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Strong banks – strong Australia

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Ms Neena Pai
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By email: EDR@treasury.gov.au

Dear Ms Pai

Improving dispute resolution in the financial system

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide this submission to the Government's consultation on the new external dispute resolution and complaints framework.

With the active participation of 25 member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community, to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

Introductory comments

The ABA welcomes the legislative package establishing a 'one stop shop' for financial services complaints. The banking industry looks forward to working with the existing External Dispute Resolution (**EDR**) schemes, the Government, and consumer stakeholders to support the establishment of the Australian Financial Complaints Authority (**AFCA**).

We believe the AFCA should utilise the best of the operating arrangements, including premises, staff, case management systems and processes, of existing EDR schemes to minimise costs and promote stability and consistency. We also believe there is an opportunity to refine existing Terms of Reference so they are fit for purpose for the new AFCA.

We note the substantial change to the EDR framework with the creation of the Minster's authorisation process, the approval of material changes through ASIC, and ASIC's new directions power. While supportive of these changes, we believe the exercise of these powers should not unduly inhibit or interfere with complaints determinations and the proper decision making and administration of the AFCA Board. Ministerial interference in these important administrative and operational matters would undermine the efficacy and certainty of the EDR system for consumers and financial services providers (**FSPs**) as well as potentially confuse the legal obligations of the AFCA Board.

The ABA also welcomes the new requirements for members of the AFCA to report on their Internal Dispute Resolution (**IDR**) activity in a standardised form, noting that industry should be extensively consulted on the design to ensure identification of emerging risks and key issues that impact customer outcomes at an industry level, while avoiding unnecessary duplication and compliance costs.

We look forward to working with the Government to establish the AFCA and we support establishing an EDR Working Party made up of Government, EDR schemes, industry and consumer representatives to develop the transition plan as soon as possible. We would be pleased to provide an ABA representative to the Working Party.

This submission sets out our response on the themes of the consultation paper, and provides responses to the consultation questions in Attachment A.

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Better banking

The banking industry recognises that customers expect banks to keep working hard to make sure they have the right culture, the right practices and the right behaviours in place. The industry's Better Banking program is a significant investment by the industry, aiming to strengthen cultural and ethical standards and improve the delivery of products and services.

On 21 April 2016, the Australian banking industry announced a comprehensive package of initiatives to protect consumer interests, increase transparency and accountability, and build trust and confidence in banks.

The Better Banking Program was developed following close consultation with key stakeholders and regulators. It targets areas of concern to the community about governance and conduct and culture in banks. The six initiatives cover the areas of remuneration, complaints handling and dispute resolution, whistleblowing, reference checking and stopping misconduct moving round the industry, banking standards and regulation of banks.

The banks and the ABA continue to work closely with key stakeholders and regulators on implementation. Progress with the implementation of the reform program is being overseen by an independent governance expert, Mr Ian McPhee. Quarterly progress reports have been published by Mr McPhee since the announcement outlining implementation results, challenges and identifying areas requiring additional attention.

The Better Banking Program consists of a suite of measures to improve conduct and culture within banks.

Financial services dispute resolution

Simple, accessible and effective EDR plays a valuable role in enabling retail and small business customers (together, 'customers') to bring and resolve disputes with FSPs.

The ABA believes that EDR offers an important and accessible alternative to the court system as it is free for customers to access, does not require formal legal representation, and resolves disputes in a less adversarial way than the court system.

EDR works best in conjunction with effective complaints handling and Internal Dispute Resolution (**IDR**) programs. IDR programs are an important element of the FSP's overall relationship with its customers and manage a wide variety of complaints, including those that have not resulted in monetary loss. Many customers have their complaints successfully resolved though IDR.

But when EDR is needed to resolve a problem, the system must work as efficiently and quickly as possible to resolve disputes and achieve fair outcomes for customers.

Stability, consistency and cost

The ABA believes that significant effort will be required to establish the AFCA and ensure it is operational from 1 July 2018. Given the timeframe, the most efficient approach will be to use the best of operating arrangements, including premises, staff, case management systems and processes of existing EDR schemes as far as possible. For example, existing paperless claims infrastructure should be used and expanded across superannuation disputes. Organisational capability, including the experience and expertise of staff should be retained to the largest extent possible. These operational arrangements should be reviewed as they are built in to the AFCA to ensure they remain fit for purpose and transition is undertaken in as smooth and streamlined a way as possible.

The banking industry and existing EDR schemes have made significant investments to operationalise existing processes, meaning cost impacts will be felt by both the AFCA and FSPs if existing arrangements are not appropriately leveraged.

For consumers, EDR access and engagement processes should remain as consistent as possible and EDR engagement programs, such as making information available in different languages should continue.

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AFCA

Transition

The ABA believes that commencing operation from 1 July 2018 is an ambitious timeframe, which will require immediate resources and input from Government, industry and consumer advocates to achieve. A transition plan for establishing the AFCA, together with a plan for running off the other schemes, should be developed as soon as possible.

Aligned with the principle of creating a 'one-stop shop' and to promote consistency for consumers and members, the ABA suggests that the AFCA be operational as soon as possible and bring in current complaints from the existing EDR schemes to be dealt with by specialist teams, under their respective existing Terms of Reference.

We do not believe the existing Financial Ombudsman Service (**FOS**) and the Credit and Investments Ombudsman (**CIO**) should continue to operate concurrently and independently outside the AFCA once the AFCA is established. We believe this would be confusing for consumers and inefficient for FSPs. It may also be difficult for existing schemes, such as FOS and CIO, to retain specialist staff beyond the commencement date for the new scheme. While we also support bringing in the Superannuation Complaints Tribunal (**SCT**) complaints, as soon as practicable, this may take some time, having regard to the complexities of the SCT model and the nature of superannuation complaints.

A clear transition plan, with fixed dates for when the operation and jurisdiction of the respective schemes stop and start, will also help manage against behavioural distortions from consumers possibly withdrawing, bringing forward or delaying making complaints.

The ABA supports establishing an EDR Working Party made up of Government, EDR scheme, and industry and consumer representatives to develop the transition plan as soon as possible.

New legislative framework

The ABA notes the significant change in EDR scheme approval, from having industry based schemes approved by ASIC having regard to regulatory guidance, to a more formal authorisation from the Minster having regard to detailed requirements set out in legislation. While we are supportive of this change, we note that this represents a shift from EDR operating as an industry-based process, to a formal co-regulatory model with increased ministerial and regulatory oversight.

For these reasons, we believe the legislation should explicitly state that:

- The approved EDR scheme is independent, not subject to direction and free from interference on decision making on complaints
- The operator of the EDR scheme is a not for profit company limited by guarantee.

Where the AFCA takes on the provision of ancillary services, such as FOS's current operation of the Code Compliance Monitoring Committee (**CCMC**) responsible for monitoring industry codes, it should be clear that the operation of the Ministerial authority and regulatory directions do not extend to other operations of the AFCA.

Minister's authority

On our reading, the drafting of section 1046, appears to enable the Minster to authorise more than one EDR scheme. The ABA believes this is inconsistent with the intention of creating a 'one stop shop' and that the drafting should be amended to ensure the authority is limited to the authorisation of one scheme.

Furthermore, we suggest a consequential amendment may be required to 912(A)(2)(b).

ASIC's role

Directions power

In exercising its power to issue regulatory requirements relating to the performance of the AFCA functions, the ABA believes ASIC should be required to meet existing office of best practice regulation requirements, including external stakeholder consultation. The power should not be used in a way that undermines the independence of the scheme and its co-regulatory structure.

ASIC's ability to give directions to increase monetary limits should be based on appropriate data regarding the types and volumes of claims falling outside existing jurisdictional limits and have regard to the principle that EDR is designed for smaller and less complex disputes. Larger more complex disputes should be heard in courts or tribunals.

We anticipate that ASIC will develop and issue a regulatory guide on how it will apply its new powers. We believe ASIC should consult extensively with the board of the AFCA, industry representatives and consumer advocates in developing that guide.

Approval of material changes

The ABA believes regulatory guidance should clearly outline the type of change ASIC would deem to be material and requiring approval. ASIC should be required to consult with the AFCA Board in giving any approval and the Board should remain able to make changes necessary for the day to day operation of the scheme. ASIC should also be required to consult with FSPs and other stakeholders.

ASIC's power to approve material changes should not be so wide as to stop the AFCA Board properly exercising professional judgment to amend the scheme to respond to operational challenges or continuous improvement initiatives. The existing consultation processes for changes to the Terms of Reference should be transferred to the AFCA.

Consultation processes

The ABA believes the exercise of both powers should be subject to consultation with stakeholders and administrative oversight.

Code Compliance Monitoring Committee

The ABA notes that the Code Compliance Monitoring Committee (**CCMC**) is currently structured through a funding and administrative arrangement between FOS and the industry. For example, compliance with the Code of Banking Practice is currently overseen by the CCMC. Historically, the CCMC has been housed with the FOS to provide synergies between operations and economies of scale to manage operational and administrative costs.

We believe the AFCA should have the ability to provide ancillary services, such as the operation of the CCMC. However we do not believe the provision of such services should be subject to the Minster's authorisation, nor the approval and directions powers of ASIC. It is critical that the CCMC remains outside the scope of the co-regulatory model contemplated with the AFCA. Therefore, we suggest that the legislation contain a specific restriction and limitation about the Minister's authority and ASIC's role, including directions and approval of material changes, with regards to the CCMC and other ancillary services.

The ABA notes that we are currently in the middle of a thorough review of the Code of Banking Practice and the CCMC. Mr Phil Khoury completed both the reviews in February and the banking industry is currently working through the recommendations.

The ABA has committed to seeking ASIC approval of the new Code of Banking Practice and making the governance arrangements for the new Code of Banking Practice more robust.

Establishing the AFCA

The ABA notes the Government's consultation document on the authorisation process for the new AFCA. While this document provides some guidance as to process, we would like more clarity from the Government on the intended process to establish the AFCA, including the process to register the company limited by guarantee, appoint the members of the Board, develop the new Terms of Reference, and manage operational and systems requirements.

The ABA looks forward to further engagement with Government on the process to establish the AFCA and seek Ministerial approval.

As previously stated, the ABA supports establishing an EDR Working Party made up of Government, EDR scheme, and industry and consumer representatives to develop the transition plan as soon as possible.

Board composition and appointment

The ABA supports the proposed model of Board composition, being an independent chair and equal representation of industry and consumer backgrounds. A balance should be struck between having representatives with experience within the expanded AFCA jurisdiction, and limiting the Board to a manageable number of directors. As part of the Terms of Reference, the AFCA Board should have appropriate access to technical and legal expertise.

Given the new co-regulatory approach, the ABA would like more clarity on how the Government intends to establish the company limited by guarantee, who will be responsible for registration, Board appointment processes and administrative processes and how the Board composition will be mandated and directors appointed.

Terms of Reference

The Terms of Reference should very clearly set out the role, powers and responsibilities of the AFCA board. Clear articulation of these powers and responsibilities will be essential in managing the interaction with ASIC's new powers and preserving the proper decision making authority of the board, as a board of directors of a company limited by guarantee. As an example, as the legislation is currently drafted, it is unclear if the AFCA will have a mandate to set its own jurisdictional limits. Such powers should be clearly expressed in the Terms of Reference.

The new AFCA Terms of Reference will need to be agreed as soon as possible to provide guidance to industry around whether AFCA intends to adopt the approaches taken by the current EDR schemes, as set out in existing fact sheets and publications (e.g. the FOS circular). These historical approaches have informed industry policy and practice both in relation to the provision of financial services and the FSPs' approach to disputes. The ABA believes the creation of the Terms of Reference of the AFCA is an opportunity to address a number of matters, as set out below.

Small business definition

The ABA believes a revised test for small business should ensure the ongoing efficiency and accessibility of EDR schemes for genuine small businesses and reflect the intention that EDR is an alternative dispute resolution process for small and less complex disputes. The standing of a small business should be assessed against a clear definition of 'small business' that takes into account:

- The number of employees
- Business turnover

- Size of the loan or investment for business purposes, and
- Total credit exposure of the business group.

The test should be quick and simple to apply, to ensure efficiency and accessibility. We note concerns about introducing new criteria in addition to the number of employees, however we believe that the additional criteria can be identified readily through information held by the FSP and the applicant, at least as easily as identifying the number of employees.

Expanding the criteria beyond the number of employees is critical to ensure the small business test is future proofed in the context of increasing automation and the digital economy, where large businesses can operate with comparatively few staff members.

There are a number of small business tests used for legal and commercial purposes. For the purpose of expanding the EDR small business credit jurisdiction, we propose the following small business test.

A business is not a small business if one of the following conditions is met:

- The number of employees is 20 people or more, or 100 people or more if the business is, or includes, the manufacture of goods (full-time equivalent); or
- Annual business turnover is $10 million or more; or
- Total credit exposure (**TCE**) of the business group, including related entities, to all credit providers is $3 million or more.

This information will be obtained at the initiation of the loan facility. This approach is intended to ensure that the AFCA covers 98% of businesses. We believe that a higher total credit exposure would capture types of businesses where EDR would not be appropriate.

Access following farm debt mediation

Farm Debt Mediation (**FDM**) is a specialised mediation process that allows a farmer and their FSP to negotiate a better financial outcome. Mediators are trained to understand the unique and complex circumstances affecting farming operations and agri-business lending.

The ABA believes that FDM should remain a separate EDR scheme. We support the implementation of a nationally consistent farm debt mediation model across Australia and have been working with the Australian Government and agricultural organisations on legislative options. The banking industry's preferred model is for national legislation based on the NSW legislation. The NSW Farm Debt Mediation Act was introduced in 1994 and provides a mechanism for the efficient and equitable resolution of farm debt disputes, without acting as a constraint on agri-business lending in NSW.

Determining funding from industry

Consistent with our general position that the operations of existing schemes should be leveraged, the ABA believes the existing funding calculation models of the existing schemes should be used, taking into account:

- Stability and consistency in fees for EDR members
- Avoiding cross subsidisation between industry segments, and
- Managing the impact on small business members.

We note that the existing industry schemes have capital reserves accrued though fees paid by FSP members. We believe these reserves should be used to fund the operation of the schemes and / or the AFCA during transition.

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Internal dispute resolution

Standard format reporting

The ABA supports the new requirement for members of the AFCA to report on their IDR activity in a standardised form. We believe this will contribute to the accountability and transparency of AFCA members, promote consumer protection, and enable the identification of emerging risks and key issues that impact customer outcomes at an industry-level. We support using a standardised format to promote consistency in reporting and enable better data analytics.

The design of the standardised format should take account of existing reporting obligations (e.g. the Code of Banking Practice which requires the provision of code breach data to the CCMC or reporting required under other industry codes), and seek to build on existing reporting frameworks, while closing gaps to ensure consistency.

There will be significant complexity and costs to industry in developing systems to provide information in a standardised format. Noting that there is currently no standardised format for IDR reporting, including differing interpretations of what constitutes a complaint, and different points at which complaints data is captured (e.g. RG 165 does not currently require a complaint resolved within five days to be captured and recorded).

Most FSPs, including banks, have historically taken a broad reading of the complaints standard and built systems to capture a broad range of complaints and circumstances, which can include matters not related to the offer of financial products and services or credit facilities. This approach has been taken to improve the quality of complaints data and assist in the identification of trends and risks, but means that there are varied approaches across the industry.

To leverage existing arrangements and avoid unnecessary cost and duplication, industry will need sufficient time to both consult on the new format and implement required changes. We propose that at least a 12 month implementation period is required once the new format is settled.

Use of IDR reporting

The ABA believes the standardised IDR reporting should be used by ASIC to enable the identification of emerging risks and key issues that impact customer outcomes at an industry-level. We do not support making the IDR reporting public at an individual FSP level, however, we would be supportive in principle of the publication of aggregated industry data.

The number and nature of complaints and complaints data will differ across FSPs due to the nature, scale and complexity of the business. Therefore, we do not believe publication at an individual FSP level provides meaningful information or benchmarks.

While noting our strong preference for aggregated industry data, if it was required that complaint data be published against FSPs (rather than aggregated), we would seek greater clarity on the definition of a complaint and what was needed to be captured and then reported under that definition, so that any benchmarking is fair and accurate. We would also seek additional information being reported to ensure the context of the complaints and complaints data is understood.

If you would like to discuss any of the matters raised in this submission, please contact Christine Cupitt, Policy Director – Retail Policy on (02) 8298 0416: ccupitt@bankers.asn.au.

Yours sincerely

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Attachment A

Consultation question	Industry response
Question 1 Are there other statutory powers the EDR body will need to resolve superannuation complaints effectively?	The ABA has not responded to this question.
Question 2 Do you consider that the Bill strikes the right balance between setting the new EDR schemes objectives in the legislation whilst leaving the operation of the scheme to the Terms of Reference?	While we are supportive of this change, we note that this represents a shift from EDR operating as an industry based process, to a formal co regulatory model with increased ministerial and regulator oversight. In the context of the new, coregulatory model, we believe the bill strikes the right balance between setting the new EDR schemes objectives in the legislation whilst leaving the operation of the scheme to the Terms of Reference. On a separate but related matter, ASIC's power to approve material changes should not be so wide as to stop the board properly exercising professional judgment to amend the scheme to respond to operational challenges or continuous improvement initiatives as well as having the ability to adapt to changes in the financial services industry.
Question 3 Are there any issues that are currently in the Bill that would be more appropriately placed in the Terms of Reference or issues that are currently absent from the Bill that should be included in the Bill?	Please see our response to question 2.
Question 4 Are there any additional issues that should be considered to ensure an effective transition to the new EDR scheme?	The most important issues to address are: • Developing a transitional plan as soon as possible to provide certainty to EDR scheme, members and consumers, • Establishing an EDR transition working party made up of Government, EDR scheme, industry and consumer representatives to develop the transition plan, and • Confirming the new process to establish the AFCA, with input and resources from Government, EDR schemes, industry and consumer advocates.
Question 5 Would moving immediately to a compensation cap of $1 million have significant impacts on the availability/price of professional indemnity insurance?	The ABA has not responded to this question.

Question 6 Are the existing sub-limits for different insurance products still required?	The ABA has not responded to this question.
Question 7 Are there any reasons why credit representatives should be required to be a member of an EDR scheme?	The ABA supports removing the requirement for credit representatives to be an EDR scheme member provided that, where a credit representatives elects to join the scheme, they retain the option to do so.
Question 8 What will the regulatory impacts of the new EDR framework be?	Regulatory impacts for industry will be significant and include: • Updating dispute systems and processes, which for banks currently align with FOS's dispute resolution framework to accommodate the new systems and processes of the AFCA, • Updating disclosure material, • Training staff, and • Building new or enhanced IDR reporting systems, to meet that standard form reporting requirement set by ASIC.