

Review of the financial system external dispute resolution framework – Response to Interim Report

Submission by Legal Aid Queensland



Review of the financial system external dispute resolution framework

Introduction

Legal Aid Queensland (LAQ) welcomes the opportunity to make a submission on the Interim Report of the Review of the Financial System External Dispute Resolution Framework and to respond to the information requests in the report.

LAQ provides input into State and Commonwealth policy development and law reform processes to advance its organisational objectives. Under the *Legal Aid Queensland Act 1997*, LAQ is established for the purpose of “giving legal assistance to financially disadvantaged persons in the most effective, efficient and economical way” and is required to give this “legal assistance at a reasonable cost to the community and on an equitable basis throughout the State”. Consistent with these statutory objects, LAQ contributes to government policy processes about proposals that will impact on the cost-effectiveness of LAQ’s services, either directly or consequentially through impacts on the efficient functioning of the justice system.

LAQ seeks to offer policy input that is constructive and based on the extensive experience of LAQ’s lawyers in the day to day application of the law in courts and tribunals. We believe that this experience provides LAQ with valuable knowledge and insights into the operation of the justice system that can contribute to government policy development. LAQ also endeavours to offer policy options that may enable government to pursue policy objectives in the most effective and efficient way.

LAQ’s Consumer Protection Unit lawyers have extensive experience providing specialist advice and representation in consumer law matters. The unit provides advice to clients as well as lawyers and financial counsellors throughout Queensland in relation to mortgage stress, house repossession, debt, contracts, loans, telecommunications and unsolicited consumer agreements.

LAQ deals with the financial system external dispute resolution (EDR) framework on a daily basis. This submission is informed by that knowledge and experience.

Draft recommendations and Information Requests

Draft recommendation 1

A new industry ombudsman scheme for financial, credit and investment disputes

There should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO.

LAQ supports the panel’s conclusion that financial services industry ombudsman schemes are the best way of ensuring access to justice for consumers with complaints about the financial services industry, rather than a statutory body.

In our experience financial services ombudsman schemes deliver an effective process and effective outcomes for consumers that cannot be replicated by a court or tribunal process.

We submit that the following key principles of the existing financial services ombudsman scheme should be included in any future schemes:

- (a) fairness – the principle of fair in all the circumstances is the key to an effective financial services ombudsman schemes.² The key difference between ombudsman and a court or tribunal is their ability to make decisions which are fair in all the circumstances taking into account the existing law and industry codes of practice. This principle is vital to protecting consumers of financial services because it allows the ombudsman to make decisions which reflect the law but are also directly responsive to a consumer’s individual circumstances. This principle of fairness leads to better outcomes for consumers because the response of the decision maker can be tailored to their experience. Courts and tribunals do not have this flexibility. Ombudsman schemes would not be as effective without the ability to make decisions that are fair in all the circumstances;
- (b) accessibility – all consumers and particularly disadvantaged consumers should be able to access a financial services EDR scheme through a simple process and at no cost;
- (c) independence – an EDR scheme must reach decisions independent of influence from any party to a dispute; and
- (d) efficiency – the individual circumstances of each consumer’s complaint must be assessed on its merits in a timely manner.

Draft recommendation 2

Consumer monetary limits and compensation caps

The new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.

LAQ supports the proposal that financial service ombudsman schemes should have monetary limits and compensation caps that are higher than the existing limits of FOS and the CIO.

We submit that the existing monetary limit of \$500,000 and compensation cap of \$309,000 do not adequately reflect the value of some current financial services products, which is preventing some consumers from accessing the current financial services ombudsman schemes to seek redress. Extending the reach of the existing financial services EDR framework will allow more consumers to use a low cost, less legalistic and more accessible dispute resolution framework.

² See FOS Terms of Reference Clause 8.2 and CIO Rules 10th edition Rule 1.5.

Draft recommendation 3

Small business monetary limits and compensation caps

The new industry ombudsman scheme for financial, credit and investment disputes should provide small business with monetary limits and compensation caps that are higher than the current arrangement, and that are subject to regular indexation.

LAQ's Farm and Rural Legal Service (FRLS) was established in the mid-1990s. The FRLS provides advice and assistance to rural producers and rural small businesses that have severe debt related problems or are in dispute with their lenders, or are otherwise facing financial hardship directly related to their business of primary production. The service works closely with rural financial counselors and professional advisors, such as agribusiness consultants, accountants and private legal advisors and represents rural producers in farm debt mediations as well as other debt negotiations with their financiers.

The FRLS specialises in representing farmers and rural small businesses in negotiating settlement of financial disputes between primary producers and financiers.

Rural producers and rural small businesses are currently unable to access the services of the FOS:

- if their credit facilities are for amounts in excess of \$2M;
- if the amount in dispute with the financial services provider is in excess of \$500,000; or
- if they have been offered and have accepted farm debt mediation.

The FOS jurisdiction set out in TOR 5.1(o) excludes claims exceeding \$500,000. TOR 5.1(r) further limits jurisdiction to exclude claims against a small business where the contract provides for a credit facility of more than \$2M.³

LAQ submits that FOS's existing monetary limits are not reflective of current commercial reality for rural producers and rural small business.

It is common for rural producers and rural small businesses to have credit facilities well in excess of \$2 million and disputes relating to credit facilities in excess of \$500,000.

It is not unusual for our clients to have large overdraft facilities, many in excess of \$1.5M. These facilities do not include core debt which relates to the purchase, development or expansion of the farming property and enterprise which are often well in excess of \$2M.

Overdraft limits are often reached annually. Generally, farming is a cost intensive business requiring significant inputs. The fluctuations in the overdraft facilities are dependent upon many things including seasonal conditions, commodity price fluctuations, timing of sales and harvest/picking regimes. Income is irregular and may only occur several times a year. Equipment required to operate a farming enterprise is

³ Similar jurisdiction limits are also located in the Credit and Investments Ombudsman Rules 10th edition. See for example Rule 10.1(t).

also very sophisticated and expensive requiring large capital outlays which are often financed independently of the overdraft. Livestock operations can have separate funding facilities independent of the overdraft. It is quite common for the value of a farm's plant and equipment to be in excess of \$1M while livestock values reflect similar if not greater investments for farming clients.

The current financial jurisdiction of FOS ensures that many rural producers and rural small businesses will not be afforded any protections offered by FOS and their only recourse in the event of a dispute is to take court action.

Additionally, LAQ submits that commencing court action to enforce rights is beyond the financial capacity of many small businesses, in particular, rural producers and rural small businesses who are seeking legal assistance with financial distress.

LAQ supports an increase in the monetary jurisdiction of financial services ombudsman schemes but considers that the Small Business claim limit and compensation cap should be \$3M as this is a commercially realistic figure given the operational costs of establishing and maintaining small businesses and, in particular, rural producers and rural small businesses. LAQ also supports the annual indexation of the monetary jurisdictional limits to ensure that monetary jurisdiction and compensation caps for financial services ombudsman remain relevant.

Information request

Page 112 - Should the national consumer credit protection law be extended to small businesses?

We refer to our submission on Draft recommendation 3 highlighting the importance of expanding the access to ombudsman schemes for rural producers and rural small business.

In LAQ's experience, rural small business and rural producers are also vulnerable to the same issues that the national consumer credit protection legislation seeks to protect consumers from financial hardship and irresponsible lending, including lending asset lending where the only means of the loan being repaid is by way of sale of the asset.

In LAQ's submission, it would be appropriate to extend national consumer credit protection law to small business because the majority of small businesses are run by individual operators who often lack the bargaining power to negotiate with credit providers or the financial capacity to afford to pursue their rights in court.

The combination of expanding EDR jurisdiction and extending national consumer credit protection law to small business is likely to further enhance the access to justice of small business operators and in particular rural producers and rural small businesses.

Information request

Page 131- Should schemes be provided with additional powers and, if so, what additional powers should be provided?

How should any change in powers be implemented?

LAQ supports financial services ombudsman schemes having further powers beyond those powers currently held by FOS and the CIO.

We submit that it would be appropriate that financial services ombudsman schemes be given the following, in addition to their current powers:

- (a) stronger power to obtain information and documents, similar to the power held by FOS UK and the Superannuation Complaints Tribunal;
- (b) power to award fair compensation for loss and damage; and
- (c) power to direct a firm to take steps that are just and appropriate supported by enforcement powers including power to restrain taking action in relation to a security.

Ombudsman schemes should retain the power to award a capped compensation amount for non-financial loss and expenses.

We submit that implementation of these additional powers, should occur over a six month period and be implemented using the same process that is currently used to change the FOS Terms of Reference or CIO Rules.

Information request

Page 135 - Does EDR scheme membership by credit representatives provide an additional or necessary layer of consumer protection that is not already met through the credit licensee's membership?

LAQ supports the proposal that credit representatives no longer need to be a member of an EDR scheme if the following, enforceable, requirements are placed on credit representatives:

- (a) credit representatives must still co-operate with EDR schemes by providing documents and information that the credit licensee does not have;
- (b) there will still be a searchable, public list of credit representatives and whose credit license they operate under on ASIC's and the financial services industry ombudsman websites so that consumers can direct their complaints to the appropriate body.
- (c) there are obligations on credit representatives when they are approached by consumers to facilitate resolution of disputes by putting them in touch with the correct credit licensee; and
- (d) the new arrangements are reviewed in 18 months' time to ensure there are no gaps in the law or unintended consequences as a result of the change.

Information request

Page 149 - What should be the monetary limits and compensation caps for the new scheme? Should they be different for small business disputes?

What principles should guide the levels at which the monetary limits and compensation caps are set? What indexation arrangements should apply to ensure the monetary limits and compensation caps remain fit-for-purpose?

LAQ refers to its submission in response to Draft recommendation 3 concerning an appropriate monetary limit and compensation cap for small business disputes.

We submit that it is appropriate that there should be different monetary limits and compensation caps for small business and consumer disputes because of the differences in the size of lending sought by small business and individual consumers.

Also, the monetary limits for consumer disputes should be \$750,000, with a compensation cap of \$750,000. It is appropriate that the monetary limit and compensation cap be of the same value to reflect the fact consumers can often be faced with disputes where the loss from a dispute is equal to the whole value of the loan or facility that they are lodging a complaint about. The consequence of having a compensation cap that is lower than the monetary limit of a financial services ombudsman is that consumers may be successful in an ombudsman complaint but still be out of pocket because the compensation cap restricts the ombudsman from making an order which reflects the full value of a consumer's loss.

We submit that it is appropriate that the monetary limits and compensation cap be reviewed and indexed yearly taking into account increases in costs.

Draft recommendation 6

Ensuring schemes are accountable to their users

Both new schemes should be required to meet the standards developed and set by ASIC. At a minimum, ASIC's regulatory guidance should require the schemes to:

- ensure they have sufficient funding and flexible processes to allow them to deal with unforeseen events in the system, such as an increase in complaints following a financial crisis or natural disaster;*
- provide an appropriate level of financial transparency to ensure they remain accountable to users and the wider public;*
- be subject to more frequent, periodic independent reviews and provide detailed responses in relation to recommendations of independent reviews, including updates on the implementation of actions taken in response to the reviews and a detailed explanation when a recommendation of an independent review is not accepted by the scheme; and*
- establish an independent assessor to review the handling of complaints by the scheme but not to review the outcome of individual disputes.*

In addition, ASIC's regulatory guidance should require the new scheme for financial, credit and investment disputes to regularly review and update its monetary limits and compensation caps so that they remain relevant and fit-for-purpose over time.

LAQ supports the continuation of the co-regulatory framework that currently applies to industry ombudsman schemes. This approach currently allows industry ombudsman schemes to develop their own approach within a framework that is set by government.

We also support the continuation of ASIC's role in providing policy guidance that sets EDR benchmarks that industry ombudsman schemes must meet and the proposed scope of ASIC regulatory guidance which is set out in paragraph 6.61 of the Panel's interim report.

We note that the Panel's proposes that an independent assessor should be appointed by financial services ombudsman. The proposed assessor would not be an avenue of appeal on the merits of a dispute but would be able to assess whether a consumer or financial firm had been treated fairly in the handling of a dispute.

We are also concerned that the proposed independent assessor would:

- (a) create confusion for vulnerable consumers who would see the assessor as an avenue of appeal for their dispute;
- (b) unnecessarily extend the dispute resolution process as it is likely parties unhappy will use the assessor even where they have been treated fairly;
- (c) not add to the quality assurance frameworks that exist in current ombudsman schemes.

Draft recommendation 7

Increased ASIC oversight of industry ombudsman schemes

ASIC's oversight powers in relation to industry ombudsman schemes should be enhanced by providing ASIC with more specific powers to allow it to compel performance where the schemes do not comply with EDR benchmarks.

Information request

Page 161- On what matters should ASIC have the power to give directions? For example, should ASIC be able to give directions in relation to governance and funding arrangements and monetary limits?

While LAQ supports ASIC's existing role that involves oversight of financial services ombudsman schemes and the provision of guidance concerning how to meet benchmarks, we do not support giving ASIC specific powers to compel performance or give directions to an ombudsman scheme.

We submit that one of the important characteristics of a successful ombudsman scheme is that its operations and decision making, within the EDR framework set by ASIC, are independent and free from influence from consumers, industry and government. Granting ASIC the power to give directions to a scheme risks that the appearance being given to consumers that the independence of ombudsman schemes, which is vital to their success, is being reduced. Reducing the independence of the ombudsman will reduce its independence and its effectiveness.

Draft recommendation 8

Use of panels

The new industry ombudsman schemes should consider the use of panels for resolving complex disputes.

Users should be provided with enhanced information regarding under what circumstances the schemes will use a panel to resolve a dispute.

LAQ supports the use of panels by financial services ombudsman schemes for resolving complex disputes.

Following the 2011 Brisbane Floods and North Queensland cyclones, LAQ had significant experience in panel decisions following the use by FOS of panels to decide insurance disputes involving LAQ clients.

In our experience, consumers responded more favourably to decisions issued by panels, even when the consumer was not successful because:

- (a) they felt the consumer's perspective was being presented when a decision about their case was being made;
- (b) they felt all relevant issues would have been discussed in more depth because there were three people involved in the decision making process;

- (c) they felt their dispute was being viewed as important by the ombudsman because it was a panel making the decision; and
- (d) they felt the decision about their case being made by a panel demonstrated that the decision was more independent.

It is important to recognise that both low value and high value disputes can involve complex questions of fact and law. Disputes of all values that are complex deserve the benefit of the Panel decision making process.

Draft recommendation 9

Internal dispute resolution

Financial firms should be required to publish information and report to ASIC on their IDR activity and the outcomes consumers receive in relation to IDR complaints. ASIC should have the power to determine the content and format of IDR reporting.

LAQ supports the view that there is a dependent relationship between effective IDR and effective EDR. Effective IDR is important because it resolves many of the simpler disputes between a financial services business and a consumer without the need for the dispute to be escalated to an ombudsman. The consequence of this is that it leaves the ombudsman's resources available to deal with more complex disputes in a shorter timeframe. This combination leads to quicker dispute resolution for consumers with both simple and complex disputes.

In our experience there is a wide variation between the effectiveness of the IDR process provided by financial services firms. IDR processes vary between:

- (a) highly effective processes that genuinely consider the complaint made by a consumer and resolve a majority of the simpler less complex disputes - these processes also effectively deal with more complex disputes so that when they are escalated to an ombudsman for decision after the issues in dispute in the complaint have been narrowed;
- (b) a rubber stamp process where the consumer's issue is not properly considered or addressed - these processes are so inadequate that the companies involved are effectively outsourcing their IDR process to the ombudsman.

LAQ therefore supports the draft recommendation that requires financial firms publish information and report to ASIC on their IDR processes and outcomes achieved. This requirement would:

- (a) allow IDR processes between firms to be effectively compared and create a competitive incentive for IDR processes to be improved; and
- (b) provide quantitative and qualitative evidence for ASIC about IDR that will allow it to further develop its regulatory guidance.

Information request

Page 162 - What IDR metrics should financial firms be required to report on?

Should ASIC publish details of non-compliance or poor performance IDR, including identifying financial firms?

LAQ submits financial service providers should be required to report of the following metrics:

- (a) the number and types of complaints received;

- (b) time frames – the length of time taken for IDR processes to be completed;
- (c) the types of resolution that were provided for different categories of complaint;
- (d) trend information over time showing the rates of resolution and whether resolutions are successfully completed by the firm and the consumer; and
- (e) unresolved/withdrawn claims.

Also, ASIC should publish details of financial firms who have an ineffective IDR process. Greater transparency around which firms have effective IDR processes will improve consumer awareness of firms who are performing well and create a competitive incentive for poorly performing firms to improve their process.

Draft recommendation 10

Scheme to monitor IDR

Schemes should register and track the progress of complaints referred back to IDR

LAQ supports a requirement that financial services ombudsman schemes register and track the progress of complaints referred back to IDR.

It is important for ombudsman schemes to have oversight of IDR processes for the following reasons:

- (a) it allows them to more easily identify systemic problems with a firm's or an industry's IDR processes;
- (b) it creates an incentive for firms or industries to resolve complaints before disputes escalate to an ombudsman scheme; and
- (c) it ensures that consumers do not drop out of the system as a result of complaint fatigue after being referred back to the IDR process by an ombudsman scheme.

Draft recommendation 11

Debt management firms

Debt management firms should be required to be a member of an industry ombudsman scheme. One mechanism to ensure access to EDR is a requirement for debt management firms to be licensed.

LAQ supports the proposal that debt management firms should be required:

- (a) to be licensed; and
- (b) To be a member of an industry ombudsman scheme.

In our experience consumers who engage the services of debt management firms experience the following issues:

- (a) they do not understand the service that is being provided to them;
- (b) misrepresentations are made by the debt management firm about the potential outcomes that are achievable for a consumer;
- (c) the service offered to consumers provides no practical benefits that could improve their existing circumstances;
- (d) the fees charged by debt management firms can make the financial circumstances of a vulnerable consumer even worse; and
- (e) other alternatives which are more beneficial to consumers are not considered.

Consumers complain that they have not been provided with the service or the quality of service that they expected.

However, as not all debt management firms are licensed or members of an industry ombudsman scheme, the only recourse of complaint for a consumer is to take legal action. As such consumers are already facing financial hardship, they cannot afford the costs of legal action.

The proposal to require all debt management firms to be licensed and a member of an industry ombudsman scheme will address this problem because the Ombudsman scheme will provide consumers with an accessible and no cost alternative to have their complaints about debt management firms heard, assessed and resolved.

Panel observation

The Panel is of the view that there is considerable merit in introducing an industry-funded compensation scheme of last resort.

LAQ supports the introduction of an industry funded compensation scheme of last resort. In our experience there are a significant number of consumers who have not received substantive access to justice because a firm who has caused loss to the consumer does not have the financial resources or professional indemnity insurance that covers the loss caused or the conduct which has caused the loss.

We support a compensation scheme of last resort accompanied by the reforms outlined by the Australian Bankers Association outlined in paragraph 7.12 of the Interim Report. However, the introduction of a compensation scheme of last resort should be introduced as soon as possible rather than be delayed until all of the reforms outlined in paragraph 7.12 have been introduced.

