Australian Finance Industry Association Limited
ABN 13 000 493 907
L11, 130 Pitt Street Sydney NSW 2000
T: 02 9231 5877

14 June 2017

Ms Nina Pai
Manager
Financial Services Unit
Financial Systems Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: EDR@treasury.gov.au

Dear Ms Pai

IMPROVING DISPUTE RESOLUTION IN THE FINANCIAL SYSTEM

Thank you for the opportunity to provide feedback on the *"Improving dispute resolution in the financial system, Consultation Paper"* (**Consultation Paper**), the *Exposure Draft Treasury Laws Amendment (External Dispute Resolution) Bill 2017* (**EDR Bill**), the *Exposure Draft Explanatory Material Treasury Laws Amendment (External Dispute Resolution) Bill 2017* (**EDR EM**) and draft regulations.

The Australian Finance Industry Association (**AFIA**)[1] is the industry advocate for Australia's finance sector. AFIA represents more than 100 leading providers of consumer, commercial and wholesale finance, including ASX-listed companies, customer owned and regional banks, captive financiers and credit reporting bureaus. Collectively, AFIA members provide billions to fund the future of Australian families, small businesses and large corporates. Equipment finance alone makes up conservatively $90B of the market. Our diverse membership and size of the market it represents see AFIA uniquely placed to provide specialist policy expertise to represent the interests of its members to federal and state governments, and Australia's financial and corporate regulators.

AFIA wants to work with the Government to achieve the underlying policy objectives sought to be implemented through the establishment of the Australian Financial Complaints Authority [AFCA] to replace the current three Schemes approach; namely, to empower consumers in the financial services sector by providing more efficient, effective and consistent dispute resolution processes and outcome.

AFIA members support an external dispute resolution [**EDR**] process that provides integrity to transparent, easily accessible internal dispute resolution processes and operates where these have failed. Customers of our members should be able to raise legitimate, well-substantiated concerns with an independent, objective third party with dispute resolution expertise in the relevant market for their consideration and determination (including remedies to address). EDR should be free and easily accessible for those customers that have been shown to be "at risk" and requiring these additional protections: namely customers of consumer finance and appropriately defined small business customers. Targeting protection to evidence-based risk

[1] Formerly the Australian Finance Conference (AFC), established in 1958, the Association resolved to change its name to better reflect its membership advocacy role and re-launched as the Australian Finance Industry Association from 1 June 2017.

ensures a solution that appropriately balances consumer/small business protection supported by a compliance framework designed to minimise cost to our members and other financial service providers (**FSPs**). This contrasts to a less-targetted approach that adds cost which is likely to be reflected in finance pricing and borne by all customers. The EDR scheme should also have a transparent pricing and case management model that reflects the diverse range of FSPs which currently operate in Australia and the diverse products they provide and channels through which they deal with their customers to ensure a competitive market is maintained with attendant benefits for customers.

The primary concerns of AFIA with the current draft of the EDR Bill are the same as those that were raised throughout the review into the financial system EDR and complaints framework (**Complaints Framework**) undertaken by the Independent Expert Panel (**Ramsay Review**). In summary, any new system should:

1. remedy the rule of law failings in the existing framework – a FSP should be able to appeal a decision by an EDR scheme that is wrong as a matter of law;

2. allow for a differentiated cost structure and variegated expertise within the Complaints Framework so as to accommodate a diverse financial services sector, including low cost low-margin participants and niche businesses; and

3. not have an anti-competitive effect such as to make it harder for new participants to enter the financial services sector or for existing smaller participants to remain in the sector.

Because the Ramsay Review, in our view, never adequately addressed these three important issues, the Government's response to recommendations in that Review and consequently design of the AFCA appears to have been premised from a flawed starting point. This in part may explain the lack of cross-industry support for the proposed new Complaints Framework,[2] except amongst those with the very largest market share.[3]

AFIA sees the EDR Bill consultation as a critical opportunity for the Government to address these omissions and create a framework that can have cross-industry support; an outcome that benefits government, industry and customers alike.

In doing so, the Government would also be addressing another policy shortcoming in the Ramsay Review in relation to the concept of the "fairness" of the Scheme and the fact that by its nature a complaint involves more than one party. Recommendations appear to have been shaped from a starting point that an assessment of fairness should be confined solely to consideration of the position of the complainant. Given the closed two-party system and broader flow-on ramifications for all customers from complaint determinations that potentially drive systemic compliance changes for the FSP respondent, we suggest an EDR scheme that is not required to consider the position of both parties when making a decision entrenches a process that is arguably lacking in fairness. This has detrimental flow on consequences, for example, in relation to the potential for a Scheme to be designed without providing the ability for a FSP respondent to be able to appeal decisions of the EDR scheme that are wrong as a matter of law.

AFIA has highlighted this significant design problem identified in the current draft of the EDR Bill together with four others in the Executive Summary below. If not fixed, we are concerned that these five key areas will, over time;

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[2] See, for example, "Industry Associations condemn new complaints authority", *Australian Financial Review*, p 17, 24 May 2017.
[3] See, for example, "ABA supports improved external dispute resolution and new compensation scheme", *Australian Bankers' Association*, Media Release, 2 February 2017.

- harm the reputation of Australia's diverse financial services sector,
- have anti-competitive impacts, and
- ultimately be detrimental to all consumers of financial services.

Executive Summary

To achieve the Government's underlying policy objectives and ensure an improved outcome for customers over the current three Schemes approach, AFIA key issues to be addressed with the Complaints Framework as currently drafted in the EDR Bill can be broadly categorised as follows:

1. **Inclusion of a right of appeal on questions of law for all financial products and services complaints:** at present, the outcome would legislate a two-tier justice system, within the framework, under which businesses operating in one segment of the financial services industry (namely, superannuation) will be able to access ordinary rule of law protections but these appear denied to businesses operating in other segments of the industry (for example, credit) without appropriate policy or other justification for the differentiation given the intention is to have one Scheme to operate going forward. A credit provider should equally be able to appeal a decision of the EDR scheme where it is has simply got the law wrong;

2. **Minister's authorisation decision should also require consideration of an assessment of (1) the proposed charging model to be borne by FSP subscribers and (2) the ability and capacity of the Scheme to deal with a differentiated market:** any system design protections should be omitted to:

    - stop the EDR scheme from being able to be operated in a high cost profligate manner, which cost is borne by business and will create a barrier to entry for smaller participants;

    - ensure that the EDR scheme is structured so as to have the capacity and expertise to deal with complaints in differing industry segments having regard to those segments and the profiles of businesses operating within them, to remove inhibitors to competition;

3. **Minimise Unintended Outcomes from Drafting to Achieve the Legislative Objective and Terms of Reference Scope**: for example, in relation to the application of the transitional provisions and unintended omission of the National Consumer Credit Protection Act (and Australian Credit Licensees) and in relation to the explanation provided in the Explanatory Memorandum of the key concept of Financial Firms and the provision in the EDR Bill.

4. **Transitional Issues:** raise complexity which, without appropriate management including in the EDR Bill, potentially cause confusion for customers and FSPs alike and potentially unnecessary cost

5. **Development of Terms of Reference (ToR) with Industry Input**: given these are critical to defining and setting the scope of the fair and efficient operation of AFCA and its ability to adapt to rapidly changing market and regulatory developments. The ToR are also drivers for operational policies and procedures and costs more generally and require industry input to ensure an appropriate balance and overall fairness for all who participate in EDR is achieved;

Further detail, including specific recommendations and potential solutions for the Government's consideration and our reasoning that underpinned these, is attached (Appendix 1 Recommendations; Appendix 2 Basis for Recommendations). In Appendix 1 we include a list of 18 specific recommendations to rectify these and other difficulties. In Appendix 2 we include detailed reasons explaining how these problems arise and why they need fixing. We also include comment on the questions asked in the Consultation Paper where we are able to contribute.

AFIA would welcome the opportunity to provide further operational and market insight to inform the Government's final position on the new Complaints Framework. If you have any queries in relation to our submission please do not hesitate to contact me on 0419 967 918 or Paul Stacey, Associate Director – Policy on 0400 438 623.

Kind regards.

Helen Gordon
Chief Executive Officer

APPENDIX 1 – AFIA RECOMMENDATIONS + PROPOSED SOLUTIONS TO ACHIEVE

LIST OF RECOMMENDED AMENDMENTS TO EDR BILL AND EDR EM

PART 1: INCLUSION OF A RIGHT OF APPEAL PARTICULARLY ON QUESTIONS OF LAW

1. The Government should address the significant omission that flows from draft legislation built on recommendations of the Ramsay Review that arguably failed to appropriately consider and address the need for a FSP regardless of product or service to be able to appeal a decision of an EDR scheme that is wrong on a question of law. The outcome reflected in the current draft EDR Bill results in a two-tier justice system within the Complaints Framework. AFIA recommends this should be addressed by amending the EDR Bill and the EDR EM to make it clear that:

   (i) the EDR decision-maker has an obligation to apply the law when making determinations; and

   (ii) all members of the scheme can appeal a determination of the EDR decision-maker to the Federal Court on a question of law.

2. The EDR Bill and the EDR EM should be amended to make clear that EDR decision-makers are obliged to apply the law and all members of the EDR scheme can appeal a determination of the EDR decision-maker to the Federal Court on a question of law by either:

   (i) inserting a new division into Part 7.10A entitled "Appeal rights on questions of law" and providing the appropriate link to the relevant legislation to confer the requisite statutory jurisdiction on the Federal Court. For example for consumer credit regulated under the National Consumer Credit Protection Act providing a similar provision to that provided in EDR Bill Schedule 1 Clause 16 Paragraph 11(1)(a) linking the NCCPA to new Part 7.10A of the Corporations Act 2001. This is the cleanest way from a drafting perspective; or alternatively

   (ii) amending Subsection 1047, which describes the scheme functions, by inserting/amending the following text in bold:

   "*(j) to deal with complaints in a way that **applies the law in a** fair, equitable and independent **manner***" (also see further recommended changes in 4. below) AND

   (iii) amending subsection 1057(3) by inserting the words highlighted in **bold** below:

   "*The EDR decision-maker must not make a determination of a superannuation complaint **or other complaint** that would be contrary to:"* AND

   (iv) amending subsection 1061(1) by inserting the words highlighted in **bold** below:

   *"A party to a superannuation complaint **or other complaint** may appeal to the Federal Court, on a question of law, from the EDR decision-maker's determination of the complaint."*

PART 2: MINISTER'S AUTHORISATION DECISION SHOULD ALSO REQUIRE CONSIDERATION OF AN ASSESSMENT OF (1) THE PROPOSED CHARGING MODEL TO BE BORNE BY FSP SUBSCRIBERS AND (2) THE ABILITY AND CAPACITY OF THE SCHEME TO DEAL WITH A DIFFERENTIATED MARKET

3. The Government should insert structural features into the EDR Bill which reduce the likelihood of an expensive new EDR scheme acting as a barrier to entry thereby counter-acting other government initiatives to increase competition within the financial services sector.

4. The EDR Bill should be amended as follows:

   (i) Subsection 1046(2), which specifies the matters the Minister must take into account when authorizing a scheme, by inserting the following text in bold:

   *"(e) the fairness of the scheme **to both complainants and members**;"*

   *"(l) **its ability to balance positive consumer outcomes with a low cost operational model which does not disadvantage smaller members**"* (new subsection 1046(2)(l))

   (ii) Subsection 1047, which describes the scheme functions, by inserting/amending the following text in bold:

   *"(j) to deal with complaints in a **cost-effective** way that applies the law in an **independent, fair and equitable** manner **to both complainants and members;**" (as previously amended per recommendation 2 above)*

   *"(l) **to ensure the scheme does not act as a barrier to entry thereby impeding competition within the financial services sector**"* (new subsection 1046(2)(l))

5. The EDR Bill should be amended to impose a specific obligation on the EDR scheme that it be structured in a manner, including operating processes and pricing, which enables it to operate in a differentiated market segment manner rather than "a one-size approach fits all" businesses across the breadth of the financial sector, regardless of member businesses' actual size, profile and industry segment.

6. The EDR Bill be amended as follows:

   (i) Subsection 1046(2) by inserting the following text in bold:

   "*(k) the expertise available to the scheme in dealing **appropriately** with complaints **in different industry segments**;*"

   (ii) Subsection 1047 by inserting the following text in bold, in addition to the changes recommended in 4. above:

   *"(j) to deal with complaints **in different industry sectors** in a way that applies the law in an independent, fair and equitable to both complainants and members**;**"*

PART 3: MINIMISE UNINTENDED OUTCOMES FROM DRAFTING TO ACHIEVE THE LEGISLATIVE OBJECTIVE AND TERMS OF REFERENCE SCOPE

7. We note the clear intention of the Complaints Framework is to capture Financial Firms that are Australian Credit Licensee credit providers. This is reflected at various points in the EDR Bill where the link is clearly provided between credit providers who have an Australian Credit License. This intention may have been less clear in the Explanatory Memorandum and we recommend revision to ensure both documents align.

8. The EDR EM be amended to better align with the EDR Bill as follows:

   (i) the definition of Financial Firms in the glossary be amended by deleting the term "credit providers" and inserting the following text in bold:

   "Australian Financial Services licensees, unlicensed product issuers, unlicensed secondary sellers, **Australian credit licensees** and credit representatives, superannuation funds (other than self-managed superannuation funds), approved deposit funds, retirement savings account providers, annuity providers, life policy funds and insurers."

   (ii) para 1.130 be amended by deleting the term "credit providers" and inserting the following text in bold:

   "This licence condition applies to all Australian Financial Services (AFS) licensees, unlicensed product issuers, unlicensed secondary sellers, **Australian credit licensees** and credit representatives."

9. We also note another apparent unintended drafting omission relating to the transitional provisions which is covered below.

PART 4: TRANSITIONAL ISSUES

10. In line with its red-tape reduction/compliance saving initiatives, we submit that the Government should revisit its approach of allowing FSPs a period of up to 6 months to become a member of AFCA after its commencement, during which it is also required to remain a member of the existing scheme.

11. As a possible alternate, the Government may wish to consider a means by which AFCA is able to regard membership of an existing scheme as 'reciprocal membership' and automatic membership of the FSP to AFCA. And a pricing model for membership should also reflect this. For example, the FSP on becoming a member of AFCA is regarded as having met its membership fee obligation up to the period it would have expired under the "old" EDR scheme. Should a formal application process for membership to AFCA be seen to have a policy basis, an alternate might be that a FSP that is currently a member of an existing scheme and on acceptance of an application to become a member of AFCA allow them a rebate or discount on AFCA membership fees equal to the amount paid as a membership fee, in whole or in part, to an existing EDR scheme to cover the period up to the period of expiry of the old EDR Scheme membership.

12. AFIA recommends that a new division, titled Transitional Measures, be inserted into Schedule 1 of the EDR Bill, with consequential changes to Schedule 2, which makes clear that:

   (i) all complaints submitted to an existing EDR scheme before commencement of AFCA must be determined by that existing EDR scheme;

(ii) no further complaints can be accepted by an existing EDR scheme after the date of commencement of AFCA;

(iii) complainants cannot choose to transfer their complaint to AFCA for resolution once it has been accepted by an existing EDR scheme;

(iv) all determinations of the existing EDR scheme are final and consumers and members cannot re-prosecute this complaint in AFCA; and

(v) AFCA will not have regard to decisions under the existing EDR scheme as having any precedential value when reaching determinations.

13. If the Government retains its existing approach to transitional issues it should correct the drafting error in Schedule 1, Part 2, item 48 of the EDR Bill so that FSPs who are currently a member of an EDR scheme because they are an Australian Credit Licensee are also allowed allow up to 6 months (or later period by regulation) to join AFCA.

PART 5: DEVELOPMENT OF TERMS OF REFERENCE WITH INDUSTRY INPUT

14. Given these are critical to defining and setting the scope of the fair and efficient operation of AFCA and its ability to adapt to rapidly changing market and regulatory developments. The ToR are also drivers for operational policies and procedures and costs more generally and require industry input to ensure an appropriate balance and overall fairness for all who participate in EDR is achieved. AFIA recommends that the initial draft terms of reference for AFCA should be released for public consultation prior to Ministerial consideration.

OTHER ISSUES:

Governance:

15. The EDR Bill and EDR EM should be amended to provide substantive guidance as to the governance arrangements which will apply to AFCA given its importance to the new EDR system.

16. Subsection 1046(2) of the EDR Bill, which specifies the matters the Minister must explicitly take into account when authorising an EDR scheme, be amended to include new item (m) as follows:

"(m) the governance arrangements of the scheme"

17. The EDR EM be amended to state that the governance arrangements applying to the new scheme will include:

(i) a board comprising no less than fourteen directors with seven directors representing industry and seven directors representing consumers;

(ii) each industry director will represent a different industry segment;

(iii) the following seven industry segments will be represented on the board: Banks and ADIs; Life, General Insurers and Insurance Brokers; Other AFSL holders; Mortgage financiers and credit representatives; Debt buyers and collectors; Other ACL holders; and Privacy Act participants;

(iv) members of each of the industry segments are entitled to vote for their industry segment director with voting rights proportionate to total fees paid by the member;

(v) each consumer director is to be elected by a panel of named consumer groups;

(vi) the independent chairman is to be elected by the board subject to the achievement of a majority of industry director votes and a separate majority of consumer director votes;

(vii) all directors and the chairman are subject to re-election every two years;

(viii) AFCA must prepare financial statements in accordance with the requirements applicable to an ASX-listed reporting entity; and

(ix) director remuneration approval requirements should mirror those applicable to an ASX listed entity, including the potential for a spill motion after two strikes.

Internal Dispute Resolution Schemes (IDRS):

18. The Government should provide guidance on when the new IDR regime is intended to commence operationally for affected FSPs, its interaction with existing breach reporting obligations, and the timetable for ongoing industry consultations, to enable businesses to prepare for the change without incurring unnecessary regulatory costs.

Material Changes s.1046(2):

19. If the recommended changes to section 1046(2) in 4. and 6. above are not made then provisions should be inserted into the EDR Bill explaining the meaning of "material changes" in section 1048(2)(d), so that there are substantive limitations on the EDR scheme making changes which may operate to damage smaller businesses and inhibit competition in the financial services industry.

Credit Representatives:

20. The government should remove credit representatives from the Complaints Framework, by deleting the words "and credit representatives" from the definition of "Financial Firms" in the glossary to, and from para 1.130, of the EDR EM where the EDR Bill is amended to insert structure features to reduce the likelihood of an expensive EDR scheme acting as a barrier to entry.

APPENDIX 2 – AFIA BASIS FOR RECOMMENDATIONS

Submission

PART 1: INCLUSION OF A RIGHT OF APPEAL PARTICULARLY ON QUESTIONS OF LAW

1. Two-tier justice system

1.1 The EDR Bill proposes to insert a new Part 7.10A titled "External dispute resolution" into the *Corporations Act 2001*, together with consequential definition changes to section 761A. Part 7.10A comprises four divisions. Division 1 concerns authorised on of EDR schemes. Division 2 concerns the Australian Securities and Investment Commission's (**ASIC**) role in regulating EDR schemes. Division 3 concerns additional provisions relating to superannuation complaints. Division 4 concerns miscellaneous matters, principally the referral of matters to ASIC and the Australian Prudential Regulation Authority (**APRA**).

1.2 Subsection 1061(1), Division 3 provides:

"A party to a superannuation complaint may appeal to the Federal Court, on a question of law, from the EDR decision-maker's determination of the complaint"

1.3 As drafted a FSP can only appeal an EDR decision-maker's determination of a complaint to the Federal Court on a matter of law if it is a party to a "superannuation complaint". A superannuation complaint is defined in section 2052 (not reproduced in full) by reference to complaints related to "a decision" by:

(a) a trustee of a regulated superannuation fund or approved deposit fund;
(b) a trustee maintaining a life policy;
(c) an insurer under an annuity policy;
(d) a superannuation provider in specified circumstances';
(e) a retirement savings account (**RSA**) provider;
(f) an insurer in specified circumstances;

or certain "conduct" by

(g) an insurer or insurer's representative in relation to specified products; and
(h) an RSA provider or RSA provider's representative.

These entities are collectively referred to as "Superannuation FSPs" in this submission, and we note what appears their greater access to justice as they can appeal decisions of the EDR decision-maker to the Federal Court on matters of law.

1.5 Other FSPs (eg Credit Provider FSPs) have no rights under the EDR Bill to appeal errors of law by an EDR decision-maker to the Federal Court.

1.6 The Ramsay Review recognized that Other FSPs have no substantive right of appeal under the existing Complaints Framework,[4] but did not directly deal with this in any of its recommendations. As we understand on considering the Report, the basis for this appears to be the Ramsay Review's understanding of the parameters of the concept of

[4] See for example page 38, *"Final Report: Review of the financial system external dispute resolution and complaints framework",* Ramsay Review.

"fairness", which was framed solely by reference to only one of the two parties subject to the Complaints Framework, namely consumers. Given the objective of having EDR, we recognise that it is appropriate to consider fairness from the position of the customer-complainant. But, equally, the EDRS complaint manager should consider the position of the other party to the complaint, the FSP respondent, and fairness in the context of their relationship with that customer in his/her own right but also as part of a broader portfolio of customers. A determination in favour of that one that is incorrect as a matter of law may have significant flow on compliance outcomes for the FSP which will impact its broader customer portfolio. By confining the concept of fairness to the customer complainant, the outcome potentially operates unfairly with detrimental impacts for the FSP customers, present and future.

1.7 The EDR EM suggests, at para 1.80, that the reason for giving Superannuation FSPs the right to appeal on matters of law is because of:

"the unique nature of some superannuation complaints"

1.8 However, an EDR decision-maker will on occasion make errors of law when determining superannuation complaints, and a Superannuation FSP will have a right of appeal. Equally, an EDR decision-maker will likely also make errors of law when determining other complaints (eg credit), and it is also equally important that the FSP respondent (eg Credit Provider FSP) have a right of appeal.

1.9 The Consultation Paper attempts to explain this dichotomy at para 24:

"… unlike other financial system complaints, some superannuation complaints may not be able to be adequately resolved by relying on the contractual obligations between the EDR scheme and its members (as set out in the terms of reference)."

1.10 The Consultation Paper, unlike the EDR EM, contemplates that an EDR decision-maker will make errors of law when determining non-superannuation complaints. However, it suggests that no right of appeal is needed to fix these mistakes by the EDR decision-maker. This is said to be because of "the contractual obligations between the EDR scheme and its members (as set out in the terms of reference)". However, the Consultation Paper does not thereafter attempt to explain how the justice of not having the law correctly applied to a Credit Provider FSP is "adequately resolved" by these "contractual obligations".

1.11 A contract is ordinarily the outcome of a negotiation between two parties, each operating at arm's length to one another, under which goods or services are exchanged for consideration, and in the course of which various supporting legal rights and obligations are created. However, the "terms of reference" (TOR) bears very little resemblance to a normal contract.

1.12 First, businesses who wish to provide consumer credit are obliged by the terms of their credit licence or financial services licence to become members of an EDR scheme. Second, an individual FSP has no capacity whatsoever to negotiate variations to the scheme's TOR. Third, existing TOR's typically deal with the possibility of incorrectly applying the law by omitting any obligation on the EDR scheme to apply the law when reaching a determination.[5]

1.13 The only way in which it could reasonably be said that the TOR "adequately resolve[s]" this issue is that it gives Other FSPs the choice of accepting what is arguably a lack of

[5] See paragraph 17.2, Terms of Reference 1 January 2010 (as amended 1 January 2015), Financial Ombudsman Service

justice (of having to abide by determinations not made in accordance with the law) or go out of business. This does not appear reasonable, nor is it good policy since it makes participation in Australia's financial services sector more expensive,[6] less certain and ultimately less competitive to the long-term detriment of consumers.

AFIA recommendations

1.14 AFIA recommends that the Government remedy this significant oversight of the Ramsay Review and include a right of appeal to the Federal Court on matters of law for all FSPs and all financial services and products where the EDR scheme does not apply the law.

1.15 This could be done by amending the EDR Bill and the EDR EM to make it clear that:

(i) the EDR decision-maker has an obligation to apply the law when making determinations; and
(ii) all members of the scheme can appeal a determination of the EDR decision-maker to the Federal Court on a question of law.

1.16 As a matter of drafting the clearest way to fix this problem is to insert a new division into Part 7.10A entitled "Appeal rights on questions of law", which clearly describes the EDR decision-maker's obligation to apply the law when reaching determinations and that all members of the EDR scheme can appeal determinations on a question of law.

1.17 Failing that

(i) subsection 1047, which describes the scheme functions, should be amended by inserting the following text in bold:

*"(j) to deal with complaints in a way that **applies the law in a** fair, equitable and independent **manner***" (also see further recommended changes in 4. Below) AND

(15) subsection 1057(3) should be amended by inserting the words highlighted in **bold** below:

"*The EDR decision-maker must not make a determination of a superannuation complaint **or other complaint** that would be contrary to:"* and

(iii) subsection 1061(1) should be amended by inserting the words highlighted in **bold** below:

*"A party to a superannuation complaint **or other complaint** may appeal to the Federal Court, on a question of law, from the EDR decision-maker's determination of the complaint."*

[6] The increased cost arises from designing compliance systems and business processes which accord with "the law", but then having to reconfigure these systems and processes to be compliant with "the lore" of EDR scheme decisions which are not made in accordance with the law.

PART 2: MINISTER'S AUTHORISATION DECISION SHOULD ALSO REQUIRE CONSIDERATION OF AN ASSESSMENT OF (1) THE PROPOSED CHARGING MODEL TO BE BORNE BY FSP SUBSCRIBERS AND (2) THE ABILITY AND CAPACITY OF THE SCHEME TO DEAL WITH A DIFFERENTIATED MARKET:

2 AFCA needs to be managed cost effectively having regard to all market segments to prevent it acting as a barrier to entry though acknowledging this flows from the broader licensing and other regulatory obligations that act as inhibitors to new entrants.

2.1 Australia's financial services sector is highly concentrated with a small number of participants having significant pricing power.[7] This situation, as found by the Coleman Review, was a matter of concern to the House of Representatives Standing Committee on Economics. The Coleman Review made a number of recommendations aimed at reducing barriers to entry and increasing competition within Australia's financial services sector, albeit with a focus on the banking segment. These were accepted by the Government.[8]

2.2 The converse of the Coleman Review's observations is that Australia's financial services sector also comprises a large and diverse range of participants operating across a wide range of industry sub-segments each with limited pricing power.

2.3 Yet the Ramsay Review when it recommended "a single one-stop shop" to apply to the entirety of licensed participants across the financial services sector, did so with no clear statement that it had taken into account the diverse and broad nature of that sector, as found by the Coleman Review. Consequently, the Ramsay Review's recommendations did not include any system design constraints to ensure that any new EDR scheme was required to operate in a cost-effective manner, particularly having regard to smaller business members.

2.4 This appears to have created a conflict of policy positions with, on the one hand, the Coleman Review recommending changes to reduce barriers to entry and, on the other, the Ramsay Review, by not dealing with pricing model discipline in its recommendations created the potential for an unconstrained-cost EDR scheme which may result in a barrier to entry for smaller competitors if the costs are set at a level that would challenge their ability to access membership.

2.5 The Ramsay Review's omission in its recommendations has flowed through to the EDR Bill which does not currently contain any structural features to prevent AFCA pricing membership or fees for complaint-handling in a way that impacts different market segments, thereby impeding the Government from achieving another of its broader policy objective of increasing competition within the financial services sector. We appreciate that the shift to a single-EDR scheme coupled with a statutory obligation to be a member as a pre-cursor to obtaining or maintaining a license to operate in the relevant market segment (eg for an ACL consumer credit provider) would in practice mean that AFCA would need to have a pricing model to accommodate the differentiated market. However, to remove underlying uncertainty and concern, we recommend that this should be made clear.

[7] See, for example, paragraphs 1.2 and 4.20, *Review of the Four Major Banks (First Report), House of Representatives Standing Committee on Economics*, November 2016.
[8] See the Treasurer's media release 9 May 2017, "*Building an accountable and competitive banking system"*, including Attachment A – Government Response to the Coleman Report.

AFIA recommendations

2.6 AFIA recommends that the EDR Bill be amended to insert structural features which reduce the likelihood of the Complaints Framework having a pricing model that may act as a barrier to entry.

2.7 AFIA recommends that the EDR Bill be amended as follows:

(i) Subsection 1046(2), which specifies the matters which the Minister must take into account when authorizing a scheme, by inserting the following text in bold:

"(e) the fairness of the scheme ***to both complainants and members****;"*

"(l) ***its ability to balance positive consumer outcomes with a low cost operational model which does not disadvantage smaller members****"* (new subsection 1046(2)(l))

(ii) Subsection 1047, which describes the scheme functions, by inserting/amending the following text in bold:

"(j) to deal with complaints in a ***cost-effective*** *way that applies the law in an* ***independent, fair and equitable*** *manner* ***to both complainants and members;****"*

"(l) ***to ensure the scheme does not act as a barrier to entry thereby impeding competition within the financial services sector****"* (new subsection 1046(2)(l))

3 EDR scheme variegated expertise across financial services industry segments

3.1 A common concern for many FSPs across multiple industry segments during the design phase of the new Complaints Framework was that a "one-stop shop" for consumers would morph into "a one-size fits all approach" regardless of business members' size, profile and industry segment. This outcome would, in turn, lead to ill-informed and inappropriate decisions being made by the EDR decision-maker leading to higher costs for individual businesses and ultimately anti-competitive outcomes across the breadth of the financial services industry.

3.2 This concern is evident in a broad range of industry submissions to the Ramsay Review, most particularly from those associations representing smaller businesses participating in the financial services industry.[9] This fundamental concern was usually expressed as a preference to retain the existing multiple EDR scheme arrangements.[10] This was broadly based on the perception that different EDR schemes had developed differing industry segment expertise, which enabled them to better balance the competing positions of FSPs and consumers when reaching decisions and that this expertise would be lost in a single mega-scheme.

3.3 There is no clear indication that the view of these smaller FSPs was appropriately and fulsomely considered and addressed in forming the recommendations in the Ramsay Review. In contrast, its view appeared to be that because the two different Ombudsman schemes already dealt with multiple industry segments within each scheme it followed

[9] See, for example, submissions by the Commercial Asset Finance Brokers Association of Australia (CAFBA) and the Mortgage & Finance Association of Australia (MFAA) amongst others.
[10] See, for example, submissions by the Australian Collectors & Debt Buyers Association (ACDBA) and Australian Retail Credit Association (ARCA) amongst others.

that a one-stop shop would have no difficulty in dealing with all industry segments.[11] Further, businesses in particular industry segments are overwhelmingly happy with their EDR schemes capacity to deal with their complaints in their segment, if not they would move to another EDR scheme and this only happens infrequently.[12]

3.4 The experience within our membership provides evidence of an alternate conclusion. Several have shifted from one Scheme to the other. We also note that the Coleman Review was skeptical of this line of reasoning in a banking context. It made a number of recommendations to overcome "customer inertia [which] also limits effective competition".[13]

3.5 In contrast, the Ramsay Review made no specific recommendations to ensure that any new EDR decision-maker was structured in a way to ensure that it was able to deal appropriately with different disputes in different industry segments in a nuanced and cost-sensitive manner given differing industry segment profiles.

3.6 In the absence of specific provisions to prevent this, the risk of a one-size fits all decision-making approach regardless of industry segment, business type and model, occurring is possible under the proposed Complaints Framework. The outcome would therefore be similar to the current situation. For example, the Financial Ombudsman Service when reaching determinations appears to benchmark the behavior of non-bank credit providers in their dealings with the customer complainant against a provider that was a bank ,[14] or to benchmark the behavior of a non-NCCP credit provider as if it was subject to the NCCP[15] etc. This creates the challenging and arguably unreasonable situation of a FSP respondent being assessed in relation to a customer complaint and how they behaved against a compliance framework that the FSP had no obligation, legal or otherwise, to comply with when dealing with that customer. As the EDRS Determinations drive compliance setting, this is not a good outcome for either the FSPs or their customers for a range of reasons.

3.7 To overcome this we recommend that the Government should ensure AFCA is structured, including operating processes and pricing, to prevent "a one-size fits all" approach to complaint determinations for any FSP member regardless of whether that approach is appropriate given the particular FSP size, profile and industry segment.

3.8 Without these structural safeguards AFCA has the potential to become a high cost, non-differentiated scheme. Smaller non-bank participants will be treated as if they were banks, non-NCCP lenders will be treated as if they were a NCCP lender and equally over time innovation, competition and smaller businesses will be diminished in the financial services sector.[16]

AFIA recommendations

3.9 AFIA recommends that, in the interests of certainty and to assist maintain a competitive market, that a specific obligation be imposed on the EDR scheme that it be structured in a manner, including operating processes and pricing, which enables it to operate in a differentiated market segment manner rather than "a one-size approach fits all" FSPs

[11] See for example para 5.41, Ramsay Review Interim Report
[12] See for example para 5.33, Ramsay Review Interim Report
[13] Para 4.58 Coleman Review First Report
[14] See, for example, FOS determinations 210216, 300272, 342787, 356362, 416004 amongst others.
[15] See, for example, FOS determinations 234031, 365522, 397496, 416004, 433152 amongst others.
[16] The terms NCCP lender and non-NCCP lender are respectively used to describe credit providers who are regulated and not regulated by the *National Consumer Credit Protection Act 2009*.

across the breadth of the financial sector, regardless of their business size, profile and industry segment.

3.10 AFIA recommends that the EDR Bill be amended as follows:

(i) Subsection 1046(2), which specifies the matters which the Minister must take into account when authorising a scheme, by inserting the following text in bold:

"*(k) the expertise available to the scheme in dealing **appropriately** with complaints **in different industry segments**;*"

(ii) Subsection 1047, which describes the scheme functions, by inserting/amending the following text in bold:

*"(j) to deal with complaints **in different industry sectors** in a way that is independent, fair and equitable to both complainants and members**;"*** (including the changes recommended in paragraph 2.9)

PART 3: MINIMISE UNINTENDED OUTCOMES FROM DRAFTING TO ACHIEVE THE LEGISLATIVE OBJECTIVE AND TERMS OF REFERENCE SCOPE:

4.1 We note the clear intention of the Complaints Framework is to capture Financial Firms that are Australian Credit Licensee credit providers. This is reflected at various points in the EDR Bill where the link is clearly provided between credit providers who have an Australian Credit License. This intention may have been less clear in the Explanatory Memorandum and we recommend revision to ensure both documents align.

4.2 For example, Para 1.129 of the EDR EM states as follows:

"*Part 2 of Schedule 1 to the Bill includes amendments which mean that certain **Financial Firms** must be members of AFCA."* (emphasis added)

4.3 The term "Financial Firms" is defined in the Glossary to the EDR EM to be:

"*Australian Financial Services licensees, unlicensed product issuers, unlicensed secondary sellers, **credit providers** and credit representatives, superannuation funds (other than self-managed superannuation funds), approved deposit funds, retirement savings account providers, annuity providers, life policy funds and insurers*." (emphasis added)

AFIA recommendations

4.4 AFIA recommends that the EDR EM be amended to align the EDR EM with the EDR Bill as follows:

(i) the definition of Financial Firms in the glossary be amended by deleting the term "credit providers" and inserting the following text in bold:

"*Australian Financial Services licensees, unlicensed product issuers, unlicensed secondary sellers, **Australian credit licensees** and credit representatives, superannuation funds (other than self-managed superannuation funds), approved deposit funds, retirement savings account providers, annuity providers, life policy funds and insurers*."

(ii) para 1.130 be amended by deleting the term "credit providers" and inserting the following text in bold:

"*This licence condition applies to all Australian Financial Services (AFS) licensees, unlicensed product issuers, unlicensed secondary sellers,* ***Australian credit licensees*** *and credit representatives*."

PART 4: TRANSITIONAL ARRANGEMENTS

5.1 The Government anticipates AFCA will be operational by 1 July 2018.[17] And for a period the current EDR Schemes and AFCA will be in operation during the transition to just AFCA. The transition brings with it significant complexities which need to be appropriately addressed for the benefit of all participants. We submit that given these complexities and the dynamic nature of a complaint-resolution process, further and more detailed consideration of the transitional arrangements is warranted. Operational input from our members and other FSPs critical to this process.

5.4 For example, how will complaints be handled during the transition period? Are there any circumstances in which an existing EDR scheme can refer resolution of an existing complaint to AFCA? Are complainants able to re-prosecute their original complaint under AFCA if they are unhappy with the outcome under an existing EDR scheme?

5.5 Para 40 of the Consultation Paper states that existing EDR schemes will deal with complaints lodged with them prior to commencement of AFCA. However, the Treasury Fact Sheet states that "Consumers will have the option to transfer their complaint to AFCA if they wish to do so".

5.6 These matters must be clarified to ensure the transition to the new arrangements do not cause unintended consequences for complainants or members. If complainants reach the conclusion they are not going to succeed in their complaint under an existing EDR scheme, can they transfer their complaint, mid-process, to AFCA in the hope of securing a better outcome?

5.7 The second important issue is that while it is proposed that FSPs who are already a member of an existing EDR scheme have 6 months after the Application Day in which to become a member of AFCA, there is still the potential for the majority of members to have overlapping memberships with two or three different EDR schemes at the one time. This will potentially mean double, or triple, the membership fees for these members. In our view, EDR scheme members, particularly smaller businesses, should not have to pay two (or three) sets of fees for membership of different EDRS (existing and AFCA) during the transition period. This would clearly be unfair and anti-competitive since smaller businesses with limited pricing power are less able to absorb such an additional regulatory cost.

5.8 Member EDR data shows that 5% of EDR complaints take longer than 6 months to get to a determination, while most complaints are finalised within 12 months. Maintaining two or three sets of EDR scheme fees based on 5% of complaints seems disproportionately burdensome.

5.9 We recommend scheme members should only be required to pay fees for the new EDR scheme, with existing EDR schemes carrying their own costs in the run-down period. The easiest way to address this issue is to amend the EDR Bill to provide automatic reciprocal membership to AFCA for all FSPs who are currently a member of an EDR

[17] Para 1.14 EDR EM

scheme at the Application Date. Fees paid to the current should also be see to cover membership of AFCA for the period remaining till the previous renewal date anniversary. An alternate would be to require the FSP to apply for membership to AFCA, but then provide a rebate or discount on a pro-rata basis for any part of an existing EDR scheme membership fee which relates to the period after AFCAs commencement.

5.9 We also noted what appears to be a drafting omission and suggest inclusion in Schedule 1, Part 2, item 48 of the EDR Bill a reference to the *National Consumer Credit Protection Act 2009* in addition to the current references to the *Corporations Act 2001* and the *Superannuation (Resolution of Complaints) Act 1993*.

AFIA recommendations

5.10 AFIA recommends that a new division be inserted into Schedule 1 of the EDR Bill to address important transitional issues in one place, with consequential changes to Schedule 2.

5.11 AFIA recommends the Government revisit its approach of FSP dual membership during the transition to minimise red-tape by reducing unnecessary compliance additions and the potential for double-subscription fee payment. For example, AFIA recommends that FSPs who are currently members of an existing EDR scheme are automatically given reciprocal membership to AFCA and their fee payment recognised up to the anniversary date of renewal under their old EDR Scheme. Or if FSPs are required to apply to become members of AFCA from its commencement date, that they are entitled to a rebate or discount on new EDR scheme membership fees taking into account the fee previously paid to cover that part-period up to anniversary date annual renewal.

5.12 AFIA recommends that the new division to Schedule 1 of the EDR Bill include provisions which make it clear that:

(i) all complaints submitted to an existing EDR scheme before commencement of AFCA must be determined by that existing EDR scheme;

(ii) no further complaints can be accepted by an existing EDR scheme once AFCA is established;

(iii) complainants cannot choose to transfer their complaint to AFCA for resolution once it has been accepted by an existing EDR scheme;

(iv) all determinations of the existing EDR scheme are final and consumers and members cannot re-prosecute this complaint in AFCA; and

(v) AFCA will not have regard to decisions under the existing EDR scheme as having any precedential value when reaching determinations, due to the risk of errors of law.

OTHER MATTERS

New EDR scheme governance structure

6.1 While a specific question was not addressed to the proposed corporate structure of the new EDR scheme, AFIA notes that the proposed model of a company limited by guarantee is inconsistent with the purpose and intended management of the scheme. Given the control the government, and ASIC in particular, will seek to have over the scheme's legislative objectives and terms of reference, the scheme would be more appropriately structured as a statutory body.

6.2 The Board of any company is obliged to put the interests of that company ahead of any other consideration under their Corporations Act obligations. This sits inconsistently with ASIC, or the government, having the power to amend the EDR scheme's terms of reference or the government of the day changing the legislative objectives. Such powers have the potential to place the directors in a compromised and conflicted position with their Corporations Act obligations.

6.3 We further note that the purpose of the EDR Bill, in general terms, is to establish the legislative architecture within which the new financial services EDR system will operate. As such, it establishes the overarching framework for the system. However, the EDR Bill does not establish the more specific and important governance framework to clearly define and shape AFCA. Because this has the potential to significantly impact the strategic direction and operating model of AFCA we recommend inclusion of this detail in the EDR Bill. At present, the EDR Bill does not appear to contain any provisions prescribing AFCA's governance structure, other than Division 2 which relates to ASIC's oversight role.

6.4 In the EDR EM, the sole reference to AFCA's governance structure is para 1.18 which reads:

"AFCA will be governed by a board comprising of an independent chair and an equal number of directors with consumer and industry backgrounds."

6.5 The Consultation Paper states at paragraph 36 that one of the matters which is expected to be addressed in the scheme's terms of reference is:

"the governance structure of the scheme (and in particular, that the Board will comprise an independent Chair and equal number of directors with consumer and industry backgrounds;"

6.4 The EDR scheme will have an operating budget of many millions of dollars, it will likely deal with complaints from many thousands of individuals and its determinations will have a widespread impact on industry. Given the fundamental importance of the EDR scheme to the success of the new Complaints Framework the EDR Bill and EDR EM should include provisions describing the governance arrangements which are to apply to AFCA in a detailed and substantive manner.

AFIA recommendations

6.5 AFIA recommends that the new EDR scheme be established as a statutory body, given the potential for government and/or regulator influence over its Terms of Reference and potentially its legislative obligations.

6.6 As a minimum,the EDR Bill and EDR EM should be amended to provide substantive guidance as to the governance arrangements which will apply to AFCA given its importance to the new EDR system.

6.7 AFIA recommends that subsection 1046(2), which specifies the matters the Minister must explicitly take into account when authorising an EDR scheme, be amended to include new item (m) as follows:

"(m) the governance arrangements of the scheme"

6.8 AFIA recommends that the EDR EM be amended to state that the governance arrangements applying to AFCA will include:

(i) a board comprising no less than fourteen directors with seven directors representing industry and seven directors representing consumers;
(ii) each industry director will represent a different industry segment;
(iii) the following seven industry segments will be represented on the board: Banks and ADIs; Life, General Insurers and Insurance Brokers; Other AFSL holders; Mortgage financiers and credit representatives; Debt buyers and collectors; Other ACL holders; and Privacy Act participants;
(iv) members of each of the industry segments are entitled to vote for their industry segment director with voting rights proportionate to total fees paid by the member;
(v) each consumer director is to be elected by a panel of named consumer groups;
(vi) the independent chairman is to be elected by the board subject to the achievement of a majority of industry director votes and a separate majority of consumer director votes;
(vii) all directors and the chairman are subject to re-election every two years;
(viii) AFCA must prepare financial statements in accordance with the requirements applicable to an ASX-listed reporting entity; and
(ix) director remuneration approval requirements should mirror those applicable to an ASX listed entity, including the potential for a spill motion after two strikes.

Internal Dispute Resolution (IDR)

7.1 Presently FSPs who are Australian Credit Licensees provide data to the ASIC on their current IDR processes and performance as a part of their annual Australian Credit Licence attestation. In addition, FSPs who are a party to the Financial Ombudsman Service's (**FOS**) General Insurance Code of Practice (GICOP) provide annual IDR data to FOS, which information we understand is onforwarded to ASIC.

7.2 The Ramsay Review was correct when it commented, "[t]here is currently no comprehensive, consistent, comparable, publicly available IDR data."[18] However, we submit that they may have arrived at a wrong conclusion when it said that "ASIC does not have the power to collect recurring data about financial firms' IDR activities".[19] And consequently little thought appears to have been given as to how the new IDR reporting regime will interact with existing IDR reporting practices, although the Ramsay Review commented these existing processes should be leveraged off.[20]

[18] Para 10.3, page 186, Ramsay Review Final Report.
[19] Para 10.4, page 186, Ramsay Review Final Report.
[20] Para 10.19, page 189, Ramsay Review Final Report.

7.3 The Ramsay Review also observed that a number of possible metrics were suggested,[21] but recommended that ASIC should "determine the content and format of IDR reporting" following consultation.[22]

7.4 Schedule 2, Part 1 of the EDR Bill deals with the new IDR reporting arrangements. The provisions in Schedule 2 have the effect of requiring:

(i) an FSP which is subject to EDR obligations;
(ii) which deals with "retail clients",[23]
(iii) to have in place an IDR system which complies with ASIC guidance; and
(iv) to provide IDR information specified by ASIC under an as yet unissued legislative instrument.

7.5 Schedule 2, Part 1 of the EDR comes into effect the day after the EDR Bill receives Royal Assent. But, operationally an affected FSP only has to start reporting the specified IDR information once the ASIC legislative instrument comes into effect.

7.6 The Consultation Paper does not provide any indication as to whether ASIC will consult with industry as recommended, or when those consultations will commence, or when the new IDR reporting regime will come into effect. In particular, no guidance is given as to whether it is intended that the new IDR reporting regime will also come into effect on 1 July 2018, or its interaction with existing breach reporting obligations. If this occurs with limited, to no, consultation with industry then this is expected to cause significant transitional regulatory costs for industry for no valid policy rationale.

AFIA Recommendations

7.7 The Government should provide guidance on when the new IDR regime is intended to commence operationally for affected FSPs, its interaction with existing breach reporting obligations and both the timetable and scope of ongoing industry consultation, to enable businesses to prepare for the change without incurring unnecessary regulatory costs.

PART 5: DEVELOPMENT OF TERMS OF REFERENCE WITH INDUSTRY INPUT

8.1 The Consultation Paper discusses from paras 32 to 39 the terms of reference which are to govern the manner in which AFCA will operate. It is clear from this discussion that the ToR will be of crucial importance to the operation of AFCA and system. This is the reason why material changes to the ToR will be subject to ASIC approval.[24]

8.2 Further, enforcement of the ToR by ASIC direction appears to be the sole means of holding the EDR scheme to account,[25] short of the Minister revoking the EDR scheme's authority, on which would be an extreme action.[26] This approach suggests that, in practice, the EDR scheme will be largely unaccountable.

8.2 Given the ToR will be of critical importance to the operation of an EDR scheme which will in practice be largely unaccountable, it is surprising that there will be no opportunity for public scrutiny of AFCA's ToR prior to its commencement. The Consultation Paper merely contemplates, at para 35, that the:

[21] Para 10.13, page 188, Ramsay Review Final Report.
[22] Recommendation 8, page 190, Ramsay Review Final Report.
[23] As defined in section 761G, *Corporations Act 2001*.
[24] Para 39 Consultation Paper and subsection 1050(1)(a) EDR Bill.
[25] Section 1051, EDR Bill.
[26] Subsection 1046(3), EDR Bill

"Minister will carefully consider the terms of reference when approving a company to be the authorised EDR scheme. The Minister will publicly outline the minimum requirements that would be expected to be included in a scheme's terms of reference for it to be designated as the authorized EDR scheme at a later date."

8.3 Because of their criticality to members operations and systems settings, AFIA recommends that the initial draft terms of reference for AFCA be released for public consultation prior to Ministerial consideration. This will allow operational issues to be identified early and resolved prior to the Minister's consideration.

Material changes

8.4 As noted in 8.1 material changes to AFCA's ToR must be approved by ASIC. However, the EDR EM does not provide any specific guidance as to what type of changes might be regarded as "material changes". The EDR EM does, though, state at para 1.62 that "when considering whether to approve the material change, ASIC must take into account the same matters that the Minister was required to consider when authorising the EDR scheme" (as contained in section 1050(3). This requirement implies, at least as a minimum, that a change is material if it affects one of the matters listed in section 1046(2). No indication is given as to what other matters, if any, are material.

8.5 As noted in parts 2 and 3 of this submission section 1046(2) does not adequately take into account the circumstances of, and cost implications to, the large number of smaller businesses operating in diverse segments of the financial services sector. Recommendations have been made elsewhere in this submission to amend section 1046(2) to overcome these defects and these are equally relevant in this context.

8.6 The concept of materiality is, by definition, specific to the entity to which it is applied. An amount which is immaterial to a large multinational, or indeed a large EDR scheme which receives millions of dollars through compulsory levies, may be very material to a smaller FSP trying to compete on price in the Australia's financial services industry.

8.7 Given the manner in which section 1046(2) is currently drafted, changes may be made by the EDR scheme to its ToR which materially adversely affect the scheme members, including potentially forcing them out of business. But, because these changes are not 'material' to the scheme, the changes do not have to be approved be ASIC.

8.8 Presumably, the intended check to this possible adverse outcome is that the new Board of AFCA comprises equal representation from industry and consumers. But, in a diverse financial services industry where most participants are smaller and lack pricing power, who will be those industry representatives and how will they be chosen in the context of a mega-EDR which encompasses all of the financial services sector, but with fewer board seats? We note the need for greater protection given the scale of the risk to individual FSPs and encourage a Board that represents the diverse market.

AFIA recommendations

8.9 AFIA recommends that the initial draft terms of reference for AFCA be released for public consultation prior to Ministerial consideration.

8.10 If AFIA recommended changes to section 1046(2) are not made then provisions should be inserted into the EDR Bill explaining the meaning of "material changes" in section 1048(2)(d), so that there is an in-substance check on the EDR scheme making changes which damage smaller businesses and hinder competition in the financial services industry.

OTHER ISSUES WITH THE EDR BILL

Discussion Paper Question 1: Are there other powers the EDR body will need to resolve superannuation complaints effectively?

The comments in sections 2 and 3 of this submission are also relevant to superannuation complaints. AFIA does not have any additional comments specific to the effective resolution of superannuation complaints.

Discussion Paper Question 2: Do you consider that the Bill strikes the right balance between setting AFCAs objectives in the legislation whilst leaving the operation of the scheme to the terms of reference?

AFIA members have no objections to the proposed approach provided the ToR operate practically to ensure:

(i) vexatious and frivolous complaints can be dealt with swiftly and at no cost to members;

(ii) Members are given the opportunity to resolve any complaints that have not been through the IDR process at first instance, without incurring any EDR scheme fees; and

(iii) AFCA has a graduating fee schedule that applies for different types of complaints taking into account the value of the complaint and allowing reduced fees to apply for small value complaints (eg default listing complaints) so that EDR scheme fees are not commercially prohibitive thereby forcing members to settle unmeritorious complaints rather than letting the matter proceed to EDR scheme determination.

AFIA Recommendations

AFCA has the authority to identify vexatious and frivolous complaints quickly and at no cost to members

Members are given the opportunity to resolve any complaints that have not been through their IDR process at first instance, without incurring any EDR scheme fees

The overall fee structure for is carefully considered with a graduating fee schedule that applies for different types of complaints and taking into account the value of the complaint, allowing reduced fees to apply for small value complaints

EDR scheme fees be reasonable so Members are not forced to settle with complainants rather than to allow a matter to go to determination.

Discussion Paper 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?

As noted in more detail in our earlier comments above, currently, there is no review mechanism for determinations of EDR schemes, which allows the schemes broad and inappropriate power to be policy makers and to set industry standards that are not based on any rule of law or contractual basis.
This has caused Members considerable frustration and unjustifiable costs due to the inequitable, uncertain and arbitrary EDR outcomes resulting from EDR schemes imposing standards, (for example, the Banking Code of Practice on non-subscriber/ non-Bank FSPs) and legal and contractual interpretations being non-challengeable.

In addition, Members operating under a credit licence are obliged to comply with credit related legislation. In doing so, they have regard to regulatory guides which ASIC publishes, setting out how it will administer relevant law. However, even those guides recognise the only true decider of the law is a court.

Members have experienced current EDR schemes applying their own interpretations of the law, which have the potential set a precedent about how an EDR will use that interpretation in the future. It is crucial to the efficient and effective operation of both the EDR scheme and management of IDR that appeals on law are available. Otherwise, EDR scheme interpretations have the capacity to undermine both regulatory intent and the law, as promulgated.

Our Members are of the view that all types of complaints should be subject to appeal rights in the Federal Court on points of law, as this has been an area of significant weakness, with inappropriate outcomes, under the current EDR schemes;

Members are also strongly of the view before that appeal right is exercisable on any type of complaint there be a review or appeal mechanism in place to allow for an efficient and cost-effective means for the review of all types of determinations.

AFIA Recommendations

AFIA strongly recommends all decisions be subject to a review or appeal mechanism.

AFIA strongly recommends all types of complaints should be subject to appeal rights in the Federal Court on points of law.

Discussion Paper Question 4: Are there any additional issues that should be considered to ensure an effective transition to AFCA?

See previous detailed comments and suggestions offered to assist improve the EDR Bill as currently drafted.

Discussion Paper Question 5: Would moving immediately to a compensation cap of $1 million have significant impacts on the availability/price of professional indemnity insurance?

Members are not able to provide an indication of the potential price impact at this point but expect such an increase in the compensation cap would significantly impact on professional indemnity insurance pricing.

AFIA Recommendations

AFIA recommends the cap itself, and the basis for such an amount, be investigated to determine whether such a high amount can be justified as appropriate. It should be considered against the resolution outcomes achieved through the EDR schemes, particularly where the finance sector has already provided funds to customers and any redress must take that into consideration.

AFIA also recommends this matter be investigated further with insurance providers, particularly as it has the potential to seriously impact on smaller Members' insurance costs, despite the unlikely event of such a compensation amount ever being awarded against them.

Discussion Paper, Question 6: Are the existing sub-limits for different insurance products still required?

Members have not provided any comment on this question.

Discussion Paper, Question 7: Are there any reasons why credit representatives should be required to be a member of an EDR scheme?

AFIA members, on balance, support the removal of credit representatives from AFCA for policy reasons. Including credit representatives in the Complaints Framework does not, in a practical sense, provide any additional level of protection for complainants. The holder of the Australian Credit License remains responsible to the complainant, notwithstanding any delegation to credit representatives.

The competing consideration, is the cost implications of excluding credit representatives from an EDR scheme. For example, if almost 25,000 credit representatives are excluded from this scheme's cost base going forward, we anticipate the funding shortfall will likely need to be made up by sharing that shortfall among the remaining EDR scheme members. Inclusion of structural features within the Complaints Framework to require the EDR scheme to have a low cost operating model, as recommended above in section 3 of our submission, would result in this real concern becomes less compelling.

AFIA Recommendations

AFIA recommends that the government remove credit representatives from the Complaints Framework and to insert structure features including pricing and operating model considerations to reduce the likelihood of an expensive EDR scheme acting as a barrier to entry.

Discussion Paper, Question 8: What will the regulatory impacts of the new EDR framework be?

The regulatory burden that our members and other FSPs will bear related to the new EDR framework includes:

- Updating multiple disclosure material, including the Financial Services Guide, Credit Guide, loan contract documents, privacy documents, default, hardship and complaint letter templates
    - There are significant costs and systems implications, including lead time frames, in updating these documents

- Training sales, operational and support staff and representatives in multiple locations across Australia
  - This is made more complex by the transitional period where complaints already lodged with current EDR schemes will be progressed through those schemes while new complaints will be progressed through the new scheme

- The additional cost burden if there is a duplication of membership fees during the transitional period
  - The move to regulated entities now being subject to levies to support regulatory bodies (e.g. ASIC, APRA and AUSTRAC Supervisory Cost Recovery Levies, plus ASIC licence fees) significantly increases operational costs, resulting in higher compliance costs which consumer must eventually carry in increased product pricing

- It is unclear the extent of the regulatory burden of reporting on IDR matters to ASIC will be as this will depend on the type and volume of information requested and the timeframes given to provide the information.
  - It will ease the regulatory burden if members are given ample time in which to collate and produce the required information
  - Relevance of the reporting requirements should be clear and only be collected if ASIC has the resources to review the data for specified purposes

- Members consider the integrity of the new scheme is highly dependent on its Terms of Reference including general accountability to service standards, documented in Service Level Agreements with EDR Scheme Members, covering areas such as:
  - Complaints management timelines;
  - Fairness and equity for all parties;
  - Clarification on the roles of law, precedents and judgments in decision-making processes;
  - Resourcing requirements;
  - Open and transparent reporting requirements on timeframes, outcomes etc;
  - Appeals processes;
  - When, or if, specific industry standards should be applied to non-subscribing members (e.g. Code of Banking Practice).

- Members require the Terms of Reference to provide clarity on matters such as:
  - Definitions, including “small business”, “material change” and “unlicensed product issuers”;
  - Consistency with regulator breach reporting requirements;
  - Whether the new Scheme can reconsider FOS/CIO decisions – in our view, all decisions made under the current schemes should be final.

- Current EDR Schemes Terms of Reference may need to be amended post transition:
  - For instance, the FOS Terms of Reference states that systemic issues can be reviewed for a period up to 12 months;
  - Clarification is required on the wind-up position of schemes post transition.

- Another key concern is the sheer volume of regulatory change and the associated compliance costs to be managed in a short period. In 2017/2018, Members will be required to manage some, or all of the following: the flex commission prohibition, changes to insurance sales and financing, data sharing/portability, increased APRA regulation and mandatory comprehensive credit reporting amongst other new compliance initiatives.
  - Compliance costs and administrative red-tape become increasingly onerous;
  - Members require significant lead time to enable their businesses to cost and implement the range of compliance obligations

AFIA Recommendations

AFIA recommend industry be heavily involved in developing the ToR of AFCA to ensure its' policies and procedures are fair, equitable, open, transparent and its decision-making consistent with contract law, the law, legal precedents and judgments.

AFIA recommends the new EDR Scheme be required to meet Service Agreement Standards as agreed with Members under its Terms of Reference

In relation to IDR and reflecting our earlier comments in Sections 2 and 3 above:

- AFIA recommends a consultation period on the form and type of IDR information ASIC will be seeking in order to provide feedback on the regulatory burden and potential costs, systems implications and operational challenges of providing certain information and its overall utility to the regulator.

- AFIA recommend a lead time of at least 18 months to 2 years to enable Members to manage all the transitional challenges, including systems changes and the associated costs, the change to the new EDR scheme will create.

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