
- equipment financers, including commercial equipment financing ranging from agri-equipment to small ticket equipment financing
- motor vehicle financiers, including consumer motor finance, novated motor finance, small business motor finance and heavy vehicle finance
- fleet leasing and car rental providers, and
- providers of commercial finance, including secured and unsecured loans and working capital finance to businesses, including small businesses.

AFIA's members range from ASX-listed public companies through to small businesses providing finance, which operate via a range of distribution channels, including through 'bricks and mortar' premises (physical branches and other outlets), via intermediaries (including finance brokers, dealerships, retail suppliers), and through online access or platforms (traditional financial institutions and fintechs).

AFIA's members collectively operate across all states and territories in Australia and provide finance to customers of all demographics from high to low-income earners and to commercial entities ranging from sole traders, partnerships and across the corporate sector in Australia.

AFIA's members provide a broad range of products and services across consumer and commercial finance, a snapshot of these include:

- consumer: home loans, personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), personal secured loans (secured by land or personal property); consumer leases of household assets (including household goods, electrical/IT devices or cars) and buy-now, pay later services;
- commercial: land, asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); business finance and working capital solutions (secured loans, online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards), together with more sophisticated and complex finance solutions.

For further information about AFIA, please see here.

Annexure B

ASIC directions power
(the additional commitment in response to Royal Commission Recommendation 7.2)

AFIA appreciates the opportunity to comment on the *Financial Sector Reform (Hayne Royal Commission Response – Stronger Regulators (2020 Measures) Bill 2020*: *FSRC Recommendation 7.2 in relation to ASIC directions powe*r (**the Exposure Draft**).

We note that the impact of a ASIC direction is not limited to financial penalties, and ASIC can also direct a licensee to halt its business, with failure to comply with an ASIC direction resulting in a banning order (which ASIC has the power to issue) and/or financial penalties. Our Members believe strongly that only the courts should be able to impose penalties on a business after hearing suitable evidence, not ASIC.

We note further that the Financial Services Royal Commission did not specifically recommend that the Government implement the ASIC Enforcement Review Taskforce's (ERT) recommendation to provide ASIC with a directions powers (**ASIC Directions Power**).

The reasons the ERT outlined in relation to expanding ASIC's powers to include the directions power at that time were:

- Applying to a court for an injunction involves significant time, resources and costs in investigating and preparing a case to the required standard to commence court proceedings. In urgent matters involving a licensee, there is utility in providing ASIC with an efficient and quick mechanism to require a licensee to put in place or modify internal systems or restrict its activities in appropriate ways to address risks to consumers.
- The resources and procedural requirements necessary to impose additional conditions or to suspend or cancel a licence can result in delay between concerns arising and ASIC achieving a protective outcome. This can leave financial consumers at risk in the interim period as surveillance and hearings take place.
- Enforceable undertakings must be agreed to by a licensee and are generally negotiated as an alternative to ASIC exercising its administrative powers or initiating court proceedings. This requires acknowledgement by the licensee of ASIC's concerns. The outcome also depends on the strength of the evidence available to support ASIC's concerns and the nature of the alternative remedies that could be pursued by ASIC.

We note that ASIC already has, in its enforcement toolkit, a large number of powers available to it to address inappropriate behaviour. Additionally, since the ERT made its recommendations, ASIC has been granted significant further powers to address breaches or potential breaches of the law. These include (in enacted or soon to be enacted legislation) the ability to:

- Strengthen ASIC's licensing powers
- Expand ASIC's power to ban individuals in the financial sector (banning powers), and
- Use ASIC's product intervention power (PIP).

Specifically, the PIP allows ASIC to intervene and take temporary action where financial and credit products have resulted in, or are likely to result in, significant consumer detriment.

In the last 12 months alone, ASIC has initiated a range of court actions, in keeping with Commissioner Hayne's view that the regulator should not seek resolution of an issue by agreement but through legal action.

In the Royal Commission Interim Report, delivered in September 2018, Commissioner Hayne noted:

> *'This cannot be the starting point for a conduct regulator. When contravening conduct comes to its attention, the regulator must always ask whether it can make a case that there has been a breach and, if it can, then ask why it would not be in the public interest to bring proceedings to penalise the breach. Laws are to be obeyed. Penalties are prescribed for failure to obey the law because society expects and requires obedience to the law.'*

AFIA supports Commissioner Hayne's view that breaches should be tested in the courts, not simply be subject to whatever action ASIC thinks appropriate. This approach is further supported by Justice Nye Perram's decision on the boundaries of responsible lending obligations in *Australian Securities and Investments Commission v Westpac Banking Corporation* (Liability Trial) [2019] FCA 1244. Justice Perram noted the NCCP Act '…….does not operate as ASIC alleges' and that 'ASIC's argument creates a whole new range of implied rules which appear altogether unnecessary'. Justice Perram found there were no grounds to support the penalties ASIC wished to impose, i.e. there was no contravention.

Both Commissioner Hayne and Justice Perram highlight the importance of a regulator identifying evidence which indicates potential breaches of the law and bringing them before the courts for both parties to be heard. Neither support the regulator having the powers to act as if a court and impose substantive penalties without due process and procedural fairness.

AFIA supports the concerns of the Law Council of Australia, who in its submission to the ASIC Enforcement Review Position and Consultation Paper 8 [1], raised concerns that the proposed directions power would:

- Create an unnecessary extension of ASIC's existing powers,
- Constitute a disproportionate response to the 'gap' in the existing regulatory regime identified by the Consultation Paper, and
- If implemented, lack adequate appeal mechanisms and oversight.

Recommendation 1 – the Bill not proceed

As ASIC already has adequate powers to address market misconduct, we believe this Bill should not proceed on the basis it places ASIC's powers above those of the courts and denies businesses' due process and procedural fairness.

If AFIA's recommendation for the Bill not to proceed does not proceed, our recommendations on the Exposure Draft is as follows:

Recommendation 2 – Include qualifications when ASIC may make a direction

In essence, section 918(1)(a) and section 78B(1)(a) provides that ASIC may make a direction if it has reason to suspect that a financial services licensee/credit licensee has engaged in conduct that constitutes a contravention of a financial services or credit law (respectively).

[1] https://www.lawcouncil.asn.au/docs/f4a83f2a-e953-e811-93fb-005056be13b5/3375%20-%20ASIC%27s%20Directions%20Powers.pdf

Our concern is that 'reason to suspect' is an unduly low threshold and risks allowing ASIC to pursue action against a licensee without locating adequate evidence or conducting sufficient investigations.

We recommend that the test include a qualification, similar to that in PIP, i.e. that ASIC must be able to demonstrate that the conduct has resulted, will result or is likely to result, in significant consumer detriment. In this case, we would recommend the qualifications to 'reason to believe' include 'by significant loss to a licensee's customers or clients or where there is evidence of significant consumer detriment and that such that the power is only triggered where critical intervention or urgent action is required'.

Recommendation 3 – Remove ASIC power to make directions based on suspicion of possible breach

We are concerned that ASIC has the power under section 918(1)(b) and section 78B(1)(b) to make directions where it suspects that a licensee <u>will</u> engage in conduct that would constitute a contravention. We understand (from the example provided in the Explanatory Memorandum), that ASIC will use breach reports of licensees to identify conduct that <u>has</u> breached financial services or credit laws.

It is unclear from the Explanatory Memorandum how ASIC could identify if a licensee <u>will</u> (as opposed to has) breached the financial services or credit laws. The wording allows ASIC to make assumptions that a licensee could have the potential to (but has not actually) breached any laws.

Therefore, we recommend either:

- Removing sections 918(1)(b) and 78B(1(b) in their entirety, or
- If the above recommendation is not accepted, providing examples in the Explanatory Memorandum of instances where ASIC could assume the conduct of a licensee could or will breach the financial services or credit laws.

Recommendation 4 – Remove section 918A i.e. directions to be made public

Section 918B and section 78C requires the publication of any direction ASIC makes under section 918 or section 78 respectively. We have raised concerns that the ambit of these new powers, and low threshold of 'reason to suspect' or even our recommendation of 'reason to believe' risks ASIC using its directions powers against licensees without locating adequate evidence or conducting sufficient investigations.

The publication of such directions, in the context where there is a lack of due process and procedural fairness, causes significant risks including:

- Potentially compromising internal investigations by organisations where there is fraud or misconduct is suspected
- Potentially compromising criminal and civil investigations by ASIC or other regulatory or law enforcement bodies
- Unnecessarily causing consumer outrage and the potential to drive up volumes of unmerited complaints to AFCA
- Risks significant reputational harm and financial damage to licensees, and

- Creates further barriers of entry to the market and reduce competition in the financial services industry.

Therefore, we recommend that section 918A, i.e. the requirement for ASIC to publish its direction(s), be removed in its entirety and instead that ASIC keep all directions that it makes confidential.

Irrespective of this recommendation, we believe that ASIC should be required to consult with industry and then explain the use of their enforcement powers, like APRA has done on their website[2].

Recommendation 5 – Ensure directions have limited timeframes

Section 918(4) and section 78B(4) provides that ASIC has powers to make directions to be in force within any timeframe it sees fit, and this could potentially allow ASIC to make directions that do not have a timeframe specified – this could be extremely detrimental to Australian financial services licensees and Australia credit licensees, and could potentially place licensees "in limbo".

We recommend that any directions made by ASIC should be limited in their operation to a period of no more than three to six months (with tightly circumscribed opportunities for extension or renewal).

[2] http://www.apra.gov.au/enforcement

Annexure C

Strengthening of breach reporting
Royal Commission Recommendations 1.6, 2.7, 2.8, 2.9 and 7.2

AFIA welcomes the opportunity to provide feedback on the exposure draft legislation in relation to the *Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2 (Reference checking and information sharing, breach reporting and remediation) (***the Exposure Draft***).*

In the Financial Services Royal Commission, Commissioner Hayne found that Australian financial services licensees were not doing enough to communicate between themselves about the backgrounds of prospective employees.

In order to address this, it was recommended (Recommendations 1.6 and 2.7) that Australian financial services licensees and Australian credit licensees should be required to give effect to reference checking and information sharing protocols for financial advisers and mortgage brokers, to the same effect now provided by the ABA's 'Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol' (**ABA Reference Checking Protocol**).

Commissioner Hayne also recommended (Recommendations 2.8 and 1.6) that requirements should be introduced on Australian financial services licensees and Australian credit licensees to report serious compliance concerns about financial advisers and mortgage brokers, respectively.

Concerns about the existing breach reporting regime were also raised, due to the existing test being subjective, and therefore largely inconsistent amongst licensees in terms of timelines and the matters reported.

As there is currently no breach reporting obligation for credit licensees that is equivalent to the reporting obligation of financial services licensees, concerns were raised that the obligation to lodge annual compliance certificates to ASIC provided only high level and generalised information, and information about breaches could not be provided in a timely way.   yes

In order to address this, it was recommended (Recommendation 7.2) that the ASIC Enforcement Review Taskforce amend the *Corporations Act 2001* to clarify and strengthen the breach reporting regime for Australian financial services licensees, and that the Credit Act is amended to introduce a comparable breach reporting regime for Australian credit licensees.

Background commentary

In principle, we support the Government's commitment to strengthen the breach reporting regime and improve reference checking and information sharing protocols in financial institutions. However, we are concerned with how this is currently drafted, and the consequences for which this substantial modification of the "significant breach" test will have on the industry. In particular, the proposed scope of objectively determinable criteria that will trigger a significant breach could lead to disproportionate regulation and could end up favouring the , larger, more resourced financial services providers. In effect, this could have, consequential adverse impacts on innovation and competition, ultimately leading to potential restrictions on access to credit.

We believe the Government's commitment to improve reference checking and information sharing protocols for financial advisers and mortgage brokers is important. However, we do not support the blanket extension of the ABA's 'Financial Advice - Recruitment Termination Reference Checking and Information Sharing Protocol' to all financial advisers and mortgage brokers. The compliance burden and costs involved in implementing this protocol should not be underestimated. The protocol was designed by large, prudentially regulated financial institutions, and is not suitable for all financial institutions.

The Government has proposed for these recommendations to come into effect on 1 April 2021. Given the cumulative impact of the vast array of changes underway in the industry, including legislative and regulatory changes, compliance system changes, technology changes and new industry standards voluntarily being adopted through codes of practice, and the likely significant impact across the different ASIC-regulated entities, we believe this timeframe is unrealistic and unreasonable.

Due to the issues highlighted in this submission, if the Government proceeds with the proposed breach reporting regime for credit licensees, it is critical that a more thorough consideration and consultation is given to the scope of the objectively determinable criteria, its impact, and how to balance the objectives of strengthening governance, accountability and transparency without causing unnecessary compliance complexities and costs, and impeding competition, innovation, customer choice and accessibility. Additionally, a longer transition and compliance timeframe should be introduced to at least 1 January 2022.

We are concerned that in the event the breach reporting regime is extended to credit licensees in the proposed form, especially to parts of the industry and emerging sectors where significant risks have not been evidenced to justify additional regulation, it will be detrimental to growth, competition, innovation, and create further barriers of entry to the market.

Commentary on the Exposure Draft

We note that Recommendation 7.2 of the Financial Services Royal Commission was to implement the ASIC Enforcement Review Report (the Report) and its recommendations to:

i) Clarify and strengthen the existing breach reporting regime for AFSL holders, and
ii) Introduce a comparable breach reporting regime for credit licensees.

Under the Exposure Draft, the test for whether a breach or likely breach is significant presently includes objectively determinable criteria for core obligations.

The test for whether a breach or likely breach of a core obligation will be deemed significant if:

a) the breach is punishable on conviction by a penalty that may include imprisonment for a maximum period of 12 months or more (3 months or more for dishonesty); or
b) the breach attracts a civil penalty provision; or
c) the breach results or is likely to result in loss or damage to customers in relation to a credit activity; or
d) any other circumstances prescribed by the regulations exist.

Otherwise licensees must make an assessment of whether a breach or likely breach of a core obligation is significant having regard to:

a) the number or frequency of similar previous breaches;

b) the impact of the breach or likely breach on the licensee's ability to engage in credit activities covered by the licence;
c) the extent to which the breach or likely breach indicates that the licensee's arrangements to ensure compliance with those obligations are inadequate; and
d) any other matters prescribed by regulations

We note that under the proposed reference checking protocol, all licensees must undertake reference checking and information sharing regarding former, current and prospective representatives, directors, employees, and credit representatives who will be involved in providing credit assistance in relation to credit contracts secured by mortgages over residential property. Failure to implement the protocol properly, would result in significant issues, including potentially privacy breaches and unfair biases or decisions to take place.

Recommendation 1 – Hold a round table meeting with Treasury to review the proposed Significant Breach Test

In the Royal Commission Final Report, it was recommended that "the 'significance test' should be retained but clarified to ensure that the significance of breaches is determined objectively" and that a comparable reporting regime for credit licensees be introduced.

In principle, we support the extension of the reporting regime to encompass credit licensees and we support a 'significance test' that provides more clarity and less ambiguity as to what a significant breach is. However, we do not support the proposed significant test and strongly believe that the current proposed regime will result in more severe detriment to the financial services industry.

Following on from our discussions with Treasury at the roundtable meeting hosted on 20 February 2020 and Treasury's request to put forward suggestions on how the "significance test" threshold could be revised, we propose a further roundtable meeting be held to discuss the following revisions:

Current draft	AFIA proposal	Examples of why the change is needed
Section 50A(5)(b) -Breaches deemed significant – civil penalty provisions	We propose the draft legislation is amended to refine the list of civil penalty provisions, taking into account the actual or potential harm of an isolated breach of each civil penalty provision, and only include provisions where an isolated breach is likely to cause detriment or harm to a consumer. We recommend that the list of civil penalty provisions to be included as significant breach reporting triggers should be drafted by ASIC to better align with the Report in that "any changes to the significance test should be supplemented by new, specific, regulatory guidance from ASIC that takes into account different businesses, products and distribution channels". In effect, by allowing ASIC the power to prescribe the significant reporting triggers (following consultation with the industry), it would allow ASIC to take scalability into consideration, have fit for purpose significant reporting triggers, and have better ability for the reporting triggers to be dynamic.	Where a licensee fails to lodge their annual compliance certificate on time, the breach would be recorded as a deemed breach on the breach register but should not be a significant breach as it has not caused detriment, loss or harm to a consumer. There should be no significant reporting trigger, based off this isolated offence. A non-material breach of an enforceable code provision would not cause detriment to a consumer, however under the current Exposure Draft, each offence would be classed as a significant breach and need to be reported.

	We recommend that when assessing which civil penalty provisions should be deemed as significant, a materiality test should be applied, similar to the way breaches of offence provisions are under section 50A(5)(b).	
	In the Report, it was discussed that significant breaches do not necessarily have to involve financial loss. However, "a breach of this nature may be worth reporting to ASIC as it may impact trust and confidence and suggest a broader systemic failing". We propose including a limb that in the event that a contravention of a civil penalty provision is systemic (regardless of whether it is classified as a significant breach reporting trigger), and has caused, or is likely to cause substantial harm or loss to a consumer, that it be deemed a significant breach. We recommend that to ensure consistency across the industry, AFCA's definition of "systemic breach" should be used, with the test for which AFCA uses for their "identified systemic breaches" being adopted here. The materiality threshold for substantial harm for systemic breaches be $10,000, however, this is indicative only and we welcome further discussion on the appropriate limit.	If a licensee became aware that due to an operational system issue over 1000 consumers had been mistakenly charged say a $16 AUD fee for a copy of their assessment, then this would be categorised as systemic. As the aggregated detriment is over $15,000 AUD then due to the systemic nature of the issue, and amount of harm caused, it would be a significant breach and need to be reported. However, for an isolated incident where a consumer was mistakenly charged $1 for a copy of their assessment, as there has not been substantial harm to the consumer, this would not be a significant breach.
Section 50A(5)(c) -Breaches deemed significant – client loss or damage	Breaches resulting in client loss or damage should not be automatically deemed to be significant under section 50A(5)(c). Instead breaches resulting in client loss or damage should be subject to a materiality threshold. We propose the use of a materiality threshold of $1000 for an isolated incident. However, we also recommend that the legislation provides for the aggregation of breaches, so that if a consumer suffered from multiple breaches from the same entity, and the cumulative total of harm was $1000 or over, then it would also be a significant breach and need to be reported.	Any breach resulting in a loss of 50 cents or $1 – even where these are isolated and / or have quickly been identified and remediated, would technically give rise to a reporting obligation as a reportable situation. That result would drive up costs for the industry and ASIC without any apparent benefit from a regulatory perspective. Where a credit card provider accidentally imposed retrospective interest charges, and the harm suffered from this was $750, this would not be a significant breach. However, if the credit card provider also failed to notify that consumer that they exceeded their credit card limit, and the harm from this was $300, then as , the aggregate harm of these breaches total over $1000, these would become significant breaches and need to be reported.
Section 50A(1)(a)(iii) -Obligation to report when licensee has commenced an investigation	We strongly believe that reporting all investigations to ASIC regardless of the outcome, will cause unnecessary administrative burden and reporting fatigue. We propose that the wording is modified, to be fit for purpose, so that ASIC should only be notified of	Where there has been a breach, the loss encountered by the consumer is $1500, but the breach is rectified within 7 days, there would be no need to report it to ASIC as a significant breach.

	a current investigation in the following circumstances: a) where there is a possible or perceived systemic breach that is likely to cause substantial harm based on the materiality threshold (the Report specifically contemplated a materiality element); or b) where a complex investigation into a possible significant breach is being undertaken, and the investigation will take longer than 30 days to complete. We recommend following the Notifiable Data Reporting regime's approach to investigations, in that it allows an entity to consider remediation work completed after identifying a breach, when determining whether there is any likely significant harm. If a breach is not systemic in nature, and if the issue has been remediated such that there is no, or minimal, consumer harm, within the 30 day period it should not be reportable at all. This approach will ensure consistency in breach reporting across the sector.	

Our recommendation to reframe and re-position the proposed changes is based on some key principles.

Principle 1 – Do not inadvertently create a negative impact on competition

We believe it is important for regulation to be used to foster an appropriate environment in the advent of a market failure or when interventions are required to achieve optimal outcomes for customers, businesses (including small businesses), the financial system, and the broader economy, and where those interventions are deemed economically unnecessary and beneficial.

There is a serious concern that the current drafting of the legislation will negatively impact on competition by creating unnecessary compliance complexities and costs and creating further regulatory barriers for newer entrants and smaller players – all of whom meet all existing laws and regulations. We believe that the proposed reporting regime will introduce unnecessary, unreasonable and disproportionate regulatory and compliance burdens.

The proposed reporting regime does not allow for scalability and will require certain fixed compliance costs and new systems in order to comply with the current drafting of the legislation. As we highlighted to the Senate Inquiry on Fintech[3]it is important to preserve Australia's status as a financial services hub and not expect new entrants to go from the ASIC Sandbox to full 'scaleup'. If left unchanged, newer players may become less able to absorb these costs and this will result in a decrease in growth, innovation and competition.

However, it is not just newer businesses that will suffer, but mature businesses too that will face additional administrative burdens and will need to develop new functions in the business in order to comply with the proposed legislation.

In particular, the current proposal for *all* (emphasis added) investigations to be reported, is one that will require unreasonable compliance burdens, and unless there are systemic or complex

[3] https://afiamail.asn.au/resources/Documents/Policy/170220%20-%20SUB%20-senate%20enquiry%20into%20consumer%20leases.pdf

investigations occurring, the burden of reporting, and resources needed to comply with this obligation, will vastly outweigh any potential benefit ASIC may have from analysing such data.

Consequently, and we are aware first-hand from various enquiries we have had, there is likely to be a significant decrease in international interest and / or investment, due to the quantity of reporting to the regulator, as opposed to other jurisdictions.

Offshore and onshore parties are unclear as to:

- what is the problem that ASIC is seeking will be solved by all investigations being reported
- when reports are provided, what is the process of ongoing engagement (included agreed timeframes) that ASIC will undertake with them, and
- what enforcement action ASIC will deem appropriate to take.

Furthermore, the proposed reporting regime, combined with the proposed Financial Accountability Regime (FAR) regime, is likely to make it difficult for entities to compete both domestically and internationally for talent, due to regulatory risk. In order to comply with the current draft (particularly with the proposed timing) it is likely that the current shortage of quality legal and compliance specialists required for this work will be exacerbated.

Principle 2 – Objective criteria

At a high level, we support the amendment of the "significant breach" test to include objective criteria. However, the NCCP is very prescriptive legislation, especially compared with the *Corporations Act 2001*. There is a practical risk that having such broad, general criteria for an objective test, combined with highly prescriptive legislation will create a 'tick-a-box' compliance culture, rather than creating a culture for each licensee to consider the potential harm and detriment each breach has caused.

This 'tick-a-box' mentality is the type of culture Commissioner Hayne recommended moving away from as one of the factors leading to poor customer outcomes. However, by drafting such prescriptive and potential over-encompassing obligations, the industry will instead be focused on complying with reporting obligations, rather than focusing on the actual breach and assessing the detriment and harm to the customer. Instead, it is recommended that the proposed legislation fosters an environment for sophisticated and judgment-based decisions.

Furthermore, having such low reporting triggers implies that compliance can be perfect and achieved. However, compliance is an ongoing process, with even excellent systems encountering issues. It is recognised by both industry and government alike that the current proposed regime will result in an unwarranted amount of reports and investigations being lodged, that will make it difficult for ASIC to properly investigate and to determine actual significant breaches from the volume of 'other' breaches received.

As a result, it is recommended that clarity is provided to the industry as to what actual "significant reporting triggers" are, so that the data being provided to ASIC is qualitative and useful, with breaches being appropriately assessed by each entity, rather than the focus being on lodging any and all breaches that may occur without proper assessment.

Principle 3- AFCA and ASIC response

We are concerned that with the proposed reporting regime, and current inclusion of all civil penalty provisions to be regarded as significant breaches, that there will be a substantive increase in complaints to AFCA, for situations for where there has been no or low detriment to the consumer.

Licensees will have to notify customers for every significant breach, and with the current drafting and inclusion of all civil penalty provisions under the current AFCA model, consumers will be able to lodge a claim to AFCA (with licensees having to pay AFCA for each claim lodged), regardless of whether the customer had encountered any sort of detriment.

AFCA is still maturing, and the current Exposure Draft will increase considerably complaint volumes such that AFCA may not be able to adequately resource or take away much-needed resources from existing complaints to look at these matters.

In relation to increased resourcing, we would like to better understand how ASIC proposes to resource itself to appropriately assess each significant breach and investigation reported. Due to potential negative impact on members' reputation arising from delays in responses from ASIC, we recommend that ASIC develop a service- level agreement with all licensees as to the timeframe in which they will respond to a significant breach report or investigation report. This would allow more timely finalisation of any rectification processes and further investment into resources. Additionally, this could ensure that regulator costs (i.e. ASIC levies) are appropriately managed and targeted to appropriate regulatory efforts and priorities.

Recommendation 2 – Clarify the definition of an investigation

We recommend that further clarity and guidance is provided as to what constitutes an "investigation". We understand from our conversations with Treasury that the drafting was purposefully kept broad. However, the current drafting seems impractical as it proposes an investigation into *each* complaint raised by customers (where the complaint related to a core obligation breach).

Instead, we recommend defining what is not an "investigation" and keeping the definition relatively broad.

For example, the current definition captures all Quality Assurance (QA) activities which are, by definition, investigations into whether an entity has breached its core obligations. An organisation with a strong commitment to compliance will conduct a large volume of QA audits, each of which will be individually reportable. Licensees should only be required to report investigations in relation to matters which appear likely to both be systemic in nature and are likely to result in significant consumer harm.

Recommendation 3 – ASIC to consider granting relief to the timing of some consumer notifications and customer compensation

We recommend that the Exposure Draft factors in large scale remediation projects. We propose that ASIC is provided the power to grant relief from complying with the timing requirements of consumer notifications and customer compensation, where ASIC and the licensee have agreed on a remediation plan.

For example, it may not be reasonable to notify a client within 10 days and pay a client within 30 days if that client is part of a larger scale remediation project.

A licensee should be given the discretion to hold off from paying a client, provided the licensee compensates the client for the delayed payment if that client is part of a broader ongoing investigation and ASIC has agreed to it.

Recommendation 4 – ASIC to provide guidance on the publication of breach reports

We recommend that ASIC considers publishing guidance on the publication of breach reports. On the one hand, there are obvious instances, such as criminal investigations, where (in order to not hamper the proceedings), there should not be any publication of the breach. On the other, there are instances where improper publication or any publication at all will cause undue reputational risks to businesses.

With the current Exposure Draft, compliant industry participants, who will take their obligations to report seriously, will incur greater costs and greater reputational harm (through reporting) than their less compliant counterparts, who may be indifferent to their obligations, or who may have invested less heavily in resources or technology to help them identify issues within their business for intervention, remediation and process improvement. This may lend a competitive advantage to less forensic or improvement focused participants, in terms of less costs, less enforcement and less adverse publicity, resulting in a counterproductive outcome. Furthermore, publishing "significant breaches" statistics without any context, such as size of the provider, types of products or services, etc is likely to be misleading with regards to the nature of breaches, the extent of issues, and the level of regulatory concern and/or potential consumer detriment.

Therefore, we recommend that ASIC consult with the industry on when publications will made, and what they will include, and that guidance is published to provide clarity to the industry.

Recommendation 5 – Amend the transitional timeframe to 1 January 2022

We strongly recommend that the implementation date of 1 April 2021 is revised to 1 January 2022, as it is currently impracticable for licensees to be ready by this date.

The transition timeframe should be 18 months from date of royal assent, assuming this is close to 1 July 2020, in order to provide adequate time for licensees to implement the necessary IT systems and develop appropriate resources needed in order to comply with their legal obligations.

Recommendation 6 – Review the reference checking protocol to address potential privacy issues

We understand that the ABA's 'Financial Advice - Recruitment Termination Reference Checking and Information Sharing Protocol' has been used as a basis for the proposed reference checking protocol.

We believe it is not appropriate for this protocol to be extended across the financial services industry, particularly where it has been designed for large, prudentially regulated financial institutions with substantial compliance systems and human resource functions.

AFIA has been developing its own Reference Checking Protocol for Authorised Representatives, based off the ABA's Reference Checking Protocol, but with standards and processes appropriate for different size financial institutions with different business models and capabilities. For example, we are exploring enhanced digitised functions that allow for better security, compliance with the *Privacy Act 1988,* and for recording of metadata so that there can be better understanding of how many red flags are being raised and with which licensees.

We would be pleased to provide Treasury with further information to ensure a fit for purpose approach is adopted across the industry.

Recommendation 7 – Remove the obligation to report breaches of other credit licensees in relation to conduct of mortgage brokers

We note that this was not a recommendation in the Royal Commission Final Report, and we do not support the general introduction of the extension of the reporting obligations of one licensee to another licensee.

We believe the inclusion of this recommendation is unduly onerous and would cause compliance complexities and costs. It is unreasonable to subject licensees to this obligation to report the wrongdoing of others on the basis of a mere suspicion of wrongdoing. This could be misunderstood and/or misused.

Reporting of breaches should be a judgment-based test and focused on what the licensee reasonably suspected at the time, rather than an objective assessment of whether it should have suspected a reportable situation to have arisen.

Furthermore, there are practical issues, in that it is difficult for a licensee to determine that a reportable situation has arisen about another licensee owing to limited or no access to the relevant information.

In the event that this proceeds, we propose the following amendments:

a) Section 50D(1)(a) should be changed to "it has reasonable grounds to suspect" rather than "there are reasonable grounds to suspect".
b) The obligation in this section to report breaches of other licensees should only apply to:
    a. the reportable situations mentioned in sections 50A(2)(a) and 50A(2)(b) (gross negligence and serious fraud); and
    b. reportable situations which give rise to foreseeable material loss or harm to retail clients.
c) The reporting obligation should be limited to only apply to conduct in relation to credit contracts secured by mortgages over residential property (and not in relation to other consumer credit contracts or to commercial lending).
d) The offence provisions should be removed on the basis that this goes above and beyond the recommendations in the Royal Commission Final Report and there is insufficient evidence to justify additional regulation.

Annexure D

Enforceability of Financial Services Industry Codes
Royal Commission Recommendation 1.15

AFIA welcomes the opportunity to provide feedback on the exposure draft legislation in relation to the *Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Enforceability of Financial Services Industry Codes (**the Exposure Draft**)*.

In the Financial Services Royal Commission, Commissioner Hayne identified a number of limitations in the current financial services industry codes framework, some of which had previously been identified in the Final Report of the ASIC Enforcement Review Taskforce.

In particular, Recommendation 1.15 of the Royal Commission Final Report proposes that the law should be amended to provide that:

- ASIC's power to approve codes of conduct should extend to codes relating to all ASIC-regulated entities, including but not limited to APRA-regulated institutions and Australian Credit License holders
- 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
- 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, balancing the need to promote industry codes of conduct as ways to foster best practices that go above and beyond the law and drive a culture of integrity, transparency and fairness and better customer outcomes
- Remedies, modelled on those set out in Part VI of the *Competition and Consumer Act 2010*, should apply where there is a breach of an enforceable code provision, and
- A mandatory codes of conduct framework for the financial services industry is established.

Background commentary

AFIA supports FICA (the Financial Industry Council of Australia) when in April 2019, they outlined that:

- They believe in the value of self-regulation as a means of supplementing and expanding on the legal framework underpinning financial services regulation, and
- The implementation of the recommendations of the Royal Commission should be guided by the overarching and important objective of maintaining the benefits and characteristics of the system of self-regulation that underpins the development of financial sector codes.

The AFIA Board has supported self-regulation (or Codes of Practice) as a key strategic priority for the last few years. We strongly believe that Code of Practice:

- Demonstrate to customers a level of service, product design, and distribution capability that gives an educational and operational context and commitment to the law and regulation and / or sets a standard of agreed behaviour that exceeds the law through best practices

- Drive change, protect consumers and small businesses, and underpin competition and innovation across the financial services industry
- Allow members to self-regulate and meet (even exceed) community expectations, and ensure that industry standards evolve in a more dynamic way than law and regulation permits
- Strengthen trust and good standing of the finance industry amongst stakeholders
- Improve industry ownership of standards as well as responsibility and accountability around compliance and risk
- Encourage less 'mature' financial services providers (who still comply with the law) to potentially lift their compliance and risk systems early to the level of more mature players who also operate over the minimum legal requirements
- Reduce the need for formal legislation or regulation
- Reduce the workload on government regulatory bodies, and
- Assist external dispute resolution schemes (i.e. Australian Financial Complaints Authority, AFCA) by providing a sector-specific and appropriate benchmark from which to assess and review complaints made by customers.

AFIA has demonstrated capability in the development, design and implementation of Codes of Practice. AFIA has three codes in place, under review and in development – AFIA's Online Small Business Lenders Code of Lending Practice, AFIA Car Rental Code, and the draft Buy Now Pay Later Code (details here).

Our Codes establish proportionate, minimum standards that are appropriate for different products, services and entities across the finance industry.

Commentary on the Exposure Draft

We note and appreciate that our members' previous feedback has been considered and that:

- The revised framework will continue to provide for:
    - Industry developed codes that are not approved by ASIC
    - Industry developed codes that are approved by ASIC, and now
    - Government mandated codes
- Code owners, such as Industry Associations, can continue to choose whether they seek ASIC approval, and
- As outlined in clause 1.43 of Exposure Draft explanatory materials, code subscribers can continue to contract directly with the independent person or body that has power to administer and enforce that Code (i.e. a code compliance committee) and/or internal or external dispute resolution mechanisms (i.e. AFCA) – this point is particularly important for some of our small business code subscribers as the wholesale funding market is still considering the implications of allowing subscribers to incorporate an agreement to abide by a code into small business contracts.

Recommendation 1 – Ensure clauses included in the ABA's Banking Code of Practice relating to responsible lending and small business lending and fairness, as defined by AFCA, do not become

legally Enforceable Codes provisions and ensure the scope of ECPs is limited, in addition to the 'significant detriment' criterion outlined in the draft, to provisions that:

- ***Set out specific obligations, rather than those that record guiding statements or principles;***
- ***Provide a clear and specific extra protection to customers beyond the existing laws, and not provisions that duplicate existing laws;***
- ***Deal 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)***

Under clause 1101(2) of the Exposure Draft, ASIC can identify enforceable code provisions if they represent a commitment to act in a manner consistent with attaining the objectives of the code and either a breach of the provision could result in significant detriment to a person or the breach of the provision could significantly undermine the confidence of the Australian public in the provision of financial services. The civil penalty for a breach of an enforceable code provision is up to 300 penalty units / breach for an ASIC approved code and 1,000 penalty units / breach for a mandatory code.

However, the courts as well as other bodies, such as AFCA, already have similar powers and can impose different monetary and non-monetary penalties for non-compliance with any relevant laws and regulations by subscribers. We also note that in the event say compliance with the Privacy Act is determined to be an enforceable code provision, then ASIC and the Office of the Australian Information Commissioner (OAIC) could have differing views on how a breach could be managed.

As discussed at the Treasury roundtable meeting on 18 February 2020, there is the potential for code provisions that are enforceable through the courts or say AFCA or the OAIC to *also* (emphasis added) be an enforceable code provision, leading to additional penalties, which, when taken in aggregate, may be material to a subscriber.

As a result, we recommend the scope of the enforceability provisions should be expressly limited, in addition to the 'significant detriment' criterion outlined in the draft, to:

- Provisions that set out specific obligations, rather than those that record guiding statements or principles
- Provisions that provide a clear and specific extra protection to customers beyond the existing laws, and not provisions that duplicate existing laws
- 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).

Treasury will be aware that Commissioner Hayne said:

> 'The responsible lending provisions of the NCCP Act do not apply to lending for business purposes. As I said in the Interim Report, the evidence and submissions provided to the Commission did not reveal any great appetite to change [this] lending framework. The submissions received by the Commission following this Interim Report were consistent with this trend. I do not consider this surprising: extending the responsible lending obligations in the NCCP Act would likely increase the cost of credit for small business and reduce the availability of credit. I am not persuaded that the benefits to be gained in individual cases from applying the NCCP Act to small business outweigh the overall costs

> of taking that step. I therefore do not consider that the NCCP Act should be amended to extend its operation to lending to small businesses'.

We believe to ensure consistency with the Royal Commission Final Report, the right regulatory settings and industry standards, and access to finance by small businesses, we recommend that the ABA's Banking Code of Practice as it relates to small business lending should not be defined as enforceable code provisions.

We similarly suggest that for the reasons above and to avoid confusing customers and other stakeholders and creating a parallel regulatory regime with the NCCP Act, that the ABA's Banking Code of Practice as it relates to responsible lending should not be defined as enforceable code provisions.

Additionally, we believe that the law should state that where ASIC has approved an industry code of conduct, that it is not necessary for the same code to be submitted to another regulator for approval. Currently, it is possible for an industry code to be approved by ASIC and then require another approval by the Australian Competition and Consumer Commission (ACCC). This is not cost-effective or efficient for industry or the regulators. Additionally, it can result in unnecessary duplication, or worse, conflict of regulatory perspectives.

Instead, we recommend that ASIC, under its competition mandate, should give consideration to the application of the competition laws as relevant to the particular code of conduct. For example, if the code of conduct contained provisions that would otherwise breach competition laws, such as price structures and/or restrictions on product or service availability, which are being introduced in the public interest and to promote better customer outcomes, ASIC should have the ability to approve the code of conduct.

Recommendation 2 – Do not make 'fairness' an ECP until further analysis has been undertaken including allowing an AFCA Final Determination to be appealed say through a court process

Building on the last point around careful and judicious use of enforceable code provisions, section (j) in the Exposure Draft explanatory materials is useful as it provides some insight into what enforceable code provisions are/could be. (Additional examples would be welcome as https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-324-product-intervention-the-sale-of-add-on-financial-products-through-caryard-intermediaries/.)

AFIA appreciates that, as outlined in clause 1.62, ASIC and the code owner can assess and discuss whether there are provisions in the proposed code that should be made enforceable. Our members recognise that ultimately, as outlined in clause 1.63, ASIC at its discretion may ultimately designate the provision as enforceable.

The examples provided in clause 1.66 about how other provisions could be designated as enforceable code provisions (e.g. conflicts of interest, cooling off periods, providing information to consumers and fees and charges) help crystallise further how enforcement (and if non-compliance, penalties) could operate as in these examples, compliance can be seen as quite binary – i.e. you meet the criteria or you do not.

In the Exposure Draft explanatory materials, clause 1.36 recognises that 'historically industry codes have delivered better outcomes for consumers than what the applicable financial services legislation at the time was able to deliver. These include consumer-specific provisions in codes that have been applied as part of external dispute resolution'. Clause 1.70 supports this by saying that provisions that may be included as an ECP may [include] commitments to the public at large.

As Treasury would be aware, regulators, the industry, public commentators and the wider community are looking at 'community expectations' in financial services. As part of this analysis, the notion of 'fairness' is becoming more prominent, with AFCA designing (and will soon be consulting on) fairness principles on which to assess complaints raised through external dispute resolution frameworks.

Our members believe that fairness must take into account all parties, not just one – this is the crux of the law of equity on which AFCA is said to be basing its current round of research.

Fairness should:

- Take into account lenders, as well as their other customers and investors, as they are all impacted by 'fairness decisions' based on one stakeholder's perspective, and
- Not be used as a basis for arbitrary decision-making.

We note that under Exposure Draft explanatory materials clause 1.76, 'the criteria that ASIC must meet in order to designate a provision to be an ECP is contained in the primary law'. However, the fairness concept has not been subject to considered judicial opinion in the lending context. When this is coupled with an inability to appeal an AFCA final determination (which may, in part, be based on the application of the fairness principle) we are seeing it negatively impacting on confidence in the external dispute resolution process and discouraging voluntary membership of AFCA. This would have adverse consequences for financial services providers and customers.

We will continue to work constructively with AFCA on these issues, but until further analysis has been undertaken and changes made to certain procedures, such as allowing a final determination to be appealed say through the courts or a tribunal, we recommend that the fairness concept is excluded as an enforceable code provision.

Similarly, we recommend that Codes of Practice that include guiding principles around behaviour, not just specific clauses dealing with conduct, disclosure and consequence, should be excluded as enforceable code provisions. Without this clarity, it is likely that Code of Practice will no longer include clauses that drive higher standards of industry practice and aspirational cultures.

Recommendation 3 – Ensure that, in order to preserve the integrity and credibility of mandatory codes, they should:

- ***be based on the deep, robust and consultative process, as outlined in clause 1.97 of the Exposure draft explanatory materials***
- ***be based on the same principles and framework as co-regulatory and self-regulatory codes***
- ***not used as a means of unnecessarily pressuring applicants to agree to potential ASIC recommendations***

We note that under the Exposure Draft:

- Not *all* (emphasis added) Codes need to be submitted for ASIC for consideration of approval – new section 1101A(3) now details the criteria where ASIC must not approve a code
- ASIC will not have a unilateral power to require a code be submitted to it for consideration, and
- The decision of whether to create a mandatory code will ultimately be a decision for government.

Our members understand why mandatory codes may now be necessary and the examples provided in clause 1.96 of the Exposure Draft explanatory materials highlight when they may be a more appropriate tool.

It is important that should the Government wish to continue to encourage subscribers to look at means of continually improving customer outcomes by going above and beyond the law and regulations, then there needs to be strict adherence to the process outlined in clause 1.97 of the Exposure Draft explanatory materials. This is to ensure procedural fairness, a critical aspect of the imposement of material penalties for non-compliance of enforceable code provisions.

Recommendation 4 – Confirm that the explanatory materials that accompany the Exposure Draft can apply to small business finance customers as well as consumers

The language in the Exposure Draft explanatory materials references 'consumer'. Given the framework provides ASIC with the power to approve codes for which it has regulatory responsibilities in relation to AFSLs, authorised representatives, issuers of financial products, credit licensees and credit representatives (under Exposure Draft explanatory materials clause 1.23,) which could in some circumstances include issues relating to small businesses, we recommend that confirmation of this is included in final documentation.

Recommendation 5 – Consider amending Division 2, 1101A 3 (c) (ii) and Division 1 A- 238A 3 (c) (ii)

Under this clause, we understand the intent behind why ASIC must not approve an industry code of conduct unless it is satisfied 'all members (within the ordinary meaning of the expression) of the applicant who provide financial services covered by the code are likely to become subscribers to the code'.

We note the comments made at the Treasury roundtable meeting on 18 February that:

- 'All' is aspirational and may not be a determinative factor used by ASIC
- Subscribers to a code are dynamic and that mandating 'all' may:
  - not be practical
  - not recognise the size and maturity of some of our members' business models (who meet their legal obligations but may not have the resources to commit to the financial and non-financial requirements of a code), and
  - limit innovation as smaller entrants to the market would be expected to be resourced to the same extent as larger members.

As a result, we suggest that the final version of the explanatory materials should refer to the 'substantial majority' of members. Alternatively, the explanatory materials should provide clarity about the aspirational nature of (c) (ii).

Recommendation 6 – Include in the final Exposure draft explanatory materials that as part of 1101 A (3) (c) it is appropriate to approve the code if in part it educates customers and other stakeholders on the law and its application

While we accept that ASIC's focus is on approving codes that impose an obligation on a subscriber that is more onerous than a law or regulation, as part of developing our AFIA codes (such as, the Online Small Business Lender Code of Lending Practice and the draft Buy Now Pay Later Code) we have received feedback from various stakeholders that they appreciate we have also restated existing elements of the law so as to improve overall understanding, context and financial literacy.

Therefore, we suggest that allowing elements of this to occur in future codes approved or not approved by ASIC will be important to clarify.

Recommendation 7 – Remove, after paragraph 1101B(4)(d), the need for an order directing the person to perform a service …for the benefit of the community or a section of the community

We believe that ASIC has (or will have) other powers that could be used to achieve the same effect as is being sought by the inclusion of this new clause – for example, the PIP and the proposed Directions Power (from the ASIC Enforcement Review). As a result, repeating this in this legislation could add a layer of cost over and above customer remediation and civil penalties, for no material additional benefit.

Recommendation 8 – Implement a materiality threshold for breach reporting of ECPs

The requirement to report breaches of enforceable code provisions to ASIC should be subject to a materiality threshold. While the 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 2001*, which are subject to much higher penalties than those proposed under the enforceable codes regime.

Annexure E

Deferred sales model for add-on insurance
Royal Commission Recommendation 4.3

The exposure draft legislation and regulations will legislate the Government's commitment to implement Recommendation 4.3 of the Royal Commission.

We acknowledge the Royal Commission's findings that there have been instances of consumer detriment regarding the sale of add-on insurances and note that there has been, and continues to be, significant change in the industry since this time.

We note that the proposed deferred sales model will apply economy-wide to the sale of add-on insurances and support the intent of the proposal to ensure customers are making informed decisions. We provide feedback in respect of motor vehicle add-on insurance and car rental damage waivers only.

Background Commentary

Both the Royal Commission and ASIC have examined the sale of add-on insurance in relation to motor vehicle sales. These studies relate to past behaviour and do not reflect current practices.

Since the release of the Royal Commission Final Report and ASIC's Report 470: Buying add-on insurances in car yards, our motor finance members have been working to improve their products and services as well as their compliance systems. This has included the withdrawal of many products, which while offering value to some customers, no longer generally meet community expectations.

Recommendation 1 – ASIC to delay its proposed use of its Product Intervention Power (PIP) for the motor dealer channel until and if such time that it is satisfied that there remains the risk of consumer detriment after full implementation and assessment of the Treasury Model

ASIC's final report in relation to the sale of insurances through caryard intermediaries is still outstanding, but its model, including the definition of key concepts varies considerably from the model proposed in the exposure draft legislation. Furthermore, we note that the interaction between this legislation and any potential use of the PIP is also unclear.

We recommend that ASIC delay its proposed use of its PIP for the motor dealer channel until and if such time that it is satisfied that there remains the risk of consumer detriment (as it describes) after full implementation and assessment of the Treasury Model (which may for example be a period of 1-2 years).

Recommendation 2 – Confirm the deferral period begins from when the customer makes a deposit or receives conditional finance approval

Our motor finance members seek clarification on how conditional sales and conditional finance will be treated to determine the time when a customer enters into a commitment (table 1 of Clause 3B of the draft regulations).

Currently the exposure draft materials do not explicitly cover these two situations. We recommend that the deferral period begins from when the customer makes a deposit or receives conditional finance approval as this represents a substantial commitment where the terms of the contract for the sale have been finalised

Recommendation 3 – Align the definition of a motor vehicle to State based legislation

Our motor finance members seek clarification of the definition of a motor vehicle as per subsection (2) of Clause 3B of the exposure draft regulations. The current drafting of this definition leads to some ambiguity of what a motor vehicle is and what specifically it captures.

For example, does it include motor powered vehicles that are not intended to be used on a road? Does it include vehicles with only two wheels? Further clarity is needed to ensure compliance.

We recommend that this could be achieved by adopting the definitions used by State based legislation of a motor vehicle when registering a vehicle. Alternatively, the definition could be changed to be a motor vehicle that carry a vehicle identification number (VIN).

Recommendation 4 – Clarify if operating lease vehicles are captured by this legislation

Clarification is sought as to whether leases for operating vehicles will be caught by this legislation. If so, we seek clarification on when the deferral period begins for this product.

Recommendation 5 – Make the sale of a car rental damage waiver product for rental car hire operators exempt from the deferred sales model

The Royal Commission examined add-on insurances in a limited number of circumstances but none of them related to add-on insurances in the rental car market.

The collision damage waiver product allows car rental customers a way to manage the risk of a large repair cost if unforeseen damage occurs during the rental.

As the term for many car rental agreements is less than the four days being proposed by the Exposure Draft, it seems impractical and inappropriate to see this product still being within the scope of section 12DO of the exposure draft legislation.

As a result, we support the exposure draft legislation creating a power for ASIC to exempt certain products sold by certain entities and that this include the collision damage waiver product for car rental customers. A factor ASIC may take into consideration is whether the product and/or entity is covered by an industry code of conduct.

Annexure F

Cap on vehicle dealer commissions
Royal Commission Recommendation 4.4

AFIA welcomes the opportunity to provide feedback on the exposure draft legislation in relation to the *Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Caps on Commissions* (***the Exposure Draft***).

We understand that the Exposure Draft specifically addresses Royal Commission Recommendation 4.4 to amend the *ASIC Act 2001* to provide ASIC with the power to:

- Enable ASIC to place a cap on the amount of commissions that may be paid to dealers in relation to the sale of add-on risk products, including tyre and rim insurance, mechanical breakdown insurance and consumer credit insurance supplied in connection with the sale or long-term lease of a motor vehicle
- Make it a criminal offence, civil penalty and offence of strict liability for someone to pay or receive a commission that exceeds this cap, and
- Provide consumers with a right to recover any commissions paid that exceed this cap.

We understand this essentially means that ASIC will be given the power to, by way of a legislative instrument, place caps on commissions for add-on risk products supplied in connection with the sale or long-term lease of motor vehicles to consumers, with examples being:

- Consumer credit insurance
- Tyre and rim insurance
- Mechanical breakdown insurance, and
- Warranties.

ASIC will also have the power to determine the basis for the commission calculation by way of actual value, market value or other means, and ASIC will be able to impose those caps through an ASIC legislative instrument.

We understand the Royal Commission ultimately found that the commissions being paid to dealers in connection with the sale of add-on insurances within caryards was resulting in actual or perceived conflicts of interest and contributing to incidences of the mis-selling of these products, noting that:

- Commissions paid to dealers regularly exceeded claims payouts to policyholders
- Insurers were paying higher commissions in an effort to encourage dealers to compete with one another to gain market share, and
- The industry had taken limited steps to reduce commission amounts, given there were few legal requirements to do so.

AFIA accepts that there have been incidences of inappropriate behaviour within the industry and is supportive of the Government's response to give effect to Royal Commission Recommendation 4.4. We note that the industry has made significant changes to its compliance systems and remuneration arrangements in relation to products sold through car dealerships. Our motor finance members continue to work with ASIC on ensuring regulator expectations translate into improved standards of industry practice.

Changes across the industry have been as a result of:

The publication of the Royal Commission Final Report in February 2019, which included the recommendation for caps to be placed on commissions

The significant work that ASIC has done in relation to the sale of add-on insurances, in particular the ASIC's Consultation Paper: Product intervention: The sale of add-on financial products through caryard intermediaries (CP 324)[4], which consults in the potential use of the PIP. We noted in our response to CP 324 that our motor finance members (some of which own caryards) were actively working with product issuers to address concerns regarding the product, insurance cover, sales practices, training, and compliance support. Our response to CP 324 is available on request.

To examine this issue AFIA has engaged with our members and our submission focuses on sections in the Bill where our members are seeking greater clarification or have comments t make.

Recommendation 1 – Align the cap currently imposed by section 145 of the National Credit Code to the cap on consumer credit insurance (CCI)

We note section 145 of the National Credit Code provides that commissions paid by insurers to motor vehicle dealers in connection with the sale of CCI taken out by a debtor are capped at 20% of the premium. We also note the new section 12DMC(9) of the Exposure Draft and paragraph 1.32 of the Exposure Draft explanatory material provides that in the absence of an applicable determination by ASIC, the cap of 20% applies. We do not see any reason for any legislative instrument of ASIC to vary or over-ride current legislation – in essence any use of the PIP to cap commissions in relation to the sale of CCI must reflect the cap currently imposed by section 145 of the National Credit Code.

Recommendation 2 – Amend the wording associated with the valuing of commissions [market value]

We note the current wording in new section 12DMC(5)(b) is confusing and recommend the wording in the Exposure Draft explanatory material is used instead:

(i) *the amount of money of the commission (to the extent that the commission is expressed as an amount of money), and*

(ii) *the market value of so much of the commission that is not expressed as an amount of money (if any),*

and that examples are provided in the Explanatory Memorandum as to how section 12DMC(5)(b)(ii) works in practise.

Recommendation 3 – Provide examples on the apportioning value of commission between products

[4] http://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-324-product-intervention-the-sale-of-add-on-financial-products-through-caryard-intermediaries/

In relation to new section 12DMC(7) and corresponding paragraph 1.26 of the Exposure Draft explanatory material, it would be helpful for the Explanatory Memorandum to contain further examples of how the apportionment would work in practise.

Recommendation 4 – Clarify the drafting on recovering commissions that exceed a cap

We refer to new section 12GFA and corresponding paragraph 1.42 to 1.44 of the Exposure Draft explanatory material – we recommend that the drafting be made clearer, i.e. that consumers can only recover commissions that exceed the cap (not the whole value of the commission), and we also an example in the Explanatory Memorandum of how the recovery may work in practise.

Recommendation 5 – Have a thorough consultation prior to enactment of legislative instrument

We recommend ASIC engage in a thorough consultation process with industry prior to the publication of any legislative instrument and associated regulatory guidance, to ensure there are no adverse or unintended consequences for businesses and their customers.