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SELF REGULATION & CODES OF PRACTICE
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1. Purpose, Types and Methods - Regulatory Matrix – Domains, Methods and Approaches

1.1 There are three main purposes of regulation in financial markets. The first is to ensure that the market works efficiently, fairly and competitively. There are principles or rules about disclosure, fraud prevention, unfair practices and anti-competitive behaviour. The second is to prescribe standards or qualities of financial services to promote "financial safety". The third is now uncommon in financial services – price controls[1] or costs subsidisation by one group of consumers to benefit another – called "social objectives".[2]

1.2 There are four main types of regulation in the financial system: regulation to promote financial market integrity; competition regulation – mergers and anti-competitive conduct; prudential regulation; and consumer protection regulation. All of these types have the purpose of ensuring that financial promises are both understood and met. The first two are less directly relevant to insurance than the last two.

1.3 Regulation, in the financial services sector, is generally thought of in a number of facets and each facet has recognised domains for the deployment of regulatory measures. Prudential regulation involves authorisation, capital, solvency and liquidity standards, with risk management vectors, framework and related strategies to prevent or minimise contagion of financial risk within the system – systemic risk: when financial distress in one market or institution is communicated to others and engulfs the system.[3] The global financial crisis from 2007 raised regulatory and community awareness of financial services entities whose size, networks and position in the system mean that each could be, in itself, a focus for systemic risk: "too big to fail" was the media label. Prudential regulation might therefore be described as giving security to customers.

1.4 Prudential regulation has the following recognised domains: authorisation or licensing requirements – these are the rules which must be complied with for an entity to be authorised to carry on a particular type of business in the financial markets; approval of ownership or control; restrictions on corporate or entity

[1] For example, the single postage rate for ordinary letters in Australia.
[2] The Wallis Report (The Report of the Financial Systems Inquiry), s 5.1.
[3] See, for example, "Financial System Inquiry", (Australian Government Discussion Paper, November 1996), Chs 4 and 7; The Wallis Report (The Report of the Financial Systems Inquiry), p 190.

form; standards for board composition and governance; capital adequacy requirements including minimum capital requirements, minimum solvency ratios of defined assets in relation to liabilities, and risk based capital; supervision of other members of the corporate group in which the regulated entity is structured (group supervision); outsourcing; and risk management frameworks, standards and arrangements.

1.5 There are recent regulatory initiatives: corporate governance, group supervision, outsourcing, executive remuneration and the hunt for systemically important financial institutions (as an antidote to the "too big to fail" venom) which have also become the domain of the prudential regulator. The Wallis Report considered that market integrity regulation and consumer protection were closely linked and used the same tools: licensing, disclosure and conduct rules. An example used is licensing – aiming to protect consumers from unscrupulous or dishonest operators and ensure that the relevant market operates efficiently. This fed into the recommendation that market integrity and consumer protection should be combined in a single agency.[4]

1.6 Market conduct or consumer protection regulation involves financial product disclosure, regulating the conduct of business and customer contracts, requirements for conduct towards customers and dispute resolution arrangements; it applies usually to retail products and customers.[5] It might be described as giving clarity to customers.

1.7 Market conduct or consumer protection regulation has the following recognised domains. The first is selling: rules about advertising, marketing, advising on and selling financial products and disclosure rules. The second is conduct of business rules – minimum terms in contracts between the regulated financial services entity and its customers (and sometimes suppliers). They include specialised requirements for customer relationships; information access, retention and disclosure – privacy, personal information and confidentiality; proper identification of the customer and arrangements to ensure that customers' funding and money are lawful – compliance with anti-money laundering rules;

[4] The Wallis Report (The Report of the Financial Systems Inquiry), pp 243-245 – ultimately implemented by incorporating the disparate consumer protection roles of the ASC, ISC and ASPC within the existing market integrity regulator (the ASC), to form ASIC.

[5] See, for example, "Financial System Inquiry", (Australian Government Discussion Paper, November 1996), Chs 4 and 8; The Wallis Report (The Report of the Financial Systems Inquiry), Ch 5.

and particular rules about the assessment of customer risk – including anti-discrimination matters.

1.8 Dispute resolution and investor compensation regulation has the following recognised domains. Firstly, there are internal and external dispute resolution schemes intended to give customers accessible, low cost, informal and law-free resolution of a complaint or dispute with a financial services entity. Secondly, there are compensation schemes including: policyholder protection funds; specialist arrangements for insolvency in the event of the collapse of a financial services entity; and professional indemnity insurance for certain entities in the relevant markets.

1.9 The regulatory methods are applied with varying focus, style and approaches: principles based or rule based; legal principles and rules; actuarial principles and rules; consultation or surveillance and enforcement.

1.10 Enforcement regulation has the following recognised domains: the enforcement regime is buttressed by gatekeepers, their activities and reports. The gatekeepers include directors, officers and senior management, auditors, actuaries and, in a more commercial sense, reinsurers. Regulation requires the compulsory appointment of internal officers and external professionals with mandated qualifications to manage the entity's business and to advise it. There are also compulsory reporting, access and audit requirements in favour of the regulator.

1.11 All purposes, types and methods of regulation are now supported by regulator surveillance, monitoring and enforcement powers: all types of regulatory intervention. The consequences for a financial services entity of a breach of or failure to comply with regulation can be grave: being the subject of significant operational intervention by the regulator; requiring different types or increased amounts of capital; ceasing operations altogether because of a revocation of its licence; and loss of reputation through serious regulatory breach.

2. Self-Regulation

Introduction

2.1 Self-regulation is an important but delicate feature of the financial services regulatory landscape. It is necessary to place it within a matrix of the principles for consumer protection self-regulation for insurance. This section sets out a working definition of self-regulation and then considers the proper domain of

self-regulation. It is then possible to assess the advantages of self-regulation. The advantages need to consider not only the current elements and criteria for good self-regulation but also the comparative advantages against shortcomings in regulation by government agency.

2.2 Self-regulation is a living system and one that has volatility. It is helpful to consider self-regulation's recent past particularly in general insurance. Finally, the analysis enables a statement of the principles for good consumer protection self-regulation for insurance. Self-regulation has and needs its principled place in the Australian regulatory system for insurance.

Definition — regulation and self-regulation

2.3 What is self-regulation? Self-regulation is difficult to define or distinguish. It is like a chameleon, taking its colour from its surroundings. It is necessary to begin with a snapshot of regulation to frame the creature in its habitat.

2.4 The discussion or analysis of self-regulation never includes prudential regulation and therefore, apart from some observations about the reason for this distinction, prudential regulation does not feature in this account or analysis.

2.5 Consumer protection regulation covers financial product and intermediary terms disclosure, regulating the conduct of business and customer contracts: "conduct of business rules"; requirements for conduct towards customers and dispute resolution arrangements. It applies usually to retail products and customers only.[6] ASIC states that: "We encourage applicants developing codes to extend code obligations beyond retail clients where this is appropriate."[7]

2.6 The Hockey Taskforce said:

> In a broad sense, regulation can be considered as a spectrum ranging from self-regulation where there is little or no government involvement, through quasi-regulation which refers to a range of rules, instruments or standards that government expects businesses to comply with, to explicit government regulation.[8]

2.7 And on self-regulation it said:

> Regimes which have been generally developed by industry (sometimes in

[6] See for example, "Financial System Inquiry", (Australian Government Discussion paper, November 1996), chs 4 and 8

[7] Compare ASIC RG 183.18, 22(c), 28-30 and 37.

[8] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, p 1.

> cooperation with government but enforced exclusively by industry). Self-regulation excludes explicit government legislation and regulation as well as regulation developed by government and handed over to industry for implementation … Self-regulation could include … Industry service charters, guidelines and standards as well as industry accreditation and complaint handling schemes.[9]

2.8 ASIC has indicated a definition for self-regulation as follows:

> Regulation where there is substantial industry-level involvement in the development or implementation of the regulation, and where the regulatory arrangement is adopted and funded by industry.[10]

2.9 ASIC then places codes in the self-regulation sphere as follows:

> 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 and disclosure for industry members that are signed up. Codes should therefore improve consumer confidence in a particular industry or industries.[11]
>
> 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 product issuers and licensed firms (and their representatives) deal with consumers. We expect an effective code to do at least one of the following:
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> (a) Address specific industry issues and consumer problems not covered by legislation;
>
> (b) Elaborate upon legislation to deliver additional benefits to consumers; and/or
>
> (c) Clarify what needs to be done from the perspective of a particular industry or practice or product to comply with legislation.[12]

The domain of self-regulation

History

[9] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, p v.
[10] Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.
[11] ASIC RG 183.17.
[12] ASIC RG 183.5.

2.10 It is convenient to begin a short account of the effect of regulation and the place of self-regulation in it with the Gower Report. The UK financial services industry was largely self-regulated in its nature until the 1980s, with only a random shot of legislation and a scattering of case law with regulatory effect.[13] In 1981, the UK Government commissioned Professor Gower's white paper on regulation for the financial services industry in the United Kingdom. The UK Government received the white paper in 1985. The Report recommended regulation to harmonise investor protection — the simple idea that the investor protection for similar products sold in similar ways should be similar. The *Financial Services Act 1986* (UK) used a mixture of governmental regulation and self-regulation. It established the regulator, the Securities and Investments Board (SIB), as the statutory agency for the supervision of investment business within the UK, the forerunner to the Financial Services Authority (FSA). The SIB presided over various new self-regulatory organisations (SROs) covering the various parts of the market and various securities and investments. There were also recognised professional bodies, recognised investment exchanges and recognised clearing-houses. Thus self-regulation was an important component of the regulatory scheme that was introduced: "practitioner (the regulated entities)-based, statue-backed regulation" was the catch-cry. It is important to note that, as the labels "securities" and "investments" suggest, this regime did not include or affect general insurance.

2.11 The *Financial Services Act 1986* (UK) was repealed and superseded by the *Financial Services and Markets Act 2000* (UK). Under this, the SIB and SROs were merged to form the Financial Services Authority (FSA), general insurance was included and a clear statutory but industry-based framework for self-regulation was lost.

2.12 It is important to note that the *Financial Services Act 1986* was not prudential regulation. In the UK, that was the *Insurance Companies Act 1982*, and it did not cover Lloyd's of London. And in Australia it was the *Life Insurance Act 1945* and the *Insurance Act 1973*. In both jurisdictions, prudential regulation preceded consumer protection and market conduct regulation. The fear of promises not being kept for lack of capital was greater than the fear of promises not being kept because of inadequate disclosure or contract terms.

[13] The *Prevention of Fraud (Investments) Act 1958* was the main but limited legislation.

2.13 Meanwhile in Australia, 1986 saw the commencement of the Insurance Contracts Act 1984, the first wide-ranging consumer protection legislation for insurance and general insurance; and 1994 saw the introduction of the first General Insurance Code of Practice. In 2001, Australia also leapt to a similar regime for a harmonised approach to financial services through the *Financial Services Reform Act 2001* which amended the *Corporations Act 2001*. It included general insurance as a financial product – a risk management product.

2.14 This sketch history points to a number of features of self-regulation. The first is that insurance and particularly general insurance is an afterthought to concerns about securities and investments. One consequence is that the harmonisation program has meant that securities and investments concepts and language have been thrust onto insurance and blurred or obscured important features of that market for the purposes of effective regulation. The second is that the pre-eminence given to prudential regulation has led to insufficient attention to good self-regulation for consumer protection or market conduct. The third is that in Australia, self-regulation has never had a principled place in the regulatory framework – it is an orphan child of good intentions and political compromise.

Criteria

2.15 The domain for self-regulation is shaped by the reasons for establishing each regime. The reasons vary from promotion of customer confidence in the industry, avoidance of regulation, to satisfying legislation.[14]

2.16 There is an incentive for self-regulation to mitigate "market failure" to deliver the optimal efficient allocation of resources in the economy, including insufficient information available to consumers to allow them to make informed choices; and high transaction costs for consumers.[15] The Hockey Taskforce stated:

> Industry self-regulation is increasingly being seen as an alternative means of promoting fair-trading, ethical conduct and streamlining compliance with agreed product and service standards in an industry. While industry self-regulation can advance consumer confidence in

[14]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, p 2; paras 32, 33 and pp 89, 90; Ch 7.
[15]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), p 18.

> products and individual companies, it also can promote good business practices.[16]

2.17 The Taskforce recognised that self-regulation may not be appropriate in all circumstances. Other forms of regulation may provide more cost effective outcomes in certain cases: "As well, community cynicism regarding industry regulating itself may lead to a distrust of self-regulatory schemes unless schemes operate effectively and consumers have confidence in them."[17]

Stakeholder participation

2.18 It is important that customers are important stakeholders in the self-regulation framework and standards:[18]

> The Taskforce supports the proposition that self-regulation should be developed and maintained in partnership between industry, the regulator and consumer organisations. This partnership is essential to identify specific problems and to arrive at effective minimum solutions. The Taskforce also recognises the important role that consumer groups can play in self-regulation development and growth.[19]

Coherence with regulation

2.19 A critical feature of self-regulation is its coherence with government agency regulation: "Government can assist in integrating schemes into the regulatory framework."[20] ASIC puts the matter this way:

> For self-regulation to be effective, it needs to be properly integrated into the overall regulatory framework ... It needs to dovetail with the law and the regulator's policies — not repeating or confusing requirements, but assisting and possibly extending them in some areas.[21]

2.20 A code should also harmonise with other codes which affect the same industry.[22] The Hockey Taskforce had an option to recommend centralising responsibility for self-regulation into one government agency: it was argued that it was confusing and bureaucratic for industry to know which regulator(s) to deal

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[16] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), p 17.
[17] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, p 1.
[18] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), paras 39–41 and pp 104–106.
[19] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), pp 64, 65 and 104–106.
[20] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), para 36 and p 96; Ch 7.
[21] Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.
[22] ASIC RG 186.32–35, p 10.

with.[23] The Taskforce considered that centralising government responsibility for self-regulation would result in a loss of expertise. The Taskforce considered that government needs to ensure departmental and agency roles in self-regulation are clear.[24] The Taskforce also rejected the idea of one regulatory agency per industry. The difficulty that leaves industry and other stakeholders is that there is little co-ordination among the various government agency regulators. Government involvement or intervention in a self-regulation scheme should be the minimum for the scheme to achieve its purpose: "The degree of monitoring by government will depend on the degree of market failure and the consequences of self-regulation failing to achieve its objectives."[25]

Conditions for self-regulation

2.21 There are three distinct parts of the analysis. The first is the identification of the conditions or criteria in an industry that make self-regulation effective: a cohesive market; a common industry interest; a viable industry association or industry commitment; a competitive market; clear objectives developed with stakeholders; the pre-eminence of customer relationships is recognised;[26] and integration into the regulatory framework.[27]

Content

2.22 The second step in the analysis is the content for self-regulation among the following: wide industry coverage; clarity in scheme documentation; consumer and industry awareness; good administration and data collection; identification of systemic issues; accountability: "Self-regulation must have vigorous and active accountability mechanisms";[28] compliance and enforcement; dispute procedures and sanctions; monitoring and reviews; and cost-effectiveness.

2.23 The prime concern of regulation for consumer protection has always been the provision of a low-cost, informal, lawyer-free scheme for complaint and dispute

[23]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), pp 103, 103.
[24]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), pp 103, 103.
[25]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Ch 7, p 100.
[26]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, paras 8–14; Chs 3, 5 and 7.
[27]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, paras 8–11, 14–16, 18; Chs 3, 5 and 7. Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.
[28]Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.

resolution.[29] Self-regulation's importance here continues, as well as constituting a standing rebuke to the legal system and its lawyers' inability to achieve accessible justice.[30]

2.24 The Hockey Taskforce is an example of the emphasis placed on disclosure as an important feature for the role of regulation in financial services markets and products.[31] Better information was: "providing the fundamental conditions necessary for markets to work efficiently".[32] An example was information to market participants about the risk of an adverse event occurring (eg campaigns advising of the damage caused by bushfires and the benefits of valuing home and contents appropriately to avoid being left out of pocket).[33]

2.25 The Hockey Taskforce summarised it as follows:

> "Self-regulation includes a host of options ranging from a simple code of ethics, to codes that are drafted with legislative precision together with sophisticated customer dispute resolution mechanisms."[34]

3. Advantages of self-regulation

Comparison with regulation — some examples of regulatory shortcomings

3.1 The history of Australian financial services regulation is that consumer protection regulation, until the natural disasters of 2011–2013 has been introduced through a careful process of inquiry, report consideration and consultation. It is prudential regulation which has been introduced usually in response to a crisis. The natural disasters generated some regulatory change. The track record on the consumer protection regulation of the insurance industry argues strongly that legislative intervention and government agency regulation can produce inadequate outcomes for Australian consumers.

3.2 In June 2000, ASIC published a report on consumer understanding of flood insurance, following severe storms and flooding, particularly in Wollongong. ASIC recommended that the standard use of key common terms should be explored and that the distinction between flood, storm and rainwater needed to

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Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), paras 42, 43, Ch 3 and pp 115, 116; Ch 8.

[30] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Ch 7, pp 81–85.

[31] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Ch 3.

[32] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Consultants' Report* (2000), Tasman Asia Pacific, pp 167, 168.

[33] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Consultants' Report* (2000), Tasman Asia Pacific, pp 167, 168.

[34] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, p 2.

be clear and consistent. A finding of that report was that there was scope for improved industry practices and better consumer understanding about flood insurance. ASIC recognised that consumer education, sales processes and disclosure were key issues in improving consumers' access to cover for flood damage in home and contents insurance policies.[35] In March 2008, the Insurance Council of Australia ("ICA") proposed a common flood definition and proposed that insurance companies would adopt it voluntarily. The ACCC saw it as a critical issue and proposed a number of conditions for transparency and consumer education, including data collection. The ACCC in July 2008 proposed to grant conditional authorisation. In early September, the ACCC released a determination denying authorisation on the grounds that the definition had the potential to introduce new concepts and to increase customer confusion. The ACCC had concerns that the ICA's proposal would deliver limited benefits to consumers. The effect of this determination was that there was no common definition of flood until mid-2012, after the two summers of natural disasters described in s 5. It is common ground that Australians would have been better served in the last two summers with a common definition of flood, rather than none at all.

3.3 The disclosure regime has long been the centrepiece of consumer protection legislation. The first for insurance in Australia were the disclosure requirements under ISC guidelines in the early 1990s, initially for life insurance. Under the Financial Services Reforms to the *Corporations Act 2001*, the disclosure regime blossomed into financial services guides, product disclosure statements and statements of advice. The PDS regime has been condemned as ineffective to protect consumers.[36] It is extremely expensive and resource intensive for insurers. The evidence is that even when the sales process is document based, the PDSs are not read. The sales process is becoming increasingly through telephone and internet, and soon apps on smart phones will be a dominant channel. There are not sufficient financial literacy skills in the community to make disclosure an effective consumer protection measure.

[35]Dr Peter Boxall, Commissioner, Australian Securities and Investments Commission, Speech at the ICA Regulatory Update, 9 March 2011.

[36]Ian Enright, General Insurance Code of Practice, 2012-2013 Review Issues Paper; NDIR Report, para 13.5: The Parliamentary Joint Committee on Corporations and Financial Services: Inquiry into Financial Products and Services in Australia, November 2009 referred to ample evidence that the disclosure regime with its axiomatic extensive documentation had failed consumers.

3.4 The Insurance Contracts Act 1984 was amended to an extent in the 1990s. Alan Cameron and Nancy Milne (Cameron/Milne) were appointed in September 2003 to conduct a general review of the Insurance Contracts Act 1984. Cameron/Milne reported on s 54 in October 2003. Cameron/Milne then reported on the balance of the Insurance Contracts Act 1984 in June 2004.[37] The report considered and recommended substantial and important changes to the Insurance Contracts Act 1984: codes of practice; utmost good faith; standard cover; third party beneficiaries; application to bundled policies; interface with marine insurance; application to discretionary mutual funds, offshore foreign insurers and other products; entering a contract and electronic communications; ASIC's powers; disclosure and representations; insured's remedies; insurer's remedies; contract cancellation; restrictions on insurers' contractual rights and remedies; interim cover; subrogation and reasons for underwriting decisions. The *Insurance Contracts Bill 2010*, giving much of the Cameron/Milne report and proposal effect,[38] had passed in the House of Representatives in June 2010 and was introduced in the Senate. The 42nd Parliament was prorogued before the Senate could vote and the Bill lapsed.[39] Another attempt at the legislation began in 2011 and by 2013 the Bill had passed the House of Representatives but on 21 March 2013 was referred to a Senate Committee for enquiry and report. The amending Act commenced on 28 June 2013. The effect of this history is that important changes many of which assist both insurers and customers with insurance contracts were delayed for over a decade. The legislative process has meant that insurance has been less effective and less cost effective than it would have been with prompt Insurance Contracts Act 1984 amendment.

3.5 In these three examples, a problem has lingered for more than a decade. The causes and the allocation of responsibility for the regulatory failure are irrelevant. The point is that the community has waited on government agency regulation for a solution to improve the position, but this regulation has failed it. The community has suffered for the delay: distress, confusion, unfairness, expense and wasted resources. The examples should make us cautious about an assumption that government agency regulation is a solution to a community or industry issue.

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[37] See the review of the *Insurance Contracts Act 1984* – "Final Report on second stage: provisions other than section 54" (June 2004, Cameron A and Milne N).

[38] It had first been recommended by Cameron/Milne — see s 7.

[39] HOR Report, para 54.

Principles and practice

3.6 The Hockey Taskforce's fundamental criterion for good self-regulation was:

> Good practice in self-regulation can be understood as significantly improving market outcomes for consumers at the lowest cost to businesses.[40]

The costs of a self-regulatory scheme, whether establishment, maintenance or the costs of the participants in complying with it, must be less than the alternatives to benefit participants and their customers.[41]

3.7 The Hockey Taskforce commented that there had already been work done in identifying industry environments and market circumstances that are more likely to lead to effective self-regulation. In particular, a general guide to whether self-regulation is appropriate can be found in the Best Practice Regulation Handbook from the Australian Government Department of Finance and Deregulation. The section on alternative regulatory forms notes:

> Self-regulation is generally characterised by industry-formulated rules and codes of conduct, with industry solely responsible for enforcement. You might assess self-regulation as a feasible option if:
>
> (a) There is no strong public interest concern, in particular no major public health and safety concerns
>
> (b) The problem is a low-risk event, of low impact or significance, and
>
> (c) The problem can be fixed by the market itself. For example, there may be an incentive for individuals and groups to develop and comply with self-regulatory arrangements (industry survival, market advantage).
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> Self-regulation is not likely to be effective if industry has an incentive not to comply with the rules or codes of conduct.[42]

3.8 In addition, for self-regulatory industry schemes, the checklist determined success factors to include:

> (a) presence of a viable industry association;

[40] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), p 59.
[41] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), pp 81–85, 97, 98.
[42] Australian Government Department of Finance and Deregulation Best Practice Regulation Handbook as at April 2013.

(b) adequate coverage of the industry by the industry association;

(c) cohesive industry with like-minded and motivated participants committed to achieving the goals;

(d) voluntary participation;[43]

(e) effective sanctions and incentives can be applied, with low scope for the benefits being shared with non-participants; and

(f) cost advantages from tailor-made solutions and less formal mechanisms such as access to quick complaints handling and redress mechanisms.[44]

3.9 The Hockey Taskforce identified the following benefits of self-regulation:

> Self-regulatory schemes tend to promote good practice and target specific problems within industries, impose lower compliance costs on business, and offer quick, low cost dispute resolution procedures. Effective self-regulation can also avoid the often overly prescriptive nature of regulation and allow industry the flexibility to provide greater choice for consumers and to be more responsive to changing consumer expectations.[45]

3.10 ASIC has indicated advantages for self-regulation as follows:

(a) it utilizes expertise of the regulated;

(b) the consent of the regulated is more likely to be enlisted;

(c) it is flexible and adaptable; and

(d) it offers consumers benefits of economies of scale, which can be derived from collective monitoring by a self-regulatory scheme.[46]

[43]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, paras 8–11, 14–16, 18, Chapters 3, 5 and 7.
[44]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Chapter 5.
[45]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), p 21.
[46]Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.

3.11 Self-regulation gives better risk management and a better risk management framework:

> Self-regulation can and should play an important "risk identification" role within the overall regulatory framework — the information generated under such a model, can help identify problem areas with industry practice, consumer knowledge, and government or regulator policies before they become bigger problems.[47]

There is an important human dimension to self-regulation and industry codes: they are effective in improving industry standards of service, the quality of customer response and the esteem of industry participants and employees.[48] The ASIC Chairman was quoted in The Australian newspaper as saying:

My approach is very much about working with industry to see if they can better self-regulate or co-regulate … I am a believer that if we can get an industry to self-regulate or co-regulate we can focus on other things.[49]

Advantages in insurance

3.12 There is a good role for self-regulation in insurance. It works best to join seamlessly the best legislation with the best market practice. It cannot substitute for either. Its benefits are harnessing the enthusiasm and pride of the industry to develop and test best practice and controls to produce agile, flexible,[50] quick and cost-effective[51] implementation within a framework of effective control, accountability and sanctions.

3.13 The systems of regulation through government agency are, and remain, externally regulated systems with a sovereign and subject (or master and servant) relationship. In a self-regulation system the regulator and the regulated entities have a mutuality: the regulator and regulation is constituted and shaped at least in part by the regulated entities. The mutuality can have disadvantages and advantages. A prominent risk is that the system can be subject to "regulatory capture" — that is, the danger that the "self-regulator" comes to

[47] Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.
[48] Insurance Council of Australia, 1999 Submission to the Taskforce on Industry Self-Regulation.
[49] 14 December 2012.
[50] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary.
[51] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary.

serve only the interests of the self-regulated industry.[52] This risk must be avoided.

3.14 It is necessary to consider the advantages of self-regulation from the perspectives of customers, the self-regulatory agency, government regulatory agencies and the regulated entities as peers.[53]

3.15 This first advantage is that a self-regulatory system allows and encourages enthusiastic rather than grudging adherence to its standards. The regulated entities are more likely to follow their spirit and out-perform an externally regulated system. The system also harnesses the participants' pride in their industry — its own regulatory governance must be seen to be good.

3.16 Self-regulation is never regarded as an alternative to government agency prudential regulation. This is a critical distinction. The key difference is that capital adequacy does not directly or immediately affect the customer experience and outcome. While prudential regulation is key to ensure that promises are kept, it is noticed by customers only in a market failure or collapse. A customer experiences consumer protection regulation on a daily basis in each interaction with the industry. This leads to the second advantage. The system should be more effective because market participants prosper only through their customers, and the closer the regulated entities are to the "regulator" the more the customer relationship drives the standards and their implementation.

3.17 A related advantage is that reputation is made both a goal and a sanction — where the market can value a brand on a balance sheet, the potential for volatility in that value will drive positive behavior.

3.18 Thirdly, a self-regulation system can deliver expertise in market and industry understanding with laser focus on issues for the customer. The industry and market with expertise and resources and without the machinery of legislation can change standards quickly to respond to changing customer needs.

3.19 Fourthly, the advantages of an accessible, low cost and quick dispute resolution scheme are now axiomatic.[54]

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[52] Jillian Segal, Deputy Chair of ASIC, Speech to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001.
[53] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Ch 7.
[54] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Ch 8.

3.20 Fifthly, while industry resources are limited, it has more abundant resources and expertise than the public sector — the self-regulatory standards can be made to work. Government agencies then have resources to deploy elsewhere.

3.21 Sixthly, the regulation is cost effective because it is funded directly by the regulated entities and it is not more invasive than is necessary for its purpose.

3.22 Seventhly, the sanctions are more likely to be considered fair by the regulated entity because they are imposed by the regulated entity's peer group.

4. The Code and current self-regulation in general insurance

4.1 The Code is a part of the regulatory framework for general insurance. The Code has always been voluntary. In late 1997, following concern that some non-ICA member general insurers had not subscribed to the Code, legislative changes were proposed to the *Insurance Act 1973* to make it a condition of registration for general insurers to belong to an approved code.[55]

4.2 The Hockey Taskforce Consultant Report stated the purpose of the Code:

> The Code sets out standards of practice for insurers. It is not intended to provide a bare minimum nor is it best practice. The General Insurance Enquiries and Complaints Scheme (FOS predecessor) claims that insurers can and do compete on the basis of service offered that is higher than the Code standard (General Insurance Enquiries and Complaints Scheme 1999). To date, the ICA has intended that the Code be used as a device to ensure the industry stays aligned with the needs of its clients (ICA 1996). The Code is intended by the ICA to be a 'living code', that is, one which is progressively developed over time after consultation with stakeholders including government and other interested groups such as consumer groups. It also is intended to be capable of adaptation to the legislative framework, changing market conditions and consumer expectations over time.[56]

4.3 The Hockey Taskforce Consultant Report also set out the other self-regulatory initiatives in the general insurance industry at the time, in addition to the General Insurance Code of Conduct and the complaints and disputes resolution arrangements:

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[55]The provisions of the short-lived *Financial Laws Amendment Act 1997*, seem not to have been activated: Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Consultants' Report* (2000), Tasman Asia Pacific, p 170.

[56]Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Consultants' Report* (2000), Tasman Asia Pacific, p 171.

(a) The Knock for Knock Agreement applying to motor vehicle insurance claims whereby each insurer agrees to pay the cost of their insured's claim without resorting to legal action. The Agreement aims to reduce costs associated with investigation and litigation and reduce delays in the claims settlement process. Currently around 88 insurers are signatories to the Agreement.

(b) The General Insurance Information Privacy Principles, which is the privacy code of the general insurance industry launched by the ICA in August 1998. It sets the standards by which the industry collects, uses, stores and disposes of the personal information of its customers; and

(c) The Insurance Disaster Response Organisation which is a self-regulatory agreement to coordinate the industry's response to the community following a major disaster. The organisation's functions include coordinating an efficient industry response to the disaster, providing a single point of contact to assist policyholders, establishing contact with the government, providing accurate information to insurers, assisting the industry to respond to claims and conducting any post disaster review.[57]

4.4 Each of these initiatives has met its end in the form set out by the Taskforce. The Knock for Knock agreements are redundant. The privacy principles were superseded substantially by the *Privacy Act 1988* which, preserved the concept of principles that were finally removed by the *Privacy Act 2012*. The Insurance Disaster Response Organisation became a part of the Code and was disbanded in 2006 after being replaced by an enhanced catastrophe response mechanism managed by ICA and in continuous operation since that time.

5. Self-regulation and codes — principles for insurance

5.1 The analysis and account above indicate that there are principles for a code self-regulation framework and principles for code content.

5.2 The code framework principles are:

1. The regulated entity community adopts voluntarily a code of practice that contains standards for the conduct of their businesses with the community and

[57] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Consultants' Report* (2000), Tasman Asia Pacific, pp 161, 162.

retail customers.[58] The adoption of the code by a regulated entity should be through a contract directly with the code governance body.[59]

2. The code governance body should be well credentialed and expert and have a sufficiently balanced representation of stakeholder interests and independent representation to give authority to its work and decisions.[60] It should have the information and resources necessary to do its work.[61] The governance framework, its process and conduct should be visible and accountable.[62]

3. All stakeholders should participate in the development of the standards in the code and its governance. The regulated entities should have an influential but not decisive involvement in the development of the standards in the code and its governance. The views of the regulated entities should be given weight as a factor in theses aspects. The code governance body should have ultimate responsibility for the development and setting of the standards.

4. The regulated entities should fund and resource the self-regulation model to a level necessary for it to work effectively.

5. The self-regulation model should be properly integrated into the overall regulatory framework; it should dovetail with the law and government agency regulation.

6. The best place for a code to work is to link legislation to market practice. Its standards link the law that affects the customer's relationship with the regulated entity and endorses, enhances and improves the industry's best practice.[63]

7. The framework and code should enhance stakeholder trust and confidence in each other and enhance the esteem of each individual involved in it.

5.3 The code content principles, based on the account and analysis above, are:

1. The code content should address all stakeholder relevant issues.[64]

2. The code should be adequately promoted.[65]

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[58] Compare ASIC RG 183.18, 22(c), 28–30 and 37.
[59] Compare ASIC RG 183.66.
[60] ASIC RG 183.13(c); ASIC RG 183.15; 27; ASIC 183.73–RG 183.75.
[61] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, paras 22–24 and pp 69–71.
[62] Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, paras 22–24 and pp 69–71; Ch 7.
[63] See also ASIC RG 183.17, 18, 22(b), (c), 28–30, 37 and 62–66.
[64] ASIC RG 183.56–RG 183.61; Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Ch 7.

3. The code objectives and scope should be clear.[66] The standards should cover the full range and all relevant phases of the regulated entity's interactions with its customers. The standards should be a "comprehensive body of rules (not single issue)".[67]

4. The standards in the code should promote good business practices, set a high standard of service and have legal minimums. The standards should be supported by education and training. The standards should contribute to the regulated entity's risk management.

5. The standards in the code should contain ethical statements, principles, rules and guidelines.[68] The standards should be enforceable.[69]

6. The code should be in plain language and accessible.[70]

The standards which are rules should be expressed as rules which are measurable and can clearly be complied with or breached to enable the regulated entity to assess what conduct is needed to comply with the standard.[71]

7. Compliance with the code should be monitored, audited and enforced by the code governance body.[72]

(a) The consequences for the breach or non-compliance with a standard, the remedies and sanctions, should have regard to the principles of procedural fairness[73] and be:

(i) sufficient to deter breach or non-compliance and consistent with the code objectives;[74] and

(ii) clear, fair and reasonable in order to promote the spirit and effect of the code.[75]

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[65]ASIC RG 183.15; ASIC RG 183.50–RG 183.55; Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, para 21 and p 68, Ch 7.
[66]ASIC RG 183.44(b) and 56.
[67]ASIC RG 183.13 and ASIC RG 183.23, 56(c) and 59.
[68]Compare ASIC RG 183.18, 22(c), 28–30, 37, 56(c) and 59.
[69]ASIC RG 183.13–15; ASIC RG 183.56; see also ASIC RG 183.17, 22(a), (e), 24, 25, 39, 40 and 44(c).
[70]ASIC RG 183.99 and ASIC RG 183.44(b) and 56; Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, para 19 and p 65, Ch 7.
[71]See also ASIC RG 183.17, 22(a), (d), (e), 24, 25, 31, 39, 40, 44(c) and (d), 56(c) and 59.
[72]ASIC RG 183.13(c); ASIC RG 183.15; ASIC RG 183.69–71; ASIC RG 183.76–RG 183.78.
[73]ASIC RG 183.69.
[74]See also ASIC RG 183.17, 22(a), (d), (e), 24, 25, 31, 39, 40 and 44(c) and (d); Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, para 20 and p 66; paras 25–28 and pp 71–77.
[75]See also ASIC RG 183.13(c), 15, 17, 22(a), (d), (e), 24, 25, 31, 39, 40 and 44(c) and (d); ASIC RG 183.67–RG 183.72.

8. A customer should have the right to complain about a regulated entity's conduct under the code and be informed about that right.[76]

9. A customer should have the right to refer a dispute about a regulated entity's conduct under the code to an external dispute resolution scheme and be informed about that right.[77]

10. The code standards and its operation should be reviewed periodically by the code governance body and reviewed from time to time by an independent reviewer.[78]

6. The Legal Effect of the Code

6.1 The Code, s 1.12 reads: "This Code does not provide to you or anyone else any legal entitlement or right of action against us"

6.2 The Code is clearly not currently enforceable as a term of an insurance covered by the Code. There are no express words that make it a term of a Code insurance and many of the Code standards as currently drafted would not be amenable to being a term of a contract. In general terms it is doubtful that the Code would be an implied term of a Code Insurance although a specific circumstance might evidence the facts which would make it an implied term. The terms of the Code, s 1.12 would also militate against the conclusion that the Code was enforceable as a term of a Code insurance.

6.3 Codes of practice do not amount to standards that have the immediate force of law. The courts have taken the view that codes of practice are formulations of accepted practice and are strong evidence of the proper standard or standard of care which should be adopted.[79] A departure from the standard without some justification will usually be regarded as constituting a breach of duty:[80]

> I am of the view that bearing in mind the function of codes, a design which departs substantially from them is prima facie a faulty design,

[76]ASIC RG 183.15(d); Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, para 20 and p 66; paras 25–28 and pp 71–77, Ch 7.
[77]ASIC RG 183.15(d); Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, para 20 and p 66; paras 25–28 and pp 71–77, Ch 7.
[78]ASIC RG 183.8, 44(e) and 79–81; Hockey Hon J, MP, *Taskforce on Industry Self-Regulation – Final Report* (2000), Executive Summary, para 29 and p 78.
[79]*Harvest Trucking Co Ltd v PB Davis* [1991] 2 Lloyd's Rep 638 (insurance intermediary); *PK Finans International (UK) Ltd v Andrew Downs & Co* Ltd [1992] 1 EGLR 172 (surveyors and valuers).
[80]*Lloyd Cheyham & Co Ltd v Littlejohn & Co* (1985) 2 PN 154.

> unless it can be demonstrated that it conforms to accepted engineering practice by rational analysis.[81]

6.4 There are other ways in which the Code is legally enforceable. Firstly, a Code corrective action and a sanction under s 7 are contractually binding on a Code Participant and if the Code Participant does not comply with the sanction then an appropriate legal contractual remedy would be available to the Financial Ombudsman Service or the Code Compliance Committee. Secondly, the Code is clearly enforceable in the sense that it is a factor in assessing whether an insurance operation is involved in unconscionable conduct under the *Australian Securities and Investments Commission Act 2001*, s 12CC(1)(h) and (3). Thirdly, there may be circumstances in which a customer can establish that the Code was a representation by the Code Participant that it would comply with the Code standards and the customer relied on that representation in order to enter into a Code Insurance. Fourthly, a court would have regard to the Code when deciding whether or not an insurer's conduct had been reasonable in the context of an award of interest under the insurance policy and the Insurance Contracts Act 1984, s 57: if the Code Participant had delayed in breach of a Code standard, that would be a factor in assessing whether the insurer's conduct was unreasonable under the Insurance Contracts Act 1984. Fifthly, and of critical importance, a court would have regard to the Code in appropriate circumstances in a claim by a customer that an insurer had breached its duty of utmost good faith under the Insurance Contracts Act 1984, s 13; if the Code Participant had acted in breach of a Code standard, that would be a factor for a court in assessing whether the insurer's conduct was in utmost good faith under the Insurance Contracts Act 1984.

6.5 ASIC's position under ASIC RG 139 is:

> By this we mean that a scheme must, as a minimum, compensate a complainant or disputant for any direct loss or damage caused by a breach of any obligation owed in relation to the provision of a financial or credit product or service. This excludes an award for punitive or exemplary damages.[82]

Ian Enright

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[81] *Bevan Investments Ltd v Blackhall & Struthers (No 2)* (1977) 11 BLR 78; [1978] 2 NZLR 97; *Holland Hannen & Cubitts (Northern) Ltd v Welsh Health Technical Services Organisation* (1987) 35 BLR 1 at 25, 26 (CA).
[82] ASIC RG 139.227.