The Senate

Legal and Constitutional Affairs References Committee

Resolution of disputes with financial service providers within the justice system

April 2019

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3.7 The committee recommends that the Australian Government establish an industry levy, to apply to the largest financial institutions on the ASX, that would raise funds for the legal assistance and financial counselling sectors to enable these sectors to provide assistance to consumers and small businesses that have disputes with financial service providers.

Recommendation 2

3.9 The committee recommends that the Australian Government improve access to legal assistance services for small businesses.

Recommendation 3

3.13 The committee recommends that the Australian Government require Australian Credit Licence holders to comply with model litigant obligations throughout the internal and external dispute resolution processes, as well as any proceedings in the courts.

Recommendation 4

3.17 The committee recommends that the Australian Government immediately implement recommendation 4.11 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Recommendation 5

3.20 The committee recommends that the Australian Government amend the *Bankruptcy Act 1966* to prevent causes of action relating to consumer credit protections from vesting in the trustee in bankruptcy.

Recommendation 6

3.24 The committee recommends that the Australian Government improve home repossession processes by requiring that creditors engage with customers at an earlier stage. This could involve:

- **(a) establishing a new mediation section at the Australian Financial Complaints Authority (AFCA) to conduct farm debt mediations, and a new bank-initiated mediation stream for consumer and small business loans;**
- **(b) requiring banks to initiate a mediation through this new AFCA process before bringing repossession proceedings against a family home; and**

(c) requiring banks to give preference and due consideration to reasonable proposals put forward by customers to restructure debts, pay down parts of debts and/or trade out of temporary financial difficulty when a customer is in financial difficulty and a loan secured by or guaranteed by a family home is in default.

Recommendation 7

3.33 The committee recommends that the Australian Government:

- **increase the current compensation cap available to consumers through the Australian Financial Complaints Authority (AFCA) to $2 million, including for credit, insurance and financial advice disputes; and**
- **remove the sub-limit on compensation available to consumers through AFCA for indirect financial loss and for non-financial loss.**

Recommendation 8

3.37 The committee recommends that the Australian Government extend the membership of the Australian Financial Complaints Authority to:

- **debt management firms;**
- **registered Debt Agreement Administrators;**
- **'buy now pay later' providers;**
- **FinTechs and emerging players;**
- **small business lenders; and**
- **professional indemnity insurers of financial service providers.**

Recommendation 9

3.41 The committee recommends that the Australian Government consider extending the loan facility limits for small businesses and farmers who wish to make a claim through the Australian Financial Complaints Authority (AFCA), in consultation with AFCA and other relevant stakeholders.

Recommendation 10

3.45 The committee recommends the establishment of a retrospective compensation scheme independent of the Australian Financial Complaints Authority to allow victims of alleged misconduct by banks who received a past external dispute resolution determination or court judgment that was manifestly unjust to apply to the scheme to have the matter reviewed with the consent of the bank.

Chapter 1

Introduction and background

1.1 On 14 February 2019, the Senate referred the issue of the resolution of disputes with financial service providers within the justice system to the Legal and Constitutional Affairs References Committee for inquiry and report by 8 April 2019. The terms of reference for the inquiry are as follows:

> The ability of consumers and small businesses to exercise their legal rights through the justice system, and whether there are fair, affordable and appropriate resolution processes to resolve disputes with financial service providers, in particular the big four banks considering:
>
> a. whether the way in which banks and other financial service providers have used the legal system to resolve disputes with consumers and small businesses has reflected fairness and proportionality, including:
>
> i. whether banks and other financial service providers have used the legal system to pressure customers into accepting settlements that did not reflect their legal rights,
>
> ii. whether banks and other financial service providers have pursued legal claims against customers despite being aware of misconduct by their own officers or employees that may mitigate those claims, and
>
> iii. whether banks generally have behaved in a way that meets community standards when dealing with consumers trying to exercise their legal rights;
>
> b. the accessibility and appropriateness of the court system as a forum to resolve these disputes fairly, including:
>
> i. the ability of people in conflict with a large financial institution to attain affordable, quality legal advice and representation,
>
> ii. the cost of legal representation and court fees,
>
> iii. costs risks of unsuccessful litigation, and
>
> iv. the experience of participants in a court process who appear unrepresented;
>
> c. the accessibility and appropriateness of the Australian Financial Complaints Authority (AFCA) as an alternative forum for resolving disputes including:
>
> i. whether the eligibility criteria and compensation thresholds for AFCA warrant change,
>
> ii. whether AFCA has the powers and resources it needs,
>
> iii. whether AFCA faces proper accountability measures, and
>
> iv. whether enhancement to their test case procedures, or other expansions to AFCA's role in law reform, is warranted;

d. the accessibility of community legal centre advice relating to financial matters; and

e. any other related matters.[1]

Conduct of the inquiry

1.2 Details of the inquiry were advertised on the committee's website, including a call for submissions to be received by 1 March 2019. The committee also wrote directly to a number of individuals and organisations inviting them to make submissions.

1.3 The committee received 153 submissions, including 23 accepted in confidence. Public submissions are available on the committee's website. A list of all submissions received is at appendix 1 of this report.

1.4 The committee held a public hearing in Sydney on 21 March 2019. A full list of all witnesses who gave evidence to the committee at this hearing is at appendix 2 of this report.

Structure of the report

1.5 There are three chapters in this report:

- This chapter outlines the administrative details of the inquiry, and provides an overview of previous inquiries relevant to the terms of reference of the committee's current inquiry;
- Chapter 2 addresses the issues raised with the committee during the inquiry; and
- Chapter 3 sets out the committee's view in respect of these issues.

Previous inquiries into financial disputes

1.6 There have been a series of recent reviews and inquiries into the financial system, including by Senate committees.[2] However, none of these inquiries have focused exclusively on the particular issue of consumers and small businesses exercising their legal rights when resolving disputes with financial service providers.

1.7 There are two recent independent inquiries that provide significant context to this Senate inquiry: the review of the financial system external dispute resolution and complaints framework, chaired by Professor Ian Ramsey (the Ramsay Review), which completed its work in 2017; and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission), which tabled its final report in the Parliament on 4 February 2019.

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1 *Journals of the Senate*, No. 140, 14 February 2019, p. 4673.

2 See, for example Phil Khoury, *Independent Review of the Code of Banking Practice*, 2017; House of Representatives Economics Committee, *Review of the Four Major Banks*, 2016–present; Senate Economics References Committee, *Scrutiny of Financial Advice*, 2017.

The review of the financial system external dispute resolution and complaints framework

1.8 The Ramsay Review was the first comprehensive review of the external dispute resolution framework for the financial system.

1.9 The terms of reference of the review were released on 8 August 2016, and subsequently amended by the government on 2 February 2017 to consider a compensation scheme of last resort (CSLR), 'and to consider the merits and issues involved in providing access to redress for past disputes'.[3] The final report of the review was published in April 2017, and contained 11 recommendations.

1.10 The final report discussed two forms of alternative dispute resolution—tribunals and ombudsman schemes. It was identified that, when compared with ombudsman schemes, tribunals can be less accessible, less flexible and dynamic, can apply a 'black letter law' approach, and can be focused on specific decisions rather than systemic change.[4]

1.11 In contrast, in providing an alternative to the judicial system, ombudsman schemes were said to offer a number of benefits to complainants, such as a simple process, an examination of non-legal issues, a capacity to investigate systemic issues, and the promotion of access to justice.[5]

1.12 The final report discussed the merits of the then three external dispute resolution (EDR) bodies in the financial system framework—the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO), and the Superannuation Complaints Tribunal (SCT).

1.13 In its report, the review panel identified that the current arrangements for superannuation disputes are in need of fundamental reform through an industry-based EDR body.[6] The panel's 'central recommendation' was therefore 'the establishment of a new single EDR body for all financial disputes (including superannuation disputes) to replace FOS, CIO and SCT'.[7]

1.14 A Supplementary Final Report was published in September 2017, and went directly to the issue of a CSLR. The Supplementary Final Report made four recommendations on the establishment of a 'limited and carefully targeted' CSLR 'to cover future unpaid compensation in parts of the financial services sector where there is evidence of a significant problem of compensation not being paid'.[8]

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3 Review of the financial system external dispute resolution and complaints framework (Ramsay Review), *Final Report*, April 2017, p. 3.

4 Ramsay Review, *Final Report*, pp. 27–28.

5 Ramsay Review, *Final Report*, pp. 30–31.

6 Ramsay Review, *Final Report*, p. 92.

7 Ramsay Review, *Final Report*, p. 91.

8 Ramsay Review, *Supplementary Final Report*, September 2017, p. v.

1.15 On 14 February 2018, as a result of the recommendations arising from the Ramsay Review, the Parliament passed legislation to establish the Australian Financial Complaints Authority (AFCA), a body that would:

> …provide a one-stop shop to ensure consumers get a fair deal in resolving disputes with banks, insurers, super funds and small amount credit providers, without the expense, inconvenience, and trauma associated with going to court.[9]

1.16 AFCA commenced operations on 1 November 2018.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

1.17 The Royal Commission, led by Commissioner Kenneth Hayne, was established on 14 December 2017 to examine ten subjects of inquiry, set out in the terms of reference.[10]

1.18 The final report of the Royal Commission was tabled in the Parliament on 4 February 2019, and contained 76 recommendations.

1.19 One of the terms of reference of the Royal Commission was to examine whether any further changes to the legal framework 'are necessary to minimise the likelihood of misconduct by financial services entities in future (taking into account any law reforms announced by the Commonwealth Government)'.[11]

1.20 In its final report, the Royal Commission examined access to professional legal advice and financial counselling services. The report identified the 'asymmetry of knowledge and power between consumers and financial services entities',[12] and commented on the 'very valuable work' undertaken by the legal assistance sector and financial counselling services.[13] It was noted that legal advice and counselling services assisted claimants to identify that they had a financial dispute and engage with alternative dispute resolution processes.[14] It was also noted that 'the difference between the result the [consumer] ultimately achieved and the situation that they initially faced' prior to receiving legal assistance was often 'very large'.[15]

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9 The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services and the Hon. Craig Laundy MP, Minister for Small and Family Business, the Workplace and Deregulation, 'Consumers win as a one-stop-shop for financial complaints passes through parliament', *Media Release*, 14 February 2018.

10 See, Letters Patent, Register of Patents No. 52, 14 December 2017, p. 67.

11 Term of Reference (h)(i).

12 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), *Final Report*, 2018, p. 490.

13 Royal Commission, *Final Report*, 2018, p. 491.

14 Royal Commission, *Final Report*, 2018, pp. 490–491.

15 Royal Commission, *Final Report*, 2018, p. 491.

1.21 Commissioner Hayne considered the role of the legal assistance sector and financial counselling services to be 'complementary' to the recommendations in the report, designed to hold financial institutions to account.[16] Commissioner Hayne concluded that law reform and reform to practices of regulators and entities will not eliminate the need for legal advice or financial counselling services, 'though they will properly aim to reduce it'.[17] Commissioner Hayne considered that:

> …there will likely always be a clear need for disadvantaged consumers to be able to access financial and legal assistance in order to be able to deal with disputes with financial services entities with some chance of equality of arms.[18]

1.22 Although Commissioner Hayne acknowledged that '[t]he legal assistance sector and financial counselling services frequently struggle to meet demand', no specific recommendations were made in the final report about funding for these services. Rather, Commissioner Hayne commented on 'the desirability of predictable and stable funding for the legal assistance sector and financial counselling services', and suggested that there should be 'careful consideration' regarding the delivery of such funding.[19]

The role of AFCA in the resolution of financial disputes

1.23 AFCA is 'a free and independent alternative to the courts',[20] established pursuant to the *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (the AFCA Act) to replace the FOS, CIO and SCT.

1.24 The operational requirements of AFCA are outlined in the AFCA Act, as follows:

> (a) the complaints mechanism under the scheme is appropriately accessible to persons dissatisfied with members of the scheme; and
>
> (b) complaints against members of the scheme are resolved (including by making determinations relating to such complaints) in a way that is fair, efficient, timely and independent; and
>
> (c) appropriate expertise is available to deal with complaints; and
>
> (d) reasonable steps are taken to ensure compliance by members of the scheme with those determinations; and
>
> (e) under the scheme, determinations made by the operator of the scheme are:
>
> (i) binding on members of the scheme; but

16 Royal Commission, *Final Report*, 2018, p. 491.

17 Royal Commission, *Final Report*, 2018, p. 491.

18 Royal Commission, *Final Report*, 2018, pp. 491–492.

19 Royal Commission, *Final Report*, 2018, p. 483.

20 Australian Financial Complaints Authority (AFCA), *Submission 41*, p. 8.

(ii) not binding on complainants under the scheme; and

(f) for superannuation complaints, there are no limits on:

(i) the value of claims that may be made under the scheme; or

(ii) the value of remedies that may be determined under the scheme.[21]

1.25 The AFCA Act also implements 'an enhanced [internal dispute resolution] framework to deal with all consumer financial disputes about products and services provided by financial firms, including superannuation disputes'.[22]

1.26 AFCA's role, and issues of concern with the way in which AFCA is a means by which disputes with financial service providers can be resolved, will be examined in more detail in chapter 2.

***

1.27 The following chapter addresses the issues raised with the committee in respect of this inquiry.

21 *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (AFCA Act), s. 4, sch. 1, pt. 1, item 2, ss. 1051(4).

22 AFCA, *Enabling legislation*, https://www.afca.org.au/about-afca/rules-and-guidelines/enabling-legislation/ (accessed 14 March 2019).

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.
>
> 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.

Chapter 3

Committee view

3.1 This chapter sets out the committee's response to the evidence received and provides its recommendations.

Funding for the legal assistance and financial counselling sectors

3.2 The committee notes that although no recommendations were made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) in respect of funding for the legal assistance and financial counselling sectors, Commissioner Hayne identified an 'asymmetry of knowledge and power between consumers and financial services entities'.[1] Commissioner Hayne also identified the significance that assistance from these services can have in determining the outcome of a financial dispute.[2]

3.3 In light of the importance of legal assistance and financial counselling services, the committee is concerned by evidence suggesting current funding levels fall short of what is required to meet demand for these services. The committee is also concerned by evidence from consumers indicating they have had difficulty in accessing such services.

3.4 The committee considers there is a clear and pressing need to provide legal assistance and financial counselling services with more funding, and thereby go some way to providing consumers and small businesses with the assistance they need when they find themselves in a dispute with a financial service provider. This added funding would also serve to complement the implementation of the outcomes of the Royal Commission.

3.5 The committee is persuaded by the recommendations of the Consumer Action Law Centre (CALC) and Financial Counselling Australia that increased resourcing to the legal assistance and financial counselling sectors should come from an industry levy.

3.6 The committee considers that a levy is the most effective way to respond to the findings of the Royal Commission. Such a levy could apply to financial institutions that are in the top 100 companies on the ASX. This would include a number of banks which were the subject of complaints from individuals submitting to this inquiry.

Recommendation 1

3.7 The committee recommends that the Australian Government establish an industry levy, to apply to the largest financial institutions on the ASX, that would

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1 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), *Final Report*, February 2018, p. 490.

2 Royal Commission, *Final Report*, February 2018, p. 491.

raise funds for the legal assistance and financial counselling sectors to enable these sectors to provide assistance to consumers and small businesses that have disputes with financial service providers.

3.8 The committee agrees that there is a real gap in legal assistance for small businesses, and that based on the evidence to this inquiry, access to legal assistance services should also be improved for small businesses.

Recommendation 2

3.9 The committee recommends that the Australian Government improve access to legal assistance services for small businesses.

The conduct of financial service providers within the justice system

3.10 The committee was disappointed to learn that the Australian Banking Association (ABA) has not developed an industry position across all of its member banks in regard to ABA members acting as model litigants. The committee notes that the ABA considers this to be a matter for each individual institution.

3.11 The committee was also concerned by evidence of misuse of the justice system by financial service providers in the process of internal dispute resolution (IDR), external dispute resolution (EDR) and in the court system.

3.12 The committee acknowledges the overwhelming evidence received that supported banks acting as model litigants. The committee agrees with this evidence, and considers that Australian Credit Licence (ACL) holders should comply with model litigant obligations in all of their dealings with customers—that is, through IDR, EDR and in the court system.

Recommendation 3

3.13 The committee recommends that the Australian Government require Australian Credit Licence holders to comply with model litigant obligations throughout the internal and external dispute resolution processes, as well as any proceedings in the courts.

3.14 The committee agrees with evidence from the Australian Financial Complaints Authority (AFCA), set out in chapter 2, that the failure to provide documentation relevant to AFCA, or the provision of misleading information about the existence of such documents, is unacceptable.

3.15 The committee considers that Recommendation 4.11 of the Royal Commission should be implemented. That is, section 912A of the *Corporations Act 2001*:

> …should be amended to require that [Australian Financial Services Licence] 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.[3]

3 Royal Commission, *Final Report*, February 2018, p. 34.

3.16 The committee notes that the Australian Government agrees that an obligation should be placed on Australian Financial Service Licence holders 'to take reasonable steps' to cooperate with AFCA in the resolution of disputes, 'including making available to AFCA all relevant documents and records relating to the issues in dispute'.[4]

Recommendation 4

3.17 The committee recommends that the Australian Government immediately implement recommendation 4.11 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

3.18 The committee agrees with Maurice Blackburn Lawyers that the existing provisions of the *Bankruptcy Act 1966* (Bankruptcy Act) enable a 'perverse outcome' such that an irresponsible lender causing bankruptcy 'may have an interest in the cause or action against itself'.[5]

3.19 The committee considers that consumers should be able to pursue actions against irresponsible lenders who may have caused their bankruptcy, and that the Bankruptcy Act should be amended to preserve accrued rights to pursue action under the *National Consumer Credit Protection Act 2009*, and under the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001*, as property of the bankrupt that are quarantined from bankruptcy and do not vest in the Trustee in bankruptcy.

Recommendation 5

3.20 The committee recommends that the Australian Government amend the *Bankruptcy Act 1966* to prevent causes of action relating to consumer credit protections from vesting in the trustee in bankruptcy.

3.21 The committee was concerned to hear that some customers are forced into court proceedings for repossession of their homes without adequate regard to their personal circumstances, causing them extreme financial and personal hardship.

3.22 The committee agrees with evidence indicating that alternative dispute resolution, namely mediation, can help avoid costly and adversarial proceedings and lead to a fairer outcome for customers.

3.23 The committee considers that there are a number of steps that could be taken at an earlier stage in the repossession process, such as:

- establishing a new mediation section at AFCA to conduct farm debt mediations, and a new bank-initiated mediation stream for consumer and small business loans. This would be open to banks with customers whose cases the bank believes may end in repossession (for instance, where default notices are issued on loans secured against or guaranteed by family homes);

4 Australian Government, *Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, February 2019, p. 26.

5 Maurice Blackburn Lawyers, *Submission 47*, p. 9.

- requiring banks (through the *Banking Code of Practice* or legislation) to initiate a mediation through this new AFCA process before bringing repossession proceedings against a family home; and
- requiring banks (through the *Banking Code of Practice* or legislation) to give preference and due consideration to reasonable proposals put forward by customers to restructure debts, pay down parts of debts and/or trade out of temporary financial difficulty when a customer is in financial difficulty and a loan secured by or guaranteed by a family home is in default.

Recommendation 6

3.24 The committee recommends that the Australian Government improve home repossession processes by requiring that creditors engage with customers at an earlier stage. This could involve:

(a) establishing a new mediation section at the Australian Financial Complaints Authority (AFCA) to conduct farm debt mediations, and a new bank-initiated mediation stream for consumer and small business loans;

(b) requiring banks to initiate a mediation through this new AFCA process before bringing repossession proceedings against a family home; and

(c) requiring banks to give preference and due consideration to reasonable proposals put forward by customers to restructure debts, pay down parts of debts and/or trade out of temporary financial difficulty when a customer is in financial difficulty and a loan secured by or guaranteed by a family home is in default.

Changes to AFCA

3.25 The committee acknowledges that AFCA will be subject to an independent, statutory review after a period of 18 months from the commencement of its operation.[6]

3.26 The committee notes that the review will take into account 'feedback, provided by complainants under the AFCA scheme…relating to whether their complaints were resolved in a way that was fair, efficient, timely and independent',[7] and must include an examination of the appropriateness of limits on:

> (a) the value of claims that may be made under the AFCA scheme (within the meaning of Chapter 7 of the Corporations Act 2001 as amended by this Act); and
>
> (b) the value of remedies that may be determined under that scheme;

6 *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (AFCA Act), ss. 4(1).

7 AFCA Act, ss. 4(2).

in relation to disputes about credit facilities provided to primary production businesses, including agriculture, fisheries and forestry businesses.[8]

3.27 The committee supports the creation of AFCA, and is encouraged by AFCA's commitment shown during the inquiry to improving and ensuring access to justice, and its determination to understand structural problems in this regard.

3.28 However, as AFCA has itself suggested, some of the parameters in which it operates should be revised. The committee considers that some of these parameters can be revised now, rather than in 18 months.

3.29 First, the committee is concerned by the evidence received which suggests victims may not be able to access AFCA, or may not be able to receive adequate compensation for the financial and non-financial loss suffered at the hands of irresponsible financial service providers, or those that are acting illegally.

3.30 The committee agrees with CALC and the Financial Rights Legal Centre that the compensation cap for consumers and small businesses should be increased, and that compensation for non-financial loss should be considered and awarded within the compensation limit for financial loss.

3.31 The committee therefore considers that the compensation caps available for AFCA for consumers should be increased from $500 000 to $2 million, including in respect of credit, insurance and financial advice disputes.

3.32 Further, the committee considers that the sub-limits on indirect financial loss and for non-financial loss should be removed.

Recommendation 7

3.33 The committee recommends that the Australian Government:

- **increase the current compensation cap available to consumers through the Australian Financial Complaints Authority (AFCA) to $2 million, including for credit, insurance and financial advice disputes; and**
- **remove the sub-limit on compensation available to consumers through AFCA for indirect financial loss and for non-financial loss.**

3.34 Secondly, the committee agrees with evidence suggesting there are gaps in the membership of AFCA, which prevents access to justice for customers whose financial service providers are not members of AFCA.

3.35 To this end, the committee considers that the Australian Government must act urgently to remediate this issue, and extend the membership of AFCA to debt management firms, registered Debt Agreement Administrators, 'buy now pay later' providers, FinTechs and emerging players, small business lenders, and professional indemnity insurers of financial service providers.

3.36 The committee notes that in a recent report examining financial hardship, the Senate Economics References Committee recommended that all credit and debt

8 AFCA Act, ss. 4(3).

management, repair and negotiation firms that are not currently licensed by AFCA be required to become members of AFCA.[9]

Recommendation 8

3.37 The committee recommends that the Australian Government extend the membership of the Australian Financial Complaints Authority to:

- **debt management firms;**
- **registered Debt Agreement Administrators;**
- **'buy now pay later' providers;**
- **FinTechs and emerging players;**
- **small business lenders; and**
- **professional indemnity insurers of financial service providers.**

3.38 The committee is concerned by evidence suggesting that victims of irresponsible financial service providers, or victims of illegal activity by financial service providers, may not be able to access AFCA on the basis of AFCA's current eligibility criteria.

3.39 The committee notes that Mr David Locke of AFCA identified that the current eligibility criteria thresholds, like the compensation caps referred to in Recommendation 7 above, were put in place before the Royal Commission, and that he considered there could be a reconsideration of those thresholds on the basis of evidence presented to the Royal Commission.

3.40 The committee therefore considers that it is imperative that the eligibility criteria to make a claim through AFCA is extended, and that this extension is made in consultation with AFCA and other stakeholders, such as the Australian Small Business and Family Enterprise Ombudsman.

Recommendation 9

3.41 The committee recommends that the Australian Government consider extending the loan facility limits for small businesses and farmers who wish to make a claim through the Australian Financial Complaints Authority (AFCA), in consultation with AFCA and other relevant stakeholders.

Compensation

3.42 The committee is encouraged by the work undertaken by the Review of the financial system external dispute resolution and complaints framework and the Royal Commission in respect of the establishment of a compensation scheme of last resort.

3.43 The committee considers that banking victims must be provided with an opportunity to have their cases reheard, including in circumstances in which they may

9 Senate Economics Reference Committee, *Credit and financial services targeted at Australians at risk of financial hardship*, 22 February 2019, Recommendation 8.

have previously missed out on compensation owing to a flawed decision by an ombudsman, or an abuse of the court process by a financial service provider.

3.44 To that end, the committee would like to see the establishment of a retrospective compensation scheme, independent of AFCA, which would allow victims of alleged misconduct by banks who received in the past an external dispute resolution determination or court judgment that was manifestly unjust to apply to the scheme to have the matter reviewed with the consent of the bank.

Recommendation 10

3.45 The committee recommends the establishment of a retrospective compensation scheme independent of the Australian Financial Complaints Authority to allow victims of alleged misconduct by banks who received a past external dispute resolution determination or court judgment that was manifestly unjust to apply to the scheme to have the matter reviewed with the consent of the bank.

Senator the Hon Louise Pratt
Chair

Additional remarks from Government Senators

1.1 The Labor and Greens Political Party References inquiry into *The ability of consumers and small businesses to exercise their legal rights through the justice system, and whether there are fair, affordable and appropriate resolution processes to resolve disputes with financial service providers*, (the Inquiry) has attempted to duplicate the work the Hayne *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*[1] (the Royal Commission) but has done so without meaningful effect and without the resources and expertise available to the Royal Commission.

1.2 As with many politically-motivated Senate references inquiries, this one raised questions regarding the intent behind the reference, bearing in mind that reforms to the system have not had the chance to become operationally effective. Government Senators note that the Royal Commission was conducted by one of Australia's most eminent jurists, the Honourable Kenneth Madison Hayne AC QC, from 14 December 2017 and 1 February 2019. Seven (7) rounds of public hearings were held, each round consisting of approximately two weeks of hearings. 10,323 written submissions were received. The Royal Commission handed down its 530-page final report on 1 February 2019 and since then the Government has accepted—and has begun the process of applying—all 76 recommendations made in the final report. This References Committee Inquiry, by contrast, was conducted from 14 February 2019 to 8 April 2019, with only one public hearing and after receiving only 127 written submissions.

1.3 Government members of the committee endorse a collaborative approach to the resolution of disputes with, and the dispensation of grievances against, the financial services sector. Working towards outcomes that offer suitable protections to consumers and lenders alike, and that promote economic activity, growth and innovation should be the objective of all interested parties.

1.4 Government members of the committee make further remarks on the recommendations of the Majority Committee Report.

1.5 **Recommendation 1** calls on the Australian Government to *'establish an industry levy, to apply to the largest financial institutions on the ASX, that would raise funds for the legal assistance and financial counselling sectors to enable these sectors to provide assistance to consumers and small businesses that have disputes with financial service providers.'*

1.6 Paragraph 2.3(a) of the Australian Financial Complaints Authority (AFCA) constitution relevantly provides that:

> The Company's (AFCA's) income is to be derived from contributions made by Members in an amount and manner as determined by the Company.[2]

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1 February 2019, https://financialservices.royalcommission.gov.au/Pages/default.aspx

2 https://www.afca.org.au/about-afca/corporate-information/constitution/

1.7 The 'Members' section of the AFCA website provides that:

> All Australian financial services licensees, Australian credit licensees, authorised credit representatives and superannuation trustees are required to be a member of the Australian Financial Complaints Authority (AFCA) under their financial services licence conditions, in accordance with ASIC Regulatory Guide RG 165.
>
> Our members include banks, insurers, credit providers, financial advisers, debt collection agencies, superannuation trustees and many more. We have over 35,000 members across the country, most will never have a complaint lodged against them. For those that do, we offer fair, independent and effective solutions for financial disputes facilitated by professional and experienced staff. [3]

1.8 The 'What we do' page of the AFCA website provides that:

> Our role is to assist consumers and small businesses to reach agreements with financial firms about how[4] to resolve their complaints. We are impartial and independent. We do not act for either party to advocate their position. If a complaint does not resolve between the parties, we will decide an appropriate outcome.

1.9 Coalition members of the committee are satisfied that the financial sector (that is, 'all Australian financial services licensees, Australian credit licensees, authorised credit representatives and superannuation trustees'—as above) contributes substantially to the cost of dispute resolution through membership of AFCA. The scope of any further contributions that may be contemplated, and the services to which such contributions should be devoted, would require careful and consultative consideration.

1.10 Coalition members of the committee also note that Recommendation 1 is vague, particularly regarding the architecture of the proposed levy scheme. The recommendation is silent regarding the intended recipients of the funding that would be raised by the levy, the proposed criteria for assessing and making funding grants, and the proposed mechanism for distribution.

1.11 **Recommendation 2** recommends that *'the Australian Government improve access to legal assistance services for small businesses.'*

1.12 It should be noted that in the 2019-20 budget the Government delivered a baseline funding boost and guaranteed long-term financial commitments for frontline legal services. This included the announcement of the development of a single National Mechanism to deliver legal assistance funding.

1.13 Government members of the committee are conscious of the challenges faced by small businesses in court proceedings involving large financial institutions and agree with the sentiment of Recommendation 2. The recommendation is, however, as

3 https://www.afca.org.au/members/

4 https://www.afca.org.au/about-afca/

vague as Recommendation 1 in that it calls for a course of action without providing context, costing, meaning or any specificity.

1.14 **Recommendation 3** recommends that the Australian Government *'require Australian Credit Licence holders to comply with model litigant obligations throughout the internal and external dispute resolution processes, as well as any proceedings in the courts.'*

1.15 Government members of the committee agree with the sentiment of the recommendation, however, the Model Litigant Rules, or Model Litigant Obligations, are guidelines for how a government body ought behave before, during, and after litigation with another government body, a private company, or an individual. Application of the Model Litigant Rules or Model Litigant Obligation to non-government legal entities would require a re-assessment and adjustment of settled areas of the justice system, which re-assessment and adjustment was not canvassed in the conduct of the Inquiry or in the Inquiry report.

1.16 **Recommendation 4** calls on the Australian Government to *'immediately implement recommendation 4.11 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.'*

1.17 Recommendation 4.11 of the Royal Commission reads:

> 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.[5]

1.18 It is noted that the Government introduced and passed the *Treasury Laws Amendment (AFCA Cooperation) Regulations 2019* that implement recommendation 4.11 of the Royal Commission. As such this recommendation is unnecessary.

1.19 Indeed, in the Budget Speech on April 2, 2019 the Treasurer remarked:

> We also provide additional resources to our financial regulators following the Banking Royal Commission. This will strengthen the financial system and deliver better outcomes for all Australians.[6]

1.20 **Recommendation 5** recommends that the Australian Government *'amend the Bankruptcy Act 1966 to prevent causes of action relating to consumer credit protections from vesting in the trustee of bankruptcy.'*

1.21 Government members of the committee found the evidence presented to the Inquiry by Maurice Blackburn to be persuasive and would suggest that this issue be referred to the Attorney-General's Department for further inquiry and consideration, and that an advice be provided to Government on the implications of this evident ambiguity. The ambiguity in question relates to a bankrupt who pursues a cause of

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5 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report: Volume 1*, February 2019, p. 34.

6 The Hon Josh Frydenberg MP, the Treasurer, *Proof Hansard,* 2 April 2019, pp. 78–79.

action against an 'irresponsible lender' for contributing to or precipitating the bankruptcy. According to s116(2)(g) of the *Bankruptcy Act 1966* 'any right of the bankrupt to recover damages or compensation for personal injury or wrong done to the bankrupt is excluded from the property that is divisible among creditors. If the entity from which a remedy in damages is sought is, however, a creditor of the bankrupt, then this entity will have an interest in the cause of action against itself. The 'irresponsible lender', as both a defendant and a creditor in this scenario, could exert influence upon the trustee in bankruptcy as to whether such a cause of action should be pursued at all. As submitted by Maurice Blackburn and noted in the majority committee report:

> This means that the wrongdoer, for example the irresponsible lender that caused the bankruptcy, may have an interest in the cause or action against itself, which it may use to influence the determinations of the trustee in bankruptcy including whether the cause of action should be pursued or assigned.[7]

1.22 This legal ambiguity requires resolution.

1.23 **Recommendation 6** recommends that the Australia Government *'improve home repossession processes by requiring that creditors engage with customers at an earlier stage. This could involve:*

- *(a) establishing a new mediation section at the Australian Financial Complaints Authority (AFCA) to conduct farm debt mediations, and a new bank-initiated mediation stream for consumer and small business loans;*
- *(b) requiring banks to initiate a mediation through this new AFCA process before bringing repossession proceedings against a family home; and*
- *(c) requiring banks to give preference and due consideration to reasonable proposals put forward by customers to restructure debts, pay down parts of debts and/or trade out of temporary financial difficulty when a customer is in financial difficulty and a loan secured by or guaranteed by a family home is in default.'*

1.24 Government members of the Committee agree that engagement between borrowers and lenders should occur at the earliest possible time where such engagement has the potential to preclude or delay repossession. As the Law Council remarked in evidence to the Inquiry:

> ..the more that can be done at that front end and at that early point, the less we will see at that very difficult end when somebody is in the Supreme Court.[8]

1.25 This was a feature of the new AFCA regime and Government members suggest the recommendation is premature.

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

8 *Proof Committee Hansard*, Thursday 21 March 2019, p. 13.

1.26 **Recommendation 7** calls on the Australian Government to:

- *increase the current compensation cap available to consumers through the Australian Financial Complaints Authority (AFCA) to $2 million, including for credit, insurance and financial advice disputes; and*
- *remove the sub-limit on compensation available to consumers through AFCA for indirect financial loss and for non-financial loss.*

1.27 AFCA has been in place since November 2018 and the Government has announced that a review will take place at eighteen months from that time. The call at paragraph 3.28 of the Committee majority's Report for a review to take place now, rather than at the pre-arranged juncture, is premature and unnecessary.

1.28 Government members of the committee support a fulsome review of AFCA's operations, including compensation caps and sub-limits, at eighteen months from November 2018 as planned.

1.29 It is noted—as it was in evidence to the Inquiry—that AFCA compensation limits impact directly on the professional indemnity insurance costs of small businesses who represent an overwhelming percentage of AFCA's 35,000 members.

1.30 **Recommendation 8** recommends that the Australian Government *'extend the membership of the Australian Financial Complaints Authority to:*

- *debt management firms;*
- *registered Debt Agreement Administrators;*
- *'buy now pay later' providers;*
- *FinTechs and emerging players;*
- *Small business lenders; and*
- *Professional indemnity insurers of financial providers.'*

1.31 Government members of the Committee agree in principle that AFCA membership should be as wide as is useful and practicable but caution that proper consideration should be given to the financial and administrative burdens that are placed upon AFCA members before making any formal proposal to expand membership. Many of the entities captured by the list in Recommendation 8 are likely to be small or even individual operations that may not be able to absorb the additional costs associated with membership. Government members are mindful that most operators in the financial services space conduct their businesses lawfully and fairly and do not take undue advantage of their customers, suppliers or competitors. It is important to acknowledge the distinction between oversight and over-regulation.

1.32 Financial sector reforms have been implemented by the Government to encourage fin-techs and start-ups, and to remove barriers to entry for new businesses. Many jobs in Australia exist in new sectors and new businesses. It would be unfortunate if attempts to regulate financial services were to have a cooling effect on other aspects of the economy, costing jobs and economic activity. It would also be undesirable to reduce competition and see only large financial services providers able

to operate because they are the only ones who can afford to do so under the applicable regulatory scheme.

1.33 **Recommendation 9** calls on the Australian Government to *'consider extending the loan facility limits for small businesses and farmers who wish to make a claim through the Australian Financial Complaints Authority (AFCA), in consultation with AFCA and other relevant stakeholders.'*

1.34 Once again, the AFCA review will take place at the allotted time.

1.35 Any change to the risk profile of lenders must be managed with great caution lest it impacts either the flow of credit, or the cost of credit.

1.36 The Government manages changes to the financial sector, and regulation of the financial sector, very carefully due to the potential for any misstep to have economy-wide implications. Any proposed changes may have complex impacts and must be considered with caution and only following extensive consultation.

1.37 **Recommendation 10** recommends *'the establishment of a retrospective compensation scheme independent of the Australian Financial Complaints Authority to allow victims of alleged misconduct by banks who received a past external dispute resolution determination or court judgement that was manifestly unjust to apply to the scheme to have the matter reviewed with the consent of the bank.'*

1.38 This recommendation is convoluted and ambiguous. It appears to be calling for a compensation scheme, a review/appeal mechanism, and a collaborative mediation scheme (between lending institutions and aggrieved borrowers) all at the same time.

1.39 It is of concern that the recommendation calls for a retrospective scheme without offering any detail as to the extent of this retrospectivity. It is also concerning that the term 'manifestly unjust' is used without any suggestion as to what might constitute a 'just' or 'unjust' determination, or whom may be called upon to make such a judgement.

1.40 Government members of the Committee would point to remarks from the Australian Banking Association which highlight the importance of the Rule of Law:

> …where there has been a determination made by a court, we believe that any process to reopen those cases would need to be considered very carefully, with particular regard to the community's trust and confidence in the certainty of court determinations and the process of appeal that's available to citizens under our justice system.[9]

Senator the Hon Ian Macdonald

Deputy Chair

9 *Proof Committee Hansard*, Thursday 21 March 2019, p. 3.

Appendix 1

Submissions, additional information and answers to questions on notice

Submissions

1. Supportive Residents & Carers Action Group Inc
2. Mr Col Shields
3. Mr Bob Ifield
4. Name Withheld
5. Ms Chandra Singh
6. Name Withheld
7. Name Withheld
8. Legal Aid Queensland
9. Ms Andigone Aguilar
10. Mr William Mott
11. Name Withheld
12. Victims of Financial Fraud
13. Australian Small Business and Family Enterprise Ombudsman
14. Financial Services Council
15. Australian Loans & Mortgages
16. Banks Gone Bad
17. Name Withheld
18. Mr Craig Perry
19. Name Withheld
20. Mr David Ifield
21. Consumer Credit Legal Service (WA) Inc
22. Community and Public Sector Union
23. Mr Robert Heal
24. Banking and Finance Consumers Support Association Inc
25. Association of Financial Advisers
26. Ms Ana Ganesh
27. Customer Owned Banking Association
28. Australian Law Reform Commission
29. Consumer Action Law Centre
30. Name Withheld
31. Ms tatjana Brandson
32. Name Withheld
33. Name Withheld

34. Mr Michael Masani
35. Mr Dario Pappalardo
36. Mr Gus Brogan
37. Name Withheld
38. Caxton Legal Centre
39. Name Withheld
40. Australia and New Zealand Banking Limited
41. Australian Financial Complaints Authority
42. Financial Rights Legal Centre
43. Australian Banking Association
44. Legal Aid NSW
45. Financial Counselling Australia
46. Public Interest Advocacy Centre LTD
47. Maurice Blackburn Lawyers
48. Mr Francis Edward Ifield OAM
49. Consumer Credit Law Centre SA
50. Women's Legal Service Victoria
51. Mr Robert smith
52. O'Grady Family
53. Dr Evan Jones
54. Mrs Philomena O'Grady
55. Mrs Anita Shannon
56. Law Council of Australia
57. Mr Selwyn Krepp
58. Thomas and Joycelyn Jordan
    Response from National Australia Bank
59. Dr Srdjan Diklitch
60. Mr Anthony Russell
    Response from Suncorp
61. Mr Lynton Freeman
    Response from Chief Justice, Supreme Court of Queensland
62. Dr Wayne Styles
63. Mr Damien Warren
    Response from Bendigo and Adelaide Bank
64. Ms Kathleen Wheeldon
    Response from Rural Bank
65. Mrs Diane Lock
66. Mr Michael Sanderson
67. Ms Michelle Matheson
    Response from Resimac Group

68. Mr Jonathon Haynes
    Response from Westpac
69. Ms Debra Viney
    Response from Rabobank
70. Mr Rory F O'Brien
71. Confidential
72. Confidential
73. Ms Lena Anderson
    Response from Gardens Lawyers
    Response from Westpac
74. Mrs Erika Biritz
    Response from National Australia Bank
75. Name Withheld
76. Mr Paul Herman
    Response from National Australia Bank
    Response from ANZ
77. Tasmanian Small Business Council
    77.1 Supplementary Submission
    77.2 Supplementary Submission
    77.3 Supplementary Submission
    Response from Code Compliance Monitoring Committee
78. JMA Parties
    78.1 Supplementary Submission
        Response from Westpac
        Response from Code Compliance Monitoring Committee
        Response to supplementary submission from Westpac
79. Mr Brett Wilson
80. Mr Nicholas Wright
    Response from Westpac
81. Name Withheld
    Response from ANZ
82. Mr Colin Uebergang
    Response from Westpac
83. Name Withheld
    Response from La Trobe Financial
84. Mrs Carolyn Thomson
    Response from ANZ
85. Bank Reform Now
    Response from National Australia Bank

86. Mr Thomas Eisen
    Response from Rural Bank
87. Nnashaat Sedhom
88. Mr Gary Tahmizian
    Response from National Australia Bank
89. Nolene and Lloyd Bradshaw
    89.1 Supplementary Submission
    89.2 Supplementary Submission
    Response from Rabobank
90. Ms Sheril Morris
    Response from La Trobe Financial
91. Ms Rita Mazalevskis
    Response from ANZ
92. Mr Neil Bradshaw
    Response from Rabobank
93. Mr John Tiver
    Response from Landmark
94. Mr Sean Butler
95. Ms Linda Somers
96. Confidential
97. Confidential
98. Confidential
99. Confidential
100. Confidential
101. Confidential
102. Confidential
103. Confidential
104. Confidential
105. Confidential
106. Confidential
107. Confidential
108. Confidential
109. Confidential
110. Confidential
111. Confidential
112. Confidential
113. Mr Chris Shannon
114. Name Withheld
115. Good Shepherd Australia New Zealand
116. Mr Ben Ifield

117. Ms Pina Smith
118. Mr Craig Ifield
119. Name Withheld
120. Mr Archer Field
    120.1 Supplementary Submission
    Response from ANZ
    Response from Rabobank
    Response from National Australia Bank
    Response from Westpac
121. Mr Sam Sciacca
    Response from ANZ
122. Ms Janine Barrett
    Response from National Australia Bank
123. Mr Des and Mrs Bernadette McKinnon
    Response from National Australia Bank
124. Mr Thomas Dunne
125. Mr Kouros Jafari
126. Mr Philip Brown
    Response from Westpac
127. Name Withheld
    Response from Bendigo and Adelaide Bank
    Response from AFG
128. Mr Bob Yabsley
    Response from National Australia Bank
129. Mr Brian Ivkovic
130. Name Withheld
    Response from National Australia Bank
131. Ms Hilda Joan Ward
    Response from Westpac
132. Mr Gary White
    Response from Resi Mortgage
133. Name Withheld
134. Mrs Diana Macdonald
135. Mr Ken Winton
136. Mr Douglas Henderson
    Response from La Trobe Financial
137. Mr Graham Filmer
138. Mr Costandino's kikiras
139. Mr Phillip Joy

140. Mr Trevor Eriksson
    140.1 Supplementary Submission
    Response from Westpac
141. Mr Craig Caulfield
142. Ms Claire Priestley
    Response from Code Compliance Monitoring Committee
    Response from National Australia Bank
143. Name Withheld
144. Waratah Gallotti
145. Mr Dale McCahon
    Response from Suncorp
    Response from Westpac
146. Ms Marion Rae
147. Mr Benjamin and Mrs Marcia Blunt
148. Michelle and Marjorie Stott
149. Mr Jeff Morris
150. Confidential
151. Confidential
152. Confidential
153. Confidential

Additional Information

1. Additional information provided by Consumer Action Law Centre, received 27 March 2019

Answers to questions on notice

1. Legal Aid NSW, answers to questions taken on notice at a public hearing on 21 March 19, Received 27 March 2019
2. AFCA, answers to questions taken on notice at a public hearing on 21 March 19, Received 28 March
3. Australian Banking Association, answers to questions taken on notice at a public hearing on 21 March 19, Received 29 March 2019
4. Law Council of Australia, answers to questions taken on notice at a public hearing on 21 March 19, Received 2 April

Appendix 2

Public hearings

Sydney NSW, 21 March 2019

Members in attendance: Senators Ian Macdonald, Pratt, Watt.

BEIGLARI, Ms Dana, Senior Solicitor, Consumer Law, Legal Aid NSW

BRODY, Mr Gerard, Chief Executive Officer, Consumer Action Law Centre

CARNELL, Ms Kate, Australian Small Business and Family Enterprise Ombudsman

CUPITT, Ms Christine, Executive Director, Policy, Australian Banking Association

DORAN, Ms Rebekah, Member, Australian Consumer Law Committee, Legal Practice Section, Law Council of Australia

KREPP, Mr Selwyn, Private capacity

LOCKE, Mr David, Chief Ombudsman and Chief Executive Officer, Australian Financial Complaints Authority

MacDONALD, Mr Nathan, Senior Policy Lawyer, Law Council of Australia

MENNEN, Mr Josh, Principal Lawyer, Maurice Blackburn Lawyers

MINING, Mr Justin, Policy Director, Australian Banking Association

SCOTT, Ms Anne, Principal Adviser, Advocacy, Australian Small Business and Family Enterprise Ombudsman

SMITH, Dr June, Lead Ombudsman, Investments, Australian Financial Complaints Authority

WALKER, Ms Mary, Chair, Alternative Dispute Resolution Committee, Federal Litigation and Dispute Resolution Section, Law Council of Australia