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Mr. Dallas Booth
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Dear Mr. Booth,

SUBMISSION IN RESPECT OF YOUR CODE OF CONDUCT REVIEW

We refer to your note of 12 February 2021 and the invitation to make a submission on your Discussion Paper, which invitation closes today.

Introduction

We are an insurance premium funder and have been operating in the Australian market since 2014 as an independent premium funder providing our services predominantly to businesses, from small to medium sized enterprises (SMEs) to large and international corporates.

The insurance premium funding industry has been operating in Australia for over 30 years and is well established in all major insurance markets around the world. An estimated $7billion in insurance premiums are funded in Australia on an annual basis, with $7.253 billion funded in FY2020. Over 97% of all premium funding is utilised for business purposes, with consumers making up a much smaller portion (just over 2% in FY 2020) of the industry customer base. An estimated 20-30% of all business insurance policies are premium funded. Insurance premium loans are instrumental in assisting SMEs to manage cash flow and working capital. The loan is repayable by way of instalments to the premium funder.

Our services are primarily made available to clients through your members and other brokers or intermediaries.

The insurance premium funding industry is represented by AFIA and we understand that AFIA has, or will be, making a submission to you on behalf of the industry as an association. This submission is made independently, both because there are specific concerns that we wish to raise regarding the use of your Code and, more generally, because we believe it will be of mutual assistance. As you know, our industry is currently engaged in considering and formulating its own Code of Conduct and we regard NIBA (and its Code of Conduct) as one of our key stakeholders and, in formulating this submission, it will be of use in your review

and it will inform our contribution to the insurance premium funders' formulation of its own Code of Conduct.

Part I. Context

It seems to us that the many of the key stakeholders may not have accurately summarised the plain meaning of Commissioner Hayne's statements. Whatever the reasons for that, the consequence is a significant amount of misinformation and discordant responses to the Hayne Royal Commission and the opportunity to effect change "*before it is imposed upon*" the various industries within the financial services system.

Accordingly, we begin our submission by taking two steps back to consider precisely what it was the Commissioner Hayne said and what he found:

> There can be no doubt that the primary responsibility for misconduct in the financial services industry lies with the entities concerned and those who managed and controlled those entities: their boards and senior management.
>
> (p. 4 of volume 1 of the Final Report
> of the Royal Commission into Misconduct
> in the Banking, Superannuation and Financial Services Industry[1])

> the community expects that financial services entities that break the law will be held to account. Not only has the law not been obeyed, it has also not been enforced effectively
>
> (p. 3 of volume 1 of the Final Report)

Commissioner Hayne found:

- the failings extended to governance and remuneration methods of the entities.
- the failings extended to regulators.
- the failings extended to vitally important organisational culture.
- by its nature, culture cannot be prescribed or legislated. (p. 376 of volume 1 of the Final Report)

Commissioner Hayne's stated that, while there is no best practice for creating a desirable culture, adherence to six basic cultural norms is critical (section 1.5.1 of the Volume 1 of the Final Report):

- Obey the law
- Do not mislead or deceive
- Act fairly
- Provide services that are fit for purpose

[1] Hereinafter referred to as **the Final Report**.

- Deliver services with reasonable care and skill
- When acting for another, act in the best interest of that other

Thus, Commissioner Hayne's concluded that a sustainable culture needs to come from within. Financial firms and the regulators should thus, as often as reasonably possible, take proper steps to:

- Assess their culture and its governance
- Identify any problems with that culture and governance
- Deal with those problems
- Determine whether the changes made have been effective (recommendation 5.6 of volume 1 of the Final Report)

This exercise involves much more than "*box-ticking*", according to Commissioner Hayne. (p. 392 of volume 1 of the Final Report)

In his words, it takes "*intellectual drive, honesty and rigour*". (p. 392 of volume 1 of the Final Report)

This particular Recommendation requires entities to take all that is set out in the Report, including all the other recommendations that are made, and apply, re-apply, and keep re-applying what is said to their culture and their governance. (p. 393 of volume 1 of the Final Report)

The intellectual paradigm

Taking a step forward, in keeping with Commissioner Hayne's exhortation, "*intellectual drive, honesty and rigour*" indicates an examination and re-examination of the intended approach, and the focus of issues to be addressed by the regulatory response, should occur as part of considering a code of conduct.

But, reliance should not be placed on that regulatory response as being determinative or even correct. Parliament, not the regulators, sets the law and the consequences. (p.492 of volume 1 of the Final Report)

Just as the thought, work and action to prevent the recurrence of misconduct is the primary responsibility of the boards and senior management of financial services firms, so too is the intended approach and the focus of issues to be addressed by the financial services firms. Codes of conduct are statements of principles in the light of which behaviours can be judged to align with, or violate, those principles in a particular sphere, combined with a means to govern (enforce / sanction) those principles and achieve the requisite behaviours. Culture is about behaviours. Behaviours in general are not amenable to legislation or regulation. Culture can – and must – be assessed by financial services entities themselves. (p.376 of volume 1 of the Final Report)

Commissioner Hayne's views are entirely consistent with the economic concepts of an open (free) market economy.

In particular, whether as "hard law" legislated by Parliament or the "soft law" of a regulatory response, Commissioner Hayne's concerns are consistent with the idea that a legislated culture would be tantamount to a closed (centrally controlled) market that may result in deleterious consequences, such as reducing innovation or thwarting the very purposes of the financial system. Purposes that require some modicum of risk-taking to grow and develop, and best serve Australian society's interests.

Risk versus Reward

The one certainty is that the future is uncertain. That truism translated into the concept of a financial system means that any financial activity, public or private, intended to achieve a particular outcome (whether profit as a financial services entity or investment as an investor / consumer or control for fiscal or monetary policy purposes or regulation for enforcement purposes) carries with it the risk that the financial activity will fail to achieve its outcome.

Economists tell us that "*the higher the risk, the higher the potential return, and the less likely it is that the potential will be achieved*."

In other words, the Australian financial system is intended to operate freely thereby allowing financial services firms to cater to the full spectrum of risk-versus-reward behaviour allowed by the law. It does so by framing several critical cultural norms identified by Commissioner Hayne as the delivery of financial services "*diligently, competently, fairly and with honesty and integrity*" i.e. with reasonable care and skill appropriate to the clients' decisions and the intended outcomes.

The Informed Consent Regime

The informed consent regime now predominant in our financial system, and the minds of the key stakeholders, is closely associated with the ideas of a free market and the economic values of diversification and specialisation. The informed consent concept has its roots in the legal precepts underpinning the very idea of a free market, namely autonomy, and self-determination.

Self-determination necessarily includes the right to make decisions about one's financial affairs. Each person is considered to be master of their own affairs, and they may, if of sound mind, expressly require the purchase of say a high risk financial product, or other potential high return product. A broker (or adviser or other financial services provider) might well believe that the particular product is not desirable or suitable, but the law does not permit the broker to substitute its own judgement for that of the client.

Philosophically, both deontological and utilitarian principles are accommodated:

- client decision-making is an inherent good because it recognizes individual dignity and personhood, and the right of self-determination.

- informed consent enhances autonomy, and all the rights that inure in that concept.

- informed consent is beneficial to both the client and society.
    - the process of deciding for oneself increases one's personal happiness and well-being.

The much vaunted opportunity to effect change "*before it is imposed*" must therefore actually be about the allocation of decision-making authority between the client and the financial services provider. This raises profound practical and moral (or philosophical) questions.

On a practical level, it is difficult to imagine an issue having a more significant impact on a financial services provider's day-to-day business, regardless of specialty. Every aspect of every type of engagement in the financial system involves numerous decisions; from the moment financial services providers receive their first client, they need to know who makes what decisions, who will be held accountable for those decisions and how their decision-making behaviour will be judged.

In turn, every decision requires information and knowledge in order to make **good decisions** (*viz.* decisions properly made in the light of the risk-versus-return equation to achieve the intended outcomes and with an understanding of the potential consequences) rather than **bad decisions** (*viz.* decisions improperly made, being made recklessly or negligently in disregard of the risk-versus-return equation, the intended outcomes, or the potential consequences).

Moral hazard

The behaviours involved in making **good decisions** rather than **bad decisions** are the behaviours that a Code of Conduct's statements of principles should be judged to align with, or violate.

In this context, a wrong or incorrect decision is of itself neither a **good decision** nor a **bad decision**. Provided that the behaviours involved in making a wrong decision (say choosing a low-risk product and low yields impair value) or an incorrect decision (say deciding not to insure for a flood and then a flood occurs), align with the principles enunciated by the Code of Conduct, then a wrong or incorrect decision would nevertheless be a **good decision**.

It is vital to maintain a clear understanding of this distinction because of another foundational cornerstone of the Australian financial system and the notion of a free market, namely that the inherent right to autonomy and self-determination comes with concomitant obligations to take responsibility and be accountable for one's decisions.

And that brings with it the dangers of **moral hazard** – the risk that rescuing users of an open financial system, both providers and consumers, from the consequences of their **bad decisions** could encourage more **bad decisions** in the future.

The question "*who decides: client or service provider?*", thus raises fundamental philosophical questions concerning the proper role of a professional in society and the

appropriate use of expertise and regulation; to paraphrase Sir Isaiah Berlin - manipulating human beings, even though for their own good, is to deny their human essence, to treat them as objects without wills of their own and therefore to degrade them.[2]

At its core, the issue of decision-making authority tests the community's expectation of and commitment to the principles of autonomy, and self-determination. Should regulators and financial services providers conduct themselves in a way that encourages or frustrates these cornerstones of Australian law and society?

Part II. Response to Questions Raised by the Discussion Paper

We believe that consideration of this overarching intellectual paradigm will answer most, if not all of the questions raised in your Discussion Paper.

For this reason we submit specific answers to Issue # 1 below, as we consider this to issue to lie at the foundation of all the other questions posed in your Discussion Paper.

We respond to your questions on Issue #1 in the context set out above.

1. RE: Question 1

   (a) Yes. Clearer objectives would be desirable. Specifically, that the Code of Conduct is not meant as a prescription or legislated cultural change. It is about the allocation of decision-making authority between client and financial services provider and the recognition of the professional advantages of your members in that regard. It is thus intended to be statements of principle (standards) against which your members behaviours will be judged to ensure the cultural norms are adhered to.

   (b) No. A Code of Conduct is by its nature statements of principles (standards) in the light of which behaviours can be judged to align with, or violate, those principles in the insurance broker sphere, combined with a means to govern (enforce / sanction) that sphere and achieve the requisite behaviours. Examples of behaviours that align with or violate the standards are meaningless because the judgment of one behaviour against one standard in one context is either too prescriptive or too broad for general application and may give a misleading impression or otherwise impose constraints on your fact-finders (your Code Commission).

   (c) No. The IBCCC is in its own words "*an independent committee that monitors adherence to the Code while also providing education and support to subscribers.*" The subject of an own motion inquiry and a recommendation that

[2] "*But to manipulate men, to propel them towards goals which you - the social reformer - see, but they may not, is to deny their human essence, to treat them as objects without wills of their own, and therefore to degrade them.*" Berlin, I. "Two Concepts of Liberty" in Liberty: Incorporating Four Essays on Liberty, p. 184; Oxford University Press (2002)

goes beyond this remit is of itself a violation of that independence. The committee is mandated to monitor, educate and support subscribers.

(d) No. A separate statement of ethics is superfluous and confusing. Your Code of Conduct is by its very nature a statement of ethics. The FASEA standards are inspirational or, at best, aspirational. To adopt FASEA standards wholesale is problematic on several levels:

(i) it treats both your members and their clients as objects without the ability to manage their own affairs and make informed decisions;

(ii) its adoption would be inconsistent with Commissioner Hayne's findings that the thought, work and action to prevent the recurrence of misconduct is the primary responsibility of the boards and senior management of your members, and so too is the intended approach and the focus of ethical issues to be addressed by your members;

(iii) it would be "box-ticking" rather than intellectually driven honesty and rigour in understanding the ethical issues and the behaviours arising therefrom that each broker (and thus the industry) needs to address.

2. RE: Question 2

(a) No. The law and the regulators provide more detail. In this regard, the notion of going "*beyond the law*" is both incorrect and wrong. It is an offensive notion that serves no one's interests, least of all Australian society: one cannot and should not as matter of fact and ethical behaviour move beyond the rule of law. Commissioner Hayne is explicit that *"the community expects that financial services entities that break the law will be held to account*." (our emphasis). A Code of Conduct is of itself a statement of non-legal but ethical standards against which subscribers wish their conduct and behaviours to be judged, regardless of the minimum and absolute requirements of the law. Whether the Code standards are higher than the standards required not to break the law is the very embodiment of autonomy and self-regulation. But, the law has no place within that sphere because culture cannot be legislated. Only the subscribers to that Code can determine whether the standards required by the Code are met and what the enforcement consequences are of breaking the Code (not breaking the law which, is for the Courts and Parliament). Whether the law or the regulator may deem breaking the Code to be breaking the law is something for the Courts and Parliament, not the Code maker or the regulators or other key stakeholders.

(b) No. See answer to 1(a) above.

(c) All of the ethical and behavioural commitments must be extended to all interactions the subscriber has, regardless of the relationship. That is how the informed consent regime is given effect to: a prospective client has distinct decisions to make and subscribers cannot have sufficient knowledge of a prospect to make its decisions; similarly in deciding on, say, an insurer for a client, the

subscriber must use its skill and knowledge to the standard required by the Code, and so on.

(d) This would create confusing and unnecessary redundancies. See answers above.

3. Not as a requirement of the Code. It is the primary responsibility of the boards and senior management of your members to use their "*intellectual drive, honesty and rigour*" to apply thought and effort to their individual cultures and behaviours. Requiring the subscribers to formally adopt the Code is prescribing culture. This is self-contradictory as the very behaviours the Code seeks to adjudicate means that a behaviour of not considering whether to formally adopt the Code, and training staff on it, would likely be a violation of the Code unless the specific member has specific reasons that it can justify to itself and explain to NIBA's satisfaction.

4. We say that NIBA has proposed changes to the standards that are higher standards than merely not breaking the law. The specific issue that requires additional work or attention is framing this distinction properly in the Code. For example, the so-called ban on conflicted remuneration is a ban of "**conflicted remuneration**" as defined in the Corporations Act. That definition is clearly reflective of Parliament's view that conflicts of the kind giving rise to conflicts between duty and self-interest do exist, must be recognised and cannot be legislated away, but should be regulated as lawful or unlawful behaviour. Thus, the Corporations Act does not seek to eliminate the conflicts, but rather the consequences. According to Commissioner Hayne's "*the very hinge about which the conflicted remuneration provisions turn, is that the payment is one that 'could reasonably be expected to influence the choice of financial product recommended to retail clients'*" (p.180 of the Final Report). Thus, as Commissioner Hayne's recommended, more, further or additional disclosures or "transparency" not only misses the point, it is often counter-productive. Accordingly, the principle enunciated in your standard 6, for example, should be directed at setting the standard of behaviour required of your members when recommending a financial product to retail clients *viz.* what would NIBA expect a member to do (or not do), regardless of the section 961B(2) 'safe harbour' provision, to ensure the member meets the NIBA standard of not being influenced in the advice given by the member? What is NIBA's standard of not being influenced when giving advice? And, so on.

Part. III Specific concerns

The specific concerns that we raise relate to the operation of your Code and its enforceability with regard to circumstances where a client's duly authorised attorney issues a notice to one of your members as the intermediary of that client.

Our experience has been that: often your members, and other brokers or intermediaries, confuse the nature of the instruction with the nature of the source of the instruction and either do not fully appreciate the distinction, or otherwise choose not to consider the implication of that distinction.

As you may know, an insurance premium funder's security for repayment is frequently the insurance policy itself. Our ability to cancel the insurance policy and obtain the return

premium as full or part repayment of a client's indebtedness enables us to provide significant cash flow benefits to clients both in terms of timing, recovery and costs. In turn, cancelling the insurance policy and obtaining the return premium is frequently in the client's interest at a time when the client has decided it no longer needs or wants the insurance policy and the immediate reduction of indebtedness from a source other than the client's bank account is highly advantageous to the client. Our entitlement to cancel insurance policies and obtain the proceeds of the policies is effected, generally, with a grant of powers of attorney from the client to us.

Thus:

- the nature of the instruction to cancel an insurance policy is an instruction from the client itself.

- the source of the instruction is an attorney, which the client decided to appoint at the outset of the loan contract.

When we act under powers of attorney duly granted to us by a client, some of your members tend to regard that as somehow an action that may not be in the interests of the client or that the exercise of the powers should otherwise be delayed or ignored. Not only is this contrary to the client's explicit decision, it is an undue interference in the relationship between the client and the premium funder that does not serve the client's interests (it may expose the client directly to additional or further costs).

We submit that broker behaviour of this type would be a violation of your Code's Standards 1, 2, 5, 8 and 12. We would hope to see clarification on this point in the proposed changes to your Code of Conduct and, particularly, we submit that insurance premium funders should be explicitly included in considering the Broker's role (Issue #4) and in the enforceability aspects of your Code (Issue #7).

Concluding Remarks

We welcome further consultation with NIBA should it require clarification of anything in this submission. If required, please contact the author by email: service@attvest.com.au.

Yours sincerely,
Attvest Finance Pty Ltd

Philip Treisman
DIRECTOR