



ASIC

Australian Securities & Investments Commission

Codes of conduct and the widening perimeter of regulatory intervention

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Introduction

Good morning everyone...

To contribute to today's discussion I want to give you a conduct regulator's perspective on codes of conduct.

At ASIC, we think codes of conduct can deliver real benefits to both consumers and code subscribers.

I personally have been a real supporter of increased co-regulation and self-regulation.

However – and I want to be very clear about this – codes:

- should not be considered a substitute for strong legislative obligations, backed by a strong regulator; and
- the effectiveness of a code will depend on the capacity and commitment of the relevant industry sector.

To unpack this for you, I want to talk about three things today:

1. How codes of conduct can help promote trust and confidence in an industry sector.
2. The industry characteristics required for a code to be effective.
3. ASIC's approach to code approval

1. How codes of conduct can promote trust and confidence

At ASIC, we believe that codes sit at the **apex of industry self-regulatory initiatives**.

To us, a code is essentially a set of enforceable rules that sets out a progressive model of conduct for industry members who have subscribed to the code.

Codes can therefore improve consumer trust and confidence in a particular industry or industries.

In particular, codes of conduct can:

- support the dispute resolution process; and
- provide certainty for consumers about the conditions under which financial products and services are provided.

However, this will only be the case if the code has effective monitoring and enforcement arrangements. We have to acknowledge at the outset that not all industry sectors have the characteristics to enable effective monitoring and enforcement. I'll come back to this point in a moment.

Relationship between codes and legislation

We believe that the primary role of a financial services sector code is to raise standards and to complement the legislative requirements that already set out how firms (and their representatives) must deal with consumers.

Accordingly, we expect an effective code to:

- address specific industry issues and consumer problems not covered by legislation;
- elaborate on legislation to deliver additional benefits to consumers; and/or
- clarify what needs to be done to comply with legislation.

Therefore, an effective code sits alongside strong legislative obligations.

And if a code is filling a gap in the law, we must think carefully about whether a legislative solution might be preferable.

ASIC is, first and foremost, a law enforcement agency. So, it should be no surprise that we want strong laws supported by an appropriate enforcement regime (including penalties that discourage misconduct).

While codes of conduct have a role, we shouldn't lose sight of their regulatory underpinnings, or that sometimes, changing the law will be the only way to go.

2. Industry characteristics required for a code to be effective

In ASIC's view, industry **capacity and commitment** is essential for a self-regulatory, or co-regulatory, code to be effective.

In particular, we think a code of conduct can lead to improved consumer outcomes in sectors where:

1. there is not too much fragmentation;
2. there is recognition and willingness across the sector about the issues to be addressed;
3. the industry has the right institutions and leadership.

In industry sectors where these characteristics are absent, it is unlikely that an effective code can be developed.

This is an important point, especially in light of the recent consultation paper to strengthen industry codes. A mandatory requirement to subscribe to an ASIC-approved code will not overcome a sector's lack of capacity to develop and administer a code.

Let me provide some further explanation about why we think these characteristics are necessary.

Fragmentation

A code of practice is likely to be less effective in a sector where there is fragmentation.

This fragmentation could be caused by:

- the existence of multiple, competing industry bodies;
- a large number of industry players that are not members of an industry body; or
- a large number of industry players of different sizes, or with very different business models or interests.

In these circumstances, it will generally be difficult to establish the necessary monitoring and enforcement arrangements.

Further, it may not be possible for this kind of industry sector to agree on the content of the code.

Recognition and willingness about issues to be addressed

Moving on to the need for recognition and willingness about the issues for the code to address.

If industry does not recognise that there are issues and agree that they need to be addressed – it will be very hard to establish an effective code.

This is because it takes time and resources for industry to negotiate a code's content and to establish and administer credible monitoring and enforcement arrangements.

If there is not commitment to the cause, it is unlikely industry will be willing to commit sufficient resources to, amongst other things, meeting the costs of monitoring the code.

Institutions and leadership

The third requirement for an effective code is that the industry sector must have the institutions and leadership to undertake the task.

There needs to be a single code monitoring body that is able to take responsibility for administering the code and monitoring compliance of all subscribers.

This is often difficult in a fragmented sector, where there may be multiple industry bodies.

There will also generally need to be a credible, and committed, industry body to lead the industry to the right outcome – and, sometimes, that outcome may be a place that industry, at least initially, does not necessarily want to go.

Before turning to ASIC's approach to approving codes, I want to say a few words about the ePayments code, because the history of the ePayments code serves as a useful case study for many of the issues I have just set out.

ePayments Code

When electronic banking was first introduced, industry sought to address consumer and regulatory concerns by introducing a self-regulatory code of practice.

However, there was no agreed position for resolving key issues such as liability for unauthorised transactions and there was no effective monitoring and compliance.

The code became active after significant Government intervention about its content – the Government effectively pushed industry to a position on the issue of liability for unauthorised transactions.

Further, a Government agency (currently ASIC) is responsible for administering the code, as there is no single industry body that has been able to accept responsibility for monitoring compliance.

In this way, the ePayments code is very much a co-regulatory code.

Nevertheless, despite the success of this co-regulatory model until now, it seems it has now reached the end of its useful life.

The code deals with fundamental consumer protections which are today critical for there to be trust in the electronic payments system.

It is time for these protections to be reflected in regulation (with sufficient flexibility to be updated as technology evolves).

Given the importance of electronic payments to consumers today, ASIC needs to be able to determine the content, monitor compliance **and enforce** the obligations.

As I mentioned earlier, codes of conduct need to sit alongside strong regulatory obligations. At the moment, for the ePayments code, this isn't the case.

Further, while most of the current ePayments Code subscribers are ADIs, eligibility for subscription is not limited and the code covers the diverse nature of current and emerging players in the electronic payments industry.

In ASIC's view, the diversity of industry membership means it is unrealistic to expect that industry can resolve the complex issues involved and achieve code terms by consensus.

For these reasons, we strongly support the use of a **legislative instrument** - rather than a code of conduct - to mandate the consumer protections in the ePayments Code.

Remember that mandating these protections was one of the recommendations of the Financial System Inquiry.

3. ASIC's approach to approving codes

Finally, I want to talk about ASIC's approach to approving codes.

Current settings

At the moment, it is not mandatory for any sector in the financial services industry to develop a code.

Where a code exists, we have a power to approve the code, and our approach to using this discretion is set out in RG 183. The criteria we consider when approving a code include:

1. consistency with Corporations Act requirements;
2. whether the process followed for developing the code was appropriate;
3. whether the code is adequately enforceable – including dispute resolution, remedies and sanctions;
4. the content of the code;

5. whether the code has effective arrangements for monitoring and reporting on compliance; and
6. whether the code provides for independent, regular reviews.

However, currently a code does not have to be approved by ASIC, and notably, none of the major industry codes have been approved by ASIC.

ASIC Enforcement Review consultation on codes

Recently, the ASIC Enforcement Review Taskforce consulted on a proposal where ASIC could require an industry sector to subscribe to an ASIC approved code.

We would, essentially, be able to ‘switch on’ a requirement to subscribe to an ASIC approved code, when appropriate.

ASIC made a submission to this consultation, and a lot of my remarks today are drawn from that submission.

In terms of how ASIC might approach this new power, if it is implemented, this will obviously depend on the terms of the legislation.

But broadly, we expect that there would generally be a two-step process. ASIC would:

1. reach a view that an existing or enhanced industry code broadly meets the requirements for approval; and
2. determine that it is appropriate to mandate that all relevant participants in that sector subscribe to the code to ensure comprehensive coverage.

We expect we would seek to exercise code approval powers for industry sectors or subsectors where:

- we are satisfied that it is necessary to enhance consumer outcomes; and
- the industry sector, or a sufficient proportion of it, has the necessary capacity and commitment to implement and manage a code that meets the approval standards.

We would also take into account:

- the likely consumer benefits of approving a code and mandating membership;
- the costs to industry and ASIC; and
- any other regulatory or law reform initiatives that might be taking place or should be prioritised in that sector.

Conclusion

ASIC is committed to exploring more co-regulatory initiatives. I think this will be important in the future as the digital revolution means we need agile and flexible laws.

Codes of conduct may well have a role to play in this, and can deliver real benefits for consumers and for industry.

However, to reiterate my key message for you today: while codes of conduct have a place:

- they should not be considered a substitute for strong legislative obligations, backed by a strong regulator; and
- the effectiveness of a code will depend on the capacity and commitment of the relevant industry sector.