

# Improving dispute resolution in the financial system

Legal Aid NSW submission to the Treasury

*June 2017*

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## About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW) to provide legal assistance, with a particular focus on the needs of people who are socially and economically disadvantaged.

Legal Aid NSW provides information, community legal education, advice, minor assistance and representation, through a large in-house legal practice and private practitioners. Legal Aid NSW also funds a number of services provided by non-government organisations, including 32 community legal centres and 28 Women's Domestic Violence Court Advocacy Services.

Legal Aid NSW welcomes the opportunity to provide a submission to the Treasury's *Improving dispute resolution in the financial system* Consultation Paper and accompanying draft legislation.

The Legal Aid NSW Civil Law Division focuses on legal problems that impact most on disadvantaged communities,

such as credit, debt, housing, employment, social security and access to essential social services. Consumer issues constitute the largest category of service for our Civil Law Division.

In 2014-15 Legal Aid NSW provided 4,887 in house advice and 5,477 minor assistance services in consumer law matters. More than one quarter of these matters dealt with credit products, including consumer leases. This submission draws on the casework experience of civil law solicitors in providing these services.

This submission addresses the questions in the Consultation Paper. In responding to these questions, we also refer to our previous submissions made in October 2016 and January 2017 to the review of the financial system external dispute resolution and complaints framework. We follow the numbering of the questions in the Consultation Paper in our submission.

## Improving dispute resolution in the financial system

Legal Aid NSW welcomes the Government's announcement of a single external dispute resolution (EDR) scheme for all financial disputes. We largely support the approach proposed by Treasury. Our submission makes proposals to strengthen the framework.

### Retaining the strengths of the Financial Ombudsman Service

In our submission to the Ramsay Review, we called for the single EDR scheme to be created by integrating the functions of the Credit and Investment Ombudsman (**CIO**) and the Superannuation Complaints Tribunal (**SCT**) into the Financial Ombudsman Service (**FOS**). FOS already handles 83 per cent of all financial disputes,<sup>1</sup> is flexible and responsive, and handles disputes quickly.<sup>2</sup>

While Treasury has chosen to proceed with the establishment of a new scheme, rather than to expand the functions of FOS, we submit that the existing structure, culture and staff of FOS should be retained as far as possible. We consider that FOS has been successful and should be used as the basis for the new scheme.

### Naming the new scheme

The Consultation Paper refers to the proposed scheme as the Australian Financial Complaints Authority. We consider that calling the scheme an 'authority' could create confusion as its primary function is to resolve disputes, rather than to regulate or issue penalties. The scheme is more appropriately described as an ombudsman scheme. Using this name would accurately reflect the scheme's function as a dispute resolution service, and provide consistency in branding with other industry EDR schemes such as the Telecommunications Industry Ombudsman, the Energy and Water Ombudsman (NSW) and the existing financial services EDR schemes.

Naming the scheme in this way would make clear that the scheme should be guided by the professional standards and best practice guidelines of the Australian and New Zealand Ombudsman Association.

We suggest 'the Australian Financial Complaints Ombudsman' as a potential name for the scheme.

### Consultations regarding the terms of reference

Legal Aid NSW notes the Treasury's proposed timeline for the authorisation of a company to operate the scheme. We are concerned that the suggested timeframes for authorisation do not allow sufficient time to develop a robust scheme, or for public consultation on the proposed terms of reference. We recommend that the timeline be amended to permit public consultation on the terms of reference.

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<sup>1</sup> EDR Review Panel, *Review of the financial system external dispute resolution and complaints framework Final Report* (Ramsay Review) (2017), 8

<sup>2</sup> Ramsay Review, 10

## Recommendations

- The new EDR scheme for financial disputes should retain the structure, approach, staff and culture of FOS, as far as possible.
- Consideration should be given to naming the scheme ‘Australian Financial Complaints Ombudsman’
- The timeline for the authorisation of a company should include time for public consultation on the proposed terms of reference.

## Legislative framework

### Question 1

Are there other statutory powers the EDR body will need to resolve superannuation complaints effectively?

Legal Aid NSW broadly agrees with the statutory powers proposed to be given to the EDR scheme in the draft legislation, subject to our responses to this question and to Question 3.

Legal Aid NSW acknowledges that the unique features of superannuation complaints require the conferral of broad statutory powers to achieve timely and effective dispute resolution for consumers. We note the importance of preserving the flexibility and adaptability of the existing EDR schemes. This is best achieved by placing rules, where practicable, in the terms of reference rather than in legislation. However, we consider that certain notification requirements should be placed in legislation as they concern complaints that may not be able to be resolved by relying on the contractual obligations between the scheme and its members.

The *Superannuation (Resolution of Complaints) Act 1993 (S(ROC) Act)* currently incorporates a ‘claim-staking’ process which ensures that, if the Superannuation Complaints Tribunal receives a complaint about a decision of a trustee concerning the payment of a death benefit, potential beneficiaries of the death benefit are notified and given the opportunity to be joined as a party. The Ramsay Review supported retaining this process.<sup>34</sup> Legal Aid NSW considers that the new EDR legislation should include provisions preserving that process. This would include requirements on trustees to identify potential beneficiaries and advise those beneficiaries in writing of the trustee’s decisions, the potential beneficiaries’ rights of complaint, and relevant time limits.

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<sup>3</sup> EDR Review Panel, *Review of the financial system external dispute resolution and complaints framework Final Report* (Ramsay Review) (2017) [7.11]

<sup>4</sup>

## Recommendation

- **The legislation should include provision for the claim-staking process when the EDR scheme receives a complaint about the decision of a trustee concerning the payment of a death benefit.**

## Terms of reference

### **Question 2**

Do you consider that the Bill strikes the right balance between setting the new EDR scheme's 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?

Legal Aid NSW considers that the Bill strikes an appropriate balance between setting the new EDR scheme objectives in the legislation while leaving the operation of the scheme to the terms of reference, subject to the comments below.

## Authorising an EDR scheme

Section 1046 sets out the matters the Minister must take into account when considering whether to authorise an EDR scheme.

### ***Minister's power***

Legal Aid NSW considers that, when authorising an EDR scheme, the Minister should take into account the best practice standards in ASIC Regulatory Guide 139, *Approval and oversight of external complaints resolution schemes*.

### ***Governance***

The Consultation Paper indicates that the terms of reference are expected to address the governance structure of the scheme. In particular, the Consultation Paper states that the Board will comprise an independent chair and equal number of directors with consumer and industry backgrounds (as recommended by the Ramsay Review).<sup>5</sup> Legal Aid NSW considers that this requirement should be included in section 1046. In addition, when deciding whether to authorise a proposed scheme, the Minister should take into account the qualifications and experience of the proposed directors.

### ***Fees***

The Consultation Paper indicates that there will be a legislative requirement that the scheme is free for members. We consider that the Bill could be more strongly worded to ensure this. Rather than requiring the Minister to take into account 'the extent to which

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<sup>5</sup> Ramsay Review, recommendation 11.

complainants are exempt from payment',<sup>6</sup> the Bill should require the Minister to take into account 'whether complainants are exempt from payment'.

Similarly, section 1047(b) should provide that it is a function of the scheme 'to ensure that the complaints mechanism under the scheme is free and accessible to any persons dissatisfied with members of the scheme'.

## The functions of the new EDR scheme

Section 1047 specifies the functions of the new EDR scheme.

### ***Community engagement***

The existing schemes' community outreach programs have increased consumer engagement with the schemes, particularly for vulnerable consumers. It is important that the new scheme undertake community outreach. Section 1047 should include, in the functions of the scheme, community engagement, raising awareness about the scheme and ensuring access for vulnerable consumers.

### ***Compliance***

At section 1047(g), the Bill refers to the scheme taking reasonable steps to ensure compliance by members with determinations of the scheme.

In considering the effect of this provision, we note the Ramsay Review's consultation on the establishment of a compensation scheme of last resort and access to redress for past disputes. Legal Aid NSW strongly supports both a compensation scheme of last resort and a process to provide access to redress for past disputes. For this reason, we encourage Treasury to carefully consider how section 1047(g) might interact with consumer access to any compensation scheme of last resort. For instance, in our view, it would not be appropriate to require a consumer to wait for the scheme to take legal action against a firm for an unpaid determination before he or she can access a compensation scheme of last resort. Rather, we would recommend that the consumer should be able to access the compensation scheme of last resort where they have received a favourable determination and the firm has not paid their award within a reasonable time. The scheme could then stand in the shoes of the consumer to recover the unpaid determination from the firm. This ensures consumers who have been the victim of misconduct do not have to suffer further delay in accessing compensation. These issues will be covered further in our forthcoming submission to the Ramsay Review's Consultation on the establishment, merits and potential design of a compensation scheme of last resort and the merits and issues associated with providing access to redress for past disputes.

### ***Reporting***

As currently drafted, section 1047(h)(v) requires the scheme to report to ASIC on 'issues affecting the complaints management functions of members of the scheme'. Legal Aid NSW considers this to be too narrow. The reporting function should reflect the current

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<sup>6</sup> Section 1046(c) of the draft Bill.

obligations on FOS and the CIO to report on 'systemic issues and serious misconduct'.<sup>7</sup> These terms should be defined as they are in Regulatory Guide 139. In our view, reporting to ASIC on serious misconduct has improved industry standards and helped many consumers affected by poor practice to obtain compensation.

Section 1065(1), which concerns matters that should be referred to ASIC and APRA, should also refer to serious misconduct and systemic issues.

### ***Independent reviews***

Section 1047(k) refers to independent reviews, but does not make provision for the timing of these reviews. Recognising the importance of periodic independent reviews, we consider that the timeframes for these reviews should be set out in the Bill. We propose that the first review be conducted three years after the establishment of the scheme, with reviews conducted every five years thereafter.

### ***Improving industry conduct***

Section 1047 should include the following functions which are performed by the existing schemes:

- *Guidance on best practice:* The existing schemes play a vital role in guiding industry practice by publishing best practice guidelines.
- *Support for Code Compliance Committees:* FOS supports a number of independent Code Compliance Committees to monitor compliance with codes of practice in the financial services industry. The Committees assist in ensuring consistency in service standards.

### ***Limits on the value of claims***

Section 1048(3) specifies that ASIC may direct the scheme to increase limits on the value of claims that may be made. The legislation should make clear that the term 'limits' includes caps on compensation as well as the monetary limits for claims.

### ***Joining other parties***

Legal Aid NSW submits that the proposed legislative power at section 1053 to join other parties to a complaint should not be limited to disputes involving superannuation, but should also be applicable to all financial services disputes.

An extension of this power to all financial services may be useful if, for example, credit representatives are not required to be members of the proposed scheme. If there is a dispute between a consumer and a credit licensee, it may be useful for the scheme to join the credit representative and hear that person's evidence, particularly if there are allegations of misconduct in respect of the credit representative.

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<sup>7</sup> Regulatory Guide 139



## Power to obtain information and documents

Legal Aid NSW submits that the proposed legislative power at section 1054 to obtain information and documents should be applicable to all financial disputes—not just to those involving superannuation.

Again regarding credit representatives, if the credit representative is not a party to a dispute between a consumer and a credit licensee, the scheme may need the power to compel the credit representative to provide relevant documents to assist in resolving the dispute.

Similarly, if the credit licensee is a franchisee and is not complying with a request for documents, the scheme could compel the franchisor to provide any relevant documents or information to assist in resolving the complaint.

## Failure to attend a conference

Section 1055(4) provides that a person commits an offence if he or she does not attend a conference when required to do so under the section.

Legal Aid NSW submits that it is inappropriate to penalise a complainant for failing to attend a conciliation conference. Such conduct does not have the potential for serious harm that justifies the creation of an offence. The complainant is likely to suffer the consequence of having his or her complaint treated as if withdrawn.<sup>8</sup> Complainants, particularly vulnerable complainants, may be more likely to be unable to attend a conciliation conference due to complex needs or limited resources. There is no 'reasonable excuse' provision in section 1055, as there is in section 1054 regarding a failure to comply with a requirement made by the EDR decision-maker. Finally, the potential for a penalty adds to the stress of an already difficult process for complainants, particularly in the context of total and permanent disability or death benefit claims.

## Unfairness or unreasonableness

Section 1057(2) requires the EDR decision maker, if satisfied that unfairness or unreasonableness exist in relation to a decision, to make a determination placing the complainant in such a position that the unfairness or unreasonableness no longer exists. Legal Aid NSW considers that this section should also require the EDR decision maker to make a determination placing a party with an interest in a death benefit in the position they would have been in if the unfairness or unreasonableness did not take place. This is the current position under section 37(6)(b) of the S(ROC) Act.

## Recommendations

- **The current standards in ASIC Regulatory Guide 139 should be considered by the Minister when authorising the scheme under section 1046.**

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<sup>8</sup> Section 1055(3)

- Section 1046 should provide that the Board shall have an independent chair and equal number of directors with consumer and industry backgrounds.
- The Bill should specify that the scheme is free from any payment by the complainant.
- Community engagement, raising awareness about the scheme and ensuring access for vulnerable consumers should be included in the scheme functions under section 1047(b).
- Reasonable steps taken under section 1047(g) should not limit a consumer's access to a compensation scheme of last resort if a firm has not complied with a determination within a reasonable time.
- Sections 1047(h)(v) and 1065(1) should reflect the current requirements under Regulatory Guide 139 to report systemic issues and matters involving serious misconduct.
- The Bill should set out timeframes for independent reviews as follows:
  - The first review should be conducted three years after the establishment of the scheme.
  - Reviews should be conducted every five years thereafter.
- Providing guidance on best practice and supporting Code Compliance Committees should be included as functions of the scheme in section 1047.
- Section 1048(3) should provide that ASIC can direct the scheme to increase both the compensation caps and monetary limits.
- There should be a statutory power to join third parties to a dispute and obtain information and documents when resolving all financial disputes.
- It should not be an offence for a complainant to fail to attend a conference when required to do so. If this offence provision is retained, there should be a 'reasonable excuse' provision.
- Interested parties joined to a death benefit complaint should be included in the scope of section 1057(2).

## Transitional arrangements

### Question 4

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

## Concerns with proposed approach

Legal Aid NSW has concerns regarding the proposal for FOS and the CIO to continue to deal with existing complaints after the new scheme has been established. This approach may make the transition unnecessarily complex and resource intensive, resulting in delayed complaint resolution. We are also concerned that the proposed transition arrangement risks a loss of staff who have significant expertise and historical knowledge of financial services dispute resolution.

We agree with the proposal that the SCT continue to hear existing matters alongside the new complaints body until 2020, given the significant difference in approach between the old and new schemes and the current backlog of complaints. We note that the SCT must be properly resourced to achieve the goal of clearing current complaints.

## Alternative approach

In our view, it is paramount that high quality dispute resolution is provided to consumers throughout the transition process. To achieve this, Legal Aid NSW recommends that the new scheme adopt the approach and culture of the existing EDR schemes. Specifically, the new scheme should take over the assets, staff and systems of the CIO and FOS, with existing complaints continuing to be resolved in accordance with the terms of reference of the appropriate scheme in place at the relevant time.

This recommendation reflects the comments made by the Ramsay Review that the current EDR arrangements are generally successful in providing low cost, speedy and flexible access to redress for consumers.

We consider that there are a number of benefits to this approach, including:

- retaining existing staff with their historical knowledge and expertise
- ensuring consistency of case management for existing complaints
- avoiding delays in complaint handling that could result from staff shortages at the existing schemes or less experienced staff and new processes at the new scheme
- avoiding a period of duplication where three schemes are operating at once, and
- avoiding time and cost involved in recruiting all new staff to the new scheme, establishing case managements systems and obtaining and fitting out office space.

### Recommendations

- **The SCT should receive an increase in funding to assist in clearing complaints by 2020.**
- **As of 1 July 2018, the new scheme should adopt the assets, staff and processes of the CIO and FOS.**
- **The terms of reference should provide for a transitional phase where existing complaints in FOS and the CIO are dealt with under the terms of reference of the relevant scheme at the time they were lodged.**

## Monetary limits

### Question 6

Are the existing sub-limits for different insurance products still required?

Legal Aid NSW supports removing the existing sub-limits. They:

- create confusion for consumers, particularly Legal Aid NSW clients who often have complex needs and vulnerabilities

- limit access to EDR for some disputes, with the outcome that consumers must undertake expensive litigation, or leave their dispute unresolved
- do not reflect the current value of financial products in Australia, and
- risk an inconsistent approach to the raising of limits as some areas of insurance have less advocacy than others.

### Recommendation

- **The existing sub-limits for different insurance products are not required and should be removed.**

## Credit representatives

### Question 7

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

Yes. Removing the requirement for credit representatives to be members of an EDR scheme could decrease access to justice for consumers with disputes involving a credit representative or where the credit licensee denies liability for the conduct of the credit representative.

It is not uncommon for a credit licensee to deny liability for the conduct of a credit representative. In particular, this occurs in situations where the credit licensee claims that the credit representative acted fraudulently or illegally.

Where the credit licensee is able to successfully deny liability, consumers are required to pursue their claim against the credit representative. However, if the credit representative is no longer required to have EDR scheme membership, consumers would not have access to this forum, and would be required to commence proceedings in court to obtain a remedy. The case study below provides an example of where a consumer might be limited to court action, rather than having access to EDR, to properly determine liability about their dispute with a credit licensee and credit representative.

### Case study: Mr and Mrs Jones

Mr and Mrs Jones were an elderly couple who entered into a loan as a co-borrower with their son for \$200,000. The loan was secured against their dwelling property on the understanding that the son would use the loan monies to build a house and that he would make all the repayments. Mr and Mrs Jones did not receive any independent legal or financial advice prior to entering into the loan.

In October 2006, their son requested an increase from the lender of the loan to \$240,000 without Mr and Mrs Jones' knowledge. Mr and Mrs Jones then signed loan application documents but were not aware of their content or implications.

In June 2007, their son approached a credit representative to refinance the home loan. Mr and Mrs Jones did not meet or communicate with the credit representative. Without instructions from Mr and Mrs Jones, the credit representative prepared and submitted an application for an investment loan for \$300,000 secured against their home. Mr and Mrs Jones were the co-borrowers in respect of the loan which was used by their son to discharge the previous home loan of \$240,000. The balance of funds were released to the son's nominated bank account.

Mr and Mrs Jones instructed Legal Aid NSW that they recalled signing the loan application but they had not actually read the document. At the time of signing the application, Mrs Jones was undertaking treatment for cancer and was frequently in hospital.

By requiring credit representatives to have EDR scheme membership, the scheme will be able to join the credit representative as well as the licensee where there is a question to be resolved about whether the credit representative was an agent of the licensee or the consumer. This will allow all relevant parties to give evidence about the issue, and for the scheme to make an informed decision about liability.

We note the Ramsay Review's comments that while requiring credit representatives to be members of an EDR scheme provides a consumer with access to EDR, consumers already have access to redress with regard to the credit licensee, who is responsible for the conduct of its representatives whether within or outside of their authorisation.

We disagree with the Ramsay Review's view on this issue, based on the current state of the law. Under the current law, we consider that it is difficult to determine from sections 76(2) and 77 of the *National Consumer Credit Protection Act 2009* (Cth) the exact circumstances where a licensee is liable for the actions of a representative.

If it were clarified by legislative amendment that a licensee remained liable for the actions of a credit representative in the case of fraudulent or illegal activity, Legal Aid NSW may support the change to the EDR membership. However, if liability remains unclear, Legal Aid NSW recommends that credit representatives should be required to maintain their membership of EDR.

### **Recommendation**

- **Credit representatives should be required to maintain their membership of an EDR scheme, unless it is clarified by legislative amendment that the credit licensee remains liable for the actions of the credit representative in the case of fraudulent or illegal activity.**

## Regulatory impact

Question 8

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

Legal Aid NSW considers that there are considerable benefits to having a 'one stop shop' for financial complaints handling. These benefits will be increased if the transition from three schemes to one is as streamlined as possible. We refer to our comments at Question 4 for more detail.