

**ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING,
SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY
SUBMISSIONS OF THE AUSTRALIAN SECURITIES AND INVESTMENTS
COMMISSION**

ROUND 3: LOANS TO SMALL AND MEDIUM ENTERPRISES

The Australian Securities and Investments Commission (ASIC) makes the following submissions in response to certain of the general questions identified within 6 topics by Counsel Assisting in closing submissions. As ASIC does not respond to all such questions (save within topic 6: regulation and self-regulation), it indicates below to which of the 6 identified topics the relevant question and response relate.

(Topic 1: responsible lending to small businesses) What are the likely consequences of owner manager branches of Bank of Queensland being recipients of trailing or other commissions, particularly having regard to the findings of the Sedgwick report into retail banking remuneration.

1. In responding to this question, ASIC does not address itself directly to Bank of Queensland and its owner-manager model, but rather, to the potential consequences of trailing or other commissions more generally.
2. In earlier submissions to the Royal Commission,¹ ASIC has noted its opinion (also expressed in ASIC's public reports) that misaligned incentives can bring about poor consumer outcomes and drive unsatisfactory conduct, in the context of both mortgage brokers² and the provision of financial advice.³
3. As ASIC has stated in the context of mortgage broking,⁴ upfront and trailing commissions can create conflicts of interest. In an overall banking context, if commissions or incentives are paid corresponding to the size or volume of loans a like

¹ ASIC's Round 1 Submissions dated 3 April 2018 (ASIC Round 1 Submissions) and ASIC's Round 2 Submissions dated 7 May 2018 (ASIC Round 2 Submissions).

² ASIC Round 1 Submissions [3]-[10], which also refer to ASIC's *Review of Mortgage Broker Remuneration* (ASIC Report 516). The Sedgwick report into retail banking remuneration (Exhibit #3.34.163) refers to ASIC Report 516 as the ASIC Report (see Exhibit #3.34.163, at page BOQ.0001.0051.0002).

³ ASIC Round 2 Submissions [8], [9]-[12].

⁴ ASIC's *Review of Mortgage Broker Remuneration* (Report 516) at [29], [30] and [115].

risk of conflict emerges. A person could recommend a loan that is larger than what is needed or can be afforded, to maximise a commission payment or other incentive. This may also extend to recommending a particular product or strategy to maximise the amount that the consumer or small business can borrow. Alternatively, a person may be incentivised to recommend a loan or options in connection with that loan in order to obtain a commission, even though that loan or those options may not be suited to the consumer or small business.

(Topic 1: responsible lending to small business) Should any of the provisions of the *National Consumer Credit Protection Act 2009* (Cth) National Credit Act which apply to consumer credit contracts also apply to credit contracts with small and medium sized business commerce? If so, why and to which small and medium sized business customers? If not, why not?

4. Although ASIC does not make a submission that the National Credit Act should apply to small businesses, it does observe that small businesses can benefit from:
 - (a) where they are dealing with a bank member of the Australian Bankers' Association Inc (**ABA**)– the protections or requirements in the Code of Banking Practice; and
 - (b) where they are dealing with a lender, broker or intermediary that is a member of FOS/AFCA – the obligations applying to members, and the ability to have their dispute heard without the need for court action.
5. However, small businesses dealing with a lender that is not an ABA member do not get the protections of the Code of Banking Practice, and small businesses dealing with a lender, broker or intermediary that is not a member of FOS/AFCA will not have access to those bodies for dispute resolution. Lenders, brokers and intermediaries who only offer their services to small businesses and therefore are not legally required to hold an Australian credit licence or, in consequence, be a member of an external dispute resolution scheme will generally not be members of FOS/AFCA unless they choose to join voluntarily.
6. These lenders can include companies that raise funds from third parties, including managed investment schemes, unit funds, and finance companies. They vary in size and include private lenders that have more limited access to capital and their credit decisions and rates of interest are dictated by this. They tend to occupy the risk areas

where the highest return for a manageable risk can be attained. This results in a concentration of business in short-term and bridging finance, with the provision of short-term loans at high interest rates (over 5% per month). Given the nature of their business models there may be significant risks for small businesses in dealing with these lenders, including asset-based lending where a short-term debt is secured against the family home and is only repayable by the sale of the home.⁵

7. However, the extent to which small businesses are exposed to lending from entities are not an ADI or a member of FOS/AFCA ought to be small given that ADIs have the bulk of the small business market.

(Topic 4: Bankwest Business Lending Portfolio) Is there any reason why valuations or investigative accountant's reports ought not be provided to customers in circumstances in which the reports have been paid for by the customer and the bank wishes to take reliance, at least in part, on such reports?

8. In ASIC's view, valuations and investigative accountant reports paid for by a customer should ordinarily be provided to that customer in full.
9. In the course of the draft Banking Code⁶ approval process,⁷ and in prior feedback to the ABA when the ABA was developing draft industry guidelines on the appointment of property valuers and investigative accountants to small businesses,⁸ ASIC (via its Insolvency Practitioners team) took a position that key documents such as valuations and instructions should be provided to customers.
10. The draft Banking Code at clause 90 provides for copies of property valuations and valuer instructions to be provided (except when enforcement proceedings have already commenced).

⁵ The risks associated with this practice were specifically addressed in the Exposure Draft of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, at https://static.treasury.gov.au/uploads/sites/1/2017/06/Exposure_Draft-9.pdf.

⁶ Unless otherwise stated, a reference in this submission to the draft 'Banking Code' is to the Australian Bankers' Association Inc's *Banking Code of Practice* (draft May 2018) - Exhibit #3.144.5.

⁷ Saadat (ASIC): Exhibit #3.162 at [105] (table – row '30-31 January 2018').

⁸ Exhibit #3.144.37 - Australian Bankers Association Inc, *Industry guideline: Appointing property valuers when lending to small businesses and primary producers*; Exhibit #3.144.38 - Australian Bankers Association Inc, *Industry guideline: Appointing investigating accountants and insolvency practitioners to small businesses and primary producers*.

(Topic 4: Bankwest business lending portfolio) Is there any reason why such transparency obligations as to valuations and investigative accountant reports should be limited by the size of the loan or limited to providing only parts of the report?

11. The size of a loan should have no bearing on whether a valuation or investigative accountant's report paid for by the customer is provided to that customer.
12. ABA industry guidelines in respect of the appointment of investigative accountants and insolvency practitioners to small businesses state:⁹

Banks should notify the customer so they are aware that some sections of the report, such as the findings and security assessment information, are made to the bank on a confidential basis. These sections may include sensitive commercial and legal information, for example, instances where the investigating accountant might uncover fraud or illegal activity.

13. ASIC does not agree that this is a proper basis for not disclosing portions of a report to the customer paying for it, particularly if a bank then intends to either discuss its findings based on that material with the borrower,¹⁰ or act upon what would otherwise be undisclosed findings or assessment information contained in the report. The draft Banking Code does not address itself to the issue of provision of all or any part of an investigative accountant's or insolvency practitioner's report.

(Topic 4: Bankwest business lending portfolio) Is it appropriate for a bank to take enforcement action when no monetary defaults have occurred and the bank can rely on non-monetary defaults? Why or why not? Should there be some additional protection for borrowers in these circumstances and ought the bank be obliged to explain such matters?

⁹ Australian Bankers' Association Inc, *Industry guideline: Appointing investigating accountants and insolvency practitioners to small businesses and primary producers* Exhibit #3.144.38 at ABA.002.001.0061 (second bullet point from base of that page).

¹⁰ Ibid, final bullet point.

14. This issue has arisen in the course of ASIC's review of ADI small business loan contracts for unfair contract terms¹¹ and during the approval process for the draft Banking Code,¹² in particular as to the use of cross-default clauses.
15. ASIC accepts that certain types of event¹³ may occur that are sufficiently material to a bank's credit or security risk (and in more limited cases, legal or reputational risk) to warrant default based action by the bank, provided in most cases that a borrower is permitted a reasonable period to remedy the default where that is possible. This applies to loan contracts with both large and small businesses.
16. In the course of its review of ADI small business contracts in 2016 and 2017,¹⁴ ASIC asserted the need for additional protections: a materiality threshold and remedy period as pre-conditions before action could be undertaken following non-monetary default, and ensuring that cross-default clauses could only be triggered by the same limited set of non-monetary default events in other finance documents. Those protections were accepted by the banking industry, first to varying extents by the Big 4 Banks¹⁵ in amendments to their small business contracts, but then also in the draft Banking Code (clauses 80-83).
17. ASIC expects a bank electing to act on a non-monetary default to be able to evidence materiality if called upon to do so and, if no non-monetary default remedy period was afforded due to an immediate risk, a bank should be able to justify why it did not provide a remedy period.
18. As stated in ASIC REP 565 'Unfair contract terms and small business loans',¹⁶ ASIC will continue to monitor the use of non-monetary default clauses by banks in the

¹¹ Saadat (ASIC): Exhibit #3.162 at [50(b)], [51(c)], [58], [63] (table – rows 'Specific events of non-monetary default' and 'Cross-default clauses').

¹² Ibid [107(a)].

¹³ See the draft Banking Code at clause 80.

¹⁴ Saadat (ASIC): Exhibit #3.162 at [63] (table – rows 'Specific events of non-monetary default').

¹⁵ A reference to Big 4 Banks in these submissions is to Australia and New Zealand Banking Group Limited (**ANZ**), Commonwealth Bank of Australia (**CBA**), National Australia Bank Limited (**NAB**) and Westpac Banking Corporation (**WBC**).

¹⁶ Exhibit #3.162.11 ASIC Report 565 *Unfair contract terms and small business loans* (March 2018) at [8] and [88]-[89].

context of unfair contract term provisions and will also do so as part of ASIC's work examining other lender contracts to ensure that they do not include unfair terms.

(Topic 4: Bankwest business lending portfolio) Is there a disconnection between what the banks are saying in their advertising, their annual reports, their other public documents, and their conduct? And if there is a disconnection between them, what, if anything, follows from that?

19. In the ASIC Round 2 Submissions, ASIC stated that in its experience although many of the banking and financial services institutions regulated by ASIC publicly state that their core values include being customer focused, 'doing what is right' for customers and acting with integrity, the reality of their conduct does not always reflect that professional ethos.¹⁷ The conduct ASIC referred to includes responding to requirements to change practices or remediate customers in a technical or legalistic way (as opposed to an approach focused on optimal customer outcomes).¹⁸ ASIC sees this as a cultural issue within banks.
20. At the level of community expectation, general public statements of intent or value, even if not rising to the level of an enforceable promise or statement, impact how consumers and small businesses expect to be treated. A simple example: it is incongruous to 'doing what is right' to require a customer to pay for a report, and then withhold it from them.¹⁹
21. What ought to flow at a minimum from such a disconnection is a firmer cultural commitment by Boards and senior management of banks to put compliance with professional legal and ethical duties to customers at the forefront of their priorities.²⁰ That may include placing greater emphasis on the latter duties, particularly, but not exclusively, in dealing with consumers and small businesses. In the context of small business and the Banking Code, for example, any disconnect may also warrant external dispute resolution providers having regard to public statements in considering what

¹⁷ ASIC Round 2 Submissions from [126].

¹⁸ Ibid [126(d)(i)].

¹⁹ See, for example, Clark (CBA): P-2683:1-6; Counsel Assisting: P-3049:35-39.

²⁰ ASIC Round 2 Submissions [127].

constitutes conduct that is, ‘fair, ethical and reasonable’,²¹ or in otherwise interpreting how the Banking Code’s ‘Statement of Guiding Principles’²² are to be applied.

(Topic 5: power and communication) Should the sales culture for small business lending reflect that of consumer lending in that business bankers are discouraged from focusing primarily on financial incentives in their key performance indicators?

22. Yes. ASIC refers to its response to an earlier question above at paragraphs 1 to 3.
23. In the ASIC Round 2 Submissions,²³ submissions were made by ASIC in respect of the remuneration and incentive policies that reward financial advisers based on generated revenue. Whilst small business banking is a different arena, with duties towards a client or prospective client very different to those arising in the provision of financial advice, inappropriately weighted incentives that are directly related to the generation of revenue or the number of new lending clients have the potential to distort small business lending decision-making or encourage failure to follow proper processes.

(Topic 6: review and regulation) Is ASIC’s approach to the unfair contract term (UCT) provisions and the consumer protection provisions²⁴ under the *Australian Securities and Investments Commission Act 2001 (Cth)* (ASIC Act)²⁵ more generally, appropriate and moulded to the risks of the contraventions and practical resources constraints on ASIC?

24. ASIC’s approach to its regulatory responsibilities and the regulatory choices it makes is informed by a consideration of the action that most effectively improves consumer (or small business) outcomes and industry participant behaviour and practice.²⁶ Its approach to the extension of unfair contract terms provisions has been to require the Big 4 Banks to make changes to their small business loan contracts, thereby bringing about change across the industry.

²¹ Exhibit #3.144.5: Clause 10 of the draft Banking Code.

²² Exhibit #3.144.5 (at ABA.002.001.0215).

²³ ASIC Round 2 Submissions from [21].

²⁴ For the purposes of this question, ‘consumer protection provisions’ is taken to be to a reference to a provision of Part 2, Division 2, Subdivision C, D or GC (other than s 12DA) of the ASIC Act, contravention of which is defined as a ‘consumer protection breach’ in s 12GBB.

²⁵ A reference in these submissions to any statute is to the ASIC Act unless otherwise stated.

²⁶ ASIC Round 2 Submissions [105]. ASIC Round 2 Submissions describe ASIC’s general approach to regulation, including its application of a ‘strategic regulation’ model, at [107]-[115] and [122]-[125].

25. In performing powers and exercising functions across a multiplicity of Commonwealth legislation,²⁷ ASIC must strive to meet the objectives set out for it in the ASIC Act.

Those objectives, which include to:²⁸

(a) *maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; ...*

(d) *administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements; and ...*

(g) *take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.*

necessarily condition the manner in which regulatory choices as to approach are made and implemented, as also do the resources available to and strategic priorities of ASIC.²⁹

26. The statutory objectives taken together encompass more than addressing the risk of contravention: they encourage the use of regulatory resources to facilitate and improve the performance of entities in a way that may achieve more than minimum legislative standards (including through industry-wide or significant industry participant consent and agreement).³⁰

27. In exercising functions and powers related to provisions contained in Part 2, Division 2 of the ASIC Act, the application of a strategic regulation model by ASIC will often involve a focus on the major financial institutions that dominate the provision of

²⁷ In addition to the ASIC Act, ASIC has functions and powers under the *Corporations Act 2001 (Cth)*, *Business Names Registration Act 2011 (Cth)*, *Business Names Registration (Transitional and Consequential Provisions) Act 2011 (Cth)*, *Insurance Contracts Act 1984 (Cth)*, *Superannuation (Resolution of Complaints) Act 1993 (Cth)*, *Superannuation Industry (Supervision) Act 1993 (Cth)*, *Retirement Savings Accounts Act 1997 (Cth)*, *Life Insurance Act 1995 (Cth)*, *National Consumer Credit Protection Act 2009 (Cth)*, and *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003 (Cth)*, as well as relevant regulation under the same. The broad nature of ASIC's mandate, extending beyond the regulation of financial markets and financial market participants, was noted by Mr Mullaly: Mullaly (ASIC): P-3012:6-15.

²⁸ Section 1(2).

²⁹ Saadat (ASIC): P-2979:10-19.

³⁰ At P-2993:8 the Commissioner noted the distinction between achieving industry-wide *agreement* and industry-wide *compliance* ('The two are radically different, I would suggest'). In response, Mr Saadat noted that both objectives are important but in the context of the unfair contract terms legislation, an agreement offered the opportunity to potentially go beyond the law: Saadat (ASIC): P-2993:10-19.

relevant financial services, particularly when seeking to improve outcomes for the greatest number of consumers (or small businesses).³¹ In ASIC's experience, the major financial institutions are well resourced, knowledgeable as to changes to the law, and while open to consider changes to their practices, they can be overly technical or legalistic in their approach to doing so.³² However, if the larger financial institutions can be made to change their practices, there is an immediate benefit for a large number of consumers and the rest of industry tends to follow.³³

28. In relation to Subdivision BA of Part 2, Division 2 of the ASIC Act (**UCT Law**) specifically, Mr Saadat summarised this approach in the following terms:³⁴

I think the strategy that we embarked upon to make sure that the big four banks had changed their contracts in the way that we felt was necessary was the right way to go; that they have about 83 per cent of market share when it comes to small business lending, and having them set the standard is very important because the rest of the industry does look at the conduct of the big four banks, and so I think given that we were able to reach the position we did with the big four, including in some respects as a result of the fact that the Code of Banking Practice was being reviewed, making sure that the commitments that were being made went beyond the strict requirements of the UCT law, I think that was a good outcome.

29. Against this background, ASIC considers that its approach to the unfair contract term provisions and consumer protection provisions in the ASIC Act, discussed further

³¹ For example, Background Paper 10 states (pg 1), using ABA figures, that bank loans to small businesses (where the loan amount is under \$2m) totalled \$261 billion in December 2015.

³² As identified in the ASIC Round 2 Submissions at [126(c)], and as referred to in the evidence of Mr Saadat in this round (Saadat (ASIC): Exhibit #3.162 at [41], [48]; Saadat (ASIC): P-2992:29 to P-2993:6, in particular at P-2992:35-37).

³³ There are similarities here with the approach of the ACCC, Mr Gregson observing “*The footprint of larger companies also say (sic) something about the harm that we are trying to address. If a larger company has a greater impact on the marketplace with its behaviour, that might be something that adds to the seriousness of the conduct. We are also the national regulator. We tend to focus in on the big end of town more than the lower end of town.*” (Gregson (ACCC): P-2959:42-2960:1).

³⁴ Saadat (ASIC): P-3004:36-44.

below in more detail, has been appropriate and moulded to addressing the risk of contravention of those provisions,³⁵ even having regard to resource limitations.³⁶

30. No regulatory decision or action is beyond criticism nor realistically could regulatory decisions or actions be effective to guarantee absolute compliance by every person with the law. Within any area of ASIC's responsibility, a particular regulatory approach is not static: it is always subject to review and reconfiguration, having regard to information available to ASIC and ASIC's strategic priorities and objectives. ASIC's approach to the extension of the UCT Law to certain small business contracts,³⁷ is no different.

The extension of the UCT Law: ASIC's approach

31. ASIC's approach to regulatory action, including enforcement action, is governed by the broader strategic regulation model referred to in the ASIC Round 2 Submissions and the evidence of Mr Mullaly in this round.³⁸
32. ASIC pursues the most effective mechanism for achieving industry-wide change, the particular methodology depending on the relevant circumstances.³⁹ This informed ASIC's initial approach to unfair contract terms in applicable small business contracts, a field in which ASIC has sought to achieve, and has in fact achieved, industry-wide change. Importantly, this approach prompted changes that went beyond the strict legal position mandated by the UCT Law to the benefit of small business borrowers.
33. ASIC's opening approach to the 12 November 2016 extension of the UCT Law involved the use of regulatory tools including the provision of regulatory information or

³⁵ While inclusion of an unfair term that is void by operation of s 12BF(1) is not a contravention of the ASIC Act, ASIC includes risk of the existence of unfair contract terms within the scope of this particular statement.

³⁶ Unlike the ACCC, ASIC did not receive further initial funding specifically to address the expansion of unfair contract term legislation to small business contracts, leading to a diversion of resources from other projects (Saadat (ASIC): Exhibit #3.162 at [6]-[7], [77]-[78]). Mr Saadat noted that the additional funding gave the ACCC an opportunity to conduct more research and outreach than that undertaken by ASIC: Saadat (ASIC): P-2991:10.

³⁷ Mr Saadat observed that the process of bilateral engagement with the Big 4 Banks took some time although, in his view, it may have taken much longer for ASIC to employ its formal investigative powers or to institute legal proceedings: Saadat (ASIC): Exhibit #3.162 at [75]; Saadat (ASIC): P-3007:26-31.

³⁸ ASIC Round 2 Submissions [107]-[115] and [122]-[125]. Mullaly (ASIC): Exhibit #3.171 at [10], [17] and [18].

³⁹ Saadat (ASIC): Exhibit #3.162 at [68].

guidance,⁴⁰ the conduct of reviews⁴¹ and issuing of reports⁴² to outline and highlight potentially harmful industry practices, and then interaction with industry to drive behavioural change.⁴³

34. The primary advantages of that approach were:

- (a) *ASIC was able to engage directly with a dominant segment of one single market in one regulatory project.* ASIC thereby sought improvements to terms applying to, and addressed risks of future contravention affecting, the maximum number of small businesses, while setting a standard⁴⁴ and publicly signalling the need for changes to the remainder of the industry sector which, in many instances, were then also included in the draft Banking Code;⁴⁵
- (b) *views of other stakeholders or in other relevant material were applied to inform and improve the method and outcome of ASIC's review process,* such as the input of the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**), and the *Review of the Code of Banking Practice* by Mr Phil Khoury (**Khoury Review**) (and the subsequent approval process for the Banking Code);⁴⁶
- (c) *consistent with its statutory objectives, ASIC sought and obtained beneficial changes to loan contracts that may go further than the law might require* (for example, to amend a term that may or may not be unfair (and therefore void) as a matter of law if decided upon by a Court, and in certain cases to extend

⁴⁰ ASIC released an 'Unfair contract term protections for small businesses' information sheet in February 2016 (Exhibit #3.162.2) and carried out in person and online presentations to industry - Saadat (ASIC): Exhibit #3.162 at [13], [14], [17] and [18].

⁴¹ Saadat (ASIC): Exhibit #3.162 from [26].

⁴² Exhibit #3.162.11 ASIC Report 565 *Unfair contract terms and small business loans* (March 2018).

⁴³ Saadat (ASIC): Exhibit #3.162 from [26]-[64].

⁴⁴ Saadat (ASIC): P-3004-39-45.

⁴⁵ An example – a remedy period and materiality threshold in respect of a lender taking default-based action for a non-monetary default – see paragraph 16 of these submissions.

⁴⁶ For example, ASIC and ASBFEO consulted as to the UCT review: Saadat (ASIC) Exhibit #3.162 at [49].

changes to Big 4 Banks's small business loan contracts up to \$3 million in aggregate credit);⁴⁷

- (d) *ASIC was able to see the substance of the changes implemented (unlike the immediate consequence of obtaining a s 12GND declaration of unfairness in respect of a term, where the nature and merit of any term put in its place would not be known in advance); and*
- (e) *the industry review process is likely to have been significantly less costly and quicker than contested litigation against any individual financial institution.*

35. Potential disadvantages of that type of approach, which ASIC sought to manage in connection with the extension of the UCT Law, were:

- (a) *the time that can be taken to complete reviews, reports and to cause behavioural change,⁴⁸ particularly when (1) considering and incorporating the input of other stakeholders or from other reports,⁴⁹ and (2) addressing other matters in parallel (as to approval of the draft Banking Code). Here, agreement by the Big 4 Banks to make changes was substantively achieved by August 2017⁵⁰ and implemented by term waivers over the following months. ASIC mitigated the delay in the period from 12 November 2016, and managed potential disadvantage, by*

⁴⁷ Saadat (ASIC) Exhibit #3.162 at [71(c)]. In the March 2017 ASIC/ASBFEO Media Release, Ms Carnell noted *'In meeting the law to cover individual loan contracts up to \$1million the banks have agreed to extend the cover to small business total loan facilities up to \$3 million which is a move in the right direction.'*

⁴⁸ However, that time may still be less than change affected through contested litigation: for example, Mr Gregson of the ACCC stated in evidence (P-2957:23-25) that the ACCC's action against JJ Richards Pty Ltd, in which orders were made in October 2017, *'resolved remarkably quickly. Almost in record time, parties consented and the matter was presented to the court quite quickly.'* As Mr Saadat of ASIC observed (P-3007:15-31), not only may litigation in respect of a bank's small business contract terms, likely contested, itself have taken longer than ASIC's review process, but one likely effect of any such litigation would be that other banks would have awaited the outcome before either applying changes to their own contracts or even further engaging with ASIC. In addition, given that an enquiry about the unfairness of a contract term must pay regard to a lender's legitimate interests, there was a risk that a particular outcome against one bank would not have a broader applicability: Saadat (ASIC): P-3003:31-39.

⁴⁹ As occurred between November 2016 and March 2017 - the ASBFEO's *Inquiry into small business loans* report was formally released on 3 February 2017 and the Khoury Report on 31 January 2017 (Saadat (ASIC): P-3006:30-46, P-3006:20 and P-3007:12-13). ASIC and ASBFEO jointly set out their continuing concerns as to UCT and banks in a media release dated 9 March 2017 (Exhibit #3.168).

⁵⁰ Saadat (ASIC): Exhibit #3.162 at [60] and Saadat (ASIC) P-3002:5-8. There were some issues not finally resolved until March 2018 e.g. Westpac's approach to cross-default clauses: Saadat (ASIC): P-3002:10-44.

obtaining the Big 4 Banks' agreement to make changes retrospective from 12 November 2016;⁵¹

- (b) *active engagement with ASIC by the relevant industry members is required for a review to be effective.* At times during the course of ASIC's terms review during 2016 and 2017, one or more ADIs appeared to be unwilling to change certain terms,⁵² but, overall, after further public and private pressure applied by ASIC, the Big 4 Banks were prepared to consider making further changes to terms⁵³ and ultimately did so; and
- (c) *industry signalling may not be universally effective to effect necessary change, particularly to outliers, and does not obviate the need for ongoing monitoring and surveillance to be implemented, which ASIC is undertaking.*⁵⁴

- 36. ASIC's regulatory approach concerning the UCT Law and small business contracts during 2016 and 2017 did not involve the use of formal investigative powers,⁵⁵ nor did it use coercive information gathering powers in respect of the entities reviewed.
- 37. In March 2017 when publicly expressing its view that certain lenders at that stage continued to use clauses of concern (itself an application of informal coercive power), ASIC did not explicitly demand amendment of terms by lenders or demand compliance with UCT Law,⁵⁶ but rather sought lender interaction with ASIC to cause necessary changes to be made. This reflected both uncertainty as to whether any individual term was in fact unfair and the absence of a formal directive power, but also that ASIC

⁵¹ This meant that in practical terms no small business customer was disadvantaged: for example, were a bank to seek to rely upon such an unfair term, it would not be necessary for a small business customer to go to court to seek a declaration that the term is void: Saadat (ASIC): P-3003:15-24.

⁵² Saadat (ASIC): P-2992:29.

⁵³ Saadat (ASIC): P-2992:42 to P-2993:6; Saadat (ASIC): Exhibit #3.162 at [52]-[57].

⁵⁴ ASIC undertakes surveillance not only of Big 4 Bank contracts but also those of other banks and non-bank financial services sector participants including financial technology lenders: Saadat (ASIC) Exhibit #3.162 at [67] and [73]. For example, ASIC has now commenced a review of the contracts of other lenders, both bank and non-bank, to ascertain whether they have incorporated the changes outlined in ASIC REP 565: Saadat (ASIC): P-3004:23.

⁵⁵ As inclusion of an unfair contract term in an applicable contract is not a contravention of the ASIC Act, however, ASIC's general power of investigation is not enlivened prior to a Court declaring a term to be unfair pursuant to s 12GND.

⁵⁶ Saadat (ASIC): P-2995-2996, in particular P-2996:20-35.

wanted amendments to go further than merely complying with the law, and could best achieve that through continued lender interaction.

38. In May 2017, ASIC, the ACCC and the ASBFEO met with the ABA and representatives of the Big 4 Banks in a roundtable discussion to address amendment of particular types of clauses within small business loan contracts,⁵⁷ which ASIC also followed up in further detail as to particular terms on a bilateral basis with individual Big 4 Banks.⁵⁸ This led to agreement by those banks to make specific further changes to small business loan contracts.⁵⁹
39. A question has been raised as to whether ASIC's process of ADI review and reporting ought to have been completed earlier than it was, specifically by or shortly after 12 November 2016 when the UCT Law came into force. There is no doubt that this would have been a preferred outcome but there were some practicalities, developments and circumstances that prevented this, while also providing an opportunity to obtain a better overall outcome.
40. First, many banks indicated to ASIC that they were planning to use the full transition period in order to update their contracts⁶⁰ and ASIC, given its finite resources, saw little point in looking at old contracts during the transition period.⁶¹ More significantly, on 6 September 2016 the Minister for Small Business announced the small business loans Inquiry to be conducted by the ASBFEO⁶² and the final report of the ASBFEO (**ASBFEO Report**) was released on 3 February 2017.⁶³ In addition, the Khoury Review came out on 31 January 2017.⁶⁴ Following the Khoury Review, the ABA immediately got in touch with ASIC to indicate the ABA's intention to rewrite the

⁵⁷ Saadat (ASIC): Exhibit #3.162 at [52]-[56].

⁵⁸ Ibid [55].

⁵⁹ Ibid [60], [63].

⁶⁰ Saadat (ASIC): P-2975:44-45.

⁶¹ Saadat (ASIC): P-2975:26-34. ASIC then wrote to many of the large banks in early September 2016 given that the legislation was due to commence in two months and it had become appropriate to obtain copies of the contracts: Saadat (ASIC): P-2984:46.

⁶² Saadat (ASIC): Exhibit #3.162 at [24].

⁶³ Saadat (ASIC): P-3006:30-46.

⁶⁴ Saadat (ASIC): P-3006:20-21.

Banking Code and then to apply to ASIC for approval of the new Code.⁶⁵ The Khoury Review contained 99 recommendations, of which 90 were supported wholly, in principle or in part, by the ABA.

41. These events impacted upon the interaction between ASIC and the banks because the banks indicated that they were willing to make further changes, in a number of instances beyond the strict requirements of the UCT Law, to meet the recommendations in the ABSFEO Report and the Khoury Review.⁶⁶

42. Mr Saadat explained:⁶⁷

We saw this as an industry-wide issue. It wasn't just an issue confined to one institution, and we were seeking to get an industry-wide outcome in relation to how banks and other financial institutions approach the UCT laws. And so with that in mind, and given the banks in the subsequent discussions that we had with them, given that they were prepared consider further changes to their contracts, partly due to the public pressure that had been applied on them through things like the review that the Small Business Ombudsman had done but also because of the fact that their Code of Banking Practice was under review and that they were looking to make commitments to take them beyond what the law required, we saw that as an opportunity to get an outcome with the big four that we could then leverage across other financial institutions.

43. ASIC considers that this approach - achieving the retrospectively applied removal of potentially unfair contract terms in a significant proportion of small business loan contracts beyond what is arguably required by the UCT Law - was effective. It aligned with the strategic objective of achieving the most effective improvement to consumer and small business outcomes, and also industry participant behaviour and practice.

Enforcement and the UCT Law generally

44. ASIC does not view the taking of action to enforce and give effect to a law as confined to legal proceedings to the exclusion of other regulatory tools. Alternative modes of regulatory action can enforce and give effect to the law by achieving broad industry-

⁶⁵ Saadat (ASIC): Exhibit #3.162 at [86] and [87].

⁶⁶ Saadat (ASIC): P-2986:39-2987:40; P-3006:20-3007:13.

⁶⁷ Saadat (ASIC): P-2992:43-2993:6.

wide change and compliance, effecting more than minimum improvement. There is therefore no sharp dividing line between regulatory actions and interventions that might be described as ‘engagement’ on the one hand and ‘enforcement’ on the other such that one must cease when the other begins.⁶⁸

45. In ASIC’s own terminology, ‘enforcement action’ extends to actions such as seeking enforcement remedies by means of infringement notices,⁶⁹ revoking, suspending or varying financial services licences, negotiated resolutions and acceptance of enforceable undertakings.⁷⁰ ASIC’s general approach to the taking of enforcement action is set out in Information Sheet 151, titled ‘ASIC’s approach to enforcement’.⁷¹
46. When deciding whether to undertake formal enforcement action in respect of misconduct generally, ASIC weighs up a range of factors including the seriousness of the alleged misconduct and its market impact, the consequences for persons affected, the general benefits of the pursuit of enforcement action and its impact on the market, the time elapsed since the misconduct occurred and the admissible evidence available to it.⁷²
47. Subject to overriding strategic priorities,⁷³ ASIC makes a decision as to which of the regulatory tools available to it is best suited to the circumstances of the case and what is the most effective regulatory outcome, bearing resourcing constraints in mind.⁷⁴
48. Having regard to the decision criteria driving the taking of enforcement action, it can be seen that other regulatory activity can respond to (and in some instances more effectively respond to) ASIC’s s 1(2)(g) statutory objective of taking (emphasis added) ‘*whatever action it can take, and is necessary*, to enforce and give effect to the law’. At the same time there can be significant market impact from alternative regulatory

⁶⁸ Saadat (ASIC): Exhibit #3.162 at [68].

⁶⁹ Although ASIC is not empowered to issue infringement notices with respect merely to the inclusion of unfair contract terms within an applicable standard form consumer or small business contract.

⁷⁰ Mullaly (ASIC): Exhibit #3.171 at [19], [21], [25]-[27]. See also ASIC Info Sheet 151 (Exhibit #3.171.1) from pages 4-7.

⁷¹ Mullaly (ASIC): Exhibit #3.171.1.

⁷² Mullaly (ASIC): Exhibit #3.171 at [15].

⁷³ Ibid [12].

⁷⁴ Ibid [16].

activity with consequences for a large number of counterparties consistent with ASIC's approach to more formal enforcement action.

49. ASIC has not found it necessary to date to commence any Court proceedings against the Big 4 Banks in relation to either the UCT Law and consumer contracts,⁷⁵ or in relation to the UCT Law and small business contracts since November 2016.⁷⁶ It has been able to enforce and give effect to the UCT Law through retrospectively applied contract amendments that may go further than the law requires,⁷⁷ to the benefit of small businesses, applying to a significant proportion of loans to those businesses by using alternative regulatory tools. In contrast to other cases where legislation may provide a bright line test of what is needed to comply (where obtaining industry agreement on what constitutes compliance and commitment to implement that is of less utility), obtaining broad-based industry agreement on what terms are unfair and what needs to change and a commitment to make those changes in an area of some uncertainty such as the UCT Law is a significant step towards achieving compliance.
50. In response to the suggestion that ASIC and the ACCC pursued divergent approaches to the enforcement of the UCT Law,⁷⁸ it should be observed that in some respects there were differences in the regulatory challenges facing the two organisations. ASIC's jurisdiction in relation to unfair contract terms is limited to the extent that such terms are included in contracts that are for a financial product or for the supply, or possible supply, of services that are financial services.⁷⁹ The financial institutions regulated by ASIC were all very much aware of the impending UCT Law having lobbied against it through the ABA,⁸⁰ whereas the ACCC has responsibility for the entire economy. Unsurprisingly, therefore, the ACCC selected a number of businesses for review from a wide range of industries: advertising, telecommunications, retail leasing, franchising, independent contractors and waste management.⁸¹ Many of those industry sectors had

⁷⁵ Saadat (ASIC): Exhibit #3.163 at [43]-[49]. As noted there, in the several broad consumer matters considered in that time, ASIC achieved outcomes through voluntary interaction with the applicable Bank.

⁷⁶ Saadat (ASIC): P-2998:22-26.

⁷⁷ Saadat (ASIC): P-2998:28-36.

⁷⁸ Saadat (ASIC): P-2989:45.

⁷⁹ ASIC Act, s 12BF(1)(c)(ii) and (ii).

⁸⁰ Saadat (ASIC): P-2983:25-39.

⁸¹ Gregson (ACCC), Exhibit #3.160 at [7.1]-[7.16].

an extensive history of consumer complaints,⁸² and unlike ASIC, the ACCC could not proceed on an assumption that the entire economy had the kind of knowledge about the UCT Law held by the banking sector.

51. Moreover, although the ACCC described moves to a primary focus on enforcement from 12 November 2016,⁸³ ‘enforcement’ is a broader notion than Court action.⁸⁴ As Mr Gregson put it, in the enforcement phase, the ACCC will in some cases accept an administrative resolution to an investigation. Depending on the circumstances, administrative resolutions can range from a commitment by a business in correspondence to a signed agreement between the ACCC and a business setting out detailed terms and conditions of the resolution. Also, administrative resolutions generally involve the business agreeing to cease the conduct and to take other measures necessary to ensure that the conduct does not recur.⁸⁵ “*Administrative action*” is apt to describe the enforcement approach adopted by ASIC with the finance industry.⁸⁶
52. Mr Gregson also observed that enforcement by the ACCC in respect of the UCT Law adopted a “*different model*”⁸⁷ than enforcing contravention provisions of the Australian consumer laws. That is because a breach of many of the provisions in the Australian consumer law is an immediate contravention of the law, with pecuniary penalties (and their greater sanction and deterrent effect) available,⁸⁸ whereas engaging in conduct with unfair contract terms is not actually a contravention of the law.⁸⁹ Thus, if a business is found to have an unfair contract term in one of its contracts, the ACCC is unable to obtain a pecuniary penalty at first instance. Only if a contract term is first declared unfair and then enforced might penalties arise.⁹⁰ In that regard, ASIC is in the same position as the ACCC.

⁸² Gregson (ACCC): P-2953:31.

⁸³ Gregson (ACCC), Exhibit #3.160 at [9.1]; Gregson (ACCC): P-2952:30-39.

⁸⁴ Gregson (ACCC), Exhibit #3.160 at [13.18]-[13.24]; Gregson (ACCC): P-2958:41-2959:2.

⁸⁵ Gregson (ACCC), Exhibit #3.160 at [13.12]-[13.13]; Gregson (ACCC): P-2956:38-40.

⁸⁶ See generally Saadat (ASIC): P-2989:45-2991:12.

⁸⁷ Gregson (ACCC): P-2955:32.

⁸⁸ Gregson (ACCC): P-2959:13-18.

⁸⁹ Gregson (ACCC): P-2955:35-36.

⁹⁰ Gregson (ACCC): P-2956:1-3. See also Gregson (ACCC) Exhibit #3.160 at [12.1]-[12.2].

53. ASIC fully accepts the deterrence value of Court proceedings, particularly in the case of large entities whose conduct has a proportionately larger impact on the market.⁹¹ Specifically in relation to the UCT Law, Mr Saadat observed that if ASIC encounters businesses that are including terms within their contracts that are unfair, and those businesses do not change their contracts in response to the concerns raised by ASIC, then “*we will commence proceedings against those businesses in appropriate circumstances*”.⁹²
54. In the case of the banks for the period shortly after November 2016, however, litigation would not have been the preferred regulatory tool. Banks were willing to further amend terms and litigation may have prevented achievement of timely industry-wide amendments that could go further than the law required. That is not to say that litigation would lack utility on a future occasion.

Other ASIC Act consumer protection provisions

55. While ASIC’s overall regulatory approach to ASIC Act consumer protection provisions is not conceptually different to that applied to the UCT provisions, including as to enforcement action, the former are pecuniary penalty provisions⁹³ which give rise to more enforcement options in terms of the issue of infringement notices and the content of enforceable undertakings.
56. Since January 2008, ASIC has across all of its regulatory responsibilities undertaken 1865 investigations involving 3493 enforcement actions, issued 370 infringement notices and accepted 194 enforceable undertakings (including 13 against Banks).⁹⁴ It has commenced 110 proceedings alleging an ASIC Act contravention, 23 proceedings

⁹¹ Mullaly (ASIC): P-3021:1-29. Likewise, Mr Gregson observed that Court proceedings are the only way to get penalties (although not immediately available in the context of the UCT Law) and that penalties are an important part of the deterrence message: Gregson (ACCC): P-2959:12-19, and larger companies may need a higher deterrence: Gregson (ACCC): P-2959:41-42.

⁹² Saadat (ASIC): P-2992:24.

⁹³ Section 12GBA.

⁹⁴ Where reference is made to Banks here, these figures relate to the following banks: ANZ, CBA, NAB, WBC, Bank of Queensland Limited and Suncorp-Metway Limited (and their respective related entities), being those entities in respect of whom ASIC was asked to provide such figures.

relating to a consumer protection provision, and 10 proceedings against Banks alleging breach of consumer protection provisions.^{95 96}

57. From another perspective, over the last three years, at least 25% of ASIC's enforcement team budget has been spent on formal investigations and enforcement action in relation to ANZ, CBA, NAB, WBC, Macquarie and AMP.⁹⁷
58. While the enforcement action statistics with respect to consumer protection provisions within the ASIC Act⁹⁸ are significantly different to those applying to the (non-pecuniary penalty) UCT provisions, ASIC does not consider that its regulatory approach necessarily differs as between the two. ASIC makes a judgment about what is the most appropriate action to take in all the relevant circumstances.
59. It is important also to note that ASIC does not look to protect consumers only through the application of those consumer protection provisions within the ASIC Act. ASIC exercises functions and powers under other legislation that give consumer protection.⁹⁹ Depending on the nature of any allegation of harmful conduct, ASIC decides which regulatory tools may be most effective to address that conduct and change behaviour, which may involve taking enforcement or other action by reference to powers under other legislation.

(Topic 6: review and regulation) Has ASIC's approach been effective in ensuring compliance with the UCT provisions that came into effect in November 2016 and the consumer protection provisions¹⁰⁰ of the ASIC Act generally?

⁹⁵ Mullaly (ASIC): Exhibit #3.171 at [28], [29] and [31].

⁹⁶ ASIC has also obtained, in relation to Banks, more than \$700 million in compensation, remediation or return of funds to investors, and \$54.3 million in community benefit payments since January 2008 (Mullaly (ASIC) Exhibit #3.171 at [30]).

⁹⁷ Mullaly (ASIC): P-3026:24-34.

⁹⁸ Those identified both in paragraph 56 above and within Mr Mullaly's (ASIC) statement (Exhibit #3.171) more generally.

⁹⁹ Mullaly (ASIC): P-3011:43 to P-3012:29.

¹⁰⁰ For the purposes of this question, reference to 'consumer protection provisions' is taken to be to a reference to a provision of Part 2, Division 2, Subdivision C, D or GC (other than s 12DA) of the ASIC Act, contravention of which is defined as a 'consumer protection breach' in s 12GBB.

60. As a result of action taken by ASIC, Big 4 Banks (representing the preponderance of small business loans)¹⁰¹ committed to, and then implemented, a series of comprehensive changes across six types of terms to ensure that small business contract loans entered into or renewed from 12 November 2016 would not include potentially unfair contract terms. In some instances, this included small business loan contracts in excess of the \$1 million threshold set out in s 12BF(4)(b)(ii), before implementation of any revised Banking Code that may also give such small business counterparties the benefit of like amendments.¹⁰²
61. While ASIC will continue to conduct surveillance of both the Big 4 Banks and the financial services industry more generally,¹⁰³ it is of some relevance that since 12 November 2016, ASIC has received only one complaint that may have raised potential unfair contract terms concerns in small business loan contracts.¹⁰⁴
62. As previously noted, ASIC's approach to the November 2016 extension of the UCT Law was not limited to obtaining technical compliance with the provisions, but extended to using the most appropriate regulatory tools to achieve improvements that may exceed what the UCT Law might require.¹⁰⁵
63. ASIC also considers it to be a positive outcome that changes arising from its bilateral discussions with the Big 4 Banks concerning unfair contract terms have been included in the draft Banking Code (itself a matter that may go beyond the law to the extent that the Code applies to a contract not otherwise falling within the scope of the UCT Law itself). Not only does that mean that such changes would apply more broadly to the 24 members of the ABA,¹⁰⁶ but also that those changed terms fall within the scope of matters to which FOS and soon AFCA may have regard as an industry standard or

¹⁰¹ Ms Bligh (ABA) gave evidence (Exhibit #3.144 at [104(c)]) that a Banking Code 'small business' definition containing a threshold of \$3 million total credit exposure would result in coverage of 97% of all businesses with a loan in Australia. The Big 4 Banks, as a subset, provide the majority of those loans.

¹⁰² Saadat (ASIC): Exhibit #3.162 at [71(c)].

¹⁰³ Saadat (ASIC): Exhibit #3.162 at [67] and [73]; Saadat (ASIC): P-3004:23.

¹⁰⁴ Saadat (ASIC): Exhibit #3.162 at [66].

¹⁰⁵ An example – a remedy period and materiality threshold in respect of a lender taking default-based action for a non-monetary default – see paragraph 16 of these submissions.

¹⁰⁶ Those members would be required to sign up to any amended Banking Code: Bligh (ABA): P-2921:44-45.

practice when considering complaints against banks more generally (including non-ABA members).^{107 108}

64. In evidence before the Royal Commission, Suncorp Group indicated that its UCT small business contract review and amendment process remained incomplete,¹⁰⁹ and correspondingly that at least some of its contracts may still contain terms that could be unfair (or a heightened risk of being unfair). This is so notwithstanding ASIC's actions and reports in connection with the Big 4 Banks. While certain necessary changes to contracts may be effected by Suncorp being an ABA member and the provisions of an amended Banking Code in due course applying to those contracts,¹¹⁰ ASIC is addressing the present issue with Suncorp Group. This evidence reinforces the need for continued surveillance and compliance monitoring, and if necessary, separate enforcement action within the rubric of strategic regulation.
65. In respect of the consumer protection provisions more generally, including those within the ASIC Act, ASIC considers that its regulatory approach has been effective in promoting compliance or promptly addressing non-compliance in a manner consistent with its strategic and statutory objectives. ASIC applies a wide array of regulatory tools to promote compliance and address non-compliance. The latter includes obtaining enforcement outcomes including compensation, remediation or return of funds to investors and obtaining community benefit payments.¹¹¹

(Topic 6: review and regulation) Is the proposed Banking Code – whether or not it is approved by ASIC – adequate to address any residual concerns about the coverage of obligations imposed on the banks?

66. ASIC is presently considering whether to approve the Banking Code under s 1101A of the *Corporations Act 2001* (Cth) (**Corporations Act**). One of the matters that ASIC is required to consider in determining whether to approve the Banking Code is its

¹⁰⁷ Bligh (ABA): P-2921:31-38.

¹⁰⁸ Exhibit #3.84.2 FOS Terms of Reference dated 1 January 2018, clauses 8.2(b) and (c) (at pg FOS.0033.0001.0018).

¹⁰⁹ Kluss (Suncorp): P-2947:13-28.

¹¹⁰ Suncorp Bank is listed in Annexure A to the Statement of Anna Bligh (Exhibit #3.144) as a current ABA member.

¹¹¹ Mullaly (ASIC): Exhibit #3.171 at [30] in relation to such outcomes from certain banks.

adequacy, that is, the extent to which the Banking Code sets consumer protection standards or offers consumer protection benefits beyond the current state of the law. ASIC's review of the Banking Code is ongoing (although temporarily deferred¹¹²) and, for this reason, it is unable to express a concluded opinion on whether the Banking Code is adequate to address any residual concerns about the coverage of obligations imposed on the banks.

67. ASIC's regulatory work continues in this regard as it should be seen as ongoing, as opposed to fixed to a particular point in time. That being said, ASIC does generally consider the proposed Banking Code to improve upon the current version of the Banking Code, and to exceed the protections currently offered by the law in several areas. In particular, the proposed Banking Code presents an improvement by:
- (a) increasing the range of contracts to which the requirements within the Banking Code will apply;
 - (b) requiring banks to employ practices to identify common indicators of financial difficulty, extend financial difficulty assistance to guarantors, restrict lending to co-borrowers, and to implement a deferred sales model for consumer credit insurance (CCI) sold through particular channels;
 - (c) offering additional protections for guarantors, including by prohibiting a bank from accepting a signed guarantee for a period of three days if the guarantor has not obtained legal advice and requiring banks to obtain recourse against the borrower in the event of default unless the borrower's security is inadequate;
 - (d) offering additional protections for small businesses, including by introducing simplified loan contracts, providing a greater period of time for a borrower to obtain alternative finance where facilities will not be removed; and
 - (e) amending or removing terms in loan contracts that may otherwise be unfair under UCT Laws (including in small business loan contracts to which UCT Law may not apply) - such as removing material adverse change clauses from loan contracts, limiting the number of non-monetary default events entitling a bank

¹¹² Saadat (ASIC): P-2968:25-29.

to take action against a borrower (and providing a remedy period) and limiting the scope of unilateral variation clauses.

68. Although ASIC has not yet approved the Banking Code, it is apparent that the Code incorporates and responds to a significant number of the recommendations arising from the Khoury Review. This was accepted in the evidence given by Mr Khoury to the Royal Commission, in which he stated that, although not incorporating the entirety of his recommendations, the new drafts of the Banking Code involved ‘significant steps forward’ with ‘substantive improvements for small business customers in a number of aspects’.¹¹³
69. Although ASIC is yet to reach a concluded view on the Banking Code, it considers that, as a general proposition, the proposed Banking Code includes ‘substantive improvements’ as identified by Mr Khoury. That is not to say that ASIC has been unconcerned about aspects of the proposed Banking Code, and those concerns have been expressed to the ABA. That process has resulted in a number of changes to the proposed Banking Code which, in ASIC’s view, has improved the consumer protection benefits offered.
70. Some of those improvements include:¹¹⁴
- (a) tightening the drafting of the Banking Code to limit the use of cross-default clauses in small business credit contracts to situations where the cross-default was either a monetary default or only a specified type of non-monetary default;
 - (b) removing financial indicator covenants from property investment loans and refining the wording of relevant Banking Code clauses so that the class of arrangements classified as ‘specialised lending’ is appropriately confined and cannot expand inappropriately over time;
 - (c) extending the CCI deferred sales period to CCI sold with personal loans (initially the draft Banking Code provided for the deferred sales model only in relation to CCI sold with credit cards);

¹¹³ Khoury: Exhibit 3.4 (WIT.0001.0033.0001) at [54]-[55].

¹¹⁴ Saadat (ASIC): Exhibit #3.162 at [107].

- (d) refining the wording of the Banking Code so that banks will not offer CCI to an individual if the individual is ‘not eligible to claim on a significant part of the policy’ (rather than ‘not eligible to claim on any grounds’);
- (e) in relation to small business lending, replacing the term ‘enforcement proceedings’ with ‘default based action’ so that banks are restricted in their ability to take various types of default based action in the event of non-monetary defaults unless the non-monetary default is of a specified type expressly mentioned in the Banking Code (e.g. insolvency);
- (f) revising the clauses that provide for accessibility of banking services to remote Indigenous customers so that those accessibility clauses apply equally to non-remote Indigenous customers;
- (g) broadening the role of the Banking Code Compliance Committee so that it is empowered to undertake investigations of breaches of the Banking Code following its inquiries (rather than limiting BCCC investigations to occasions where a breach has been reported to the BCCC);
- (h) including greater substance in the Chapter of the Banking Code dealing with valuations and the appointment of investigative accountants to better reflect the content of the ABA’s voluntary industry guidelines on banks’ use of property valuations and appointment of investigative accountants.

71. An issue raised by ASIC that remains unresolved concerns the definition of ‘small business’ in the Banking Code.¹¹⁵ Under the proposed Banking Code, a business is a ‘small business’ if, at the time it obtains the banking service, it: has an annual turnover of less than \$10 million in the previous financial year; has fewer than 100 full-time equivalent employees; and has less than \$3 million total debt to all credit providers. The Khoury Review recommended that the amount of total debt be increased to \$5 million. ASIC has raised issues concerning the definition of ‘small business’ with the ABA, including whether the threshold amount of total debt should be increased. In response to ASIC’s concerns, the ABA agreed to increase the initial limit of full-time

¹¹⁵ Saadat (ASIC): P-2969:4-22.

employees from 20 to 100, but otherwise indicated that it did not support any further changes.

72. ASIC is continuing to review the definition of ‘small business’ in considering whether to approve the proposed Banking Code. ASIC has not determined its final position, but notes that the proposed Banking Code (particularly if approved) will be subject to periodic review (which will allow for continual improvement and refinement of the Code).

(Topic 6: review and regulation) Would the absence of ASIC approval undermine the effectiveness of the Banking Code?

73. ASIC *may* approve codes of conduct relating to any aspect of the activities of financial services licensees, authorised representatives of financial licensees or issuers of financial products (being matters in relation to which ASIC has a regulatory responsibility) under s 1101A(1) of the Corporations Act. Section 1101A(3) clarifies that ASIC *must not* approve a code of conduct (or approve a variation of such a code) unless ASIC is satisfied that:
- (a) the code, or the code as proposed to be varied, is not inconsistent with this Act or any other law of the Commonwealth under which ASIC has regulatory responsibilities; and
 - (b) it is appropriate to approve the code, having regard to the following matters, and to any other matters that ASIC considers are relevant:
 - (i) the ability of the applicant to ensure that persons who hold out that they comply with the code will comply with the code as in force from time to time; and
 - (ii) the desirability of codes of conduct being harmonised to the greatest extent possible.
74. ASIC’s approval of a code indicates ASIC’s satisfaction that the code meets the criteria in s 1101A(3) of the Corporations Act, and ASIC’s own criteria for what constitutes an effective code of conduct (which is discussed further below). ASIC does not, however, administer or enforce approved codes. Codes, like the proposed Banking Code, are

self-regulatory arrangements. Under Chapter 49 of the proposed Banking Code, the BCCC will be responsible for monitoring and enforcing compliance with the Code.¹¹⁶

75. ASIC's approach to approving codes of conduct is set out in Regulatory Guide 183 which is titled 'Approval of financial services sector codes of conduct' (**RG183**).¹¹⁷ RG183 makes it clear that ASIC expects that an effective code will do one of the following: 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 from the perspective of a particular industry, practice or product to comply with legislation. RG183 also sets out the matters considered by ASIC in determining whether a code meets the threshold criteria for what ASIC considers to be a code, the statutory criteria in s 1101A(3) of the Corporations Act and other criteria that ASIC considers to be relevant.¹¹⁸
76. As a minimum, ASIC requires that a code should satisfy the following criteria:¹¹⁹
- (a) the rules contained in the code must be binding on (and enforceable against) subscribers through contractual arrangements;
 - (b) the code must be developed and reviewed in a transparent manner, which involves consulting with relevant stakeholders including consumer representatives; and
 - (c) the code must have effective administration and compliance mechanisms.
77. Once a code is determined to meet these minimum threshold requirements, ASIC will consider whether the code meets the statutory criteria in s 1101A(3) and ASIC's own criteria for an effective code. These criteria include whether: the code provides consumer benefits beyond that provided by the law; the code is consistent with the Corporations Act and any other relevant law of the Commonwealth; the applicant for approval is able to ensure compliance with the code; there are appropriate remedies and sanctions for non-compliance; the code meets certain standards in terms of development, content, enforcement, administration and review to justify

¹¹⁶ Saadat (ASIC): Exhibit #3.162 at [115].

¹¹⁷ Saadat (ASIC): Exhibit #3.162.13.

¹¹⁸ Saadat (ASIC): Exhibit #3.162.13 at RG183.5.

¹¹⁹ Saadat (ASIC): Exhibit #3.162.13 at RG183.20.

harmonisation.¹²⁰ There are further criteria touching upon the content, administration and enforceability of a code that ASIC may consider in determining whether to approve that code.¹²¹ It is also a condition of approval that a code must be independently reviewed at intervals of no more than three years.¹²² ASIC would carry out continuing monitoring or oversight of an approved code.¹²³

78. Although the Banking Code is a self-regulatory arrangement and ASIC's approval (or lack thereof) does not detract from its legal status,¹²⁴ ASIC's approval of a code of conduct is a signal to consumers that they can have confidence in that code,¹²⁵ and that it has been assessed in accordance with appropriate regulatory guidelines.¹²⁶
79. ASIC approval is a signal that ASIC is satisfied that the code provides consumer protection benefits beyond that currently protected by the law by reason of the fact that the code has been determined to meet the criteria specified in s 1101A(3) of the Corporations Act and the criteria specified in RG183.
80. ASIC's view as to whether a code satisfies the relevant criteria will be influenced by the input that ASIC has had in ensuring that the provisions of the code achieve stronger consumer protection outcomes. An approved code is likely to satisfy ASIC that it achieves consumer protection benefits, even if the fact of ASIC approval is not known by consumers.
81. However, the iterative process of determining whether a code of conduct satisfies the criteria in the Corporations Act and RG183 will, in most cases, itself improve the consumer protection outcomes that are achieved within the code. ASIC believes that this has been the case with the draft Banking Code. In certain instances, including in respect of the Banking Code, improvements in a code are likely to flow to other industry members or associations.

¹²⁰ Saadat (ASIC): Exhibit #3.162.13 at RG183.29-49.

¹²¹ Saadat (ASIC): Exhibit #3.162.13 at RG183.42-81.

¹²² Saadat (ASIC): Exhibit #3.162.13 at RG183.82.

¹²³ Saadat (ASIC): Exhibit #3.162.13 at RG183.141.

¹²⁴ Saadat (ASIC) P-2967:36-38.

¹²⁵ Saadat (ASIC): Exhibit #3.162.13 at RG183.3.

¹²⁶ Bligh (ABA): P-2914:9-12.

82. ASIC expects, for example, that the Customer Owned Banking Association is likely to review and update its *Customer Owned Banking Code of Practice* having regard to changes to the Banking Code in its reviewed form.¹²⁷
83. It follows that an ASIC determination not to approve a code such as the Banking Code after the processing of an approval application *could* undermine the effectiveness of that code, but not necessarily so: an unapproved code could still be a significantly more effective document than its predecessor or than its originally proposed form. It could still result in improved wider industry outcomes.
84. ASIC must also take into consideration that a decision not to approve a code may deter other industry participants from seeking ASIC approval of their codes of conduct due to a perception that the bar set by ASIC for its approval may be seen as too high. This would diminish the effectiveness of a code of conduct because ASIC's experience is that codes are improved by the process of obtaining ASIC approval.

PW Collinson
Lynton Hogan
Roshan Chaile

Counsel for ASIC
12 June 2018

¹²⁷ In this regard, it should be noted that the present COBA Code has similarities to the existing ABA Banking Code.