

Review of the financial system external dispute resolution framework (Review)

Submission by Credit Corp Group Limited (Credit Corp)

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Executive Summary

Mandatory ombudsman scheme membership has been one of the most successful aspects of the regime introduced through the *National Consumer Credit Protection Act 2009 (NCCP)*. The schemes have provided efficient, timely and consistent dispute resolution to the benefit of both consumers and credit providers.

The existence of alternative ombudsman schemes has been critical to the success of mandatory ombudsman scheme membership. Alternatives have made the schemes more accountable, efficient and innovative. The existence of alternatives has ensured that schemes derive the benefits of industry segment specialisation and remain close to the interests of both consumers and credit providers. Alternative schemes have introduced a comparative discipline of benchmarking which has served to drive continuous improvement to the benefit all stakeholders.

Credit Corp does not support any consolidation or merger of ombudsman schemes. Credit Corp is concerned that a merger would create an unaccountable and monopolistic bureaucracy, which would deliver diminished consumer outcomes and damage competitiveness in the financial sector. Credit Corp considers that present controls over the integrity of ombudsman decision-making are operating effectively to serve the interests of consumers and credit providers.

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 \$5.5 billion across 800,000 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 \$1.2 billion of defaulted consumer credit obligations, restructured into sustainable repayment arrangements across 150,000 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 100,000 Australians avoid higher cost and unsustainable 'payday loans' 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 (**EDR**) 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.

Context for Credit Corp's Response

Credit Corp has had direct experience with two ombudsman schemes. Credit Corp was a member of the Financial Ombudsman Service (**FOS**) for approximately 3.5 years from late 2008 to July 2012 and has been a member the Credit and Investments Ombudsman (**CIO**) for the last 4 years. The Chief Executive Officer of Credit Corp currently serves as an industry director on the board of CIO.

As described above Credit Corp's business almost exclusively operates in the area of consumer credit. Credit Corp notes that all the media and political attention which has surrounded this Review has focused on perceived shortcomings in financial planning, insurance and small business / agriculture lending. Credit Corp does not operate in these segments and its submission is informed only by its experience as a consumer credit provider.

Credit Corp also understands that only a very small proportion of the disputes reported to its EDR provider, CIO, relate to the areas of attracting adverse scrutiny. We consider that there is no justification for merging CIO's consumer credit activities with another scheme when it is operating so successfully and is not involved in any areas of identified shortcoming.

The Success of EDR

Credit Corp is very supportive of the existing system of EDR. Mandatory ombudsman scheme membership for holders of an Australian Credit Licence has been one of the most positive aspects of the reforms introduced through the NCCP.

Ombudsman schemes fulfil the objective of addressing the imbalance of resources between consumers and credit providers in dealing with disputes. The schemes are readily accessible and independent in their decision-making. Ombudsman personnel have the skills, knowledge and resources to ensure that consumers do not need any form of representation. While the schemes emphasise procedural fairness and have resort to the relevant law, industry codes, good practice and fairness in all the circumstances they are not excessively legalistic and communicate using plain language. This has made dealing with the schemes easy for both consumers and credit providers.

The schemes are transparent and predictable for credit providers and have served to provide ongoing and timely clarification of expected standards. Decisions and guidance notes are published and these have ensured consistency, while also assisting in raising standards and promoting compliance. Credit providers have not been required to wait for the outcomes of litigation to resolve legislative uncertainties.

EDR has assisted the regulator in achieving its objectives. The regulator has largely been relieved of the burden of receiving consumer disputes. Reporting and interaction with ombudsman schemes, together with details of systemic issues has provided timely information to identify emerging issues and highlight individual credit providers for further investigation.

The annual reporting of complaint statistics for each credit provider has also served to lift standards and provide information to consumers and other stakeholders. Credit Corp's experience is that

credit providers look to improve their systems to reduce complaint rates to both manage costs and preserve reputations.

The Importance of Alternative Schemes

It is critical that ombudsman schemes are accountable to credit provider members. All the costs are borne by the credit provider, regardless of the merits of a matter. The schemes are free to consumers and no paid representation is necessary because embedded in the costs funded by credit providers are the resources to assist consumers in recognising and articulating complaints. Findings are binding on the credit provider and cannot practically be appealed. Unlike court, a decision in favour of a credit provider in no way enhances the provider's rights. Consumers, on the other hand, are free to ignore ombudsman determinations and can press claims through the courts.

This sets up an imbalance where consumers and their representatives can potentially abuse EDR to pursue unmeritorious complaints. The prospect of escalating complaint charges can be used to extract settlements for unmeritorious complaints. For this reason EDR must be very accountable to credit providers for costs and efficiency. This can only effectively occur if credit providers have access to alternative schemes and schemes are not so large and all-encompassing that they lose touch with the individual concerns of a diverse membership base.

Costs and Efficiency

Without an alternative for credit providers there is little to motivate ombudsman management to operate efficiently and prevent a scheme from becoming an inward-looking and self-serving bureaucracy. It is only if credit providers can identify a more cost-effective and efficient alternative, more attentive to individual member concerns, that ombudsman management will be motivated to contain costs, put in place systems to minimise the scope for abuse and remain accountable to individual credit provider members.

It is important to note that the cost of EDR is ultimately borne by consumers as a whole and the economy. If EDR is inefficient, unaccountable and prone to abuse the costs are passed on to all consumers in the form of higher prices and more limited availability of financial products and services. Costly and inefficient EDR favours larger and entrenched operators, who are able to more readily afford such cost and inefficiency, diminishing competition in the broader financial services market. In the context of abuse, this means that there is effectively a cost transfer from consumers who do not complain to those consumers who press unmeritorious claims.

Credit Corp's experience in switching schemes in July 2012 demonstrates this point.

Debt purchasing is a competitive low-margin business. The average credit amount outstanding is just \$8,000. Approximately half of Credit Corp's ombudsman disputes relate to default listings placed on the credit files of customers by the original creditor prior to sale of an account to Credit Corp. In many instances these disputes are pursued in circumstances where the relevant debt has been repaid and the customer has engaged the services of a 'credit repair firm' to find a way to remove the listing so that further credit can be obtained. Many of these firms use templated correspondence to assert every possible technical defect in the original listing.

Credit Corp's experience as a member of FOS at the time was that in circumstances where the FOS case manager found that a consumer's complaint was not made out, the case could not be closed at an early stage. Notwithstanding the case manager's view, if the case was not settled in favour of the consumer the complaint would continue to escalate for a formal decision. In many instances the cost of such a decision would exceed the balance outstanding. For most credit listing disputes we found

ourselves expending large sums to defend listings for no commercial reason other than to preserve the integrity of credit bureau information to assist the proper functioning of the credit system.

The cost became unsustainable and it was necessary to consider the alternative scheme. We found that CIO case managers had the ability to close cases at an early stage if it was clear that a consumer's complaint could not be made out. By switching to CIO we were able to reduce costs without settling unmeritorious complaints. We also experienced improved timelines which further reduced our costs, because we were able to resume collection activity more promptly.

We note that since 2012 FOS has made changes to its processes to improve its timeliness and efficiency. We question whether such changes would have been effected in circumstances where there was no alternative scheme.

We also note that both CIO and FOS have subsequently put in place measures to limit the scope for abuse of the schemes by 'credit repair firms'. While these measures have proved imperfect and have not curtailed abuse they have been useful articulations of standards.

Specialisation

While one large bureaucratic scheme might be affordable and accountable to the largest and most-entrenched financial service providers, it is unlikely to serve the interests of a more competitive and innovative financial system. It is important that schemes are close to their membership bases so that they can respond to individual concerns and don't act as a barrier to increased competitiveness.

The consumer financial services market is large and diverse, comprising distinct products and services. It is appropriate that such a market is serviced by alternative ombudsman schemes. This has facilitated a degree of specialisation and focus by the schemes. FOS deals with a much higher proportion of complaints from larger providers and insurers. CIO services smaller credit providers, including operators in credit-impaired or non-conforming segments and debt purchasers. This has allowed each scheme to develop approaches adapted to the type of complaints such providers generate using specialisation to produce fair and efficient outcomes.

One aspect of this specialisation is the fee model adopted by the different schemes. Smaller organisations engaged in lower-margin credit activities or in the early stages of development require certainty over their short-run costs. These organisations also need the ability to defend unmeritorious complaints in order to properly establish their compliance systems through a test-and-learn approach. CIO's fee model provides this certainty by sourcing 70% of funding from annual membership fees. CIO's complaint management approach encourages the defence of unmeritorious and abusive complaints because it is not reliant on complaint escalation for ongoing funding (It should be noted that CIO membership fees are based on historical complaint volumes so that in the medium-run members do bear the total cost of their complaint activity).

Innovation and Adaptability

Innovation and adaptability is encouraged by having more than one scheme. A large bureaucratic organisation enjoying a statutory monopoly has little incentive to improve and innovate to the benefit of consumers and providers. A comparative scheme provides a benchmark and the motivation for schemes to show leadership.

Both FOS and CIO have exercised leadership in different areas over time. FOS has taken leadership in outreach programs to promote better engagement with disadvantaged communities. Similarly, CIO has historically taken leadership in dealing with consumer hardship and managing complaints where

legal proceedings had commenced. FOS has been a leader in identifying systemic issues and encouraging remediation by financial service providers. More recently, CIO has increased its focus on systemic issues and has taken the innovative step of amending its rules to enforce compliance with its findings.

It is difficult to conceive of this degree of innovation and adaptability in a single scheme environment.

Comparative Discipline

It is Credit Corp's observation that FOS and CIO do not actively compete for financial services provider members. Rather the existence of an alternative or benchmark scheme enhances accountability to both consumers and financial services providers.

Both schemes operate with a high degree of transparency to facilitate comparability. The schemes publish rules, guidance notes, decisions and systemic issues together with statistics on complaints, timelines and outcomes. This material effectively creates an impetus for continuous improvement as each scheme strives to ensure that it is equal to or better than its rival from the perspective of stakeholders including the supervising regulator, consumers and financial services providers.

Credit Corp does, however, note that both schemes would benefit from greater dissection of complaint statistics into industry segments and a standardised reporting protocol. By way of example it is difficult to compare the timeliness of the schemes because FOS excludes the period while complaints are referred to Internal Dispute Resolution (**IDR**) from its reporting, while CIO includes this period. Aggregated timelines may also be affected by the composition of disputes, with FOS dealing with a significantly higher proportion of insurance matters.

Integrity of Decision-Making

Credit Corp is not aware of any evidence that the existence of alternative schemes has adversely affected the integrity and consistency of decisions. Credit Corp's experience with FOS and CIO is that both schemes will reach similar conclusions in similar fact circumstances.

Credit Corp did not switch schemes because of any perception that it would get more favourable decisions from one scheme over the other. Rather, Credit Corp switched schemes to avoid the escalating costs associated with defending unmeritorious complaints.

There are strong and effective controls in place to ensure the integrity of ombudsman scheme decisions. From a governance perspective these include the requirement for an independent chairman and equal numbers of industry and consumer directors. Other controls include the requirement for an independent review against regulatory guide requirements and benchmarks every five years. There is close oversight by regulators with detailed quarterly reporting and periodic engagement. The publication of rules, guidance notes, decisions, systemic issues and complaint outcome statistics creates transparency and provides consumer stakeholders with the material to challenge schemes in order to hold them to account.

The existence of alternative schemes acts as a further control, providing consumer stakeholders with comparative outcomes to bring to the attention of the schemes.

Response to the Issues Paper

1. Question 2: Do you agree with the way in which the panel has defined the principles outlined in the terms of reference for the review ?

- 1.1 Efficiency should include consideration of the costs per unit of output.
- 1.2 Equity should be expanded to ensure that uneven cost burdens are not abused to extract favourable resolution of unmeritorious claims.
- 1.3 Comparability of outcomes should incorporate predictability. Scheme decision-making should be predictable to provide financial service providers with certainty in the design of products and compliance systems.
- 1.4 Accountability should be expanded to include accountability to financial service providers for costs and the prevention of abuse.

2. Questions 5 -9: Internal dispute resolution (IDR)

- 2.1 IDR is easy for consumers to access and delivers effective outcomes. More than 80% of all complaints received by Credit Corp are directly received into IDR and are resolved prior to any further escalation.
- 2.2 All communications with consumers record details of Credit Corp's EDR provider. Where consumers report a complaint to EDR in the first instance, the complaint will be referred to IDR for a limited period. EDR will resume management of the complaint in circumstances where the complaint is not resolved during the specified period.
- 2.3 As a debt buyer there are instances where consumers seek to lodge disputes with the original credit provider's EDR scheme, which is generally FOS. This is readily resolved between the EDR schemes, with referral to Credit Corp's EDR provider, CIO. It is not Credit Corp's view that this arises due to confusion about EDR schemes, but rather a conscious preference by some consumers to deal with their original credit provider.

3. Question 10-12: Regulatory oversight of EDR schemes and complaints arrangements

- 3.1 Credit Corp is comfortable that the existing level of regulatory oversight is adequate.
- 3.2 Oversight and community perceptions of the integrity of ombudsman schemes would be improved by more standardised statistical reporting by the schemes with greater disaggregation of statistics into industry segments. More regular auditing of statistics and dispute outcomes would also serve to enhance perceptions of scheme integrity and independence.

4. Question 13: In what ways do the existing schemes contribute to improvements in the overall legal and regulatory framework ? How could their roles be enhanced ?

- 4.1 Publication of guidance notes, decisions, case studies and systemic issues provide important clarification for financial services providers. These materials provide timely resolution of uncertainties in legislation and highlight areas for improved compliance.

4.2 CIO's recent rule change providing the power to compel compliance with remediation of a systemic issue will greatly enhance the ability of CIO to complement regulatory enforcement. This should reduce the requirement for regulators to initiate separate enforcement action for identified systemic issues.

5. Questions 14 -34: Existing EDR and complaints arrangements

5.1 These questions are addressed in pages 1 – 5 of this submission.

5.2 The current monetary limits are adequate in the context of consumer disputes, but these limits may not be adequate for small business disputes.

5.3 Simply raising limits for small business disputes is unlikely to be an adequate solution. It is our observation that to accommodate larger disputes, it may be necessary to introduce more court-like features into ombudsman schemes. This may dramatically increase costs and make 100% provider funding unworkable. EDR works well for consumer credit disputes because the NCCP places a prescriptive onus on providers to look after the interests of consumers, often in ways that are at odds with consumers' express preferences. Unless similar laws are extended to small business EDR may be unworkable.

5.4 For discussion of reporting refer to page 5 and paragraph 3.2 of this response.

6. Questions 35 – 36: Triage service

6.1 Credit Corp considers that a triage service could be provided as an extension of the services provided by existing schemes. There are only a small number of EDR schemes in Australia and front-line staff in each scheme could be readily trained in the scope of each scheme and could provide links and other reference material to assist in directing consumers to a relevant scheme.

7. Question 37: Should it be left to industry to determine the number and form of the financial services ombudsman schemes ?

7.1 The responsibility for setting the form of schemes and approving schemes presently rests with the regulator, ASIC. While industry may propose schemes the requirements imposed by ASIC and the regulatory guide are onerous and serve to limit the proliferation of schemes.

8. Question 38: Is integration of the existing arrangements desirable ? What would be the merits and limitations of further integration ?

8.1 For the reasons outlined on pages 1 -5 of this submission Credit Corp does not believe that any merger of FOS with CIO would be desirable.

9. Question 39: How could a 'one-stop shop' most effectively deal with the unique features of the different sectors and products of the financial system (for example, compulsory superannuation) ?

9.1 Credit Corp does not believe that a 'one stop shop' would do anything other than create a large and unaccountable bureaucracy. Already, where schemes deal with different sectors they set up specialised departments for sectors and dispute types. On top of this the schemes establish additional layers of general management. This just creates a large

organisation with more senior executives who are increasingly remote from both consumers and financial services providers.

- 9.2 In the context of monopoly service provision Credit Corp is concerned that this would entrench an inward-looking and unaccountable organisation incapable of operating efficiently to service the changing needs of consumers and financial service providers.

10. Question 40 - 41: What form should a 'one stop shop' take ?

- 10.1 Credit Corp does not support a 'one stop shop'. Credit Corp supports ombudsman schemes, but only in the context of the existence of alternative schemes. No ombudsman scheme should be granted with monopoly jurisdiction. It is fundamental to our constitution and system of western democracy that only courts are granted monopoly jurisdiction.
- 10.2 If a single scheme is imposed on industry then it should take the form of a tribunal and should operate using only legal principles and legal methods. Such a tribunal should be subject to appeal and review through the court system.
- 10.3 Such a tribunal should be funded from consolidated government revenue and should have the power to impose obligations on both consumers and financial services providers.