Chapter 2

The issues

2.1 This chapter addresses the issues faced by consumers and small businesses when resolving disputes with financial service providers through the justice system, in particular the court system and through the Australian Financial Complaints Authority (AFCA).

2.2 This chapter begins by examining the *Code of Banking Practice* (Banking Code), and discusses ways in which financial service providers have allegedly misused the justice system and the call by many submitters for banks to act as model litigants in an effort to address such practices. This chapter also discusses the accessibility of the court system, the legal assistance and financial counselling sectors, and the way in which financial disputes are resolved through AFCA. The chapter concludes by examining the issue of a compensation scheme of last resort (CSLR).

The Code of Banking Practice

2.3 The Banking Code is integral to the resolution of disputes between banks and their customers through 'both internal dispute resolution (IDR) and external dispute resolution (EDR) processes'.[1]

2.4 The current, 2013 voluntary code Banking Code is described as 'the banking industry's customer charter on best banking practice standards'.[2] Provisions of the code address the resolution of disputes with customers.[3]

2.5 The current Banking Code was finalised in 2013 and sets out the purpose of the code—namely, to set the standards of good banking practice for banking services 'to follow when dealing with persons who are, or who may become, our individual and small business customers and their guarantors'.[4] Breaches of the code are investigated by the Code Compliance Monitoring Committee.[5]

2.6 The current code applies to:

a) new banking services we provide to you on or after that date;

b) new Guarantees we take from you on or after that date; and

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1 Australian Banking Association (ABA), answers to questions on notice, 21 March 2019 (received 29 March 2019), p. 1.

2 ABA, *Banking Code of Practice*, https://www.ausbanking.org.au/code/banking-code-of-practice (accessed 22 March 2019).

3 ABA, *Code of Banking Practice 2013*, 2013, Part F.

4 ABA, *Code of Banking Practice 2013*, 2013, p. 6.

5 ABA, *Banking Code of Practice*, https://www.ausbanking.org.au/code/banking-code-of-practice (accessed 22 March 2019).

c) things we do on or after that date in respect of some pre-existing banking services and Guarantees.[6]

2.7 In July 2016, and as part of an industry initiative 'announced in April 2016 to raise banking standards', an independent review of the Banking Code was conducted by Mr Phil Khoury.[7]

2.8 As a result of the review, in December 2017 the Australian Banking Association (ABA) submitted a new Banking Code to the Australian Securities and Investments Commission (ASIC) for review.[8]

2.9 On 31 July 2018, ASIC approved the new Banking Code and noted the following about its development:

> ASIC's approval of the Code follows extensive engagement with the ABA, following a comprehensive independent review and extensive stakeholder consultation. The ABA made additional significant changes to the Code in order to satisfy ASIC that it met our criteria for approval.[9]

2.10 The new, enforceable Banking Code 'sets out the standards of practice and service in the Australian banking industry for individual and small business customers, and their guarantors'.[10] The new Banking Code also addresses resolution of complaints through internal and external dispute resolution processes.[11]

2.11 The new Banking Code will commence operation on 1 July 2019 and signatory banks will have until this date to implement the code.[12] As compliance with the code is a condition of membership of the ABA, 'banks with personal or small business customers in Australia will be required to sign up to the new [code] if they wish to be members of the ABA'.[13]

2.12 The ABA has identified that the new code includes initiatives such as proactive contact with customers deemed at risk of financial difficulty, improved protections for guarantors in order 'to ensure they understand their obligations', and '[a] new independent body who will investigate breaches and apply sanctions as needed'.[14]

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6 ABA, *Code of Banking Practice 2013*, 2013, p. 8.

7 ABA, *Banking Code of Practice*, https://www.ausbanking.org.au/code/banking-code-of-practice (accessed 22 March 2019).

8 ABA, 'A new higher standard in Australian banking', *Media Release*, 31 July 2018.

9 Australian Securities and Investments Commission (ASIC), 'ASIC approves the Banking Code of Practice', *Media Release*, 31 July 2018.

10 ABA, *Banking Code of Practice*, 2018, p. 4.

11 ABA, *Banking Code of Practice*, 2018, Part 10.

12 ABA, 'A new higher standard in Australian banking', *Media Release*, 31 July 2018.

13 ABA, 'A new higher standard in Australian banking', *Media Release*, 31 July 2018.

14 ABA, 'New Banking Code standards should be adopted by entire industry', *Media Release*, 7 September 2018.

2.13 Despite these claimed improvements, some submitters identified shortcomings with the new Banking Code. For example, Financial Counselling Australia (FCA) submitted that, during the review of the current Banking Code, consumer advocates requested that ASIC Regulatory Guide 209 (RG209)—'which contains detailed guidance on how the responsible lending provisions'—be included in the new Banking Code.[15] FCA noted that the request for the inclusion of RG209 in the code was 'never recommended or implemented'. [16]

2.14 In its submission, the Consumer Action Law Centre (CALC) noted that the current code 'imposes very few requirements on signatories in relation to the sale of debts to debt buyers'.[17] CALC also noted that the ABA rejected Khoury's recommendation that 'banks be required to monitor compliance by their debt assignees' with legislation, the code and the ASIC Debt Collection Guideline.[18]

2.15 The new Banking Code will be subject to formal review every three years.[19]

Alleged misuse of the legal system

2.16 The committee received evidence that financial service providers will sometimes seek to use their vastly superior resources to resolve legal disputes with customers in a way that is neither fair nor proportionate.

2.17 For example, the Office of the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) referred to its 2016 *Inquiry into small business loans*, which 'found that banks do not seek to resolve disputes in a fair or proportional manner'.[20] ASBFEO explained that its inquiry also found that in disputes over loan facilities, banks:

> …will aggressively seek to cover their risk moving rapidly to place a loan into default and engage insolvency practitioners to sell assets to recover funds. Banks procure these services to enable their own decision-making with regard to the loan security. Disputes over these services often end up with no access to justice as the banks say it is nothing to do with them as the third party is a representative of the business.[21]

2.18 Ms Dana Beiglari of Legal Aid NSW informed the committee that, based on Legal Aid's casework experience, lenders may misuse the legal system when dealing with elderly guarantors:

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15 Financial Counselling Australia (FCA), *Submission 45*, pp. 10–11.

16 FCA, *Submission 45*, p. 10.

17 Consumer Action Law Centre (CALC), *Submission 29*, p. 3.

18 CALC, *Submission 29*, pp. 3–4.

19 ABA, 'A new higher standard in Australian banking', *Media Release*, 31 July 2018. The 2013 code was subject to review every five years.

20 Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Submission 13*, p. 1.

21 ASBFEO, *Submission 13*, p. 1.

> [T]here can be a tendency for lenders to act quickly to use their legal rights, often in court, but to act slowly when entering into practical hardship arrangements that fit the needs of the individual consumer in the dispute.[22]

2.19 CALC informed the committee that, based on its casework experience, the debt recovery process—the most common reason it identified for the use of the legal system to resolve financial disputes—tends to target the most vulnerable people involved in financial disputes:

> People who are struggling with problem debt who do not engage [with IDR, hardship or EDR processes] are most at risk of having homes repossessed by banks through the legal system, or having debts sold to external debt collectors which sometimes use the legal system as part of debt recovery.[23]

2.20 CALC expressed concern with a number of other practices undertaken by financial service providers that involve the use of the legal system, and court processes in particular, to the detriment of consumers. These practices include the use of legal action 'to pressure consumers into unaffordable repayment plans or repaying debts that might not be legally owed'.[24]

2.21 Other submitters also discussed what they consider the misuse of the legal system by financial service providers in resolving disputes. For example, the Consumer Credit Legal Service WA (Inc) (CCLSWA) raised concerns that some financial service providers are not acting in accordance with the requirements of the *National Consumer Credit Protection Act 2009* (NCCP Act)[25] and the *National Credit Code* (NCC), which provide that consumers are entitled to certain documents.[26]

2.22 Mrs Anita Shannon informed the committee about their experience with the misuse of the NCC:

> [I]t would appear in reality a consumer under a loan agreement and mortgage with trustee Credit Provider under a non-bank / securitisation scheme has limited (if any) legal rights with regard to the relationship with the trustee Credit Provider, even when the loan agreement and mortgage fell under the previous Consumer Credit Codes (UCCC), now the National Credit Code (NCC) and is therefore disadvantaged further than a borrower who went to a Bank.
>
> The trustee Credit Provider contracts with others to originate loans and mortgages on its behalf and refuses to take any form of responsibility for those entities misconduct in the origination of the loan despite the

22 Ms Dana Beiglari, Senior Solicitor, Consumer Law, Legal Aid NSW, *Proof Committee Hansard*, 21 March 2019, p. 16.

23 CALC, *Submission 29*, pp. 2–3.

24 CALC, *Submission 29*, pp. 3–4.

25 The *National Consumer Credit Protection Act 2009* governs lending to consumers, as distinct from lending for a business purpose.

26 Consumer Credit Legal Service WA (Inc) (CCLSWA), *Submission 21*, p. 4.

> non-contracting out provisions of the Consumer Credit Codes (now S.191 of the NCC).[27]

2.23 The enforcement of the NCC has recently been strengthened by the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2018*, which received Royal Assent on 12 March 2019. That Act implemented certain recommendations of ASIC's Enforcement Review Taskforce,[28] by amending the *Corporations Act 2001* (Corporations Act), the *Australian Securities and Investments Commission Act 2001*, the NCCP Act and the *Insurance Contracts Act 1984* in order to introduce a stronger penalty framework for corporate and financial sector misconduct.

2.24 On a related issue of concern, AFCA acknowledged that the failure to provide documentation relevant to AFCA, or the provision of misleading information about the existence of such documents, is 'completely unacceptable'.[29] Dr June Smith, the Lead Ombudsman at AFCA, expressed the organisation's support for legislative amendments to the Corporations Act that would address this issue:[30]

> [W]e are fully supportive of the [Royal Commission's proposed] amendment to section 912A in relation to cooperation with AFCA and a firm having to use reasonable means to provide documentation and to cooperate with the service—and we would use that not only in relation to documents in the dispute but also in relation to the provision of documentation associated with the professional indemnity insurance policy that may be in place, the current levels of that and whether or not there have been notifications of claims.[31]

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27 Mrs Anita Shannon, *Submission 55*, pp. 2–3.

28 On 19 October 2016, the Minister for Revenue and Financial Services, the Hon. Kelly O'Dwyer MP, announced a taskforce to review the enforcement regime of ASIC—see, The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'ASIC Enforcement Review Taskforce' , *Media Release*, 19 October 2019. The Taskforce report was provided to the Government in December 2017.

29 Mr David Locke, Chief Ombudsman and Chief Executive Officer, Australian Financial Complaints Authority (AFCA), *Proof Committee Hansard*, 21 March 2019, p. 54.

30 The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) recommended that ' Section 912A of the Corporations Act should be amended to require that AFSL holders take reasonable steps to co-operate with AFCA in its resolution of particular disputes, including, in particular, by making available to AFCA all relevant documents and records relating to issues in dispute'—see, Royal Commission, *Final Report*, 2018, p. 34 at Recommendation 4.11.

31 Dr June Smith, Lead Ombudsman, Investments, the Australian Financial Complaints Authority (AFCA), *Proof Committee Hansard*, 21 March 2019, p. 54.

Model litigant obligations

2.25 The committee received evidence that one way in which to address the alleged misuse of the legal system by financial service providers is to impose an obligation on these providers to act as model litigants.[32]

2.26 The content and application of model litigant obligations vary between the Commonwealth, states and territories.[33] At the Commonwealth level, the model litigant obligation is part of the *Legal Services Directions 2017*, issued by the Attorney-General pursuant to the responsibility vested in this officer for the maintenance of proper standards by the Commonwealth in litigation.[34] CALC considered that the obligation to act as a model litigant that applies to government agencies is integral to the rule of law.[35]

2.27 The ABA advised the committee that it 'has not developed an industry position across all of its member banks on behaving as model litigants'.[36] The ABA further explained that, in its view, there is:

> …merit in each bank considering what that means for their bank in their approach to litigation and dispute resolution, and making a determination [about behaving like a model litigant] individually.[37]

2.28 However, the committee received evidence that this approach does not serve the interests of consumers and small businesses. Indeed, CALC took the committee to a key observation of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission)—that there exists an 'asymmetry of power and information between financial institutions and their customers'—to illustrate this point.[38] CALC considered this asymmetry of power to be similar to the 'imbalance of power when someone is in dispute with a government'.[39]

2.29 Similarly, Mr Josh Mennen of Maurice Blackburn Lawyers (Maurice Blackburn) considered the model litigant obligation on government agencies a 'reasonable standard' which 'ought to be applied to financial services providers dealing

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32 Mr Col Shields, *Submission 2*, p. 1; Banks Gone Bad, *Submission 16*, p. 3; CALC, *Submission 29*, p. 6; Maurice Blackburn Lawyers (Maurice Blackburn), *Submission 47*, p. 2.

33 Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No. 72, 5 September 2014, Volume 1, p. 430.

34 See s. 55ZF of the *Judiciary Act 1903*.

35 CALC, *Submission 29*, p. 5.

36 Ms Christine Cupitt, Executive Director, Policy, ABA, *Proof Committee Hansard*, 21 March 2019, p. 2.

37 Ms Cupitt, ABA, *Proof Committee Hansard*, 21 March 2019, p. 2.

38 CALC, *Submission 29*, p. 5.

39 CALC, *Submission 29*, p. 5.

with consumers'.[40] In its submission, Maurice Blackburn argued that a requirement for financial service providers to act as model litigants would:

> …place an onus on them deal with claims or disputes promptly, pay legitimate claims or compensation without litigation, act consistently in the handling of claims and litigation, and keeping the need for litigation to a minimum.[41]

2.30 Although conceding that there may be an 'enforcement issue' with respect to government agencies complying with the obligations, Mr Mennen considered that 'the rules themselves look sound'.[42]

2.31 In their submission to the inquiry, the Australia and New Zealand Banking Limited informed the committee that it will publish principles that are:

> …aimed at giving retail and small business customers an understanding of the steps we will take to ensure that we respond to their complaint against us in a respectful and fair way. The principles extend to setting out standards of conduct we will adopt if a matter ultimately involves litigation.[43]

2.32 Notably, Mr David Locke, the Chief Ombudsman and Chief Executive Officer of AFCA, stated that AFCA is 'open' to making adjustments to its rules, remit and processes 'to ensure that we meet community expectations', including by acting in accordance with model litigant rules.[44] Mr Locke opined that AFCA and financial firms should both conduct themselves in accordance with model litigant responsibilities.[45]

Accessibility of the court system

2.33 There was general consensus amongst submitters and witnesses to this inquiry that the court system is seldom the best forum in which consumers and small business owners can resolve disputes with financial service providers.[46] For example, CALC submitted:

> The court system is rarely the most suitable forum to resolve financial services disputes fairly, particularly for consumers experiencing vulnerability and disadvantage. The process is slow, legalistic, complex and expensive. Courts expose consumers to serious costs risks, and present significant barriers to accessing justice. The resources required to run a case

40 Mr Josh Mennen, Principal Lawyer, Maurice Blackburn, *Proof Committee Hansard*, 21 March 2019, p. 26.

41 Maurice Blackburn, *Submission 47*, p. 2.

42 Mr Mennen, Maurice Blackburn, *Proof Committee Hansard*, 21 March 2019, p. 26.

43 Australia and New Zealand Banking Limited, *Submission 40*, p. 3.

44 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 51.

45 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 54.

46 See, for example, CCLSWA, *Submission 21*, p. 12; Ms Ana Ganesh, *Submission 26*, p. 3; Dr Evan Jones, *Submission 53*, p. 2.

> via the court process, as opposed to EDR, are significant and the process is daunting and entirely inaccessible for participants without access to legal advice and representation.[47]

2.34 CALC suggested that, in contrast to the court system, 'EDR is better equipped to support unrepresented consumers as processes are less formal'.[48]

2.35 In CALC's experience, most disputes between financial service providers and consumers are dealt with in the first instance 'via providers' [IDR] or hardship teams'.[49] In the event that a dispute is not resolved to the satisfaction of the consumer, the consumer may abandon their complaint, or look to an EDR process, such as AFCA.[50]

2.36 In its submission, Legal Aid NSW identified circumstances in which court action is a necessary and preferable approach to resolving legal disputes.[51] However, in its experience, 'the court system can be an impractical, inefficient and costly means of resolving financial disputes'.[52]

Bankruptcy

2.37 Another issue that goes to the accessibility of the court system is the ability of a bankrupt party to pursue a cause of action against a financial service provider, an issue discussed in detail by Maurice Blackburn.

2.38 Maurice Blackburn identified the 'perverse outcome' that, in situations involving financial service providers, an irresponsible lender causing bankruptcy 'may have an interest in the cause or action against itself'.[53]

2.39 Maurice Blackburn submitted that it was 'essential to rectify this perverse outcome':

> Section 116(2)(g) of the *Bankruptcy Act* (1966) excludes from property divisible among creditors ‘any right of the bankrupt to recover damages or compensation for personal injury or wrong done to the bankrupt’ and any damages or compensation recovered in respect of such injury or wrong. However that does not appear to assist in the case of irresponsible lending as the question of what is a ‘wrong’ has been judicially considered, and cases indicate this will extend to claims arising from the person compared to claims arising from property interests.
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> One way to remedy this is to legislate an exception in section 116(2) *Bankruptcy Act* (1966) such that actions against [financial service

47 CALC, *Submission 29*, p. 6.

48 CALC, *Submission 29*, p. 6.

49 CALC, *Submission 29*, p. 2.

50 CALC, *Submission 29*, p. 2.

51 See, Legal Aid NSW, *Submission 44*, p. 7.

52 Legal Aid NSW, *Submission 44*, p. 7.

53 Maurice Blackburn, *Submission 47*, p. 9.

> providers], including those taken under the *National Consumer Credit Protections Act* (2009) and National Credit Code, are not divisible among creditors but remain the property of the consumer. That is, causes of action against any creditor should be quarantined under bankruptcy law.[54]

Home repossession

2.40 Some witnesses also discussed the issue of home repossession, and possible changes to this process that could reduce the hardship faced by customers subject to home repossession.

2.41 The committee heard that it was preferable to address the issues pertaining to home repossession before engaging with the court system, owing to the difficulties faced by consumers who are engaged in court proceedings.

2.42 For example, Ms Rebekah Doran of the Law Council of Australia (Law Council) informed the committee about the challenges faced by consumers with respect to proceedings regarding home repossession in New South Wales:

> There have been a lot of challenges with that process once the person is at the stage of a judgement being entered against them and the home repossession process being underway. That is because of the centralisation of that through the Supreme Court. Particularly for people in regional and remote areas, engaging with the court in the Sydney Supreme Court is incredibly difficult.[55]

2.43 Ms Mary Walker of the Law Council referred the committee to the example of farm debt repossession, where 'there are a lot of possession matters' that are brought into the EDR scheme 'very early on':

> I think we need to be mindful not only that we need to be accessing capacity to resolve disputes early but that they may very well need to be accessed outside of the court stream and dealt with internally through the ombudsman schemes or otherwise. However, one of the other problems is: if you have too many barriers to entry for someone who actually needs to be in the Supreme Court then what you're doing is creating more burden. It's a real balance about how these things are dealt with.[56]

2.44 In Ms Walker's experience of alternative dispute resolution schemes that are set up to target particular issues are 'often very effective'.[57]

2.45 Mr Gerard Brody of CALC also considered that 'lenders should use repossession only as a very last resort', and prior to pursuing this end, 'should take all

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54 Maurice Blackburn, *Submission 47*, p. 9 (citations omitted).

55 Ms Rebekah Doran, Member, Australian Consumer Law Committee, Legal Practice Section, Law Council of Australia (Law Council), *Proof Committee Hansard*, 21 March 2019, p. 13.

56 Ms Mary Walker, Chair, Alternative Dispute Resolution Committee, Federal Litigation and Dispute Resolution Section, Law Council, *Proof Committee Hansard*, 21 March 2019, p. 13.

57 Ms Walker, Law Council, *Proof Committee Hansard*, 21 March 2019, p. 13.

steps—as they are obligated to do under their own codes of practice—to offer assistance to people in financial difficulty'.[58]

2.46 Mr Brody opined that a system need to be created 'where people are pushed into a fair dispute resolution process to resolve [the dispute] before it escalates to repossession'.[59] Mr Brody suggested how and at what point dispute resolution could be offered:

> I think that any time any credit provider is using a court process to recover debt—it doesn't really matter what sort of debt it is—they should be required to inform the customer of their right to go to the ombudsman service. But, more than that, I think the court should be creating a process to facilitate that being transferred to that system. At the moment, of course, credit providers are required to inform people, but people tend not to read everything. So I think it needs a more interventionist approach, which would mean the court could actually assist. That would benefit the courts as well. They have enough cases as it is. They would probably prefer that matters not proceed through the courts. They could take an interventionist role to make sure that before a case goes too far down the court pathway it is stayed and referred to somewhere like AFCA to be resolved, if it's possible to resolve it, before it advances to any sort of court process.[60]

The legal assistance and financial counselling sectors

2.47 The committee heard from the Law Council that the legal assistance and financial counselling sectors provide assistance to people engaged in disputes with financial service providers in a range of circumstances:

> Financial counsellors, community legal centres and legal aid services, and often pro bono services provided by law firms, work incredibly collaboratively to try to cover the field of legal assistance to the extent that we can. Often that requires us to match the level of service with the need of the consumer. For example, it might be that, if the matter is simply that a person is in temporary hardship and they need a temporary arrangement, a financial counsellor would be best placed to do that. I guess there's a range in the level of assistance someone might need. For example, perhaps advice is sufficient. In the cases that I deal with as a legal aid solicitor, we're dealing with vulnerable clients who will require ongoing representation much of the time. To turn to the small business question, there is certainly a distinct lack of assistance available for small business. There's no question about that. To some extent advice is able to be provided by financial counsellors, particularly where they're sole traders. Legal aid does that on occasion. But ongoing representation is not available.[61]

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58 Mr Gerard Brody, Chief Executive Officer, CALC, *Proof Committee Hansard*, 21 March 2019, p. 45.

59 Mr Brody, *Proof Committee Hansard*, 21 March 2019, p. 45.

60 Mr Brody, *Proof Committee Hansard*, 21 March 2019, p. 46.

61 Ms Doran, Law Council, *Proof Committee Hansard*, 21 March 2019, pp. 9–10.

2.48 As noted by Legal Aid NSW, some disputes are best resolved through the court system, and for that reason, 'readily available legal assistance services are critical'.[62] However, the committee heard that many consumers are unable to access this legal assistance, creating 'real gaps in access to justice'.[63] CALC advised the committee that this is particularly true for the those consumers who cannot afford to pay for their own lawyers, but are too wealthy to qualify for legal assistance—that is, the 'missing middle' of consumers who have disputes with financial service providers.[64]

2.49 The strain on the legal assistance sector was highlighted in evidence to the committee from Ms Walker of the Law Council. Ms Walker discussed one of the significant findings of the Law Council's 2018 Justice Project, namely that 'only a small number—less than three per cent—of means-tested legal aid grants for legal representation and dispute resolution in 2016-17 were for civil law matters'.[65] The Law Council informed the committee that:

> This places a notable burden on the broader legal assistance sector, particularly on chronically under-resourced community legal centres, which are left to address the void of legal assistance services for civil law matters.[66]

2.50 Many submitters to this inquiry referred to the evidence presented by the National Association of Community Legal Centres (NACLC) and FCA in their joint submission to the Royal Commission.[67] In that submission, NACLC and FCA outlined the levels of demand for legal and financial counselling services with respect to the resolution of financial disputes. In respect of the demand for legal services, that the NACLC and FCA estimated that in 2018:

> …at least 6.4% of the population (aged 15 or over), around 1.2 million people, will have experienced a credit or debt legal issue in a 12 month period. (These figures would be higher if they included insurance matters.) A conservative estimate would suggest at least 20% of the group that experienced a credit or debt legal issue - 240,000 people a year - would be financially disadvantaged and therefore need access to free legal information and/or advice.[68]

2.51 In respect of the demand for financial counselling services, it was noted that:

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62 Legal Aid NSW, *Submission 44*, p. 7.

63 Mr Brody, *Proof Committee Hansard*, 21 March 2019, p. 45.

64 Mr Brody, *Proof Committee Hansard*, 21 March 2019, p. 45.

65 Ms Walker, Law Council, *Proof Committee Hansard*, 21 March 2019, p. 8.

66 Ms Walker, Law Council, *Proof Committee Hansard*, 21 March 2019, p. 8.

67 See, for example, Consumer Credit Law Centre SA, *Submission 49*, p. 6; CCLSWA, *Submission 21*, p. 17.

68 National Association of Community Legal Centres (NACLC) and FCA, *Submission to the Royal Commission*, p. 6 (citations omitted).

> Community based financial counsellors assist approximately 120,000 clients a year, and the National Debt Helpline receives 170,000 calls a year, and struggles to keep pace with this demand. Waiting times for financial counselling are frequently up to four weeks, and many services have full waiting lists.[69]

2.52 NACLC and FCA therefore called for 'funding of $157 million per annum to create a properly funded network of community financial counselling and community legal services'.[70] This would equate to '$1 million for the National Debt Helpline, $130 million for 1,000 financial counsellors, and $26 million for an additional 200 community financial service lawyers located across Australia'.[71]

2.53 Many submitters to this inquiry also wrote in support of NACLC and FCA's call for specific funding for the legal assistance and financial counselling sectors,[72] and some submitters made their own recommendations with respect to funding for CLCs and financial counsellors. For example, CALC recommended:

> …there be a substantial injection into the resourcing of financial counselling and community legal services to assist with disputes in the finance sector, and for this to be paid for through an industry levy.[73]

2.54 A large number of submitters also recommended increased, secure and predictable funding to the broader legal assistance sector, as well as to financial counselling services.[74] For example, Women's Legal Service Victoria recommended that the Australian government also 'resource Legal Aid Commissions to broaden availability of funding for priority clients to pursue small property matters, including joint debt disputes'.[75]

Small business

2.55 The committee heard evidence that there are gaps in the provision of legal assistance for small business.

2.56 For example, Legal Aid NSW informed the committee that Legal Aid Commissions focus primarily on consumers, rather than farm disputes or small business disputes.[76] However, at times Legal Aid has had to address business issues that are tied up with consumer issues, such as when an older person is a guarantor for a business loan:

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69 NACLC and FCA, *Submission to the Royal Commission*, p. 5 (citations omitted).

70 NACLC and FCA, *Submission to the Royal Commission*, p. 2.

71 NACLC and FCA, *Submission to the Royal Commission*, p. 2.

72 See, for example, Consumer Credit Law Centre SA, *Submission 49*, p. 6; CCLSWA, *Submission 21*, p. 17.

73 CALC, *Submission 29*, p. 23.

74 See, for example, Consumer Credit Law Centre SA, *Submission 49*, p. 6; Law Council, *Submission 56*, p. 10.

75 Women's Legal Service Victoria, *Submission 50*, p. 7.

76 Ms Beiglari, Legal Aid NSW, *Proof Committee Hansard*, 21 March 2019, p. 17.

> The current state of play is that we have different scopes of assistance that we can provide that have different guidelines attached to them. So you could get advice for free from a Legal Aid service in respect of that matter, and you might be able to get small scopes of assistance like contacting the bank to try to advocate an outcome. But, if you were to be represented in court or if you were to be represented in AFCA, you would need a larger scope of assistance from Legal Aid.[77]

2.57 The Law Council identified that there exists a 'significant gap' in legal assistance for small business, as they have 'a very different set of legal problems and a very specific need for legal assistance'.[78] The Law Council considered that small businesses 'would certainly benefit from specialised legal services'.[79]

Resolving disputes through AFCA

2.58 Generally, submitters and witnesses welcomed the establishment of AFCA, and cautioned that as the statutory authority had only been in operation for a short time, its efficiency and effectiveness cannot yet be accurately evaluated.[80]

2.59 However, other submitters also highlighted shortcomings with AFCA, and suggested some improvements to its operations. This section will address the suggested improvements most commonly raised by submitters and witnesses.

The accessibility and appropriateness of AFCA

2.60 AFCA addresses the statutory requirement of accessibility[81] in two ways: first by increasing awareness of its existence; and secondly by making its service easy to use.

2.61 In its submission, AFCA outlined the work it undertakes with respect to accessibility,[82] such as working with the following key stakeholders as part of its outreach program:

> …financial counsellors, community legal centres and financial rights centres,…vulnerable and disadvantaged groups including culturally and linguistically diverse communities, those experiencing family violence, elder abuse or socio-economic disadvantage and Aboriginal and Torres Strait Islander communities.[83]

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77 Ms Beiglari, Legal Aid NSW, *Proof Committee Hansard*, 21 March 2019, p. 17.

78 Ms Doran, Law Council, *Proof Committee Hansard*, 21 March 2019, p. 10.

79 Ms Doran, Law Council, *Proof Committee Hansard*, 21 March 2019, p. 10.

80 See, for example, ASBFEO, *Submission 13*, p. 1; ABA, *Submission 43*, p. 3; Law Council, *Submission 56*, pp. 11–13.

81 Imposed upon it by the *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act* 2018, Sch 1, pt, 1, it. 2, para. 1050(4)(a).

82 AFCA, *Submission 41*, pp. 11–13.

83 AFCA, *Submission 41*, pp. 10–11.

2.62 In its submission, AFCA also stated that it ensures there is ease of access to its service for complainants: its 'processes aim for a minimum of formality, with regular phone contact with complainants and financial firms and appropriate flexibility to consider individual circumstances that arise'.[84]

2.63 Legal Aid NSW spoke favourably of AFCA, which it considers 'the most appropriate, fair and efficient way for Australian consumers to resolve their dispute' in 'the vast majority of cases':

> AFCA is a free and independent forum which is accessible. Disputes are resolved on the papers—that is, via telephone, email or letter—which is of great benefit to regionally based clients. AFCA can make a decision based on what's fair in all the circumstances, and the strict rules of evidence do not apply to this forum. AFCA also reports to the regulator about systemic issues that are emerging, and it has a consumer liaison group which can also report systemic issues. AFCA can conduct systemic issues investigations where appropriate. For these reasons, we consider AFCA to be the most appropriate and accessible forum for resolving disputes.[85]

2.64 Although supporting the establishment of AFCA, CCLSWA suggested that AFCA is 'operating within limitations not optimum to consumer outcomes' and advocated for the expansion of AFCA's role and resources.[86]

2.65 In his evidence to the committee, Mr Locke conceded that:

> …a lot more needs to be done to make sure that we are a more accessible service, particularly to communities who have traditionally not used AFCA, because of language needs, health needs, cultural backgrounds or other vulnerabilities.[87]

Membership of AFCA

2.66 Many submitters to the inquiry advocated for the expansion of AFCA's membership, the existing membership resulting in the reduction of access to justice for customers of firms that are not members of AFCA.[88]

2.67 Mr Brody expanded on this issue in his evidence to the committee:

> …debt management firms, debt agreement administrators and buy-now pay-later firms are not required to provide their customers access to dispute resolution through AFCA. Our caseworkers see the harm caused by these financial service providers and a lack of avenues to resolve disputes when they arise.[89]

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84 AFCA, *Submission 41*, p. 12.

85 Ms Beiglari, Legal Aid NSW, *Proof Committee Hansard*, 21 March 2019, p. 15.

86 CCLSWA, *Submission 21*, p. 13.

87 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 52.

88 CALC, *Submission 29*, p. 10. CALC had a number of other criticisms of AFCA, outlined in its submission at pages 10–17.

89 Mr Brody, CALC, *Proof Committee Hansard*, 21 March 2019, p. 41.

2.68 CALC recommended that debt management firms, registered Debt Agreement Administrators, 'buy now pay later' providers, FinTechs and emerging players, and small business lenders should all be required to become members of AFCA.[90]

2.69 CCLSWA also submitted that 'small business lenders should be required to be a member of AFCA before being able to provide credit to small business borrowers',[91] a recommendation also made by the FCA.[92] CCLSWA considered that such a change 'would provide small businesses and guarantors for small business loans an [alternative] avenue for redress that is not currently available to consumers'.[93]

2.70 In its submission to the committee, ASBFEO proffered that '[a]ll providers of financial services and third parties engaged by providers should be required to have an external dispute resolution service', namely, AFCA.[94]

2.71 In respect of third party membership of AFCA, Maurice Blackburn referred specifically to the professional indemnity insurers of financial service providers, recommending that they, too become members:

> [P]rofessional indemnity insurers [for financial service providers] should be members of AFCA so as to be subject to its determinations. That would be consistent the common law doctrine of 'direct recourse' and the statutory regimes which enable a claimant to look beyond the insured wrongdoer and seek recovery directly from the relevant professional indemnity insurer…[95]

2.72 Mr Locke acknowledged the existence of 'clear regulatory gaps' in AFCA's membership which 'need to be addressed', reasoning that:

> …by requiring all of these firms and providers to be members of AFCA, and also having a proper licensing and regulatory regime in respect of some of these unlicensed parts of the sector, much greater protections could be provided to consumers and small businesses.[96]

2.73 Further, in response to a question on notice about the recommendation made by Maurice Blackburn, AFCA noted that professional indemnity insurers are required by section 912A of the Corporations Act 'to be members of AFCA if they hold a financial services licence which enables them to offer products and services to retail clients'.[97] AFCA noted that for those professional indemnity insurers that do not hold a licence, this is 'usually because it is limited to wholesale clients'.[98] AFCA informed

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90 CALC, *Submission 29*, p. 11—see Recommendation 10.

91 CCLSWA, *Submission 21*, p. 13.

92 FCA, *Submission 45*, p. 5.

93 CCLSWA, *Submission 21*, p. 14.

94 ASBFEO, *Submission 13*, p. 2.

95 Maurice Blackburn, *Submission 47*, p. 13.

96 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 51.

97 AFCA, answers to questions on notice, 21 March 2019 (received 28 March 2019), p. 4.

98 AFCA, answers to questions on notice, 21 March 2019 (received 28 March 2019), p. 4.

the committee that any changes to membership 'would require a change to the operation of the Corporations Act as well as to the AFCA Rules', but considered that 'it would be appropriate for this to reviewed'.[99]

Eligibility criteria and compensation thresholds

2.74 Many submitters suggested that AFCA's eligibility criteria and its powers to award compensation could be expanded to ensure access to justice for a greater number of consumers. For example, Legal Aid Queensland observed that 'the current AFCA jurisdictional caps may exclude many farmers'.[100]

2.75 Other submitters objected to an increase in these thresholds. For example, the Customer Owned Banking Association (COBA) expressed concern with expanded eligibility criteria and compensation thresholds, warning that 'it is important for any deliberation on changing these to be undertaken with a careful assessment of the potential impact on stakeholders'.[101] COBA argued that:

> …increasing AFCA's eligibility criteria and compensation thresholds may inadvertently lead to higher professional indemnity insurance premiums (and/or excesses) or higher contingent funding requirements for financial firms, including COBA member ADIs.
>
> The financial impact associated with such operational cost increases would add to the regulatory compliance burden that weighs more heavily on smaller players in the market than major banks due to a high fixed costs component. This handicaps the capacity of challenger banking institutions to grow and expand into new markets and hence reduces competitive pressure on major banks. High regulatory costs ultimately hurt consumers because resources are diverted away from investment in product innovation, better service and better pricing.
>
> Any increase in AFCA's eligibility criteria and compensation thresholds may also operate to expand AFCA's remit and inadvertently move away from the original intent of EDR as a mechanism for those without the financial means to pursue a claim through the court process.[102]

2.76 Table 2.1 sets out AFCA's eligibility criteria and compensation thresholds.

99 AFCA, answers to questions on notice, 21 March 2019 (received 28 March 2019), p. 4.

100 Legal Aid Queensland, *Submission 8*, p. 6.

101 Customer Owned Banking Association (COBA), *Submission 27*, p. 2.

102 COBA, *Submission 27*, p. 2.

Table 2.1 Monetary limits—eligibility criteria and compensation

	Row	Type of claim					Compen-sation amount limit per claim	Monetary restriction on AFCA's jurisdiction
Claim for direct financial loss	1	**Income Stream Insurance** Claim on a Life Insurance Policy or a General Insurance Policy dealing with income stream risk or advice about such a contract. If the claim is in excess of this monthly limit, the monthly limit will apply unless: • the total amount payable under the policy can be calculated with certainty by reference to the expiry date of the policy and/or age of the insured; and • that total amount is less than the amount specified in row 6. If this is the case, then the limit will be the amount in row 6.					$13,400 per month	Amount claimed by Complainant must not exceed $1 million
	2	**General Insurance Broking** Claim against a General Insurance Broker except where the claim solely concerns its conduct in relation to a Life Insurance Policy (in which case row 1 or 6 applies, as the case may be).					$250,000	Amount claimed by Complainant must not exceed $1 million
	3	**Uninsured Motor Vehicle** Claim under another person's Motor Vehicle Insurance Product for property damage to an Uninsured Motor Vehicle caused by a driver of the insured motor vehicle – see B.2.1 f)(i)					$15,000	Amount claimed by Complainant must not exceed $1 million
	4	Credit Facility	Claim arising from a credit facility provided to a Small Business or Primary Producer – see C.1.2e and C.1.3b	by a borrower	of a Small Business loan		$1 million	Credit facility must not exceed $5 million
					of a Primary Producer loan		$2 million	
				by a guarantor to set aside a guarantee supported by security over	the guarantor's principal place of residence		unlimited	Credit facility must not exceed $5 million
					other security	for a Small Business loan	$1 million	Credit facility must not exceed $5 million
						for a Primary Producer loan	$2 million	
	5		Claim arising from a credit facility that was provided to someone other than a Small Business or Primary Producer	by a borrower			$500,000	Amount claimed by Complainant must not exceed $1 million
				by a guarantor to set aside a guarantee supported by security over	the guarantor's principal place of residence – see C.1.2e		unlimited	unlimited
					other security		$500,000	Amount claimed by Complainant must not exceed $1 million
	6	**All other claims (excluding Superannuation Complaints)** In any other circumstance by any Complainant (whether or not a Small Business or Primary Producer)					$500,000	Amount claimed by Complainant must not exceed $1 million
	7	Claim for indirect financial loss					$5,000	not applicable
	8	Claim for non-financial loss					$5,000	not applicable

Source: AFCA, *Operational Guidelines to the Rules*, p. 189.

Compensation

2.77 Although '[t]he compensation cap has increased by more than threefold in the last decade',[103] the majority of submitters who addressed this issue advocated for an increase in AFCA's compensation caps.

2.78 For example, CALC considered that an increase in the compensation caps:

> …will incentivise all [financial service providers] to act appropriately in the first place, and resolve customers complaints in a timely manner, which should reduce the number of AFCA complaints over time.[104]

2.79 In respect of AFCA's existing sub-limits on compensation, which it submitted are 'too low', CALC referred to the findings of the Royal Commission:

> The Banking Royal Commission revealed the stress, anxiety, and hardship caused by irresponsible loans. Despite these impacts, AFCA can only award $5000 compensation.
>
> Increasing these limits will incentivise all [financial service providers] to act appropriately in the first place, and resolve customers complaints in a timely manner, which should reduce the number of AFCA complaints over time.[105]

2.80 Both CALC and the Financial Rights Legal Centre (FRLC) proposed the following recommendations in respect of AFCA's compensation scheme:

Table 2.2 Proposed caps for AFCA compensation

Limit/Cap	Recommendation
Claim limit (general)	$2 million
Compensation cap (general)	$2 million
Consequential financial loss	Remove existing sub-limit of $5,000 for 'indirect financial loss'. Empower AFCA to award fair and reasonable compensation within the general compensation cap
Consequential non-financial loss	Remove existing sub-limit of $5,000 for non-financial loss. Empower scheme to award fair and reasonable compensation within the general compensation cap
Life insurance claims	No cap (alternatively, include within general compensation cap)
General insurance broking	Remove existing sub-limit of $250,000 and include within general compensation cap

Source: CALC, *Submission 29*, p. 13; FRLC, *Submission 42*, p. 2.

2.81 In its submission, Legal Aid NSW also supported an increase in compensation caps, including sub-limits; a position that was 'informed in particular by our casework with victims of disasters who are making home insurance claims'.[106]

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103 Association of Financial Advisors, *Submission 25*, p. 3.

104 CALC, *Submission 29*, p. 13.

105 CALC, *Submission 29*, p. 13.

106 Ms Beiglari, Legal Aid NSW, *Proof Committee Hansard*, 21 March 2019, p. 19.

2.82 In response to questions on notice, AFCA conceded that its 'compensation caps for non-financial loss and indirect loss are probably too low and need to be reconsidered', and that ' there are inconsistencies across the product lines'.[107] In terms of changes to the compensation caps, AFCA recommended 'the removal of the monthly Income Protection limit', but noted that precise caps are 'a matter for Government to determine'.[108]

Eligibility criteria

2.83 As seen in the table above, CALC and the FRLC also recommended increasing the threshold for eligibility criteria.

2.84 Further, FCA recommended enabling AFCA to consider disputes where the financial service provider has obtained a default judgment in court; removing the two-year limitation period on an IDR dispute; and removing AFCA Rule C.2.2.(d), which excludes complaints that are 'lacking in substance'.[109]

2.85 Other submitters also recommended changes to AFCA's eligibility criteria. For example, Dr Smith of AFCA outlined the practical limitations of the existing eligibility criteria thresholds:

> There have been many conversations around the compensation caps, for example, in relation to life insurance matters. We can see that the cap related to monthly income protection insurance, for example, is $13,400 per month for that stream of products. We have had only two that have been outside that limit in their time at AFCA...
>
> At the moment we have one complaint we are looking at where the amount is about $1.25 million. The complainant has income protection cover and that started on 3 October 2015. The amount of benefit he is entitled to receive each month would mean that currently his dispute stands at $882,954. However, that accumulates every month, so, if we extrapolate it out, based on those amounts his claim will be worth $2.25 million by August 2023, when he turns 65. So, indeed, the $13,400 cap is quite limiting and even the $1 million cap does preclude some people who may even be on the average monthly earnings from raising and then pursuing their claim before AFCA.[110]

2.86 The committee also heard about other financial disputes that may exceed the $500 000 cap:

> If we also look at financial advice disputes that we see and assess, there are many related to self-managed superannuation fund advice, for example, and investment in property. There are also many who are moving towards retirement who may have investments that are well over that $500,000. In remediation programs that we've conducted with financial firms, those caps

107 AFCA, answers to questions on notice, 21 March 2019 (received 28 March 2019), p. 8.

108 AFCA, answers to questions on notice, 21 March 2019 (received 28 March 2019), p. 8.

109 FCA, *Submission 45*, pp. 14–15.

110 Dr Smith, AFCA, *Proof Committee Hansard*, 21 March 2019, pp. 52–53.

> are usually waived, and, whilst we haven't seen many matters that have been outside of our terms of reference in relation to the caps, we do feel that might be because consumers are self-selecting. They know what the cap is and, therefore, they don't come to AFCA.[111]

2.87 In his evidence to the committee, Mr Locke noted that eligibility criteria compensation thresholds were put in place before the Royal Commission, that is, before 'the nature and extent of some of the issues that we've been exposed to through that inquiry' were understood.[112] Mr Locke suggested that 'there could be fresh consideration of those levels now'.[113]

A compensation scheme of last resort

2.88 As discussed in chapter 1, the review of the financial system external dispute resolution and complaints framework (Ramsay Review) recommended the establishment of a CSLR.[114]

2.89 The Royal Commission recommended the implementation of these recommendations:

> The three principal recommendations to establish a compensation scheme of last resort made by the panel appointed by government to review external dispute and complaints arrangements made in its supplementary final report should be carried into effect.[115]

2.90 The Australian government accepted the recommendation to establish a CSLR, noting that it would establish a 'forward-looking' scheme within AFCA.[116] The government explained that it would also:

> …require AFCA to consider disputes dating back to 1 January 2008 — the period looked at by the Royal Commission, if the dispute falls within AFCA's thresholds as they stand today.[117]

2.91 The committee heard that this scheme was too limited. For example, Maurice Blackburn submitted that '[t]he CSLR should also cover those consumers who made complaints to one of AFCA's predecessors', but that were undetermined due to the

111 Dr Smith, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 53.

112 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 51.

113 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 51.

114 Review of the financial system external dispute resolution and complaints framework (Ramsay Review), *Supplementary Final Report*, September 2017, pp. 13–15.

115 Royal Commission, *Final Report*, 2018, p. 41 at Recommendation 7.1.

116 Australian government, *Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, February 2019, p. 36.

117 Australian government, *Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, February 2019, p. 37.

insolvency of the financial services provider, such as those complaints lodged with the former Credit and Investments Ombudsman.[118]

2.92 In considering the establishment of a retrospective compensation scheme, Mr Locke considered that 'there are challenges if you are reopening matters that perhaps have gone to court or perhaps have been dealt with through the ombudsman scheme'.[119] However, Mr Locke noted that, fundamentally, the starting point should be 'what is fair for consumers…If things were got wrong then I think they should be set right'.[120]

***

2.93 The following chapter sets out the committee's view in respect of changes that can be made to the justice system to ensure that, in future, consumers and small businesses engaged in disputes with financial service providers are able to exercise their legal rights.

118 Maurice Blackburn, *Submission 47*, p. 12.

119 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 59.

120 Mr Locke, AFCA, *Proof Committee Hansard*, 21 March 2019, p. 59.