Min-it Software

Financiers Association of Australia

Joint Submission –

TREASURY Consultation –
Treasury Laws Amendment External Dispute Resolution Bill 2017

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Background Information

This submission is made on behalf of the Financiers Association of Australia ("FAA") and Min-IT Software clients.

The Financiers Association of Australia ("FAA") and Min-it Software ("Min-IT") welcomes the opportunity to submit this submission on Treasury's consultation on extending unfair contract terms to small businesses.

The FAA, having been established since the 1930's, is an organisation for individuals and companies involved in the fields of finance and credit provision. The FAA's members are either non-ADI credit providers, providing loans up to $5,000 over terms of up to 2 years, mortgage financiers or business financiers.

Aside from the software produced in-house, specifically by or for franchised organisations, Min-IT Software is a leading loan management software supplier to the micro-lending sector of the Australian market. Additionally, it has a number of clients providing motor vehicle finance as well business loans and consumer leases.

The vast majority of Min-IT's clients are not affiliated with any industry association.

Introduction

We consider it highly disappointing that Treasury chose not advise those that made submissions to the Ramsay Report on External Dispute Resolution back in October 2016 of this issuance of this draft legislation and consultation.

This legislation, announced by the Treasurer in this year's budget, is based on the Ramsay Report. We consider, as do others, that the Ramsay Report was flawed. The Panel, having issued a consultation paper, then failed to meet with industry participants and came up with its own proposals for Government to consider, independent of Senate recommendations.

Just as with the original Ramsay consultation, it would appear that this consultation has also not been widely circulated as we know of no individual ACL holder that has been advised of it. This is a serious oversight as almost all of the businesses affected in the small to medium finance sector are small businesses who would continue to be severely affected by this proposed legislation if passed without amendment. We have to question if this has been deliberate.

We, ourselves, only became aware of it by a chance comment from a Senior Government MP's staff member.

The Current Consultation

Rather than respond to all of the individual questions raised, we will respond only to those that affect our members and clients and make some general observations on the Draft Bill itself.

Whilst we are fully supportive of the need to reform External Dispute Resolution in the financial sector, the draft legislation proposes to create an ombudsman model using a company limited by guarantee and then force industry participation by making it a condition of a Commonwealth law or under the conditions of a licence or permission issued under such a law (cf s.1047 of the Draft Bill). In other words, for those providing credit, the Australian Securities and Investment Commission ("ASIC") will continue to require "membership" of the EDR prior to its issuance of either an Australian Financial Services Licence ("AFSL") or an Australian Credit Licence ("ACL"). This is no different to how ASIC mis-uses both the Credit Industry Ombudsman Ltd ("CIOL") and the Financial Services Ombudsman Ltd ("FOSL") now. This draft legislation merely perpetuates the current issues industry has with both of these entities albeit under a new name.

We already have an issue with the practice of requiring "membership" of an EDR scheme by ASIC prior to even considering any AFSL or ACL application. With most of these applications now taking upwards of 4 months or more to process (and we are aware of some that are approaching 18 months), new applicants should not be required to actually join an EDR until their application has been assessed and ASIC confirms a licence will be issued. If a licence application is to be denied, this will have been a total waste of money. ASIC's role is to regulate, not to assist an EDR provider with funding for a potential licence holder.

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?

We fail to see how in reporting data to ASIC, "there will be enhanced transparency and accountability of the internal dispute resolution (IDR) activities of firms"[1]. Simply reporting on the number of IDR transactions may lead consumers to incorrect decisions or perceptions about the licence holder and could lead to some within the industry attempting to manipulate the reportable figures. This will depend entirely on what ASIC comes out with as to what is to be reported but it has a possible consequence of making larger compliant businesses appear far more non-compliant simply if the number of complaints are to be reported.'

As we stated in our submission to the Ramsey report, we have already witnessed evidence of some consumer advocates orchestrating complaints against lenders, sometimes aided by inside-knowledge from those on the current EDR scheme Boards, purely with the purpose of imposing pecuniary penalties.

Reporting IDR "complaints", vexatious or otherwise, can be easily stacked against any licence holder after the fact. We are already witnessing a large increase in "phishing" expeditions by consumer advocates to lenders seeking copies of all documents to credit contracts on the grounds there 'may' be a complaint. This is a total and unashamed abuse of process.

We are aware both FOSL and CIOL will investigate any complaint, even if vexatious. This skews their reporting and we are of the opinion such complaints, once proven, should be reported separately.

[1] 2017, Treasury EDR Consultation Paper, p.3, para 21

There is also the question of what is ASIC itself going to do with the information. The National Consumer Credit Protection Act 2009 already contains a requirement for mandatory reporting of breaches, so is the intention it will start investigating licencees with seemingly large numbers of complaints? With ASIC's funding model, there is the potential for a conflict of interest that may need addressing.

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?

We have two major issues with the Draft Bill and both are inter-related.

Firstly, rather than forming the AFCA as a proper Tribunal as we and others in the industry suggested in our response to the Ramsey Report, similar to the UK Financial Ombudsman Service model, Government is perpetuating the current model with all its known flaws. Rather than listening and taking on board what industry has said about the way both current EDR schemes work, the Ramsey Report simply discounted just about everything and all of industry's complaints. This is yet another instance of wilful blindness by a Government-appointed Panel. In taking the consumer advocates point of view, this legislation further erodes the rule of law as the AFCA will be free to do as ASIC suggests.

Whilst it is commendable that s.1046 of the Draft Bill requires the scheme to be:

a) accessible;
b) independent;
c) fair;
d) accountable;
e) efficient; and
f) effective

and these are all traits required by the current schemes and contained in a Regulatory Guide, ASIC has failed to enforce complaints brought against CIOL and FOSL when they have not been followed. The author has personally brought two matters to its attention and in each instance, ASIC decided not to act. On that basis, we suggest ASIC is not a good choice to be the overseer of the scheme as its own culture seems to side with that of consumers.

Secondly, the Draft Bill contains provisions that already impose a bias in how the AFCA is to operate.

Section 1056 (1) states “[t]he EDR decision-maker may, on his or her own initiative or on the request of a party to a superannuation complaint, refer a question of law arising in relation to the complaint to the Federal Court for decision”.

Section 1056 (3) states “[i]f a question of law in relation to a complaint has been so referred to the Federal Court, the EDR decision-maker must not:
(a) make a determination to which the question is relevant while the reference is pending; or
(b) do anything that is inconsistent with the opinion of the Federal Court on the question.”

As ACL and AFSL holders do not have such a right enshrined in the draft legislation, it is clear the AFCA will have to uphold a higher standard of evidence requirement for superannuation complaints than it does for other financial complaints. Aside from the fact the Superannuation Complaints Tribunal “(SCT”) already has full Tribunal powers whereas neither CIOL nor FOSL do, there is no clear reason for this discrepancy.

This is particularly so if we are not to witness the continuation of decision practices such as CIOL now makes where it refuses to take case law into account and uses phrases like "we feel… " or "in our opinion…" yet refuses to justify those decisions logically. EDR "members" have a right to know the complaint is being properly dealt with in law and recently, Aviva Life & pensions (UK) Limited applied for judicial review of a decision by the (UK) Financial Ombudsman Service ("UK FOS") to the High Court [2]. The Court was asked to consider Aviva's demand that UK FOS provide full reasons for its departure from making a decision in accordance with s,2, s.3 and Schedule 1 of the Consumer Insurance (Disclosure and Representations) Act 2012 was fair and reasonable. The Court found it must do so.

In order to avoid perpetuation by the AFCA of the same kind of 'social justice' decisions emanating from the current EDR providers, if the Government is not prepared to grant it full Tribunal status (with a capital "T") and move away from a company limited by guarantee structure, then this ability to refer matters of law to the Federal Court should and must apply to ACL and AFSL decisions as well.

Also in regard to this section, the word "may" leaves it open to interpretation and unclear to the parties. Whilst one party may want the matter referred to the Federal Court, it would appear the matter is left to the sole discretion of the EDR decision-maker. This is inconsistent with good complaint handling as if the EDR decision-maker chooses not to do so, then the EDR decision-maker would be free to make whatever decision he or she wants.

We note, though, s.1061 allows any party to a superannuation complaint to "appeal to the Federal Court, on a question of law, from the EDR decision-maker's determination of the complaint".

[2] Aviva Life & Pensions Limited v Financial Ombudsman Service [2017] EWHC 352 (Admin)

We recommend that s.1056 (1) be re-worded so that any party to a complaint may apply to the Federal Court for review and that sections 1056, 1058, 1061 be removed from Division 3 so that the provisions apply to all complaints and all references to superannuation contained in them be deleted.

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

Whilst the legislation requires all AFSL and ACL holders to be "members" of the AFCA at its proposed commencement date of 01 July 2018, it is abundantly clear that no thought has been given to current contractual arrangements licencees have with the two existing EDR schemes, CIOL and FOSL.

The consultation paper suggests that "once the new body is operational, all new complaints will be heard by AFCA. It is proposed that all disputes that are lodged with the FOS/CIO prior to this date will be dealt with by the CIO/FOS. As such, it is anticipated that financial service and credit providers will be required to be members of the new EDR scheme and their existing EDR scheme as FOS and CIO work through their remaining complaints"[3].

"Membership" dates are not aligned to a single calendar date, so licencees are required to pay their annual "membership" fee on different dates throughout the year. In the event that CIOL or FOSL have an ongoing complaint that has not been settled, depending on how long it takes to make a determination, the licencee may also be forced to pay for an additional annual fee to that EDR scheme provider even when it is also paying ongoing fees to the AFCA.

[3] Ibid 1, p.6, para 40.

As there is no mention of any pro-rata fee for AFCA “membership” being contemplated for the first year, that would mean almost all licencees will be forced to pay “membership” of both the AFCA and the current EDR scheme concurrently. For a Government that has said it is committed to assisting small businesses, which the vast majority of licence holders are, there needs to be some measure that provides some form of financial relief. Government cannot expect the existing EDR schemes to do so and as this is new body is being set up at the insistence of the Treasurer, then this must be encapsulated in the legislation as a transitional measure.

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

The consultation paper believes that removing the obligation for credit representatives to be “members” of an EDR scheme could potentially lower the regulatory burden on industry without impacting on consumer’s ability to access redress. This is based on the fact the licensee retains overall responsibility for the conduct of its representatives.

Whilst we agree with the fact, we must firmly disagree with the suggestion. We also believe that Authorised Representatives under an AFSL should also be “members” of an EDR scheme.

Our reasoning for this is simple. ASIC demands that everyone involved in financial transactions should take responsibility and be accountable for their actions. Removing the requirement for credit representatives to not be “members” of an EDR

is completely at odds with this requirement and is justification for requiring Authorised Representatives of an AFSL to be members of an EDR scheme.

From what we have seen and heard from credit specialist lawyers, FOSL already takes the attitude it doesn't want to deal with either credit representatives or authorised representatives. We are yet to see any terms of reference for the AFCA and so cannot comment on what that body may or may not do. If the facts are not adequately or properly conveyed to those making decisions by either the licence holder and/or by the EDR decision-maker, though, in taking such a stance, it can lead to incorrect decisions being made.

It is important that information from those at the 'coal face' of any complaint where a credit representative (or authorised representative) is involved be given more credence than any argument put forward by the licence holder.

This is because the licence holder may not and/or possibly does not care about the ramifications of paying the consumer or any complaint costs levied by the EDR provider simply because of the indemnity provided by the credit representative contained in the contract between the two parties. In other words, the credit representative will ultimately end up paying, regardless of the facts, if the licencee decides to capitulate or the EDR scheme makes an adverse finding.

We are aware of a number of decisions that have been made at EDR where a credit representative has been financially penalised because the true facts of the case were not disclosed by the licence holder to the EDR provider.

As we stated in our submission on the Ramsey Report dated 16 October 2016, many licencees simply agree to what a consumer has requested or demanded, regardless of whether it has complied with any legislation, as the EDR's have a culture of being more sympathetic to the consumer. Even if they were legally and morally correct, the EDR's make the ACL holder or credit representative pay

anyway. The general industry stance is that as EDR costs so much, capitulation is better than fighting a matter yet this unfortunately leads to adverse and unintended consequences for the lenders subsequently.

Furthermore, depending on the cost structure levied for complaints by the EDR provider, by removing credit representatives from being “members”, the licencee may subsequently see a significant increase in its complaint costs because all the complaints would start to be levied against it and not the relevant credit representative.

Furthermore, by also requiring authorised representatives to be “members”, this should reduce the overall “member” cost as the membership base is widened.

Consequently, for the reasons stated, we firmly remain of the opinion that credit representatives should continue to be “members” of an EDR scheme and we believe that authorised representatives should be required to join such a scheme.

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

For FAA members and clients, areas where there could be an increase in regulatory burden for industry will primarily be focussed around:

a) amending regulatory forms and other disclosure material; and
b) the cost of providing IDR data to ASIC.

Unless there are to be major differences in the way complaints are handled, we do not envisage the cost of staff training to be an issue as all ACL holders are already required to train staff on dealing with complaints.

It will depend entirely on the software FAA members and clients use as to whether there will be a cost for updating regulatory forms and other material. For those FAA members that have their own software, there may be legal advice required as well as the actual cost of amending documents within the software by software developers. For Min-IT Software clients, we will update all forms free of charge though we may have to incur our own legal advice costs. Without knowing exactly what ASIC intends doing, this is somewhat of a chicken and egg situation and for that reason we could not provide indicative costs.

Again, without knowing how, when and what data ASIC intends to require licence holders supply IDR data, what definitions of 'complaint' are to be used and remembering that no personal information is to be supplied, we cannot provide any indicative costs. We will have to wait for ASIC to provide this information before making comment.

Not all systems may be able to cope with any electronic reporting ASIC may determine it requires, however, and so some ACL holders may also be forced to change their software supplier and incur substantial conversion costs in order to comply. These costs may include new hardware, software, training, data and document conversions and this will vary depending on the size of the business and its market position.

On that basis, we fail to see how Treasury can possibly assess the regulatory impact of the new EDR framework by costing the regulatory impact using the Government's regulatory burden measurement framework because there are too many unknowns.