FINANCIAL OMBUDSMAN SERVICE AUSTRALIA

Inquiry into lending to primary production customers

Financial Ombudsman Service Australia Submission

May 2017

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Overview

The Financial Ombudsman Service (FOS)[1] welcomes the opportunity to contribute to the Inquiry into lending to primary production customers. This submission addresses a number of matters within the Inquiry's Terms of Reference and highlights some of the recent reforms in the financial system external dispute resolution (EDR) and complaints framework.

FOS's views on this consultation are based on our experience of dealing with the overwhelming majority of disputes in the financial services sector, outside of the financial firms' own internal dispute resolution processes.

This financial year FOS will receive over 39,000 disputes. The Credit Investments Ombudsman (CIO) and Superannuation Complaints Tribunal (SCT), based on annualized half year data, will receive approximately 5,500 and 2,400 disputes respectively. Given current dispute volumes (up by 15% over dispute numbers in 2015-16), our projections for next year anticipate the receipt of more than 40,000 disputes.

Although FOS handles thousands of disputes every year we are acutely aware that there is an individual story behind every one of these disputes. In many cases, it is a story of not just financial loss but also the human toll of stress, anxiety and ill health which has flow on effects beyond the people involved in disputes to the community more generally. We therefore aim to deliver dispute resolution services in way people can trust and in doing so seek to understand all sides of a dispute and resolve it fairly and impartially.

The vast majority of disputes received by FOS are from individuals (almost 95%) and close to 6% from small businesses, including those involved in primary production industries. Of these, FOS accepts just over 1,000 business finance disputes a year, and most (62%) are about business loans. The main issues reported in these disputes are financial difficulty and decisions made by financial firms, including lending decisions.[2]

FOS and its predecessor scheme, the Banking and Financial Ombudsman have been dealing with small business disputes (including disputes about lending to primary production customers) since 2003.

The recent Review of EDR (the Ramsay Review) and the various inquiries and reviews where small business lending has been considered, have supported the role of EDR for small business disputes and increases to EDR's small business jurisdiction, including access to EDR by primary producers.

[1] This submission has been prepared by the office of the Chief Ombudsman and does not necessarily represent the views of the board of FOS. It draws on experience of FOS and its predecessors in the resolution of disputes about financial services.
[2] FOS Annual Review 2015-16

FOS also supports reforms designed to prevent disputes arising in the first place by ensuring that consumers are treated fairly in all their dealings with financial firms. In the context of this inquiry, this includes: improved practices in relation to the provision of valuations to borrowers by lenders; extending the national consumer credit law to small businesses and ensuring that small businesses are aware of their rights to pursue their dispute through EDR.

Review of the EDR and complaints framework

The Ramsay Review, a review of the EDR and complaints framework, was undertaken to ensure the framework effectively meets the needs of users of the financial system. The Final Report of the Ramsay Review was released on 9 May 2017 with the Government endorsing all 11 recommendations.[3]

While the Ramsay Review acknowledged that the current industry ombudsman arrangements generally provide low cost, speedy and flexible access to redress for consumers and small businesses, changes are required to address the following:

- the current multiple schemes with overlapping jurisdictions contributes to consumer confusion and makes it more challenging to achieve comparable outcomes for consumers with similar complaints
- competition and competitive tension between schemes does little to drive innovation and better outcomes for consumers
- multiple schemes result in duplicative costs for industry and for the regulator and limits the ability to deal with systemic issues and improve practices across industry sectors and
- the monetary limits and compensation caps of the schemes have fallen behind what is required to ensure access to justice for consumers and small businesses.

Single scheme

The Ramsay Review recommended that there should be a single EDR scheme for all financial disputes to replace FOS, the CIO and the SCT.

FOS supports the establishment of a single scheme for financial and superannuation disputes based on the key elements of the industry ombudsman model as proposed by the Ramsay Review. The proposed single scheme, based on the key features of the industry ombudsman model will simplify, strengthen and increase access to free EDR for consumers and small businesses.

It will also enable more Australians, including those involved in small business, to obtain access to justice by being able to bring their dispute to a single, independent

[3] See the Treasurer's media release on 9 May 2017 which includes the Government's response to the Ramsay Review.

alternative dispute resolution body rather than having to navigate multiple schemes or go to court. Further, the changes will ensure that Australia remains at the forefront of innovation in alternative dispute resolution in the financial sector.

Expansion of current jurisdictional limits

In our first submission[4] to the Ramsay Review, which included information gathered through FOS's own consultation on the expansion of its small business jurisdiction, we highlighted the gaps that currently exist and which limit small businesses' access to EDR options for credit facility disputes. Many of these small businesses are primary producers.

We provided detailed analysis of available lending data in support of an increase to claims limits and compensation caps both in the consumer and small business jurisdictions.[5] We also called for no monetary limits for disputes about setting aside a guarantee where it supports a mortgage or security relating to a guarantor's primary place of residence.[6]

It is pleasing that the Ramsay review recommended an increase which has been endorsed by the Government. Recommendation 5[7] is pertinent to this inquiry:

> *For small business disputes, other than credit facility disputes, the EDR body should commence operations with a monetary limit of $1 million and a compensation cap of no less than $500,000.*
>
> *For credit facility disputes, small businesses should be able to bring a claim where a small business credit facility is of an amount up to $5 million and the new body should be able to award compensation in an amount of up to $1 million.*

Whilst our analysis and dispute experience shows that the majority of credit facilities are below this limit, the new credit facility limit will provide much greater access to free EDR to a significant proportion of small business claimants. This includes industries that that may require access to higher credit facilities. For example in the farming industry, a total credit facility is often well in excess of the outstanding debt figures identified.[8]

Consistent with FOS's submissions to the review[9], the following recommendation has also been agreed (recommendation 4):

> *[…] There should be no monetary limits and compensation caps for disputes about whether a guarantee should be set aside where it has been supported by a mortgage or other security over the guarantor's primary place of residence.*

These important changes to be introduced with the new single EDR body will enable many more small businesses to obtain access to justice by being able to bring their

[4] FOS submission to the Ramsay Review, (Part 1) October 2016
[5] FOS response to the Ramsay Review's Interim Report- Appendices C & D.
[6] Ibid p. 26
[7] Final Report- Ramsay Review, p.172
[8] FOS response to the Ramsay Review's Interim Report
[9] ibid

dispute to an independent alternative dispute resolution body rather than having to go to court.

Farm debt mediation

The farm debt mediation arrangements in each of the states and territories differ and not all have schemes in place. A nationally consistent approach has been called for and FOS is supportive of this because it would help ensure consistency and reduce complexity in access to appropriate alternative dispute arrangements.

In its recent inquiry into small business loans, the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) recommended that 'EDR schemes must be expanded to include […] borrowers that have previously undertaken farm debt mediation'.[10]

The Ramsay Review considered the ASBFEO's recommendations and current arrangements. It recommended that borrower's access to EDR, after having undertaken farm debt mediation, should be considered within the context of the current consultation being undertaken by the Minister for Agriculture and Water Resources[11] to assess the best way to implement a nationally consistent farm debt mediation approach.

The recent recommendation of the independent review of the Code of Banking Practice is for the new EDR scheme to have the power to consider disputes that have been subject of farm debt mediation, but had failed to settle. We understand that industry's response is to support such an obligation.

We would be happy to further contribute to the consultation and implementation of future recommendations.

Lending, foreclosure and default practices

a. Lending, and foreclosure and default practices, including constructive and non-monetary default processes.

In the disputes we see at FOS, it is unusual for a financial firm to rely on a non-monetary default alone in calling in a loan. While it happens from time to time, it is more likely that a financial firm will rely on a payment default to call in a loan. Where a default notice is served, there is usually only a short period of time given to comply with the notice. However, in most cases this follows a longer period of negotiation, where a range of options are usually explored.

[10] Australian Small Business and Family Enterprise- Inquiry into Small Business Loans Report, Recommendation 13, p. 53
[11] http://www.agriculture.gov.au/ag-farm-food/drought/assistance/approach_to_farm_debt_mediation

The role of other service providers

b. The roles of other service providers to, and agents of, financial institutions, including valuers and insolvency practitioners, and the impact of these services.

Under the current framework, valuers and investigating accountants appointed by a financial firm are not required to be members of an EDR scheme. The following actions of a valuer, accountant or receiver may arise in a dispute at FOS:

- The fees charged for the valuation and the financial firm's use of the valuation (as opposed to the valuation itself)
- The cost of the accountant (which is passed to the consumer) or the initial decision to appoint an investigating accountant and
- Whether the financial firm should have appointed a receiver, whether the receiver's costs were excessive, and whether the receiver undersold the company's assets.

The ASBFEO in its inquiry into small business loans recommended[12] 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.

The Ramsay Review considered the ASBFEO's recommendation and noted that when a consumer or small business is making a complaint about the conduct of third party or agent, the EDR scheme will look to the financial firm (commonly a bank that is a member of the EDR scheme) to provide the relevant information pertaining to the dispute issues. Accordingly, it did not recommend changes as it was of the view that current arrangements for obtaining information were working.

In practice, the contractual relationship between FOS and the financial firm, enables FOS to obtain information that relates to a third party engaged by the financial firm from the financial firm itself. If this information is not provided, FOS is able to draw an adverse inference against the financial firm. Our experience however, is that the financial firm, who has a contractual or agency relationship with the third party is able to obtain the information from the third party and provide it to FOS when requested.

Provision of valuations

In relation to the role of valuers and the issues FOS commonly sees when investigating lending disputes, our view is that fewer disputes would arise if valuations were provided to borrowers at the earliest opportunity in the lending process. Our dispute experience indicates that, where borrowers do not receive valuations of their property and issues arise in relation to the provision of the loan, they end up feeling as if they are/were unable to make an informed decision in respect of their loan application.

[12] Australian Small Business and Family Enterprise Ombudsman Inquiry into Small Business Loans Report, Recommendation 13, p. 53

The ASBFEO, in its inquiry into small business loans recommended that all banks should provide borrowers with a choice of valuer, a full copy of the instructions given to the valuer and full copy of the valuation report.[13]

The Independent Review of the Code of Banking Practice also recommended that the Code should be amended to require signatory banks processes in relation to valuations and investigating accountant's reports to be fair and transparent. In the case of small business, the Reviewer recommended that this obligation should apply to a credit facility below $5million.[14]

We support the provision of valuations obtained by a lender in the course of a loan application to the borrower, as early as possible in the process.

Internal Dispute Resolution (IDR)

c. The appropriateness of internal complaints handling and dispute management procedures within financial institutions

EDR schemes are not the primary 'resolver' of customer complaints in the financial sector. This is the role of financial firms dealing directly with their customers.

FOS holds the view that it is better for both parties if firms can resolve problems directly with their customers. We have embedded this view in our dispute process by ensuring that all complaints we register are referred back to the firm for another chance to sort out directly with its customer.

The quality of how firms directly deal with complaints by their customers has the greatest potential to improve customer outcomes across the financial system.

Reporting of IDR data

In our submission to the Ramsay Review[15], we note the lack of consistent publicly available IDR data and how this hampers a proper system-wide assessment of financial sector dispute resolution – how effective the current system is and whether it is improving over time. While the annual reports of the various financial sector Codes of Practice provide details of IDR complaints, this only covers organisations that subscribe to the Codes. Other jurisdictions, such as the UK, collect and publish consistent, comparable industry data on IDR on a regular basis.

The Ramsay Review's recommendation 8[16], when implemented, will see standardised reporting of IDR activity by all financial firms to ASIC, including reporting of outcomes for consumers in relation to complaints. This is a welcome initiative.

[13] ASBFEO inquiry into small business loans, recommendation 8
[14] Independent Review of the Code of Banking Practice, January 2017, recommendation 29
[15] FOS submission to Ramsay Review October 2016, (Part 1), p.14
[16] Final Report- Ramsay Review, p.190

Role of EDR schemes in fostering better IDR

In our submission to the Ramsay Review, we also note that EDR schemes have a role to play in influencing the standard of IDR handling in individual firms, in specific industry sectors and across financial services as a whole. FOS does this (among other things) through data capture and analysis about the registration and referral of disputes it receives, as well as through our liaison work with financial firms. The analysis is shared with major and mid-tier firms (both individually and through benchmarking reports), industry associations and, when required, with ASIC. The analysis is evidence-based and specific in nature so that firms can act upon it to improve their IDR processes.

The Ramsay Review recommended that the single EDR scheme refer all complaints back to IDR upon receipt for a further attempt at resolution and register and track the progress of those complaints. This is a feature of the current FOS process which has been in existence since 2015.

Reasonable written notice

d. The appropriateness of loan contract terms particular to the primary production industries, including loan-to-value ratios and provision of reasonable written notice.

The 2016 report of the Parliamentary inquiry into the impairment of customer loans[17] recommended that banking codes of practice administered by the Australian Bankers' Association or the Customer Owned Banking Association, and other regulatory arrangements, be revised to require that:

- Authorised deposit taking institutions must commence dialogue with a borrower at least six months prior to the expiry of a term loan. Further, where a monetary default has not occurred, they must provide a minimum of three months' notice if a decision is made to not roll over the loan, even if this means extending the expiration date to allow for the three months following the date of decision.
- If a customer is meeting all terms and conditions of the loan and an authorised deposit taking institution seeks to vary the terms of the loan, the authorised deposit taking institution should bear the cost associated with the change and provide six months' notice before the variation comes into effect.
- Customer protections relating to revaluation, non-monetary defaults and impairment should be explicitly included in the code.

[17] Inquiry into Impairment of Customer Loans May 2016

- Subscription to a relevant code becomes mandatory for all authorised deposit taking institutions.

FOS supports the implementation of the above initiatives.

Default notice period

The recent review of the Banking Code of Practice[18], also considered signatory banks' default notice periods. The Review noted that unlike credit provided to an individual that is regulated by the National Credit Code, there is currently no statutory or Code requirement as to what period of default notice must be provided to a small business borrower before a credit provider may proceed to enforce its rights under the credit contract.

To further lift standards for small business customers, the Reviewer recommended that for small business customers with a credit facility below $5million that the Code require signatory banks to provide 30 days' notice before beginning enforcement proceedings against a small business customer in default under a credit contract. A 30 day timeframe would be the same period of notice as that mandated under legislation for consumer credit and so it provides equal treatment to small business.

FOS supports the implementation of the above recommendation in relation to all credit providers, to enhance protections and provide equal treatment for small business customers.

Extending the national consumer credit law to small business

There is a currently a gap for some small business consumers because the National Consumer Credit Protection (NCCP) Act 2009 does not apply to loans for business purposes. Accordingly, some credit providers who provide facilities only to small businesses are not required to hold an Australian Financial Services License (AFSL) or an Australian Credit License (ACL) and are therefore not necessarily members of an EDR scheme.

However, small business customers of any financial firm that joins and EDR scheme, for whatever reason (e.g. because they hold an AFSL or an ACL, or choose to voluntarily join FOS) can lodge a dispute with us.

One way of addressing the gap is to extend the national consumer credit protection law to small businesses, as mooted in 2009, but not progressed. This includes also extending Parts 2 to 6 of the National Credit Code (NCC) (relating to disclosure, related mortgages and guarantees, changes to the contract, enforcement and penalties) to small business lenders. In addition, all small business lenders should be a member of an EDR scheme.

[18] Independent Review of the Code of Banking Practice January 2017.

Extending these provisions would also ensure a level playing field for all small business lenders. Banks and mutual approved deposit-taking institutions that subscribe to a relevant code of practice have adopted some of the requirements of the NCCP Act and NCC in relation to small business lending.

Further, applying the provisions of the NCCP Act and NCC to all lenders would ensure more consistent practices across the industry, especially in relation to three main areas: inappropriate lending decisions, changes to the terms and conditions, and enforcement when a loan is in default, as noted above.

Informing small businesses about EDR

Currently if a request for financial difficulty assistance is declined by a lender, section 72 of the National Credit Code (NCC) requires the creditor to inform the debtor of their rights to EDR and the contact details of the EDR scheme they could approach. However, while this applies to individual consumers, it does not apply to small businesses.

In our submission to the Independent Review of the Code of Banking Practice[19], FOS noted that while clause 28.8 of the Code of Banking Practice requires signatory banks to provide certain information after deciding whether to provide financial difficulty assistance, it does not refer to any information about EDR.

We therefore submitted that a small business customer should receive information about their rights to EDR in the following:

- in any default notice they receive
- when their request for financial difficulty assistance is declined and
- when they receive notice that a bank does not intend to renew a loan that is about to expire.

The Review has since recommended[20] that the Code of Banking Practice include a requirement for signatory banks to inform Code customers (at the same time as informing customers of mediation options) of their entitlement to access the bank's internal and then external dispute resolution processes.

We are of the view that this requirement should be applicable to all financial firms and not just signatories of the Code of Banking Practice. This will ensure small businesses, like individual consumers, are aware of their rights to pursue their dispute through EDR, if they are unable to resolve it directly with their financial firm.

[19] FOS submission to the Independent Review of the Code of Banking Practice
[20] Independent Review of the Code of Banking Practice, Recommendation 14 pp. 62-63