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Senate Economics Legislation Inquiry into the Treasury Laws Amendment (Putting Consumers First — Establishment of the Australian Financial Complaints Authority) Bill 2017

CIO welcomes the opportunity to comment on the above Bill (**AFCA Bill**).

The Australian Financial Complaints Authority (**AFCA**) is intended to replace the Credit and Investments Ombudsman (**CIO**), the Financial Ombudsman Service (**FOS**) and the Superannuation Complaints Tribunal (**SCT**) as of 1 July next year.

Executive Summary

CIO opposes the AFCA Bill for the following reasons:

(a) The SCT's present backlog of cases is solely attributable to chronic underfunding over many years. That is easily fixed by adequately resourcing the tribunal. The SCT should not be rolled into an industry-funded member-based ombudsman scheme such as AFCA.

Because employees are compelled by Commonwealth legislation to contribute a substantial percentage of their income into superannuation accounts (and decisions relating to those accounts have potentially life changing impacts), a statutory Commonwealth tribunal is the most appropriate forum to determine the rights and obligations imposed by that legislation.

There is nothing in the AFCA Bill to suggest that all of the current member protections in the Superannuation (Resolution of Complaints) Act 1993 (Cth) and elsewhere will be fully replicated in the AFCA model.

There is no precedent anywhere in the world for dispute resolution bodies charged with resolving disputes about superannuation or pensions to be other than a statutory tribunal.

(b) Despite being trumpeted by the Government as something entirely new and designed to obviate the need for a Royal Commission, AFCA is merely a rebranding exercise. It will have the same powers and jurisdictions as CIO, FOS and the SCT, but with a few bells and whistles. AFCA will not be equipped to weed out poor corporate culture or call out moral obloquy, or be able to deal with or prevent future financial scandals.

(c) It would be reckless and irresponsible to design and implement a single industry ombudsman scheme without the benefit of the findings of a Royal Commission or banking commission of inquiry. How else would we know the extent of the problem and how it would be best addressed? The findings of such an inquiry may also suggest that an entirely different model to AFCA should be preferred.

(d) Small business will be no better off, even with increased monetary limits and compensation caps. AFCA will not be able to accept small business or primary producer complaints against commercial lenders that are not required to be licensed. Nor will AFCA be able to deal with complaints about credit provided for the purchase of commercial property like farm land, retail property or warehouses unless the credit provider is also engaging in consumer lending.

(e) AFCA will be no different from FOS in relation to primary producer disputes. In the context of primary producer loans and guarantees, the non-statutory AFCA will not be able to join third parties such as valuers, investigative accountants or receivers. Nor will it be able to obtain information and documents from them, subpoena them as witnesses, bind them to its decisions or enforce a decision against them. This is because these third parties, not being required to be licensed under the relevant law, will not be members of AFCA.

Further, like FOS, AFCA will not accept complaints from primary producers where they have previously undertaken farm debt mediation with their lender.[1]

(f) AFCA will not be able to hear a complaint about an unfair contract term or definition in an insurance contract because the AFCA Bill has not taken the opportunity to remove the exemption protecting insurance contracts from the operation of any law which provides relief for unfair contracts or unconscionable conduct.

(g) In relation to a superannuation complaint, AFCA will not be able to make a decision which would be contrary to the terms and conditions of the insurance contract.[2] Consequently, an out-of-date, unreasonable or excessively restrictive medical definition can still be the basis of denying a consumer a life insurance payout on a superannuation policy (CommInsure case). The only exception is if the *sale* of the product was unfair or unreasonable. In the case of hundreds of thousands of employer's default super funds, it is unlikely that the member

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[1] See shaded box on page 18 of FOS's submission to the Small Business & Family Enterprise Ombudsman Discussion Paper at https://www.fos.org.au/custom/files/docs/fos-submission-to-the-small-business-and-family-enterprise-ombudsman.pdf

[2] section 1055(7)(c) of the AFCA Bill

would ever be able to show that there was some irregularity in the sale of the life policy.

(h) AFCA will not be able to hear complaints against unscrupulous property spruikers because advice relating to investment in real property is an unregulated activity and so not a financial service for the purposes of mandatory EDR membership. Consumers have suffered significant losses over the years as a result of this regulatory gap.

(i) AFCA's increased monetary limits and compensation caps will not necessarily result in AFCA receiving many more complaints or operating any differently from FOS. For example, AFCA's terms of reference will, like FOS', almost certainly allow for an unfettered discretion to exclude a dispute if it considers the dispute would be more appropriately dealt in another forum, such as a court.

If there really was a need to increase its monetary limits and compensation caps, FOS could have done so at any time by simply changing its terms of reference. It chose not to.[3] Nor was it encouraged to do so by ASIC.

Increased monetary limits and compensation caps will have a knock-on effect on the cost of professional indemnity insurance premiums, and may render these unaffordable to smaller financial firms. The banks and insurers are large enough to be self-insured and will therefore have a competitive advantage over smaller financial firms.

(j) The major banks will be the big winners of the AFCA Bill. Smaller and more innovative financial firms, including fintech disrupters, operating on thinner margins and not having the benefits of scale and incumbency, but fiercely competing on price, will be least able to absorb or pass on any increased cost that

[3] CIO has never sought to increase its monetary limits and compensation caps because there have only been two instances in the last 13 years where the amount of loss claimed was above the present $500,000 monetary limit. The average compensation awarded by CIO over that period was under $10,000.

may result from an inefficient single scheme monopoly. This will undermine competition in financial services and play into the hands of the major incumbents.

It is therefore not surprising that about 90% of the non-bank industry (essentially competitors of the major banking incumbents) made submissions to the Ramsay Review through their peak industry bodies supporting the continued existence of CIO and FOS. The Ramsay Review largely ignored these submissions. Further, there is no industry representation on either the expert reference panel or the transition team appointed by the Government to oversee the move to a single scheme, despite the fact that AFCA will be an industry funded and member-based ombudsman scheme constituted as a company limited by guarantee.

(k) Having a single ombudsman scheme will not be in the interests of CIO's 24,000 members, 97% of which are sole traders and small businesses. They will lose an industry-specific ombudsman scheme that has the particular knowledge, expertise and history of successfully resolving disputes in their sector.

(l) Being a non-statutory monopoly, AFCA will be far less accountable and transparent to its stakeholders than either a statutory scheme which is subject to appropriate checks and balances or the present two ombudsman scheme model which acts as a check on the broad discretions and powers of FOS and CIO which 'compete' with each other in the same sector.

(m) The proposal to establish AFCA is not supported by economic analysis, sound argument or evidence. The Ramsay Review was unable to demonstrate the cost benefits of replacing FOS, CIO and the SCT with AFCA. The review's assertion that multiple EDR schemes result in increased costs for the regulator is also flawed. On the contrary, the proposal to establish AFCA has led the government to announce that an additional $4.3 million will be made available to ASIC.[4]

[4] http://sjm.ministers.treasury.gov.au/media-release/044-2017/

(n) CIO and FOS are extremely effective in dealing with 'Mum and Dad' complaints as well as straight-forward small business disputes not involving large sums of money. That they do this very well has been publicly acknowledged by consumer advocates, ASIC, the independent reviews conducted in relation to each scheme, and the Ramsay Review itself. Over 90% of the complaints lodged with CIO and FOS are from individuals.

(o) The existence of two 'competing' ASIC-approved EDR schemes has allowed each scheme to benchmark its performance against the other in terms of innovation and performance levels, and this continues to produce better consumer outcomes. For example, when CIO started accepting complaints about financial hardship (even in relation to non-regulated loans), this was soon followed by FOS. This significant reform led to a major change in the case profiles of both CIO and FOS - financial hardship complaints now make up about 25% of all complaints received by both CIO and FOS. Similarly, FOS followed suit when CIO started requiring financial firms to discontinue enforcement action while a complaint was open with CIO. There are numerous other examples.

(p) There is no empirical evidence of consumer confusion as to which of CIO or FOS consumers should take their complaints. ASIC's own submission to the Ramsay Review acknowledges that there is a lack of evidence of consumers being 'shopped around schemes or potentially never getting to the scheme that can help them'. This is consistent with the findings of the New Zealand Ministry for Business, Innovation and Employment which found no evidence that the multiple scheme model caused consumer detriment or that it did not deliver the right consumer outcome.

About CIO

Holders of an Australian financial services licence or an Australian credit licence, and credit representatives of the latter, are required by law to be a member of an external dispute resolution (**EDR**) scheme approved by the Australian Securities and Investments Commission (**ASIC**).

CIO is one of only two ASIC-approved EDR schemes for financial services in Australia, the other being FOS.

The key objective of CIO is to provide consumers with an independent no-cost alternative to legal proceedings for resolving disputes with financial firms who are members of CIO.

CIO is a not-for-profit public company which receives no government subsidy, and its operations are funded entirely by membership and complaint fees levied on financial firms who are members of CIO.

CIO has more than 24,000 members, about 97% of which are sole traders and small businesses. Given the make-up of its membership base, CIO has over the years developed deep expertise in the non-bank sector and in the business models, sales practices and structures within which it operates.

CIO operates predominantly in the credit sector. Its membership comprises non-bank lenders, mortgage brokers, debt purchasers, finance companies, consumer lease providers, credit reporting bureaus, time share operators and small amount lenders, among others.

CIO opposes the AFCA Bill for the following reasons:

1. <u>The SCT should remain a statutory tribunal</u>

   Given the SCT is fundamental to the functioning of Australia's $3 trillion compulsory superannuation system, it would be unwise, unnecessary and certainly without precedent, for it to be rolled it into an industry-funded member-based ombudsman scheme.

The SCT's present backlog of cases is solely attributable to chronic underfunding over many years, a fact acknowledged by Professor Ian Ramsay in his review of Australia's three financial sector Ombudsman schemes (**Ramsay Review**).

The SCT operates on a paltry budget of $5.1m and has always been mendicant to ASIC for its funding and staffing. This can easily be fixed without having to roll it into an industry ombudsman scheme, as is being proposed by the AFCA Bill.

The fact that AFCA will be given similar powers to the SCT (eg. a right of appeal to the Federal Court for superannuation complaints) confirms that the SCT is unique and much would be lost if it were to be subsumed by an industry ombudsman scheme.

At present, there is nothing in the AFCA Bill to suggest that all of the current member protections in the Superannuation (Resolution of Complaints) Act 1993 (Cth) and elsewhere will be fully replicated in the AFCA model, including section 46(5) of that Act which provides that the Federal Court must not make an order awarding costs against a complainant if the complainant does not defend an appeal instituted by the superannuation trustee or insurer. Further, under the current SCT regime, a complainant can appeal against a decision by the SCT not to deal with their complaint.

With compulsory superannuation, consumers/employees have no choice as to whether or not they make Superannuation Guarantee Charge contributions. Because employees are compelled by Commonwealth legislation to contribute a substantial percentage of their income into superannuation accounts (and decisions relating to those accounts have potentially life changing impacts), a statutory Commonwealth tribunal is the most appropriate forum to determine the rights and obligations imposed by that legislation. Being purely the function of regulation by the Commonwealth, the resolution of disputes over the administration of those funds is within the province of administrative law, not contract or consumer law.

On a practical level, the skill sets and technical knowledge of the staff of the SCT and any industry-based dispute resolution scheme are going to be very different. A different approach and culture is required and it is difficult to imagine how the two could co-exist in the same scheme.

After almost five years' work on a possible merger between the Pensions Ombudsman (United Kingdom's equivalent of the SCT) and the United Kingdom's Financial Ombudsman Service (**UK FOS**), both schemes recommended to the government that the merger be abandoned. What is likely, at considerable expense to industry and government and damage to consumers, is that this may ultimately be the same result for AFCA and the SCT in a few years' time. It will be a messy omelette to unscramble.

The lesson for Australia is that a dispute resolution scheme for superannuation products with statutory compulsory contribution does not sit well with one designed for other financial services.

Indeed, there is no precedent anywhere in the world for dispute resolution bodies charged with resolving disputes about superannuation or pensions to be other than a statutory tribunal.

In South Africa, the Financial Sector Regulation Act 2017 was enacted to implement a twin peaks model of financial regulation. This may eventually result in the establishment of an office of chief ombudsman for the financial sector to oversee individual ombudsman schemes (comprising both statutory and voluntary ombudsman schemes). As an alternative, it may result in the merging of the voluntary schemes, but it is not expected that the Office of Pension Funds

Adjudicator, a statutory scheme similar to Australia's SCT, would be part of any such merger.

The reasons cited are that consumers are sceptical about the independence of non-statutory ombudsman schemes because they are funded by the very institutions against whom complaints are made. Statutory ombudsman schemes are perceived as having greater independence and autonomy, and hence more likely to assist a consumer, than a non-statutory scheme.

2. AFCA offers nothing new

Despite being trumpeted as something entirely new and intended to obviate the need for a Royal Commission, AFCA is merely a rebranding exercise. It has the same powers and jurisdictions as CIO, FOS and the SCT, but with a few bells and whistles.

For example, the AFCA Bill prescribes certain key features and regulatory oversight under which AFCA will operate. But these are virtually the same as CIO, FOS and SCT's:

(a) The SCT already possesses the 'additional powers' that are being given to AFCA for superannuation complaints.

(b) To meet those few key requirements that CIO and FOS do not already comply with, CIO and FOS need only amend their existing terms of reference to allow them to increase their monetary limits and compensation caps,[5] appoint an independent assessor, conduct more frequent independent reviews and use panels to decide certain types of cases.

[5] CIO has never sought to increase its monetary limits and compensation caps because there have only been two instances in the last 13 years where the amount of loss claimed was above the present $500,000 monetary limit. The average compensation awarded by CIO over that period was under $10,000.

(c) As for regulatory oversight, the proposal to allow ASIC to issue 'directions' to the scheme operator to undertake specific measures adds little, if anything. ASIC already has the power to revoke CIO or FOS' approval if they do not meet ASIC's requirements. This constitutes a far greater incentive for CIO and FOS to comply with ASIC's requirements than the mere power to issue 'directions'.

More significantly, if only one scheme is authorised by the Minister, as is being proposed, it is inconceivable that the Minister would elect to revoke AFCA's authorisation because this would leave tens or hundreds of thousands of consumers with absolutely no cost-free redress against financial firms.

What then will be the sanction for mismanagement, governance dysfunction, poor performance or non-compliance by AFCA?

3. <u>AFCA is a wasted opportunity</u>

The AFCA Bill is in response to the recommendations of the Ramsay Review. The truth is that the Ramsay Review was hastily commissioned to fend off calls for a Royal Commission and placate those who were calling for a wide-ranging statutory financial services tribunal.

The Ramsay Review focused on the existing two-ombudsman scheme model – CIO and FOS – although both are acknowledged to be performing well by consumer advocates, ASIC and the Ramsay Review itself.

Not having statutory powers, CIO and FOS were never intended, nor are they equipped, to publicly expose bad behaviour, impose penalties on financial firms or deal with complicated disputes involving large sums of money.

Being non-statutory, AFCA will be no different. It will not be equipped to weed out poor corporate culture or call out moral obloquy. Only a Royal Commission can do this. Nor will it be able to impose penalties for wrong doing. Only a statutory tribunal can do this.

Lacking statutory and 'own motion' powers, any investigation by AFCA into systemic issues will also fail to expose and address poor organisational cultures and short term profit mindsets.

It follows that, not being able to investigate the root cause of these scandals, AFCA will also be powerless to prevent their re-occurrence. [6]

We cannot see how a non-statutory ombudsman would, even with increased monetary limits and regulatory oversight, deal with financial scandals any differently from how they have been dealt with by FOS to date.

It would be reckless and irresponsible to design and implement a single industry ombudsman scheme like AFCA without the benefit of the findings of a Royal Commission or banking commission of inquiry. How else would we know the extent of the problem and how it would be best addressed?

The findings of such an inquiry may suggest that an entirely different model to AFCA should be preferred; for example, a statutory tribunal for certain types of disputes (such as those relating to superannuation, small business or primary producers), or a scheme that avoids many of the shortcomings of AFCA (which are discussed further below).

It would be a complete waste of money to create a single ombudsman scheme which a Royal Commission or banking inquiry may subsequently find is not fit for purpose. CIO estimates that, despite the Government's optimistic forecast,[7] AFCA

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[6] This is despite the Minister's assertion to the contrary: http://kmo.ministers.treasury.gov.au/speech/015-2017/

[7] http://www.afr.com/business/banking-and-finance/financial-services/devil-in-the-detail-for-new-dispute-resolution-body-20170917-gyj5vk

will instead cost about three times the operating costs of CIO, FOS and the SCT initially. But it will offer nothing new.

4. <u>AFCA and FOS – what's the difference?</u>

The major financial scandals since the global financial crisis are attributable to the big banks (and in particular, their financial planning and insurance divisions). They are and have always been members of FOS. CIO does not have any banks or insurers as members.[8]

If the Committee believes that FOS did not or could not fix these financial scandals when they occurred, then it must also accept that AFCA will be no different. This is because AFCA will essentially be a replica of FOS, and none of the 'enhancements' being afforded to AFCA are capable of addressing the root structural causes of these scandals. Like FOS, AFCA will only be able to look at problems *after* the event and it will not be able to prevent the re-occurrence of financial scandals.

5. <u>Small business is no better off</u>

AFCA will be no different from FOS in relation to small business disputes. Not being a statutory scheme, AFCA will not be able to subpoena documents, verify discovery by affidavit, summon witnesses, take evidence on oath, cross-examine witnesses on the statements or documents they have given, or investigate criminal fraud.

Given AFCA will lack the powers of a statutory scheme, its ability to deal fairly and effectively with small business disputes is limited, even with increased monetary limits and compensation caps.

AFCA will also not be able to accept small business or primary producer complaints against commercial lenders that are not required to be licensed under

[8] CIO has a few mutual banks as members. They were previously building societies and credit unions.

the National Consumer Credit Protection Act 2009 (Cth). Banks are certainly not the only source of credit to small businesses and primary producers.

Nor will AFCA be able to deal with complaints about credit provided for the purchase of commercial property like farm land, retail property or warehouses (unless the credit provider also engages in consumer lending).

Even where AFCA has jurisdiction to deal with a particular dispute, small businesses and primary producer customers will not be able to enforce AFCA's decisions or seek a judicial review of an unfavourable AFCA decision.

The Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) or a small business tribunal should be empowered to investigate and adjudicate small business disputes that are outside the existing jurisdictional limits of EDR schemes or, alternatively, to investigate and adjudicate ALL small business disputes, to the exclusion of the existing schemes.

This is consistent with the recommendation of the Parliamentary Joint Committee Inquiry into the Impairment of Customer Loans that, in order to address the vulnerability of small business and commercial borrowers, the ASBFEO act as a small business loans dispute resolution tribunal where gaps in the EDR schemes remain.

6. <u>Primary producers are no better off</u>

AFCA will be no different from FOS in relation to primary producer disputes.

AFCA will not have developed specialisation in the context of primary production. Primary producers are a vulnerable and disadvantaged group because their cashflow and ability to repay debt are often dictated by the vagaries of the weather. Although financial counsellors do a wonderful job, there are fewer and fewer rural financial counsellors available to help farmers. Primary producers also have limited or no access to free legal advice.

Many primary producers are small family businesses — who may still have to borrow millions of dollars to achieve their commercial objectives — yet are run by an individual, family or partnership that has significant personal exposure due to the use of personal assets such as the family home as security.[9] When in financial difficulty, they face a number of issues with their lenders, and with valuers, investigative accountants and receivers.

Evidence presented to the Parliamentary Committee on the Impairment of Customer Loans showed, for example, that valuations were significantly reduced between loan establishment and the appointment of receivers, and businesses were being valued not at their market value as a going concern, but just a collection of business assets. This is exacerbated when the bank appoints a receiver who was previously the investigating accountant to the primary producer business.

In many cases, primary producers in financial difficulty are unable to pursue their rights through the courts because the process is either unaffordable, or they have lost control of their financial assets due to the appointment of receivers.

In the context of primary producer loans and guarantees, the non-statutory AFCA will not be able to join third parties such as valuers, investigative accountants or receivers. Nor will it be able to obtain information and documents from them, subpoena them as witnesses, bind them to its decisions or enforce a decision against them. This is because these third parties, not being required to be licensed under the relevant law, will not be members of AFCA.

Further, like FOS, AFCA will not or is unlikely to accept complaints from primary producers where they have previously undertaken farm debt mediation with their lender.[10]

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[9] http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/customer_loans/Report/b01

[10] See shaded box on page 18 of FOS's submission to the Small Business & Family Enterprise Ombudsman Discussion Paper at https://www.fos.org.au/custom/files/docs/fos-submission-to-the-small-business-and-family-enterprise-ombudsman.pdf

This is despite the Australian Small Business and Family Enterprise Ombudsman recommending that EDR schemes "must be expanded to include disputes with third parties that have been appointed by the bank, such as valuers, investigating accountants and receivers, and to borrowers who have previously undertaken farm debt mediation".[11]

7. Insurers will continue to get off scot free

Insured consumers will be no better off with AFCA.

AFCA will not be able to hear a complaint about an unfair contract term or definition in an insurance contract. This is because insurance contracts are exempt from the operation of any law which provides relief for unfair contracts or unconscionable conduct.

8. Life insureds get a raw deal

In relation to a superannuation complaint, AFCA will not be able to make a decision which would be contrary to the terms and conditions of the insurance contract.[12]

Consequently, an out-of-date, unreasonable or excessively restrictive medical definition can still be the basis of denying a consumer a life insurance payout on a superannuation policy (CommInsure case). The only exception is if the *sale* of the product was unfair or unreasonable. In the case of hundreds of thousands of employer's default super funds, it is unlikely that the member would ever be able to show that there was some irregularity in the sale of the life policy.

9. Property spruikers will continue to harm consumers

AFCA will not be able to hear complaints about property spruikers.

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[11] ASBFEO's Inquiry into small business loans 12 December 2016
https://cdn.tspace.gov.au/uploads/sites/51/2017/02/Inquiry-into-Small-Business-Loans.pdf
[12] section 1055(7)(c) of the AFCA Bill

At present, CIO and FOS can deal with complaints about investment advice, but not about advice relating to investment in real property because this is an unregulated activity and so not a financial service for the purposes of mandatory EDR membership. This is an arbitrary and irrelevant distinction, and one that can be difficult to explain to consumers who are facing significant losses.

The AFCA Bill relies on the scope of existing financial services laws in determining when consumers will and won't have access to EDR, with the result that there is no improvement at all in the lack of access to EDR for the victims of bad advice about property investment.

Given the significant problems caused by property spruikers over many years, a considered response to CIO's feedback to the Ramsay Review, or a genuine attempt to improve access to justice for Australian consumers, might have seen this point addressed.

10. <u>AFCA's increased monetary and compensation limits are not what they seem</u>

AFCA's increased monetary limits and compensation caps will not necessarily mean that AFCA will receive many more complaints or operate any differently from the way FOS does at present. There are a number of reasons for this:

(a) For a consumer to suffer a loss of anything close to $1m, the underlying credit facility will have to be very large indeed. This is because the loss the borrower (as opposed to a guarantor) typically suffers will not be the amount of the loan, but rather the costs of the loan (interest and fees, for example), or the difference between what was lent and what should suitably have been lent.

(b) An EDR scheme's inability to subpoena a third party to attend as a witness or produce documents, join third parties, cross-examine witnesses and take evidence on oath means that its decisions are only ever going to be made 'on the papers'. This severely hampers its ability to investigate and determine, with the appropriate level of rigour and confidence, complex disputes or claims for large compensation amounts.

Perhaps this is why the monetary limits and compensation caps in other jurisdictions are much less than that of CIO and FOS', and certainly significantly less than AFCA's. To name a few:

- UK Financial Ombudsman Service: Compensation limit is £150,000.
- Canadian Ombudsman for Banking Services and Investments: Monetary limit is C$350,000, but decisions are non-binding on both parties.
- New Zealand's Banking Ombudsman Scheme: Monetary limit is NZ$200,000.

(c) The benefits of AFCA's increased monetary limits and compensation caps are illusory if AFCA's terms of reference, like FOS', allow for an unfettered discretion to exclude a dispute if it considers the dispute would be more appropriately dealt in another forum, such as a court. This is more likely to occur, but is certainly not limited to, cases where the dispute is complicated or involves a large sum of money.

For example, in the Goldie Marketing case,[13] FOS ruled, and the Court subsequently accepted, that FOS was entitled to exclude the dispute because it was experiencing a staff shortage and lacked the relevant expertise.

Indeed the Court concluded that it would impose an unworkable and unrealistic burden on FOS if FOS was prevented from taking into account practical or administrative considerations, including staff resourcing, capability and availability.

[13] Goldie Marketing v FOS [2015] VSC 292

> It might be noted that, if there was really a need to do so, it has always been open to FOS to increase its monetary limits and compensation caps by simply changing its terms of reference.[14] It chose not to. Nor was it encouraged to do so by ASIC.

Increased monetary limits and compensation caps will have a knock-on effect on the cost of professional indemnity insurance premiums, and may render these unaffordable to smaller financial firms. The banks and insurers are large enough to be self-insured and will therefore have a competitive advantage over smaller financial firms.

11. <u>AFCA undermines competition in the financial services</u>

It is painfully ironic that the major banks will be the big winners of the AFCA Bill. They know AFCA is a diversion to avoid a Royal Commission.

AFCA will only enhance the existing banking oligopoly and entrench Australia's uncompetitive financial system. ASIC's Chairman, Greg Medcraft, should be congratulated on calling out Australia's banking oligopoly and shaming the banks on their entrenched culture and poor conduct – "ASIC's Greg Medcraft lashes bank 'oligopoly' for out of cycle rate hikes" – The Australian 6 April 2017.

The simple fact is that AFCA will undermine competition in financial services and play into the hands of the major incumbents. A single private ombudsman such as AFCA is without precedent in the global financial services landscape because it will be unaccountable and will burden smaller players with costs which will render them uncompetitive.

Smaller and more innovative financial firms, including fintech disrupters, operating on thinner margins and not having the benefits of scale and

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incumbency, but fiercely competing on price, will be least able to absorb or pass on any increased cost that may result from an inefficient single scheme monopoly.

In the short term, larger incumbents, like the banks, operating with wider margins can absorb these costs and, in the longer term, take advantage of diminished market competition and pass these costs on to consumers.

Predictably, the major banks and their peak industry body support the creation of AFCA since a consolidation of the two existing ombudsman schemes into a single mega scheme will have little or no impact on their profitability. In fact:

(a) The cost of having complaints heard by an ombudsman scheme is not a significant cost to the major banks. It is, however, for smaller financial firms who operate on much thinner margins. Costs impede the ability of smaller financial firms to compete on price, especially in the early stages of their development.

(b) The major banks have larger margins which enable them to settle claims on a commercial basis, even those without merit. Smaller firms generally do not have the resources to settle unmeritorious complaints.

(c) The major banks, invariably the largest generators of complaints, benefit from a single ombudsman scheme because the scheme will inevitably tailor its processes to deal with their large volume of complaints, at the expense of smaller financial firms.

(d) The major banks also benefit from a single ombudsman scheme because their EDR costs will be subsidised by the influx of thousands of smaller financial firms who are presently members of CIO.

12. No accountability or transparency

It might be argued that UK FOS[15] is an example of a 'single' ombudsman scheme that appears to work well.[16] However, UK FOS is a statutory scheme (although industry funded) and is highly regulated with many checks against the misuse of monopoly power. Such checks are completely absent from AFCA.

For example:

- UK FOS' decisions are subject to judicial review[17].
- Its regulator, the Financial Conduct Authority, appoints directors to its board. (Interestingly, the chairman and directors are not appointed to represent individually the interests of any particular group or sector.)[18]
- UK FOS' budget is approved by the regulator, the Financial Conduct Authority, so it is accountable for how it uses and accounts for its resources.
- Its financial accounts are laid before Parliament.
- UK FOS is regularly called to give evidence to Parliamentary committees (which can be contacted by stakeholders about any concerns they may have).
- It is covered by the Freedom of Information Act.
- It has a relatively low monetary limit.

Being a non-statutory monopoly, AFCA on the other hand will be far less accountable and transparent to its stakeholders than a statutory scheme subject to appropriate checks and balances.

15 http://www.financial-ombudsman.org.uk
16 It is not, in fact, a single scheme as there also exists, as an entirely separate body, the UK Pensions Ombudsman.
17 Judicial review on the merits as well as the process is available for decisions of UK FOS.
18 http://www.financial-ombudsman.org.uk/faq/answers/research_a2.html

In the absence of these checks and balances, the only check on the broad discretions and powers of a non-statutory scheme is the existence of two ombudsman schemes operating in the same sector in 'competition' with each other.

13. No economic basis for AFCA

The Ramsay Review's recommendation to establish AFCA is not supported by economic analysis, sound argument or evidence.[19] Nor did the review demonstrate any cost benefits to replacing FOS, CIO and the SCT with AFCA.

The review's assertion that multiple EDR schemes result in increased costs for the regulator is flawed. On the contrary, the proposal to establish AFCA has led the government to announce that an additional $4.3 million will be made available to ASIC.[20]

AFCA will eliminate the benefits which the existing two ASIC-approved ombudsman schemes (CIO and FOS) currently provide: better consumer outcomes through benchmarking,[21] service quality comparison, innovation with better processes and services and pressure to keep costs down.

Compared to firms in more competitive markets, a typical not-for-profit monopoly will tend to charge more for its services and spend it on bloated staff numbers, higher managerial salaries, excessive executive remuneration, lavish offices and other wasteful spending.[22]

Unlike a conventional monopoly where buyers can walk away if the quality of the service is low or prices charged by the monopolist are high, financial firms will

[19] Economic analysis of the Ramsay Interim Report by ACIL Allen Consulting, January 2017
[20] http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22library%2Fbudget%2F2017_15%22
[21] This is discussed in detail in CIO's response to Ramsay's Issues Paper: Pages 40/41: https://www.cio.org.au/assets/1212423/Submission%20to%20the%20EDR%20Review%20Panel.pdf
[22] Managerial Discretion and Expense Preference Behaviour, Robert Y Awh and Walter J Primeaux, Jr.

have no choice but to remain members of AFCA given that membership is mandatory.

This is not a problem under the current two ASIC-approved scheme model because competitive tension between CIO and FOS means that they have to be responsive and accountable to financial firms who can credibly threaten to take their membership to the other scheme.

14. Industry ignored

Having a single ombudsman scheme will not be in the interests of CIO's 24,000 members, 97% of which are sole traders and small businesses.[23] CIO members will lose an industry-specific ombudsman scheme that has the particular knowledge, expertise and history of successfully resolving disputes in their sector.

It should come as no surprise that about 90% of the non-bank industry (essentially competitors of the major banking incumbents) made submissions to the Ramsay Review through their peak industry bodies supporting the continued existence of CIO and FOS.

Regrettably, the Ramsay Review largely ignored these submissions and instead relied heavily on a Joint Consumer Submission to the review, despite the fact that less than 5% of consumers lodging complaints with CIO and FOS are represented by consumer advocates and financial counsellors.

Industry has been called upon to make three separate submissions to date on this issue and on each occasion their concerns were dismissed or ignored without logical argument, facts or data. On the last occasion the submissions were not published by Treasury until the day before submissions to this Committee closed.

[23] FOS may also have small members, but that segment is not the focus of their work – 85% of all complaints dealt with by FOS are about large members who receive more than 100 complaints a year.

The consumer advocacy groups appear to have had additional access and consultation not afforded to industry. For example, the final version of the AFCA Bill was shared for comment with consumer groups but not with industry prior to finalisation.

CIO's members and their industry associations represent competitors to the banking oligopoly but they have been so badly ignored and brow beaten by the political process that some are no longer prepared to make a fourth submission to this Committee. They have, understandably, submission fatigue.

To make matters worse, there is no industry representation on either the expert reference panel or the transition team appointed by the Government to oversee the move to a single scheme, despite the fact that AFCA will be an industry funded and member-based ombudsman scheme constituted as a company limited by guarantee. This means that there is no representation by anyone concerned with efficiency, accountability to industry and fairness to all parties.

15. CIO and FOS work well for Mum and Dad complaints

CIO and FOS are extremely effective in dealing with 'Mum and Dad' complaints as well as straight-forward small business disputes not involving large sums of money. That they do this very well has been publicly acknowledged by consumer advocates, ASIC, the independent reviews conducted in relation to each scheme, and the Ramsay Review itself. Indeed, over 90% of the complaints lodged with CIO and FOS are lodged by individuals.

CIO and FOS were never intended, nor are they equipped, to expose bad behaviour by assigning and publicising moral culpability to, or imposing penalties on, financial firms. That is beyond their remit, as it will be beyond the remit of a single non-statutory ombudsman scheme such as AFCA

While a proliferation of EDR schemes may not be ideal, CIO is of the firm view that the current two scheme model offers better outcomes for consumers.

Scheme benchmarking

Having two ASIC-approved EDR schemes has allowed each scheme to benchmark its performance against the other in terms of innovation and performance levels (**scheme benchmarking**), and this produces better consumer outcomes.

Indeed, the independent and periodic reviews of EDR schemes compare each of CIO and FOS, and in doing so, recommend one scheme implement particular improvements seen in the other.[24] It is also very clear that ASIC's approval requirements for the EDR schemes have changed over time to impose on one scheme improvements observed in the other. This can only raise best practice in EDR. It cannot be achieved under a single ombudsman scheme model.

Without the stimulus of EDR benchmarking and a comparative discipline, turnaround times, service levels, innovation and continuous improvement would suffer and there would be less incentive to keep costs in check and run the scheme efficiently.

The present two-scheme EDR model in Australia has spurred productivity growth and created a self-sustaining process for continual reform and reassessment. That process drives ongoing benefits for the sector and for consumers and small businesses.

Competition among Ombudsman schemes

There are some who take the position that there should be no competition at all between ombudsman schemes in the same industry sector. They go so far as to say that financial services as whole should only have one ombudsman scheme to prevent the perceived drawbacks of competition.[25] This position ignores the benefits to both consumers and industry of having at least two 'competing' EDR schemes.

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[24] See, for example, FOS' Independent Review 2013, pages 25 (para 3), 39 (para 3), 44 (last para), 60 (second last para), 75 (para 5), 76 (para 3), 132 (last para) and 133 (second last para): https://www.fos.org.au/custom/files/docs/independent-review-final-report-2014.pdf

The fact that two schemes exist in competition with each other has prompted each scheme to evolve and innovate so as to provide better outcomes for consumers. For example, when CIO started accepting complaints about financial hardship (even in relation to non-regulated loans), FOS soon followed. This major reform led to a major change in the case profiles of both CIO and FOS - financial hardship complaints now make up about 25% of all complaints received by CIO and FOS. Similarly, FOS followed suit when CIO started requiring financial firms to discontinue enforcement action while a complaint was open with CIO. There are numerous other examples.[26]

This kind of competition and comparative discipline drives the sort of innovation necessary to adapt to changing circumstances and markets. It is possible to point to numerous examples of staid and poorly performing markets being targeted and materially changed for the better by new entrants bringing innovative approaches that better meet the needs of their customers.

The Ramsay Review suggests that competition between EDR schemes may lead to unnecessary duplicative costs and an inefficient allocation of resources for industry and for the regulator.

With respect, that is akin to saying that Australia would be better off with a single provider of financial services or a single supermarket operator. Any benefit gained by removing duplication will be more than offset by increased bureaucracy and a lack of accountability to stakeholders.

It might be noted that there is no empirical evidence of consumer confusion as to which ASIC-approved EDR scheme consumers should take their complaints.

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[25] http://www.anzoa.com.au/assets/anzoa-policy-statement_competition-among-ombudsman-offices.pdf

[26] See other examples at page 40 under 'Innovation': https://www.cio.org.au/assets/1212423/Submission%20to%20the%20EDR%20Review%20Panel.pdf

ASIC's own submission to the Ramsay Review notes that there is a lack of evidence of consumers being 'shopped around schemes or potentially never getting to the scheme that can help them'.

This is consistent with the findings of the New Zealand Ministry for Business, Innovation and Employment which found no evidence that the multiple scheme model caused consumer detriment or that it did not deliver the right consumer outcome.

Nor is there evidence of forum shopping or arbitrage by financial firms (for instance, where a financial firm selects an EDR scheme with a reputation for leniency).

To the extent that financial firms compare different schemes and 'shop' them, comparisons are made based on service levels, value and the ease of doing business – not bias to business or perceived laxity.

Unlike a conventional monopoly where buyers can walk away if the quality of the service is low or prices charged by the monopolist are high, financial firms will have no choice, given scheme membership is mandatory, but to remain members of AFCA.

I would welcome the opportunity to discussion our submission with the Committee.

Sincerely,

[redacted]

Raj Venga
Chief Executive Officer and Ombudsman