Credit Corp Group

Dispute resolution in the financial system
Treasury Laws Amendment (External Dispute Resolution) Bill 2017 ('the Bill')

Submission by Credit Corp Group Limited ('Credit Corp')
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Executive Summary

In its present form the Bill will promote an inefficient and uncompetitive financial system which has the potential to reduce the living standards of all Australians and damage economic growth by compromising the ability of the financial system to meet the needs of its users.

The Bill subjects all financial services providers, other than those in the superannuation industry, to uncertain and unpredictable decision-making by an unaccountable single private body.

Uncertainty in decision-making by the proposed Australian Financial Complaints Authority ('AFCA') will serve to increase compliance costs and inhibit product and service delivery innovation as operators attempt to deal with uncertain and unpredictable compliance requirements.

The proposed AFCA will be an unaccountable monopoly provider which, in the absence of external controls, will impose excessive costs on financial services providers.

Uncertain decision-making and the imposition of excessive monopoly-provider costs will damage competition in the market for financial services. In particular, smaller and more innovative financial services businesses which do not enjoy the benefits of scale, incumbency and government support will be least able to absorb costs and limitations associated with uncertainty. AFCA will enhance the market power of major incumbents and decrease competition in the market for financial services.

To address these substantial shortcomings Credit Corp recommends the following amendments to the Bill:

1. Decisions for all complaints, not just superannuation complaints, should be in conformance with the law
2. All decisions, not just those for superannuation complaints, should be capable of appeal to the courts on questions of law
3. Legislated governance controls should be imposed to ensure accountability for costs and a competitive financial services market, including:
    - Election of separate industry directors for each industry segment to ensure the representation of smaller financial services businesses.
    - Financial and remuneration disclosure in accordance with that applicable to listed public companies.
    - Detailed disclosure of expenses, particularly expenses not directly related to the resolution of complaints, including marketing, promotion, outreach and sponsorships.
    - Annual company member voting on the financial statements and the remuneration report, with a 75% majority requirement and provision for a board spill motion in the event of two successive failures to achieve such a majority.

Company Profile

Credit Corp is Australia's largest provider of sustainable financial services to the credit impaired consumer segment. The company has been listed on the Australian Securities Exchange since 2000 and forms part of the S&P ASX 200. Credit Corp employs 1,000 Australians and the face value of its total receivables is $6 billion across 850,000 consumers.

Credit Corp has a proven track record of promoting financial inclusion.

In our core business of debt purchasing we work with consumers who have, for various reasons, found themselves in default of their credit obligations. We agree affordable repayment plans with our customers and improve their credit standing over several years as a pathway to financial inclusion. We maintain the most successful hardship program in the industry with a current portfolio of $1.3 billion of defaulted consumer credit obligations, restructured into sustainable repayment arrangements across 160,000 individual customer accounts.

In our consumer lending business we provide the cheapest and most sustainable loan products to consumers with limited borrowing alternatives. All of Credit Corp's products feature interest and fee rates below the caps applicable to mainstream consumer lending. To date, Credit Corp has helped 150,000 Australians avoid higher cost and unsustainable products through its market leading alternatives.

Credit Corp has an impeccable compliance record. Despite being the largest and longest-established debt purchaser in Australia, we have never been the subject of a regulatory order or undertaking. We have one of the lowest rates of external dispute resolution complaints in the industry. We work cooperatively with consumer advocacy groups on matters of industry concern and have a long term partnership with Kildonan Uniting Care.

Uncertain and unpredictable decisions damage competition

Certainty in the law, regulation and judicial outcomes are critical preconditions for a competitive and efficient market. We have seen uncertainty in law and policy over many years have a detrimental impact on the national energy market, to the point where Australians now face some of the highest energy costs in the world and increasingly unreliable supply.

It is only when regulation and judicial outcomes are certain that industry has the confidence to invest and innovate to the benefit of all Australians. Certainty reduces the barriers to entry and decreases the costs of compliance. Certainty provides the parameters for product and service delivery innovation. Certainty reduces risk and allows new entrants to raise capital more cheaply and compete with major incumbents by employing lean cost structures and narrow profit margins.

The financial services industry already suffers from some of the most complex and onerous regulation facing any industry. All around the world, the wave of regulation introduced since the global financial crisis has produced a more concentrated financial services market dominated by inveterate incumbents. It is only recently that we are starting to see the potential for technology and innovation to challenge this dominance. The government must take care to ensure that regulatory complexity is not supplemented by judicial uncertainty to extinguish the prospects for a more competitive financial services market.

At best, uncertain decision-making will damage competition. At worst, uncertain decision-making may result in the withdrawal of financial services from entire consumer and business segments, with dire consequences for the economy and the living standards of all Australians.

The proposed AFCA will exacerbate uncertainty

The two existing ombudsman schemes enjoy wide decision-making discretions. The terms of reference of both the Financial Ombudsman Service ('FOS') and the Credit and Investments Ombudsman ('CIO') provide that decision-making is subject to fairness in all the circumstances taking into account good practice, industry codes and any relevant legal principles. Even when the existing schemes seek to apply the law, they can do so incorrectly without accountability. The contractual nature of ombudsman scheme membership means that decisions are not practically amenable to appeal through the courts.

There are numerous examples of unpredictable ombudsman decision-making by the existing schemes. These can be found in many of the submissions to the Ramsay Review. A brief list of examples is summarised below:

1. Ombudsman determinations that any form of repayment forbearance exercised by a lender represents a contractual variation, which means that a customer's credit bureau file cannot be updated to show that the account is in arrears. This is at odds with the position under Privacy Law, the view taken by the prudential regulator (APRA) and will serve to undermine the agenda to promote data sharing to stimulate competition in the consumer credit market.
2. The use by ombudsman of subsequent income tax assessments in responsible lending cases, rather than the verification data available at the time the credit decision was made.
3. The application of Australian Banker's Association ('ABA') Code of Banking Practice provisions in decisions affecting non-banks which do not undertake the activities of banks.
4. Consumer hardship contractual variations incorporating discounts in the principal amounts outstanding and reductions in contractual interest rates. Notwithstanding that such impositions are at odds with section 72 of the National Credit Code.
5. Holding a bank liable for the majority of the loss suffered by an account holder who transferred large sums to an overseas fraudster in circumstances where the name of the account to which the money was transferred was not the same as any name on the relevant alert list published by the authorities.

For all non-superannuation complaints the proposed AFCA will have the same decision-making discretion enjoyed by FOS and CIO. AFCA will have the power to create novel principles and the freedom to inconsistently impose such principles on industry without being subject to any form of review or scrutiny.

AFCA will have even less accountability than the existing ombudsman schemes for certain and predictable decision-making. Both FOS and CIO are subject to accountability imposed by the ability of member financial firms to move to an alternative scheme when decision-making proves too unpredictable. As a single monopoly scheme AFCA will not be subject to any such accountability and will enjoy wholly unfettered decision-making discretion.

This unfettered discretion will be complemented by expanded jurisdiction, with the ability of the scheme to set its own dispute limits and compensation caps. The starting point for consumer complaints will be a doubling in the dispute limit to $1 million and the absence of any limits or compensation caps in the context of a mortgage over a guarantor's home.

It is without global precedent for any ombudsman scheme, let alone a private monopoly scheme, to exercise such decision-making discretion over disputes involving such large amounts.

More certain decision-making

To address the uncertainty and unpredictability of decision-making contemplated by the Bill, Credit Corp recommends that provisions presently quarantined to superannuation complaints be extended to apply to all disputes.

> **Credit Corp recommends that proposed section 1057(3) requiring that all decisions must not be contrary to the law and proposed sections 1056 and 1061 providing for appeal to the Federal Court on questions of law should be extended to all disputes.**

Extending these provisions will provide for more certain and predictable decisions in the interest of a more competitive financial system to the benefit of all Australians.

There is no cohesive logic for limiting the above provisions to superannuation complaints. Financial services are used by all Australians. More Australians have bank accounts than superannuation. Every working Australian making a contribution to superannuation will require access to some form of credit throughout their life.

The idea that superannuation complaints should be subject to more certainty because they involve larger amounts is not supported by the facts.

While it is not contemplated that superannuation disputes will be subject to any monetary limits or compensation caps the reality is that many non-superannuation complaints will involve amounts in excess of the majority of superannuation complaints. The present average superannuation balance at retirement is less than $300,000. This is significantly lower than the proposed minimum consumer dispute limit of $1 million and the minimum consumer compensation cap of $500,000. It is also significantly lower than the proposed small business dispute limit of $5 million and the minimum business compensation cap of $1 million.

Much seems to be made in the explanatory materials about the unique involvement of third parties in superannuation disputes. The example of the interest of a dependent in a death benefit is highlighted. However, there is no difference between the interest of a dependent in a death benefit within superannuation and an interest in a death benefit on a life insurance policy held outside superannuation. Furthermore, third parties will regularly have an interest in a credit or investment dispute. Many investments take the form of an interest in a trust and involve dealings with a trustee, which is identical to the arrangement for superannuation. The distinction is artificial and without any basis in fact.

There is no logic to a “one-stop-shop” dispute resolution scheme applying completely different processes and decision-making principles to different industry segments. There will be no consistency and efficiency in such a scheme. Rather than a “one-stop-shop” it will be an unwieldy conglomerate operating according to different rules. Users will rightly question why similar complaints will be subject to vastly different processes and outcomes depending on whether or not the dispute involves the superannuation system. This irrational bifurcation is unacceptable in the context of the reasons for establishing a single monopoly scheme.

All disputes should be subject to decisions which are not contrary to the law and all disputes should be subject to appeal to the Federal Court on questions of law.

High costs and inefficiency damage competition

It is well-established that high regulatory costs act as a barrier to entry and favour large entrenched incumbents in any market.

Smaller and more innovative operators invariably look to disrupt established markets through price competition. These operators look to exploit lean cost structures and narrow profit margins to undercut incumbents. Increased regulatory costs bear heavily on such businesses, because they have no ability to absorb such impositions and must immediately pass them on to consumers in the form of higher prices.

Larger incumbents with market power can absorb increased regulatory costs for a period of time. Incumbents can temporarily absorb cost increases within a large cost structure while they wait for their smaller competitors to fall away.

The proposed AFCA will be unaccountable for costs and efficiency

AFCA will operate as a private monopoly provider. Any party operating in the financial services industry will be required to be a member of AFCA and will be required to fund its operations.

AFCA will have no incentive to keep costs down. Like all monopolies, without external controls, it will exhibit expense preference behaviour. Excessive amounts may be spent on board and executive remuneration, office facilities, travel and matters not directly connected with the business of resolving disputes, including marketing and promotion.

We have recently seen national media reporting alleging excessive remuneration, self-serving promotion expenditure, poor governance and inadequate disclosure in the example of the professional accounting body CPA Australia. The Bill contains no measures or controls to prevent scandalous conduct within AFCA.

As a monopoly AFCA will have no incentive to operate efficiently. There will be no alternative scheme for members to join and no alternative from which to benchmark any aspect of efficiency. In fact, it will be in AFCA's monopoly interests to encourage the lodgement and escalation of unmeritorious disputes as funding will be reliant on an escalating complaint fee model. If more complaints escalate for formal decisions the scheme will receive increased funding, regardless of the merits or outcomes of disputes.

The lack of accountability for costs and efficiency will be exacerbated by an unaccountable governance structure. As a private ombudsman scheme AFCA will resemble FOS and CIO, where the requirement for equal numbers of consumer and industry directors will likely mean that directors will be appointed by the board itself. The board will be self-perpetuating.

It is also likely that the board will be over-represented by individuals more closely aligned with the dominant financial services segments and their incumbents. There is unlikely to be any representation from smaller industries and members. In particular, those smaller members looking to increase market competition are likely to be unrepresented.

AFCA will also be subject to the limited financial disclosure requirements of a private company. Despite being a very large monopoly, as is the case for CIO and FOS, there will not be the sort of detailed disclosure of board and executive remuneration required by publicly listed companies in Australia. There will be no requirement for members to vote on remuneration and no consequences for the board if members disapprove.

More accountability for costs and efficiency

To address the absence of any accountability for costs and efficiency by AFCA, Credit Corp proposes legislated governance controls within the Bill.

> **Industry directors should be directly elected from each industry segment from the votes of members in each segment. Each industry director should be subject to re-election every two years.**
>
> **The independent chairman should be appointed by a separate majority of both industry and consumer directors. No independent chairman should remain in office without commanding a separate majority of consumer and industry directors.**
>
> **All directors, including the chairman, should be subject to a maximum term of 6 years.**
>
> **Financial reporting requirements should be equivalent to those required for a publicly listed company. This will include a detailed remuneration report disclosing all aspects of the remuneration of directors and key management personnel.**
>
> **Additional financial reporting requirements detailing expenses by expenditure category, with a focus on those expenses not directly related to the business of resolving disputes. In particular, detailed disclosure of overhead, administration, marketing, promotion, outreach and sponsorship expenditure should be required.**
>
> **Annual member votes on the financial statement, remuneration report and expenditure report with a 75% majority voting requirement. If such a majority is not achieved in two successive annual votes a motion to spill all directors will be put to the members.**

It is important that AFCA is accountable to all financial services industry participants, not just the major incumbents. Under the present arrangements the interests of smaller members are recognised by the industry directors of CIO who possess backgrounds in mortgage broking, independent wealth management, debt collection and non-bank lending. This contrasts with the much larger FOS, where the present industry director backgrounds are limited to the major banking, insurance and wealth management institutions. Without controls to ensure appropriate board representation from smaller members AFCA will be overwhelmed by the interests of the major financial services incumbents.

These controls will ensure that AFCA does not exclusively serve the interests of the major financial services incumbents to the detriment of smaller operators. They will encourage confidence in AFCA by all industry members, not just the dominant incumbents. In doing so, the controls will preserve and enhance competition in the market for financial services.

The controls will also promote accountability for costs, efficiency and performance. Unless industry directors are subject to regular election by members they will not be accountable to industry. If directors serve for excessive terms they will become too closely aligned with the internal interests of AFCA management and staff, rather than the interests of consumers and industry.

As experience over the last ten years has shown, nothing sharpens corporate accountability more than a democratic vote of members with public consequences. Voting on remuneration and implementation of the ‘two strikes’ rule for publicly listed companies has proven to be critical to the control of corporate largesse. In the context of the creation of a private monopoly adopting the same control should be considered as a mandatory requirement.

Many of these proposed measures are based on the governance standards imposed on listed public companies under the Corporations Act. Others are based on recognised standards of governance adapted to the nature of a monopoly private ombudsman scheme.

Why shouldn't AFCA be subject to the highest standards of governance ? Unlike most corporations AFCA will operate as a monopoly. Unlike all corporations membership of AFCA will be compulsory. Unlike many other corporations AFCA will levy fees on its members and issue judicial determinations which will bind members. Unlike any publicly listed corporation members who are unhappy with standards of governance and accountability for costs and efficiency cannot simply sell their shares and move elsewhere.

Response to the Consultation Paper

1. Proposed requirement for mandatory Internal Dispute Resolution ('IDR') reporting to ASIC

1.1 The proposal for mandatory IDR reporting represents an unnecessary burden which will be counterproductive to the objective of promoting strong IDR and compliance by financial services providers.

1.2 There are already sufficient incentives for strong compliance and IDR systems. EDR is very costly and costs are levied based on disputes. Poor compliance and IDR management will see more disputes escalate to EDR, with more dispute fees. Furthermore, EDR schemes already actively monitor IDR through their systemic issues jurisdiction. EDR schemes are in the best position to monitor a provider's IDR effectiveness because every dispute reaching DER will already have been subject to IDR.

1.3 Existing reporting by EDR schemes of disputes already provides regulators and consumers with an indication of standards of compliance and IDR management by financial services providers. Published 'league tables' of EDR statistics for individual providers already encourage positive performance.

1.4 Reporting of IDR will encourage non-compliance with IDR requirements. IDR reporting is always subject to inaccuracy. Some expressions of dissatisfaction may be resolved at an initial customer interface, while some may resolve only when escalated to a specialist complaints team. Those disputes resolved outside the specialist team may not be recorded. Some organisations with a strong commitment to compliance and strong accountability disciplines will seek to capture all expressions of dissatisfaction, including mere service queries, as part of an ongoing commitment to continuous improvement in quality service provision. These organisations will be penalised by reporting a higher volume of disputes than an organisation with poor systems, poor recording and no commitment to improving service delivery. The reporting of IDR statistics will promote the interests of poorer operators at the expense of more conscientious competitors.

1.5 The proposal for mandatory IDR reporting is misconceived and will do nothing more than promote widespread non-compliance and encourage conscientious financial services providers to dismantle present control systems.

2. 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 ?

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 ?

2.1 The Bill does not strike the right balance.

2.2 The basis for decision-making is detailed in the Bill for superannuation complaints but is not detailed for other complaints. Decisions on all disputes should not be contrary to the law and all decisions should be subject to appeal to the Federal Court in the manner, and for the reasons, set out in this submission.

2.3 The Bill does not mandate any governance and disclosure requirements for the proposed AFCA. The natural tendency of any monopoly provider is to avoid accountability and to

abuse member resources. The governance and disclosure standards set out in this submission should be imposed on AFCA within the Bill. Detailed reasons for the imposition of such standards are provided within this submission.

3. Questions 4: Are there any additional issues that should be considered to ensure an effective transition to the new EDR scheme ?

3.1 The transition contemplates contemporaneous membership of both a legacy scheme and the new scheme. The federal government should provide financial services providers with a rebate of any fees payable to the legacy scheme during this period of overlap.

3.2 The legacy schemes will incur numerous costs in winding down operations. These may include costs pursuant to long-term contracts such as premises leases, information technology and other services. Such costs may also include initiatives to retain experienced personnel subject to predation by the new scheme and other alternative employers as it becomes clear that career progression will be absent from the legacy scheme. The federal government should allocate transitional funding to the legacy schemes to deal with these unexpected additional costs. Such costs should not be borne by industry who have already invested in establishing the existing schemes and will now be required to bear the cost of establishing a new scheme.

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

4.1 Credit Corp notes CIO’s submission to the Ramsay Review and the various reasons detailed therein for requiring EDR membership by credit representatives.

4.2 In particular, many of the activities of a credit representative are such that they are not made pursuant to any agency relationship with a credit licensee. For example, a credit representative may recommend one licensee’s high cost product without adequately explaining to the consumer that a lower cost product by another licensee provides equivalent features. In such a circumstance the consumer would only have recourse to the licensed credit provider. There will be no ability for the licensed credit provider to obtain any information relevant to the credit representative’s explanation of another credit provider’s product. In the absence of EDR membership by the credit representative the consumer would be faced with pressing its claim against the credit representative through the courts.

5. Question 8: What will the regulatory impacts of the new EDR framework be ?

5.1 Throughout this submission Credit Corp has highlighted the impact of the proposed unaccountable monopoly EDR framework on competition and the efficiency of the Australian financial system. Credit Corp is concerned that without the amendments detailed in this submission the competitiveness and efficiency of the financial system will be damaged and the living standards of all Australians will be reduced.

5.2 Throughout this submission Credit Corp has advocated measures to improve the certainty and predictability of EDR decision-making. Credit Corp has also advocated measures to ensure accountability for costs and efficiency by the monopoly EDR scheme. These proposed amendments to the Bill will mitigate the potential for damage.

Table of proposed amendments to the Bill

Section	Amendment	Purpose
1057	Add new sub-section 1057(4): The EDR decision-maker must not make a determination of a complaint that would be contrary to law.	To extend the operation of sub-section 1057(3)(a) to all complaints to reduce uncertainty and unpredictability in EDR decision-making and recognise that there is no rational basis for limiting this important control to superannuation complaints.
1056	Delete the word *'superannuation'* from sub-section 1056(1) so that it reads: The EDR decision-maker may, on his or her own initiative or on the request of a party to a complaint, refer a question of law arising in relation to the complaint to the Federal Court for a decision.	To extend the operation of section 1056 to all complaints.
1061	Delete the word *'superannuation'* from sub-section 1061(1) so that it reads: A party to a complaint may appeal to the Federal Court, on questions of law, from the EDR decision-maker's determination of the complaint.	To extend the operation of section 1061 to all complaints.
1048	Insert additional sub-section 1048(1)(f): a condition that the constitution of the operator of the scheme must require: (i) equal numbers of directors with consumer and industry backgrounds and an independent chair; (ii) that the number of industry directors is set such that there is one industry director for each discrete and material industry segment comprising members of the operator; (iii) that each industry director is separately elected by a simple majority of members from one discrete and material industry segment; (iv) that each industry director will be subject to re-election every two years; (v) an election of at least 50% of all industry directors at each AGM; (vi) that the independent director who will fulfil the position of chair will only hold office as a director while enjoying separate majority support from directors with a consumer background and directors with an industry background; and	To ensure a representative governance structure to promote an appropriate degree of accountability for costs and efficiency. To ensure accountability to industry and equal representation of the interests of smaller industry segments. To restrict the scope for poor governance by imposing an appropriate maximum term for all directors.

Section	Amendment	Purpose
	(vii) that no director will remain in office for a period exceeding six years.	
1048	Insert additional sub-section 1048(1)(g): a condition that the constitution of the operator of the scheme must require: (i) the preparation and publication of annual audited financial statements in conformance with the requirements applicable to a listed public company under Part 2M.3 of the Corporations Act; (ii) the preparation and publication of an annual audited remuneration report in accordance with the provisions of section 300A of the Corporations Act; (iii) the preparation and publication of an annual audited expenditure report detailing expenses by expenditure category including but limited to specific line items for each of overheads, administration, marketing and promotion, outreach, sponsorship and other expenditure not directly related to the business of resolving disputes; (iv) at each AGM, a non-binding member vote to adopt the financial statement, remuneration report and expenditure report; (v) that if 25% of votes cast are against the adoption of the reports a “strike” will be recorded by the operator in the same manner as would apply to a listed public company in relation to a remuneration report; and (vi) that if at the next AGM there is a second “strike”, the board spill provisions of Part 2G.2, Division 9 of the Corporations Act will apply.	To ensure appropriate and transparent financial and remuneration disclosure. To promote high standards of governance and accountability for financial resources by providing for board consequences in the event that the standards of governance and accountability for financial resources expected by more than a quarter of the membership are not met. To bring governance standards into line with those expected for a listed public company, while acknowledging the unique features of the proposed AFCA.