Chapter 4

Other EDR schemes and borrower protections

Introduction

4.1 This chapter examines EDR schemes for ADIs and other legislated borrower protections. Each of the EDR schemes is briefly summarised followed by an analysis of the coverage of the scheme, as well as any gaps identified in the scheme's coverage.

Self-regulation through codes of conduct

4.2 The Code of Banking Practice and the Customer Owned Banking Code of Practice are the two primary sources of self-regulation in the Australian banking industry.

4.3 The Australian Bankers' Association (ABA) manages the Code of Banking Practice (the Code) that applies to their members. The ABA describes the Code as the banking industry's customer charter on best banking practice standards. It sets out the banking industry's key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their banking services. The Code applies to personal and small business bank customers.[1] Operation of the FOS and the role that it plays in relation to EDR and borrow complaints was discussed in detail in the previous chapter, so it is not covered again here.

4.4 ASIC informed the committee that courts have considered that the Code may operate as a contract between banker and customer; however, a breach of the Code does not constitute unconscionable conduct and does not require a bank to subordinate its own interests to that of the borrower. ASIC noted that a breach of the Code is a factor that may be considered by the Court in determining unconscionability.[2]

4.5 The Customer Owned Banking Association (COBA) manages the Customer Owned Banking Code of Practice (COBCOP). COBCOP is described as the code of practice for Australia's credit unions, mutual banks and mutual building societies.[3] COBCOP is discussed further below.

FOSCode

4.6 The FOS has a Code Compliance and Monitoring Team (FOSCode) which is a separately operated and funded business unit of FOS, reporting to the Chief Ombudsman. The Team supports independent committees that monitor compliance with codes of practice in the banking, customer-owned banking, general insurance and

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1 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

2 ASIC, *Supplementary submission 45,* p. 9.

3 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

insurance broking industries. These committees are comprised of an independent Chair, an industry representative and a representative of consumers and small business. The aim is to achieve service standards that people can trust within the respective industries.[4]

4.7 The role of the independent FOSCode committees is to work with both industry and consumers to ensure that key promises made about service delivery are met and that financial service providers have effective systems in place to ensure compliance with those obligations and to resolve disputes with their customers, if and when they arise. This is done by actively monitoring compliance through annual compliance statement returns, shadow shopping, own motion inquiries and investigating concerns lodged by consumers that the codes may have been breached.

4.8 The FOScode committees have undertaken inquiries into a range of matters including whether banks are meeting their obligations to borrowers in financial difficulty, the visibility and accessibility of information for consumers about the Codes and internal and external dispute resolution, chargebacks, direct debits and guarantees.[5]

CCMC

4.9 The CCMC is an independent compliance monitoring body established by the Australian Bankers' Association under clause 36 of the 2013 Code of Banking Practice (the Code). It is comprised of an independent chair, a person representing the interests of the banking industry and a person representing the interests of consumers and small business. This is consistent with the model for self-regulatory governance under ASIC's Regulatory Guide 183.[6]

4.10 The CCMC states that it adopts a collaborative approach to working with code-subscribing banks and aims to be a trusted and valued partner, assisting banks to comply with their Code obligations. The CCMC's Mandate (which is an attachment to the Code) sets out its powers and functions, which include:

- monitoring banks' compliance with the Code's obligations;
- investigating an allegation that a bank has breached the Code, and
- monitoring aspects of the Code that are referred to the CCMC by the ABA.[7]

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4 Financial Ombudsman Service, *The Code Compliance and Monitoring Team*, https://www.fos.org.au/the-circular-22-home/fos-news/the-code-compliance-and-monitoring-team/, (accessed 2 April 2016).

5 Financial Ombudsman Service, *The Code Compliance and Monitoring Team*, https://www.fos.org.au/the-circular-22-home/fos-news/the-code-compliance-and-monitoring-team/, (accessed 2 April 2016).

6 CCMC, *Submission 4*, p. 1.

7 CCMC, *Submission 4*, p. 1.

4.11 The CCMC informed the committee that the Code is a voluntary code of conduct which sets standards of good banking practice for subscribing banks to follow when dealing with individual or small business customers of a code-subscribing bank, or a guarantor. The CCMC indicated that:

> Eighteen banks, representing 13 banking groups, currently subscribe to the Code meaning that it covers approximately 95% of the Australian retail banking industry.[8]
>
> Once a bank has subscribed to the Code, it becomes part of the enforceable contract between the customer and the bank. A breach of the Code by a bank is a breach of that contract.[9]

CCMC jurisdiction limits

4.12 Routine CCMC investigations are limited to matters that occurred within the previous 12 months, however the CCMC can request a bank's permission to go beyond 12 months or the CCMC can initiate an own motion inquiry:

> The 12-month rule…arises quite frequently when complaints are received. When it does arise, our experience to date is that, mostly, the banks will agree to allow us to go behind the 12-month period…Once a bank declines to allow us to go beyond the 12-month period in the code, that is the end of the matter from our perspective…[except] if we were to form a view that, indeed, the bank was being unreasonable in refusing its permission to go beyond the 12-month rule, we could, under another provision in the code, initiate an own motion inquiry.[10]

4.13 The CCMC acknowledged that there are no specific provisions in the Code that relate to the revaluation of security or impairment of loans. The CCMC is therefore not able to investigate issues relating to impairment or valuations. The CCMC informed the committee that it has no record of investigating any matters where impairment or valuations were raised as part of a complaint, nor any record of any individual or small business bank customer approaching the CCMC with a complaint solely about revaluation of loan security or loan impairment.[11]

4.14 The CCMC also informed the committee that the code does impose a number of obligations that are relevant to this inquiry. The obligations are:

- clause 27, to act as a prudent and diligent banker in assessing a customer's ability to repay a credit facility;

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8 CCMC, *Submission 4,* p. 1.

9 CCMC, *Submission 4,* p. 2.

10 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, pp 13, 14.

11 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

- clause 28, an obligation to try to assist customers with their agreement and cooperation to overcome financial difficulties with any credit facility held with the bank; and
- clause 20, to provide at least 10 days' notice to a small business customer of any change to terms and conditions where the change will be materially adverse to the customer and will only affect that customer.[12]

4.15 The Tasmanian Small Business Council argued that the CCMC rules mean that many matters are not heard:

> In fact, any of the 16 banks against which a complaint has been lodged can refer the complaint to 'any forum', meaning they can commence an action in the court, refer customers to the Financial Ombudsman or, as has recently been the case in drought-affected farming areas, force customers into mediation. In each of these cases, customers' rights to have the monitors investigate the code breaches are dishonestly taken away.[13]

4.16 The CCMC has a limited capacity to assist borrowers. The only action the CCMC can take is to determine whether a breach of the Code has occurred. The CCMC informed the committee that:

> The sole remedy we can provide for an individual is to say, 'Yes, you are quite right. Bank X did breach the Code Of Banking Practice.' The reason people come to us rather than going elsewhere is usually because they want to, for example, have a technical finding of a breach of the code which might assist them in litigation or other dealings.[14]
>
> The Code does not give the CCMC the power to make orders for compensation, declarations on the rights and entitlements of parties or issue fines and penalties. Where an allegation to the CCMC is concurrently also in another forum (such as FOS or a Court) the CCMC puts its process on hold until that other forum has finished its review.[15]

4.17 The ABA informed the committee that the limitations on the CCMC apply to avoid duplication of process, possible inconsistent findings and to ensure that an allegation a bank has breached the code is made in a timely way.[16]

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12 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 12.

13 Mr Geoffrey Fader, Chair, Tasmanian Small Business Council, *Committee Hansard*, 16 October 2015, p. 1.

14 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 17.

15 CCMC, https://forms.fos.org.au/CCMC/(S(nvvafgnb02z3ow1ceufs5qj2))/Complaint/New, (accessed 23 March 2016).

16 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Committee Hansard*, 18 November 2015, p. 29.

4.18 The CCMC informed the committee that under the terms of its mandate, any decision made by the FOS to the effect that a code-subscribing bank has breached the Code will be adopted by the CCMC.

4.19 The Code applies to retail banking customers of banking services provided by banks to individual and small business customers or potential customers as defined in the Code. The CMCC advised the committee that:

> It also applies to any individual from whom a bank has obtained or proposes to obtain a bank guarantee. Thirteen banking groups currently subscribe to the code, meaning that it covers approximately 95 per cent of the Australian retail banking industry. The code forms an important part of the broader national consumer protection framework. It is a means by which code-subscribing banks complement statutory law and regulation in areas relating to service issues for consumers, standards of professional conduct, banking practices and, importantly, ethical behaviour.[17]

4.20 In its 2013–14 Annual Report, the CCMC noted that in 2013–14, 26 of 48 and that in 2012–13, 12 of 84 alleged breaches of the Code were confirmed by the CCMC.[18] As noted above the CCMC is only able to determine that a breach has occurred.

Borrower awareness of the code

4.21 The Tasmanian Small Business Council argued that the existence and contents of the Code of Banking Practice are not well known by customers:

> The Australian Bankers' Association say publicly that the Code of Banking Practice is part of the lending agreement which customers enter into. Few, if any, banks actually provide a copy of that code to the customer when the time comes to sign the documentation, although it is referred to consistently through the lending agreement.[19]

4.22 The ABA argued that information on EDR and the Code is readily available and that information about these arrangements must be prominently published by the bank, including in branches, on internet sites and in telephone banking services.[20]

4.23 The CCMC provided information about how it sought to inform bank customers about the banking code of practice:

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17 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 12.

18 CCMC, *2013 –14 Annual Report*, p. 24.

19 Tasmanian Small Business Council, *Committee Hansard*, 16 October 2015, pp 3, 7.

20 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Committee Hansard*, 18 November 2015, p. 29.

> …there is a listing of the number of locations to which the code is actually provided, one of which is 'every branch of every bank in the country'. In order to ensure that these are readily available to members of the public, the CCMC has its staff undertake mystery shopping expeditions: in different locations they simply walk into a branch to see whether the code is readily available—and not only in branches but on a range of websites. There are also several hundred subscribers, in various ways electronically, to information about the code. That represents consumer groups and others.[21]

4.24 The CCMC also noted that it maintains contact with financial counsellors and other bodies that are dealing with people in financial trouble. The CCMC informed the committee that:

> For example, the most prominent one is Financial Counselling Australia. There are approximately a thousand financial counsellors across Australia. We address and attend their conferences, we send staff out talking to consumer groups, we talk to local legal groups—legal aid groups and other community legal centres.[22]

Credit and Investments Ombudsman

4.25 The Credit and Investments Ombudsman (CIO) provides a free, independent and partial dispute resolution service to facilitate the resolution of complaints between consumers and participants of the EDR scheme. In doing so, the CIO provides both consumers and financial services providers with an alternative to legal proceedings for resolving financial services disputes. The CIO is required to meet benchmarks prescribed and approved by ASIC to operate as an EDR scheme in the financial services industry. Participants of the CIO scheme include non-bank lenders, finance brokers, credit unions, building societies, debt collection firms, financial planners, trustees, servicers, aggregators, mortgage managers, and many more.[23]

4.26 The CIO is also funded by participating financial service providers through fees including application fees, an annual user levy based on the size of the business[24] and service fees for complaints received by the CIO.[25]

4.27 The CIO scheme has the following limits in relation to small business:

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21 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 15.

22 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard*, 16 October 2016, p. 16.

23 Credit and Investments Ombudsman, Our Role, http://www.cio.org.au/about/our-role/, (accessed 27 March 2016).

24 Credit and Investments Ombudsman, *Applying for CIO Membership*, http://www.cio.org.au/members/apply-for-membership/, (accessed 31 March 2016).

25 Credit and Investments Ombudsman, http://www.cio.org.au/members/member-faqs/are-there-any-fees-for-cio-hearing-a-complaint/, (accessed 27 March 2016).

- the borrower did not have net assets of $2.5 million or more for each of the two financial years prior to the date of making the complaint;
- the borrower did not have a gross income of $250,000 or more for each of the two financial years prior to the date of making the complaint; and
- excluding claims where the financial services provider had, before the complaint was received by the scheme, commenced legal proceedings against the small business complainant in relation to a credit facility having a credit limit of more than $2 million.[26]

Customer Owned Banking Code Compliance Committee

4.28 The Customer Owned Banking Code Compliance Committee (Code Compliance Committee) supports credit unions, mutual banks and mutual building societies to achieve their service standards. The Code Compliance Committee monitors compliance with the Customer Owned Banking Code of Practice (COBCOP) which is a set of promises outlining how Australia's customer owned banks should behave in their dealings with customers.[27]

4.29 The role of the Code Compliance Committee is to investigate allegations that a customer owned bank has breached its obligations under the COBCOP and to work with the customer owned bank to ensure the breach does not happen again.[28]

ASIC

ASIC's role in regulating credit

4.30 In relation to issues raised by the terms of reference, ASIC identified that its role as the national regulator for consumer credit is based on:

- administering the broader regulatory framework for insolvency practitioners, including receivers, under the Corporations Act; and
- to the extent that it applies, the regulatory framework for lenders under the ASIC Act and the *National Consumer Credit Protection Act 2009* (National Credit Act)—noting that the National Credit Act does not apply to loans for business purposes.[29]

4.31 ASIC also administers the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which contains provisions relating to prohibitions on

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26 Credit and Investments Ombudsman, *Credit and Investments Ombudsman Rules*, 5 May 2014, pp 12, 40.

27 Customer Owned Banking Code Compliance Committee, *About us*, http://www.cobccc.org.au/about-us/, (accessed 2 April 2016).

28 Customer Owned Banking Code Compliance Committee, *About us*, http://www.cobccc.org.au/about-us/, (accessed 2 April 2016).

29 ASIC, *Submission 45*, pp 3, 6.

unconscionable conduct and false or misleading representations in relation to financial services, including credit. These ASIC Act provisions are not limited to consumer credit, and extend to credit for business and commercial purposes.[30]

4.32 ASIC's role in relation to commercial lending and borrowing is more limited as consumer protection laws under the Australian Consumer Law do not apply.[31] For commercial lending activity, ASIC's role is limited to administering the consumer protection provisions in the ASIC Act, including the prohibition on false or misleading representations and unconscionable conduct.[32]

4.33 ASIC regulates the conduct of lenders and receivers (and other insolvency practitioners) under the provisions of the Corporations Act, the ASIC Act and the *National Consumer Credit Protection Act 2009* including the National Credit Code.

4.34 ASIC noted that disputes between lenders and borrowers, including the actions of receivers, do not necessarily suggest that the lender or receiver has breached a regulatory obligation enforced by ASIC. This is more so the case in relation to commercial lending and borrowing, where ASIC has a limited jurisdiction compared with consumer credit. In addition, the focus of ASIC's regulatory action must be the public interest. Given limitations of ASIC's resources, ASIC's role does not extend to taking actions against lenders or receivers on behalf of individuals or businesses in relation to their private disputes.[33]

4.35 ASIC informed the committee that:

> ASIC does not intervene in individual disputes in financial services and corporate regulation, and is not resourced to undertake such a role. ASIC's role is not to provide an ombudsman or mediation service for individual disputes. This includes disputes between lenders and debtors. The exception is where such action would serve a broader public interest. The regulatory obligations for commercial lending activity are far more limited than for retail (consumer) lending. In general, the number of reports we have received relating to commercial lending and the issues relating to the inquiry's terms of reference is small.[34]

30 ASIC, *Submission 45*, p. 7.

31 ASIC, *Submission 45*, p. 7; see also Mr Peter Kell, Commissioner, ASIC, *Senate Economics Committee Hansard*, Inquiry into the post-GFC banking sector, 8 August 2012, p. 59.

32 ASIC, *Submission 45*, p. 9.

33 ASIC, *Submission 45*, p. 8.

34 Footnote: ASIC, *Submission 45*, p. 6.

National Consumer Credit Protection Act

4.36 ASIC is the national regulator for consumer credit under the *National Consumer Credit Protection Act 2009* (NCCP Act). Central elements of the NCCP Act include:

- a licensing regime that imposes minimum standards of conduct for credit industry participants, including requirements for competence, mandatory membership of an ASIC-approved external dispute resolution (EDR) scheme, compensation arrangements, and adequate compliance and risk management systems. The licensing regime provides mechanisms to cancel an Australian credit licence (credit licence) and ban persons from engaging in credit activities;
- responsible lending obligations (discussed below); and
- lender disclosure and conduct obligations under the National Credit Code which includes specific requirements for pre-contractual disclosures, interest charges, mortgages, and enforcement action.[35]

Previous consideration of reforms

4.37 ASIC informed the committee about previous reforms that considered extending protection of the National Consumer Credit Protection Act to small business. In December 2012, the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 was released for public consultation. Among other items, the bill proposed amendments to the National Credit Act to extend regulation to small business lending, with a focus on disclosure of fees by finance brokers and responsible lending provisions focused on equity stripping (i.e. the practice of lending to small business borrowers seeking to refinance another loan on which they had defaulted on repayments and where the new loan is to be secured by a mortgage over residential property).[36]

4.38 In February 2013, the Commonwealth government announced that it had decided that any reforms to small business finance would be deferred as consultation had indicated a need to further examine a number of key issues, including whether the benefits could be delivered in a more targeted and effective way. Further reforms have not been proposed. ASIC indicated that its understanding is that some small business representatives were concerned that the proposed amendments may restrict lending in the sector.[37]

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35 ASIC, *Submission 45*, p. 6.

36 ASIC, *Submission 45*, p. 18.

37 ASIC, *Submission 45*, p. 18.

4.39 While some submitters and witnesses to this inquiry have sought reforms to small business finance, some small business peak bodies do not share that view. For example, the Commercial Asset Finance Brokers Association of Australia (the national peak professional body of the equipment finance industry) made the following statement in its 2013–14 annual review:

> It is well known that CAFBA, through its association with the Council of Small Business Organisations of Australia (COSBOA), was the primary force behind the previous government's deferral of NCCP Phase 2, which would have pushed consumer type legislation into small business lending. The effect of this would be to make lending to small business more difficult and more expensive.[38]

4.40 The committee notes the above concerns about access to finance. However, during its inquiry into business set-up transfer and closure, the Productivity Commission found that access to finance is not a significant barrier for most new businesses and that businesses with a credible business plan are successful in seeking debt or equity finance.[39]

Responsible lending

4.41 The NCCP Act requires all providers of consumer credit, including brokers and intermediaries to meet reasonable lending conduct requirements so that they do not provide credit products and services that are unsuitable, either because they do not meet the consumers' requirements or because the consumer does not have the capacity to meet the repayments.[40] ASIC informed the committee that:

> Responsible lending obligations, which mandate that credit licensees must make inquiries into a consumer's objectives and financial situation and verify their financial situation. Credit licensees must assess this information and not provide or suggest credit to a consumer if that credit will not meet the consumer's objectives or the consumer will not be able to meet their financial obligations without substantial hardship.[41]

4.42 Data collected by APRA shows that the responsible lending obligations have had a positive impact on the credit industry. The amount of new approved low documentation loans issued by ADIs declined 89.52% from approximately $4.8 billion on 30 June 2009 to $0.5 billion on 30 September 2013. As a percentage of all new

38 Commercial Asset Finance Brokers Association of Australia, *2013–14 Annual Review*, p. 2.

39 Productivity Commission, *Business Set-up, Transfer and Closure*, September 2015, p. 15.

40 Treasury, *Answers to questions on notice*, taken on 1 December 2015, received on 14 December 2015.

41 ASIC, *Submission 45*, pp 6–7.

household loans approved per quarter, the proportion of low doc loans fell from 6.95% to 0.66% over the same period.[42]

4.43 ASIC undertakes regular monitoring of responsible lending, covering 79 per cent of owner-occupied mortgages in the big four banks every year and the remaining 160 ADIs every 13 years.

4.44 FOS informed the committee that when a consumer cannot make their loan repayments, they may claim their financial services provider should not have given them the loan because they never had the capacity to repay it. The consumer may lodge a dispute with FOS seeking compensation for a loss resulting from provision of the loan. FOS refers to this as a "responsible lending" dispute. When FOS considers responsible lending disputes, FOS decides whether it was appropriate for the financial services provider to enter into the loan.[43]

Unconscionable conduct

4.45 The ASIC Act contains prohibitions on unconscionable conduct and false or misleading representations in relation to financial services, including credit. These provisions are not limited to consumer credit, and extend to credit for business and commercial purposes.[44]

4.46 In seeking to enforce loans, lenders are subject to a prohibition on engaging in unconscionable conduct. Section 12CB of the ASIC Act prohibits unconscionable conduct in relation to credit facilities, including commercial loans. The protections can apply to conduct in relation to the initial provision of credit and the collection of a debt owing under a contract, including enforcement action. Through its submission, ASIC informed the committee that:

> Whether particular conduct is unconscionable turns on the specific facts of the case. Establishing unconscionable conduct across a number of loan transactions can be more difficult than establishing unconscionable conduct in an individual transaction. In addition, the courts impose a high bar when a party is seeking to establish unconscionable conduct in relation to a commercial loan, as performance of contracted promises freely and fairly made is central to commerce.[45]

4.47 Where lenders are regulated under National Credit Code they are generally required to provide debtors with a written default notice containing prescribed particulars. Lenders seeking to enforce loans must also meet certain other requirements, including that:

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42 ASIC, *Submission 45,* p. 11.

43 Financial Ombudsman Service, *Submission 46,* p. 5.

44 Treasury, *Answers to questions on notice,* taken on 1 December 2015, received on 14 December 2015.

45 ASIC, *Submission 45,* p. 16.

- at least 30 days be given to the debtor to rectify a default; and
- a lender cannot commence enforcement action until it has dealt with any hardship application made by the debtor.[46]

4.48 ASIC informed the committee that it is very difficult to establish conduct that is unconscionable under the law. There have been some court cases, but borrowers have had a very difficult time in establishing their case. ASIC indicated that:

> …we have not seen a case where we would say we get involved and will explore or better something or widen the class or the definition of 'unconscionable conduct'. [47]
>
> In making a finding of unconscionability, Courts have generally concluded that some moral fault or responsibility or lack of ethics was involved. This requires a consideration of legal, commercial and social norms. The courts therefore impose a high bar when a party is seeking to establish unconscionable conduct in relation to a commercial loan, as performance of freely made contractual promises is central to commerce.
>
> In addition, the statutory unconscionable conduct prohibition as it applies to the provision of credit does not extend to borrowers who are publicly listed companies.[48]

Unfair contract terms

4.49 Consumers are also protected from unfair terms in standard form consumer contracts. The ASIC Act allows a court to declare void a term in a standard form consumer contract for certain financial products or financial services that it finds to be unfair. A term is unfair if it:

- would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

4.50 The Financial System Inquiry (FSI) considered unfair contract term provisions and supported the government's proposal to extend unfair contract term protections to small businesses and encouraged industry to develop standards on the use of non-monetary default covenants.[49] From 12 November 2016, unfair contract

46 ASIC, *Submission 45*, p. 16.

47 Mr Warren Day, Senior Executive Leader, ASIC, *Committee Hansard*, 23 November 2015, p. 11.

48 ASIC, *Supplementary submission 45*, p. 4.

49 Financial System Inquiry, *Final Report*, December 2014, p. xxvii.

term protections will also be available to small businesses (businesses employing fewer than 20 people) when they engage in standard form contracts worth no more than $300,000, or $1 million if the contract duration is longer than 12 months.

4.51 The FOS supported the introduction of unfair contract terms for small business. However, in doing so, the FOS noted that the introduction of the legislation may not address all of the concerns being considered by the committee. For example, if there has been a significant fall in the loan-to-valuation ratio, it may be fair and reasonable for a lender to require that the level of borrowing be reduced rather than repaid, in order to meet the lending-to-value ratio requirements. That may not necessarily be an unfair contract term in itself.[50]

Financial hardship

4.52 The National Credit Code also provides borrowers with mechanisms to seek changes to credit contracts on the grounds of hardship and for the courts, on application, to reopen unjust transactions or to annul or reduce unconscionable interest or other charges.[51] ASIC informed the committee that:

> A lender may agree to change the terms of the credit contract in response to the hardship notice by reducing the repayments, extending the period of the contract or postponing the due date, or any combination of changes.
>
> The lender need not agree to change the credit contract as a result of a hardship notice. This is especially true if the lender does not believe there is a reasonable cause (such as illness or unemployment) for the debtor's inability to meet their obligations or the lender reasonably believes the debtor would not be able to meet their obligations under the contract even if it were changed.
>
> If the lender decides not to change the credit contract, the debtor may take the matter to an EDR scheme. This has become a significant source of disputes for EDR schemes.[52]

4.53 The eligibility provisions for financial hardship have varied in recent years in the following way:

- for loans established from March 2013, there are no caps on the loan value. Prior to March 2013, there were upper limits that varied over time and between states and territories;[53] and

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50 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 8.

51 ASIC, *Submission 45*, p. 18.

52 ASIC, *Submission 45*, p. 20.

53 ASIC, *Trouble with debt*, https://www.moneysmart.gov.au/managing-your-money/managing-debts/trouble-with-debt#hardship, (accessed 23 March 2016).

- since January 2014, FOS has been able to consider financial difficulty application and has the power to vary the terms of some personal or residential credit contacts.[54]

4.54 The CCMC informed the committee that during the 2014-15 financial year, the CCMC conducted an own motion inquiry into how well banks comply with the Code's financial difficulty obligations. The CCMC inquiry confirmed that banks had improved the way they deal with customers, including small businesses, when they were experiencing difficulty repaying a credit facility.[55]

> This inquiry found that banks had in place adequate systems and procedures to meet these obligations. The inquiry did, however, make some recommendations to promote better informed decisions by prospective guarantors.[56]
>
> During the last financial year, 44 allegations were received alleging that banks had breached their obligations under the code. Of this number, we determined that 19 were actual breaches of the code and that only five of the breaches related to the provision of credit obligations.[57]

4.55 In its inquiry into financial difficulty, the CCMC made the following recommendations for ways in which banks could increase their level of compliance with the Code:

- ensure that their processes and procedures are applied consistently for all customers, including those who are not represented by a consumer advocate;
- ensure processes are appropriate for customers with particular issues, for example those related to poor mental health or family violence;
- consider whether their procedures are adequate to avoid making unnecessary or inappropriate requests for information that may be difficult or time consuming for customers to fulfil; and
- continue to identify areas where further improvements can be made by analysing data regarding customers who request assistance more than once and complaints related to financial difficulty assistance.[58]

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54 Cameron Ralph Navigator, *2013 Independent Review report to the Board of the Financial Ombudsman Service,* p. 54.

55 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

56 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

57 Mr Christopher Doogan, Independent Chair, Code Compliance Monitoring Committee, *Committee Hansard,* 16 October 2016, p. 12.

58 Code Compliance Monitoring Committee, *Financial Difficulty Own Motion Inquiry,* November 2015, p. 7.

Australian Small Business and Family Enterprise Ombudsman

4.56 The Australian Small Business and Family Enterprise (ASBFE) Ombudsman was established on 15 March 2016.[59] Under the assistance function, the Ombudsman responds to requests for assistance by an operator of a small business or family enterprise.[60]

4.57 The assistance requested may relate to a dispute with another entity. In that case, the ASBFE Ombudsman may recommend that an alternative dispute resolution process be undertaken. The ASBFE Ombudsman may keep a list of alternative dispute resolution providers, to assist small businesses and family enterprises in accessing alternative dispute resolution.[61] Treasury described this function of the ASBFE Ombudsman as providing a concierge service for small business dispute resolution.[62]

4.58 The ASBFE Ombudsman has information-gathering powers and where directed by the Minister, the ASBFE Ombudsman would inquire into matters including by taking evidence in hearings.[63] As discussed in chapter 2, the committee is recommending a significantly enhanced role for the ASBFE Ombudsman.

Farm debt mediation

4.59 Farm debt mediation (FDM) is a mechanism to facilitate a discussion between a farmer and their bank or other lender so they can better negotiate their financial position. The process uses an independent mediator to help identify workable solutions.[64] The ABA informed the committee that:

> The ABA believes that farm debt mediation can deliver positive outcomes for all parties. The process varies across jurisdictions. Currently NSW and Victoria are the only states with mandatory farm debt mediation schemes. The ABA has advocated for some time for the implementation of a consistent farm debt mediation model across Australia.[65]

4.60 The ANZ encouraged the committee to 'consider recommending a national approach to farm debt mediation', and noted that:

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59 Announcement by Minister for Small Business and Assistant Treasurer, the Hon Kelly O'Dwyer MP, http://www.asbfeo.gov.au/news-article/asbfeo-commences, (accessed 22 March 2016).

60 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, p. 3.

61 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, pp 3–4.

62 Treasury, *Australian Small Business and Family Enterprise Ombudsman*, http://www.treasury.gov.au/Policy-Topics/Business/Small-Business/Family-Enterprise-Ombudsman, (accessed 2 April 2016).

63 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, p. 4.

64 Australian Bankers Association, *Submission 47*, p. 12.

65 Australian Bankers Association, *Submission 47*, p. 12.

> While formal schemes are not currently available in all states and territories, ANZ's approach is to offer farm debt mediation in all cases, even if it is not mandatory. All Australian farmers should have access to high-quality, independent mediation processes operating under nationally consistent principles.[66]

4.61 NAB supported the development of a national farm debt mediation scheme:

> …a single national farm debt mediation scheme should be implemented as a matter of priority. Our experience of the existing state based farm debt mediation schemes is positive. That is particularly so where there is additional legal, financial, health and community support provided to our farmers. However, there are areas of ambiguity and inconsistency across the various state schemes which would benefit from a national approach.[67]

4.62 The Department of Agriculture informed the committee that a national approach will ensure that all farmers, regardless of where they do business, have access to a consistent and fair method of addressing debt serviceability issues:

> The FDM working group was re-established and has developed an options paper which identifies key aspects and processes within a national FDM approach and how these could be implemented consistently Australia-wide. Further work is planned with the states and territories, as well as other key stakeholders, to settle the finer details and establish the best processes for implementing a nationally consistent scheme in due course.[68]

Commercial arbitration

4.63 The committee has noted the existence of commercial arbitration providers and sought the banks' views of the use of commercial arbitration for small business and commercial loan disputes that fall outside the jurisdiction on EDR schemes.

4.64 ANZ acknowledged that in some cases borrowers cannot afford to participate in court proceedings against banks, but indicated that ANZ was not in favour of commercial arbitration, stating that:

> Ultimately, the arbitration process is going to require exactly the same as the court process. It is going to be just as costly. Mediation is clearly a better outcome if the parties can get to a point where they can agree. I am aware of several cases where there is no way there is going to be an agreement and, for the most part, they will go through a court process. It is unfortunate, but that is just where it is. We get to a point where you cannot agree to something that you absolutely do not agree with. It is not about the

66 Mr Graham Hodges, Deputy Group Executive Officer, ANZ, *Committee Hansard*, 13 November 2016, p. 65.

67 Mr Timothy Williams, General Manager, Group Strategic Business Services, National Australia Bank, *Committee Hansard*, 18 November 2015, pp 8–9.

68 Department of Agriculture, *Submission 44*, pp 2–3.

> dollars here or there; it is about fundamental disagreement. That is where you have those problems.
>
> I know that we have got to a point with some of our customers where we have paid them to get legal advice to help them through an issue because they have a completely different view. We have paid for them to get independent legal advice to help them better understand their situation because we believe that they are wrong. They are better to get the advice there and come back and mediate, rather than to go through a whole court process. But there are some customers—and we are talking about at the very margins—who will never agree with you. They will fight to the last. I would say one or two of the customers who are in dispute in this inquiry fit into that camp.[69]

4.65 The Commonwealth Bank indicated that, in its view, commercial arbitration had provided an expedient alternative in the past, however the costs of the process were now more substantial:

> …whilst in the past it had quite an attractive element to it, these days commercial arbitration itself is quite a lengthy, time consuming and legalistic process. Perhaps to just take your question away from commercial arbitration per se and to look at some alternative dispute mechanisms, my response to that would be: in the case of small business, that might be an appropriate position to take. However, I imagine that, in the case of medium to large businesses, we tend to operate on the basis that those businesses are able to pursue their legal rights if the parties are unable to come to an agreement.[70]

4.66 In 2010, the *International Arbitration Act 1974* (Cth) was amended to increase the effectiveness, efficiency and affordability of international commercial arbitration.[71] In May 2010, the Standing Committee of Attorneys-General agreed to implement a Model Commercial Arbitration Bill (Model Bill) to apply to domestic arbitration in Australia. These reforms were aimed at harmonising domestic arbitration law with the law applying to international arbitration. The first State to implement the Model Bill was NSW which passed the *Commercial Arbitration Act* 2010 in June 2010. The majority of other states and territories in Australia have now followed suit. These reforms provide the framework for internationally experienced

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69 Mr Graham Hodges, Group Chief Executive Officer, ANZ, *Committee Hansard,* 4 April 2016, p. 31.

70 Mr David Cohen, Group Executive for Corporate Affairs and Group General Counsel, Commonwealth Bank of Australia, *Committee Hansard*, 4 April 2016, p. 40.

71 Australian Centre for International Commercial Arbitration, http://acica.org.au/about, (accessed 8 April 2016).

arbitrators to resolve local, cross-border and international disputes on Australian territory.[72]

4.67 The committee noted that in general the fees for commercial arbitration are still likely to be lower than court costs based on the example fees set out in the Australian Centre for International Commercial Arbitration rules. The example fees include a $2 500 registration fee, plus an administration fee ranging from 1 per cent of the dispute for dispute up to $500 000 to a maximum fee of $60 000.[73] The costs are generally borne by the unsuccessful party, however, the arbitration process can apportion costs between the parties.[74]

Summary of dispute resolution schemes and consumer protections

4.68 Table 3.1 provides a summary of the existing dispute resolution schemes and consumer protections that a borrower may consider if they have a dispute with their lender.

72 Australian Centre for International Commercial Arbitration, http://acica.org.au/about, (accessed 8 April 2016).

73 Australian Centre for International Commercial Arbitration, http://acica.org.au/assets/media/Rules/2016-Rules-and-Schedule/ACICA-Fee-Schedule-2016.pdf, (accessed 8 April 2016).

74 Australian Centre for International Commercial Arbitration, *Arbitration Rules*, 1 January 2016, p. 36.

Table 4.1: Existing dispute resolution schemes and consumer protections

Protections and dispute mechanisms available to borrowers	Retail / Residential	Small Business	Larger Commercial
Internal dispute resolution with lenders	Y	Y	Y
Financial Ombudsman Service	Y	Some	N
FOSCode – FOS Code Compliance monitoring team	Y	Some	N
Code Compliance Monitoring Committee^^	Y	Some	N
Credit and Investments Ombudsman***	Y	Some	N
Customer Owned Banking Code Compliance Committee#	Y	Some	N
Responsible lending NCCP Act	Y	N	N
Financial hardship NCCP Act	Y	N	N
Prohibitions on unconscionable conduct###	Y	Y	Y
Protection from unfair contract terms##	Y	Some	N
Australian Small Business and Family Enterprise Ombudsman*	N	Concierge only	N
National Farm Debt Mediation**	N	N	N
Commercial arbitration	N	N	Some
Taking action through the courts	Y	Y	Y

Source: Treasury, *Answers to questions on notice*, taken on 1 December 2015, received on 14 December 2015. # Customer Owned Banking Association, *Customer Owned Banking Code of Conduct*, January 2014, p. 6. # The COBCOP notes that the code may be voluntarily applied to other customers. ## ASIC information sheet, *Unfair contract term protections for small businesses.* *Announcement by Minister for Small Business and Assistant Treasurer, the Hon Kelly O'Dwyer MP, http://www.asbfeo.gov.au/news-article/asbfeo-commences, *Australian Small Business and Family Enterprise Ombudsman Act 2015*, pp 6–7, Treasury, *Australian Small Business and Family Enterprise Ombudsman*, *http://www.treasury.gov.au/Policy-Topics/Business/Small-Business/Family-Enterprise-Ombudsman*, (accessed 22 March 2016). *** Credit and Investments Ombudsman, *Credit and investment ombudsman rules*, 5 May 2014, p. 14.

** Department of Agriculture, *Submission 44*, p. 2. ### ASIC *Supplementary submission 45*, p. 4.

Committee view

4.69 As discussed in chapters 2 and 7, both borrowers and lenders have discretion to make commercial judgments under loan contracts that enable them to take actions that, theoretically, significantly affect the financial position of the other party. In practice only the small business borrower is likely to be significantly affected. While the committee appreciates that these are private contracts that parties are able to freely enter into, the committee is concerned that the transparency and accountability associated with the discretion to make commercial judgements by banks is insufficient for customers to be assured that they are being treated fairly at all times.

4.70 Where disputes arise that affect the interests of banks, the loan contracts, prudential standards and accounting standards allow the banks to adequately protect their interests. Borrowers, on the other hand, have limited power or capacity to negotiate contract terms with banks when loans are established. Where disputes affect borrowers' interests:

- borrowers subject to circumstances including receivership are often unable to use the court system to protect their interests during disputes because the borrowers have lost legal control of their financial resources;
- there is a group of borrowers for whom no dispute resolution mechanism exists because their circumstances fall outside the jurisdiction of existing dispute resolution mechanisms; and
- existing dispute resolution mechanisms can be complex, lack transparency and are fragmented across multiple organisations, some of which are not perceived by borrowers to be sufficiently independent from banks.

4.71 The FOS informed the committee that it considers that there are some banks' small business recovery areas where refresher training in relation to provisions of the Code of Banking Practice 'would not go astray'. The FOS also argued that there are provisions of the code that are of great benefit to individuals and small businesses, particularly those relating to lending standards, the taking of guarantees, and hardship.[75]

4.72 The committee considers that refresher training is not sufficient. As recommended in chapter 2, the ASBFE Ombudsman should lead the development and implementation of an appropriate professional standard framework by working with relevant experts in financial services, ethics and education.

75 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 16 October 2015, p. 8.

ASBFE Ombudsman and EDR schemes

4.73 The committee welcomes the creation of the ASBFE Ombudsman and the assistance function it has in providing a concierge service for dispute resolution, and notes that this service has the potential to assist small business to navigate dispute resolution schemes and protections available to them. The committee also welcomes the provisions that enable the ASBFE Ombudsman to recommend that parties to a dispute participate in alternative dispute resolution.

4.74 The ASBFE Ombudsman has the power to:

- gather information and conduct investigations, including through gathering evidence at hearings; and
- publicise the fact that a party withdraws from or refuses to participate in dispute resolution.[76]

4.75 However, the ASBFE Ombudsman is not able to conduct dispute resolution and is not able to provide assistance if the person requesting assistance became aware of the action more than 12 months before the request was made.[77] The committee is concerned about this timeframe. The nature of matters that arise in long term contracts such as consumer and small business loans means that the impact of banks' actions may not be apparent within 12 months. For actions such as irresponsible lending, unfair contract terms or unconscionable conduct associated with troubled loans the impacts on the borrower are likely to occur more than 12 months after the action as many submissions to this inquiry have alleged.

4.76 As noted above, the ASBFE Ombudsman may publicise the fact that a party withdraws from or refuses to participate in dispute resolution. The committee welcomes that as an important aspect of accountability for both parties. However, the committee is concerned that such a penalty is unlikely to compel a bank to participate in dispute resolution and many borrowers will remain unable to seek an independent consideration of their dispute.

4.77 The provisions of the ABSFE Ombudsman Act prevent the ombudsman from recommending commercial arbitration.[78] As discussed earlier in this chapter, commercial arbitration could provide a viable alternative to courts for those businesses and commercial borrowers that do not qualify for EDR schemes. The committee therefore recommends in chapter 2 that the ABSFE Ombudsman be empowered to recommend commercial arbitration for larger commercial loans above its current jurisdiction.

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76 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, sections 3, 71.

77 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, sections 68, 71.

78 *Australian Small Business and Family Enterprise Ombudsman Act 2015*, section 4.

4.78 The committee acknowledges the Australian Government's announcement on 20 April 2016 that ASIC would work with FOS to review FOS's small business jurisdiction with a view to extending FOS's current jurisdiction to include a wider range of small businesses loans, as well as conducting a review of monetary limits and compensation caps.[79]

4.79 In chapter 2, the committee has recommended that the ASBFE Ombudsman coordinates such reforms to ensure that gaps do not remain in the dispute resolution arrangements for small business.

Farm Debt Mediation

4.80 The committee supports the development of a nationally consistent approach to farm debt mediation. The committee notes that some work has been progressed by the Department of Agriculture to develop a nationally consistent farm debt mediation scheme.

4.81 In chapter 2, the committee is recommending the development of a nationally consistent mediation scheme for both farm debt and small business loans. The committee suggests that the development of the small business loan mediation scheme could be informed by existing farm debt mediations schemes and the work undertaken to date to develop a national farm debt mediation scheme.

79 ASIC, *Supplementary submission 45*, pp 9–10.