



ASIC

Australian Securities & Investments Commission

Monitoring the self regulatory landscape

An address by Jillian Segal, Deputy Chair, ASIC, to the Financial Services Consumer Conference 2000, 9 November 2000, Sydney.

Thank you for inviting me to talk with you this morning about ASIC's views on Codes.

I must say it is a most timely conference. Within ASIC we have also been doing a great deal of thinking about the role of Codes of Conduct in the post Financial Services Reform Bill context. The present reviews of the payments system Codes make such thinking unavoidable.

Since it is rare, however, that I get the opportunity to talk to this many financial services consumer advocates at one time, I thought I would first spend some of my time this morning filling you in on what ASIC has been doing more generally. Then I will get into the detail of where our Code thinking has been leading us.

As most of you no doubt know, ASIC has now had responsibility for consumer protection in the non-credit related areas of financial services for a little over two years. (We are likely to also have TPA type credit responsibilities once the FSR legislation is through). In that time, we have been extremely active. This activity can perhaps be best understood if it is seen as occurring in two stages.

Stage one involved doing what I would like to call the "ground work".

It involved coming to grips with the new legislation and understanding how the financial services industries operate. It involved recruiting and training appropriate staff (and here we were lucky enough to recruit a number of excellent people who had previously been active in the consumer movement and consumer credit legal circles). It also involved getting to know our stakeholders in the new areas of industry, the consumer movement and building collaborative relationships with them. Importantly it involved risk identification and priority setting.

From the outset of our new responsibilities, we have tried to ensure that our approach is proactive and based upon appropriate assessments of risks rather than simply reactive and process based. We have focused on developing our ability to identify risks, problem areas or patterns of non-compliance and designing interventions that effectively control or reduce them.

This has meant undertaking not just risk assessment work, but also putting considerable efforts into priority setting. While we employ numerous criteria in setting our priorities, important ones include the serious and prevalence of the conduct, the detriment caused to consumers and whether the consumers affected are at a particular disadvantage.

Both risk identification and priority setting involve an active dialogue with our consumer and industry stakeholders. We won't know all of the risks if we don't go out there and talk to the people affected. Setting priorities is also complicated by the fact that budgetary limitations mean that regulators can never take on all problems that they see in the market place.

Stage 2, of course, involves trying to solve the problems we have identified and prioritised. In doing this we use a range of tools from an ever expanding toolbox. We have to pick the right tools for the right outcome. The toolkit includes criminal proceedings, civil actions, administrative solutions (such as bannings or enforceable undertakings), education, compliance reviews, surveillance, self regulatory initiatives, law reform, policy development, etc, etc. Inevitably, the best solutions involve using a combination of tools.

What have we actually done?

In the risk identification area:

- We commissioned Chant Link to survey consumer issues. We asked them to identify, describe and rank the relative importance of consumer issues of concern within the financial services sector (excluding credit). Many of you were, no doubt, contacted as part of that survey. You won't be surprised to know that the issues affecting low and very low income segments were found to be quite different from those affecting middle and higher income groups. Amongst the top issues found, however, were super choice and consumer empowerment, the independence of advice, banking issues and the need for improved dispute resolution processes.
- We commissioned the Financial Services Consumer Policy Centre to conduct a stocktake of consumer financial services education material and, in particular, to look at areas where education could be improved. The results have been fed into our education strategy. The stocktake has been transformed into an online directory of consumer education material to be launched next week.
- We commissioned Rice Kachor Research to outline fees and charges on investment products, commission structures in the market and market trend areas to help us identify high risk areas for misselling. That research was one factor leading to our present disability insurance campaign.
- We commissioned Chant Link to discover whether consumers understand the fees applicable to their transaction accounts and whether there is a need for improved disclosure. This research led to ASIC establishing a working group to improve transaction fee disclosure.

All of these initiatives are in addition to our regular surveillance of the marketplace, formal and informal liaison structures and ongoing analysis of complaints statistics.

In terms of forming the collaborative partnerships necessary to help us identify the main problems and solve them, we have undertaken numerous initiatives:

- We established the Consumer Advisory Panel to advise us on consumer protection issues. CAP meets quarterly and consists of an independent chair and nine representatives from key consumer groups. It was involved in the commissioning of a number of the risk identification projects I just outlined.
- Establishing other outcome specific working groups to help us develop solutions such as the EFT and Transaction Fee groups. On these, we include both industry and consumer representatives.
- Consolidating strong relationships with a broad range of consumer and industry groups which involve both formal and informal liaison mechanisms. They also involve joint ventures such as the joint shadow shopping exercise we did with ACA on financial advisers and joint education ventures such as Super Decisions which we undertook with ASFA.

As to doing the actual work, as I said, most problems require a multi-faceted approach, but for this morning's purposes I will divide my discussion of regulatory outcomes into three main areas:

- Enforcement and Compliance
- Policy; and
- Education and Communications

Our enforcement cases range from large matters involving major entities to smaller scale scams.

Some of our more significant cases in the enforcement area have included:

- The Westpac case where failure to make the level of disclosure required and inappropriate investment advice from some advisers led ASIC to accept an enforceable undertaking that will improve disclosure documents and compliance. We also took a similar action against

Suncorp Metway.

- The Aboriginal Community Benefit Fund case which involved the sale of funeral funds and life insurance products to Aboriginal consumers in remote communities. We alleged that the sales involved conduct that was misleading, deceptive and unconscionable. ASIC obtained consent orders that, among other things, required ACBF to offer refunds and establish a compliance program.
- We are also currently investigating another set of complaints about misselling to Aboriginal communities. We intend to follow the present campaign with a major communications exercise designed to raise awareness with communities and relevant organisations about the issue of misselling and also put other financial services operators on notice about what we consider to be inappropriate selling practices in this area.
- We have put a very high priority on ensuring that we are equipped to deal with e-commerce crime and have established an electronic enforcement unit with advanced cyber-forensic skills. Our e-commerce related enforcement actions include Rentech where we successfully brought actions against two men who sent over four million spam emails with the purpose of pumping and dumping the US Stock, Rentech. We received assistance from our US equivalent, the SEC, in bringing this action. We have also taken a number of actions against trading software promoters for making false and misleading claims about the money that could be earned using their software and actions against those providing unlicensed investment advice on the net.
- In the superannuation area, we have brought a number of cases against investment advisers who have tried to illegally access their client's super funds.
- Just last Friday we filed in the Federal Court against one of Australia's largest industry superannuation funds, the TWU's, alleging that the Trustee of the Fund had misled members as to the type of disability cover the Fund arranged for them.

- Last financial year we banned 50 unsuitable people from giving investment advice – the highest number ever.

In the compliance area we have:

- Compared our list of registered insurance brokers with those listed as brokers in the Yellow Pages. This has led to an increase in registration applications and a media campaign about the importance of dealing with a registered broker.
- We also ran a campaign which examined superannuation disclosure documents provided to continuing members.
- At the moment we are undertaking a compliance survey in the disability insurance area. Even though the campaign is yet to be completed, it is already focussing attention on disability claims handling procedures.

We have also been exceedingly active in the policy area.

- We have issued our policy statement on the approval of dispute resolution schemes. This has resulted in a number of improvements to schemes and, importantly I think, a requirement that the schemes report systemic issues to ASIC.
- We are working to expand the EFT Code to cover all forms of electronic banking, not just EFTPOS and ATM transactions.
- We conducted a review of flood insurance policies which led to some suggestions for improved disclosure. We also issued a consumer information brochure.
- We have been very active about the need to improve disclosure of transaction banking fees, making a submission to the parliamentary inquiry and chairing the working party I just

mentioned. We are already seeing results in terms of improvements in disclosure.

- There has also been lots of action in the Codes area, especially with the present reviews of the Payments System Codes, but I will get to Codes in a moment.
- Perhaps our biggest policy challenge in the next year relates to the implementation of the Financial Services Reform legislation and ensuring that the benefits for consumers expected from it can be achieved as soon as possible.

The last category of initiatives I want to mention relate to consumer education and information. Just a few of our initiatives in this area include:

- In July this year we released a discussion paper which looks at what our consumer education strategy should be for the next few years. I suspect that a number of you here today will also be at our Stakeholder's Forum in Melbourne later this month where we hope to get further input from you on this topic.
- ASIC has improved our website and added FIDO, a consumer site, which provides hot tips, alerts, stories of scams to avoid, information and contact details about how to complain to ADRs and ASIC and, later this month, a special link to information targeted at youth.
- We also constantly look for ways of selling our consumer protection messages to the media – just some of our techniques have included last year's award winning Millennium Bug Insurance Scam, our regular release of Consumer Alerts and the monthly Gull of the Month awards for true stories about outrageous financial scams.

But enough about what we have been doing. Let me move onto the topic that is the focus of today's conference - Codes.

What I want to say about Codes this morning can be summed up in three main propositions.

Firstly, in the post FSR environment, there should continue to be a role for Codes in the regulatory mix.

Secondly, what that role should be needs debating. The role of Codes seems clearest when Codes are dealing with issues not covered by legislation and, to a lesser extent, where they are improving on protections provided in legislation. It is least clear in the area of clarifying legislation where there are competing alternatives.

Thirdly, though, industry Codes are not an all purpose panacea. They are not always the appropriate response to a problem and, even where they may be appropriate, they aren't worth having unless they meet certain minimum requirements in terms of broad industry coverage and support, content, transparency, accountability and enforceability.

Running through my presentation will be aspects of ASIC's current thinking on some of the yet to be resolved issues associated with the interaction of financial services Codes and the Financial Services Reform legislation. Of course, we are interested in hearing your thoughts on these issues.

Our present analysis sees Codes as serving three main purposes:

1. they can deal with consumer protection issues not covered in legislation;
2. they can clarify what needs to be done to comply with legislative requirements; and
3. they can elaborate or build upon legislative requirements and set out something approaching best (or at least good) practice in an area covered by the legislation.

To date financial services Codes such as the banking, credit union and building society Codes, the EFT Code and, to a lesser extent, the general insurance and life insurance Codes have been focussed on the first of these purposes. That is, they have established rules about disclosure, conduct, training and dispute resolution in areas not covered by legislation.

To varying degrees they have served useful purposes. It is easy to look at some Codes today and see only their weaknesses, but if you go back to the time they were established, they did indeed introduce some important basic protections for consumers – especially in terms of improvements in disclosure practices, dispute resolution and access to ADR schemes.

The issue now is can they serve a useful role in the future given FSRB? My answer, subject to the reservations I will mention, is yes for at least some Codes. Codes can, and should, continue to be a part of the matrix of consumer protection financial services regulation in Australia. In particular, where industries have a genuine and ongoing commitment to making a Code an effective, living, transparent and enforceable regulatory instrument then there can be a real role.

The subject for debate is, therefore, just what the role of Codes in a past FSRB environment should be.

Probably the most important role for Codes in the future will continue to be dealing with issues not covered in legislation. Where an issue is not dealt with explicitly in primary legislation, there is little possibility of relevant regulations and more limited opportunities for ASIC to influence conduct through ASIC policy statements or guidance. This fact alone creates a good case for retaining some Codes. In addition:

- Where new issues and technologies are emerging there is often a reluctance to deal with them in legislation until there has been time for the matter to settle. In the meantime, there can be some real consumer protection issues. Codes provide a very useful vehicle for providing that protection. An example of this at the moment is the proposal to include stored value products in the EFT Code.
- Codes also allow for best endeavours clauses which may be the only way that agreement can be reached on a desirable course where, for example, one is dealing with emerging technologies and there is a desire to ensure that regulation does not stifle product innovation.

- Perhaps most importantly, however, good Codes, as I will discuss later, include monitoring and review mechanisms. These provide an important tool for industry itself (at least initially) to identify whether or not the system is working and new or emerging issues.

Sometimes Government will fulfil that role, but, as we all know, Governments have competing pressures and priorities and limited resources and I think that the built in review mechanisms in Codes are perhaps the best guarantee we have that there will be regular formal environmental scans to identify problem areas.

Having said all of this, ASIC recognises that Codes will not always be the right mechanism for dealing with new or old problems. Sometimes a strong case can be made for immediate legislation. Alternatively, the facts may suggest an approach which is less formal than a Code.

The mere fact that a problem is identified and a solution proposed does not mean that agreement can always be reached about dealing with the issue in the relevant Code. In our experience to date, however, we have found that once an issue is identified as part of a review or monitoring process they can't then just be swept under the carpet. Some will get taken up in Codes; others will be addressed in other ways. If it is serious enough, it may eventually become the subject of legislative attention. At a minimum though, it becomes part of the debate.

The role of Codes in relation to the second function I identified – clarifying legislation – is the most difficult. It is certainly the area which has been causing us the greatest challenges.

In the disclosure context, for instance, Treasury's commentary to the first draft of the FSR legislation stated that:

The list (of disclosure requirements) is cast in fairly general terms, with the capacity for the information that must be included under particular heads in relation to particular products to be fleshed out in a number of ways:

- Through a regulation making power (see proposed subsection 983C(2))
- Under an industry Code of conduct which may be approved by ASIC; and
- Through ASIC guidance in the form of policy statements.¹ (These are statements developed by ASIC in consultation with relevant stakeholders, including consumer groups. They usually relate to one of our discretionary powers or to interpretation of the law. Some are detailed statements on what is required to comply with the law or gain ASIC approval. Others provide some relief from legislation or modify its effect based on various relevant considerations. Our approach to enforcement of these powers and legislative provisions often flows from what is said in the policy statements. The policy statement you are probably most familiar with is PS 139 which sets out ASIC's criteria for approving a dispute resolution scheme.)

A fourth alternative, of course, is for it to be left to individual businesses to work out for themselves how best to comply or for the issue to be addressed through some other mechanism such as industry standards.

As to which of these methods is to be preferred in a particular instance, I suspect that relevant considerations may include:

- First, the extent to which either ASIC or Treasury see present compliance as an issue and want to set some clear directions.
- Relatedly, the relative priority of the area to Government and ASIC since both regulations and ASIC policy statements require the devotion of resources. There is already a queue forming for the use of those resources in the FSR implementation context.

¹ *Financial Services Reform Bill, Commentary on the draft provisions*, Department of the Treasury, February 2000, p.145.

- Finally, the extent to which the industry wants to pre-empt Government and set out its own clarifications in documents such as Codes of conduct or industry standards. Where industry does this in a manner which satisfies Government's concerns and where that document enjoys broad based acceptance within the industry the need for Government action is clearly diminished.

The first three mechanisms - regulations, Codes and ASIC policy statements - should all involve consultation with the full range of interested parties – consumers, industry and government. The difference is really in who has the final say in settling the mechanism. In the case of Codes, industry will settle the form (though if they want the Code approved by ASIC, ASIC will have a stronger say on content). In the case of regulations it will be the Government, and in the case of ASIC policy statements it will obviously be ASIC. That said, as each of these mechanisms seeks to clarify what the law requires, it will, of course, be the courts which, at the end of the day, have the final say.

Of course, ASIC does not have a predetermined view about which of the four mechanisms identified is the most appropriate for clarifying the legislation. Each case will need to be assessed on its own merits.

Timing is making that particular assessment job particularly difficult in the context of the payments system Codes for two reasons. First, there will be different views about what, if any, elaboration there should be of the basic disclosure items set out in the FSR legislation. If there is to be some fleshing out in some areas, consideration needs to be given to whether different products, or types of products, will need distinct approaches (eg, for investment, risk and deposit taking products) or whether a more generic approach should be adopted. Again, we expect that there will be divergent views on this issue from different market sectors. These are important issues we will need to actively discuss with market participants and professional associations over the next month or so, before we settle a position.

The situation is further complicated because our views on the need for a policy statement in the deposit taking area are likely to be influenced by the adequacy of alternative industry arrangements.

As I understand it, however, those undertaking the Code reviews are interested in our views as to what should be provided in Codes and what by ASIC Policy or regulation.

At this stage, we are suggesting to the Code reviewers that their issues papers canvass all areas where they believe disclosure content issues arise and then seek feedback as to which is the most appropriate vehicle for addressing particular issues.

The final role I identified for Codes was to elaborate or build upon legislative requirements to set out something approaching best, or good, practice in an area covered by legislation. While the distinction is sometimes slight, this is different from setting out rules for how to comply with legislation. To illustrate this, the Government would have the power to prescribe what disclosures are required for specific products to meet the disclosure requirements of the FSR legislation. They would not have the power, however, to require industry to do more through regulations than the legislation prescribes.

The FSR legislation is deliberately generic. It provides general rules to cover all types of financial products. It is recognised by everyone, however, that there may be instances where specific products or transaction mechanisms require additional protections. For instance, it may be that in some situations additional notice to that envisaged by the FSR legislation should be required of changes to certain terms and conditions. Certainly the EFT working party has taken that view about certain EFT specific disclosures. In these instances, Codes provide the most readily available vehicle for addressing such product/transaction specific concerns.

The big issue for all of us in the context of the current reviews is working out where such additional protections are justified in Codes and where the FSR protections are adequate and the Code provisions are simply inconsistent duplication. ASIC's current thinking is that we should not automatically presume that if an existing Code provides slightly more protection, then it is better. Inconsistent regimes have the potential to create confusion, increased costs and breaches. We need to look at these issues with an open mind.

More generally, another issue which must be considered in the current Codes debate, and which applies to two of the functions discussed earlier, is the extent to which Codes should duplicate legislative provisions. In the past, a case has been built for some duplication of key protections (such as the prohibition on misleading and deceptive advertising) because of its educative effect. When one considers, however, the extent of regulation for financial services products now, it is hard to pick out what one you would particularly want to emphasise.

At this point, ASIC's thinking is against duplicating provisions which are in legislation. It increases the chances of eventual inconsistencies and does not usually serve any clear purpose. Where there is a particular need to highlight certain legislative requirements, however, we do see scope for Codes including notes which draw attention to those legislative requirements.

Perhaps surprisingly, one of the most difficult issues we have found in the context of the present Code reviews is identifying where duplication exists.

An issue which is exercising our attention at the moment, for example, is the inter-relationship between the Product Disclosure Statement provisions in the FSR legislation and the terms and conditions disclosure provisions in the payments system Codes. There is some overlap in terms of what is required under both sets of requirements and issues associated with the timing of when they must be supplied.

We are asking ourselves whether there is duplication given that the purposes of the two documents are different. Product disclosure documents are designed to assist consumers decide whether to acquire a product and, if so, to select between products and product providers. Terms and conditions documents are designed to set down the rules governing the relationship between the consumer and the product provider. That said, PDS's will obviously have contractual force, although they may well not set out all the precise details of the terms and conditions. The question we are, therefore, considering is whether there is a need to separately require disclosures which are in the PDS to be in the terms and conditions document.

Of course, the debate about Codes is not just confined to how they should interact with legislation. Perhaps even more important is the debate about what constitutes a good Code. That is, how do you make Codes work and be truly effective?

As some of you may realise, under the ASIC Act we have the power to approve Codes of Conduct. Such a power is likely to remain post the FSR reforms, albeit in a slightly different form and with no Codes being compulsory. We are presently in the process of preparing a draft policy statement on how we will exercise our Codes approval powers. In this context we will be very interested in reading Berna Collier's report on self-regulation which is about to be launched.

While the final content of the draft policy statement will obviously not be settled until we have seen the exact wording of the Codes approval power in the FSR legislation, I think it is safe to flag here a number of the issues we expect will be covered in the draft statement. These issues go to content, transparency, accountability and process.

First, we see good industry based mechanisms as being most likely to emerge where their development and review has involved the combined input of consumers, industry and government. We will be looking for such input in determining whether a Code should be approved.

On this point, I should say that we recognise that resource constraints make it very difficult for consumer groups sometimes to have the level of involvement we all think desirable. ASIC is trying to work with you and others to address this problem. While we have not been able to provide a systemic solution to date, we have been able to assist in particular instances. For instance, through CAP we have provided funding to assist with the survey of case workers which was done as part of preparing the consumer movement's submission to the Banking and Credit Union Codes.

We will also want to see that work has been done on identifying just what the current consumer protection issues are in the industry and that these issues are being addressed either through the Code or, if it is more appropriate, through some other mechanism.

Likewise, we will expect to see effective monitoring provisions in place. These provisions should involve something more than a self assessment process although such processes may play a part in the monitoring process.

We will expect to see that there are processes in place for training appropriate staff about their obligations under the Code.

We will also expect that where there is a breach of the Code there is somewhere to complain and action which can be taken to ensure that the breach is rectified. At present, while ASIC will raise with institutions instances of non-compliance with payment system Codes of which we become aware, and institutions will usually respond positively to address the problem, this is all done on an informal basis. Enforcement of the Code should not be dependant upon such informal processes. The Code itself should set out procedures for dealing with non-compliance.

Finally, as we all know, the financial services sector is a dynamic one with constant innovations in terms of product design and delivery mechanisms. This means that there is the potential for Codes to become dated. Therefore, we see it as essential that Codes contain a requirement that they are regularly reviewed – probably about every three years.

Our draft policy statement is also likely to set out the criteria for ASIC revoking a Code.

I could go on about what constitutes a good Code, but I will not today as I am sure, like me, you are looking forward to hearing the results of the Government's inquiry into self-regulation which is likely to touch upon similar themes.

To conclude though, I would like to reiterate my basic messages on Codes:

- Firstly, in the post FSR environment, there will continue to be a role for some Codes in the regulatory mix.

- Secondly, what that role should be needs debating. The role seems clearest when they are dealing with issues not covered by legislation and, to a lesser extent, where they are improving upon protections provided in legislation. It is least clear in the area of clarifying legislation where there are competing alternatives.
- Finally though, industry Codes are not an all purpose panacea. They are not always the appropriate response to a problem and, even where they may be appropriate, they are not worth having unless they meet certain minimum requirements in terms of broad industry coverage and support, content, transparency, accountability and enforceability.

Thank you.