CUSTOMER OWNED BANKING ASSOCIATION

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7 October 2016

EDR Review Secretariat
Financial System Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

By email: EDRreview@treasury.gov.au

Dear Sir/Madam

Review of the financial system external dispute resolution framework

The Customer Owned Banking Association (COBA) welcomes the opportunity to comment on the Government's Issues Paper *Review of the financial system external dispute resolution framework*.

COBA is the industry association for Australia's customer-owned banking institutions – mutual banks, credit unions, and building societies. Collectively, the sector we represent has $101 billion in assets and more than 4 million customers.

Our sector's market-leading customer satisfaction reflects the success of our model in putting customers first. COBA members strive to resolve customer disputes internally but when this can't be achieved they seek to ensure customers understand their right to access external dispute resolution.

Customer owned banking institutions are members of the Financial Ombudsman Scheme (FOS) or the Credit and Investments Ombudsman (CIO). Around 85 per cent of the sector subscribes to FOS and the remainder subscribe to CIO.

COBA welcomes this review of EDR framework and we look forward to seeing stakeholder views on the performance of the framework.

Our view is that EDR is performing effectively, if not perfectly, in the retail banking market but we acknowledged this generally good performance does not apply to:

- victims of financial advice scandals;
- victims of life insurance scandals; and
- the borrowers of small business, commercial and farm loans identified by the *Impairment of Customer Loans* report by the Parliamentary Joint Committee on Corporations and Financial Services.

We support the proposal for a 'triage' service to overlay the existing schemes, rather than the folding FOS and CIO into a single scheme. The benefits of having two ASIC-approved EDR schemes for retail banking, rather than a single scheme, include:

- capacity to benchmark service levels, efficiency and costs against a 'competitor';
- incentives to innovate and improve performance; and

- choice for FSPs in meeting their statutory obligation to provide customers with EDR.

A triage service would not require any changes to the EDR schemes but would ensure that consumers would have a one-stop shop to find 'their' EDR scheme. A triage service should be operated by an appointee by the boards of both CIO and FOS. It should be funded by the EDR schemes.

As noted in the Issues Paper, EDR provides an avenue for people to resolve their disputes without going through adversarial court processes. It allows disputes to be completed in a timelier manner and at a lower cost than the formal legal system. EDR's focus on 'fairness' has the potential to produce results that are more satisfactory to participants.

A COBA member noted that the most positive feature is that it is a system that is easy to use for both consumers and FSPs: "By and large, from an FSP perspective, we have confidence that the system leads to the right outcome which is available at a low cost and generally follows principles of fairness and good judgement with regards to using prior case examples, a systematic approach and legal principles as the basis for arriving at a decision."

Some COBA members questioned aspects of the funding models of the EDR schemes but there was no widespread call for change. The existence of two schemes allows for differences in funding models.

Having two EDR schemes also helps to strike the right balance between providing adequate protection for consumers and reducing regulatory compliance costs. Having two schemes allows for differences in focus and culture to reflect the breadth and diversity of the FSP community.

In reviewing the EDR framework and considering questions of whether to create an entirely new body, by integrating the current schemes, and whether to establish an additional forum such as a 'banking tribunal', it is important to recognise the key strengths and limitations of the current system.

The current EDR schemes set out to resolve disputes in a co-operative, efficient, timely and fair manner and to proceed with the minimum formality and technicality. The schemes are not bound by any legal rule of evidence and they are not bound by legal principles though they are required to have regard to legal principles and legal requirements, industry codes, industry practice and previous relevant decisions. FOS "will do what in its opinion is fair in the all the circumstances" and CIO has regard to "fairness in all the circumstances."

The nature of EDR means there is a considerable subjectivity and discretion in decision-making. The capacity for such a system to occasionally produce an 'outlier' decision that is highly unsatisfactory for, but nevertheless binding on, an FSP underlines the case to maintain choice for FSPs between two ASIC-approved schemes.

To illustrate the point about subjective, discretionary decisions, here are two examples of EDR scheme determinations within the last 12 months:

Example 1: An applicant was awarded 65% of his losses ($235,000) in a case where he paid more than $360,000 to an overseas investment company that he had not previously dealt with, making 21 separate transactions over a period of more than two weeks and progressively losing a greater and greater amount of funds. The applicant did not provide any information to show that he made detailed inquiries beyond the company's website. There was information readily available from a detailed internet search which would have alerted him to the scam, including a listing on ASIC's MoneySmart website. Two weeks before the applicant started making credit card transfers, ASIC had sent an alert to certain FSPs, including the FSP in this case, warning about the scam operator in question.

However, the email did not positively confirm that the company was engaging in fraud and there was a difference between the name in the ASIC alert and the name of the merchant to which the payments were made. In this case, the EDR scheme determined that the applicant should bear 35% of his losses.[1]

Example 2: An applicant was relieved of liability for $80,000 arising from a guarantee because the FSP breached a procedural requirement, with no weight given to what was fair and reasonable for the FSP. In this case the EDR scheme put the entire emphasis on strict application of a relatively minor procedural requirement in a code rather than the surrounding circumstances, i.e.: the applicant was involved in the credit transaction from the inception, having been present when the borrowers applied for the loan; on that occasion, the FSP met with the applicant alone and explained to her the nature of the loan and the proposed guarantee; the FSP met with the applicant again prior to her signing the guarantee and recommended she seek legal and financial advice before signing the guarantee; the applicant signed an acknowledgement that she had received that recommendation but declined to seek any such advice; the FSP provided the applicant with the required National Credit Code documentation, which advised her (under the heading 'Important') of her right to withdraw from the guarantee by written notice at any time prior to the funding of the loan; the applicant had four business days in which she could have exercised that right; and, the applicant provided no evidence that she did not understand the guarantee.[2]

New tribunal?

The Parliamentary Joint Committee on Corporations and Financial Services report *Impairment of Customer Loans* made recommendations to address the vulnerability of small business and commercial borrowers, including the creation of a small business loans dispute resolution tribunal.

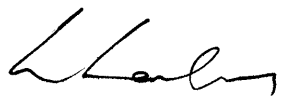
COBA view is that a new specialist tribunal to deal with commercial loans would be preferable to the collapse of existing schemes and the creation a new single body to deal with all retail banking disputes. (See also our submission, attached, to FOS on Small Business Jurisdiction.) The very name 'tribunal' implies a more legalistic framework than the existing EDR framework.

COBA shares the concerns expressed by consumer representatives in their 24 August 2016 letter to the Prime Minister on dispute resolution in banking services where they warned that a new tribunal:

- may potentially drag out or delay dispute resolution, particularly if it is added to existing bodies or is not funded appropriately; and
- may operate legalistically, as is the case with other Australian tribunals, creating barriers to access that many consumers may not be able to overcome.

Thank you for the opportunity to contribute to this review. Please do not hesitate to contact Alex Thrift at athrift@coba.asn.au or 02 8035 8447 if you wish to discuss any aspect of this submission.

Yours sincerely



LUKE LAWLER
Head of Public Affairs

[1] https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/404469.pdf
[2] https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/380323.pdf

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23 September 2016

Ms Silvia Renda
Senior Manager – Strategic Review
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By email: smallbusiness@fos.org.au

Dear Ms Renda

FOS Consultation on Small Business Jurisdiction

The Customer Owned Banking Association (COBA) welcomes the opportunity to comment on the Financial Ombudsman Service's (FOS) Consultation Paper *Expansion of FOS's Small Business Jurisdiction*.

COBA is the industry association for Australia's customer-owned banking institutions – mutual banks, credit unions, and building societies. Collectively, the sector we represent has $101 billion in assets and more than 4 million customers. Most COBA member institutions use FOS for their external dispute resolution (EDR).

COBA supports EDR as an effective way to resolve customer disputes in a quick and cost effective way without the need for consumers having to go to court. However, COBA has some concerns with the proposed changes to FOS's small business jurisdiction. COBA believes that these proposals go beyond the original intent of EDR and could have unintended consequences of limiting small business lending and increasing costs for small business lending.

COBA understands that FOS's small business jurisdiction was originally created to support small businesses such as sole-traders and small operators (less than 20 employees for non-manufacturing businesses) who have limited resources and knowledge to challenge a dispute with their financial institution through the court system.

The proposed changes to expand FOS's small business jurisdiction moves away from this original intention and allows larger businesses involved in more sophisticated lending arrangements to have access to EDR. COBA is concerned that this moves away from the original intention of EDR as a mechanism for those without the means to pursue their claim through the courts.

As an example, a business with a $10 million credit facility or a business with a $2 million dispute is likely to be sophisticated. Given loan to value ratios, a business with a $10 million credit facility is likely to have at least $15 million in gross assets. A business of this size is likely to have the resources to make take legal action through the court system. COBA questions whether it is proportionate or appropriate for businesses of this size and sophistication to have access to external dispute resolution.

ASIC's own website makes the point that consumer and commercial lending should be treated differently:

> *"In relation to commercial loans, the courts generally impose a high bar when a borrower (or ASIC) alleges that conduct of a lender is unconscionable. Courts interpret these laws in light of the business nature of the transaction and on the basis that* ***generally commercial parties can look after their own interests****. Therefore, although conduct may seem unfair, this may not necessarily amount to unconscionable conduct under the law. To successfully take action for unconscionable conduct in commercial lending, there must be some evidence that the lender has improperly taken advantage of a power imbalance between the parties."*[1]

We feel that the proposed changes do not reflect the fact that consumers and commercial borrowers have a different level of sophistication and therefore should have different avenues for redress.

COBA is concerned that the proposed changes will have the unintended consequence of ADIs becoming more risk averse about small business lending, particularly for larger value credit facilities. Lenders may seek to limit small business lending or seek to build risk minimisation strategies into the process which have the potential to increase costs for small business. For example, lenders may insist on something like a "Financial Advice Certificate" from an accountant or lawyer to ensure the borrower understands the terms of the credit facility prior to entering into a credit arrangement.

In addition, COBA is concerned about the potential jurisdiction overlap between an expanded FOS and the Australian Small Business and Family Enterprise Ombudsman, which exists to[2]:

- Advocate for small businesses and family enterprises;
- Provide access to dispute resolution services to assist businesses to resolve disputes without resorting to costly litigation; and
- Ensure that government policies take into account the needs of small businesses and family enterprises.

COBA questions whether FOS is the right organisation to undertake the specialist area of small business disputes, particularly when the Small Business and Family Enterprise Ombudsman already exists and could deliver this service.

Other specific comments are outlined below.

COBA does not support the increase in the small business credit facility (SBCF) compensation cap from $309,000 to $2,000,000 because the magnitude of the increase has not been justified. COBA believes that this quantum of compensation is better left to the courts because FOS is not bound by legal precedents or legal principle.

COBA members also believe that the SBCF limit for debt related disputes and the prohibition of debt recovery proceedings should both be capped at $5 million rather than the proposed $10 million.

COBA does not support the proposal to amend the remedies that FOS can award to include the ability to forgive a debt or vary an unregulated credit facility. This is unacceptable for EDR as lenders do not have the ability to appeal.

The proposed change to the prohibition of debt recovery to $10 million from $2 million is significant and COBA does not believe this five-fold increase is justified. Instead, we suggest this should be capped at $5 million. COBA is also concerned that this could be

[1] http://asic.gov.au/about-asic/contact-us/how-to-complain/disputes-about-commercial-loans/
[2] http://www.asbfeo.gov.au/about

used as a delaying tactic by unscrupulous operators in cases of insolvent trading. The changes must protect both secured and unsecured creditors of a business.

The inability for ADIs to have FOS decisions reviewed creates a level of uncertainty for ADIs. Increasing the amount of compensation that can be awarded to $2 million exacerbates this risk. FOS, in its decision making, is not bound by legal precedents or legal principles.

COBA has no comment on proposal 3.1, which seeks to clarify the small business definition. However, one COBA member has suggested that it would be preferable if FOS included a gross assets and/or revenue test for an aggregated group, rather than relying solely on a maximum employee test. For example, for reporting and auditing purposes, the Corporations Act provides that a 'small proprietary company' is a company with two of these three characteristics:

- annual revenue of less than $25 million;
- fewer than 50 employees at the end of the financial year; and
- consolidated gross assets of less than $12.5 million at the end of the financial year.

COBA is concerned that there is little mention of aggregation and how tests to determine "small business" status will apply to groups of related individuals and entities. Aggregated groups generally include both commercial and consumer debt. COBA seeks further clarification on how the limits would apply in these circumstances.

COBA also seeks clarification on how the proposed funding model will operate. ADIs that have very few or no small business customers should be exempt from any funding model.

Please do not hesitate to contact Alex Thrift at athrift@coba.asn.au or (02) 8035 8447 if you wish to discuss any aspect of this submission.

Yours sincerely

LUKE LAWLER
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