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EDR Review Secretariat
The Treasury
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Dear Sir or Madam

MFAA Response to the Interim Report of the Review into External Dispute Resolution and Complaints Framework, 6 December 2016

On behalf of the Mortgage & Finance Association of Australia (MFAA), we welcome the opportunity to respond to the interim report of the Review of the financial system external dispute resolution and complaints framework released on 6 December 2016.

With over 12,600 members, the MFAA is Australia's leading professional association for mortgage and finance brokers. The aim of the MFAA is to help MFAA members to be recognised as trusted professionals and to be their client's first choice. To achieve this aim, the MFAA promotes and advances the broker proposition to consumers as well as external stakeholders including governments and regulators, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development.

The mortgage and finance broking industry is relatively new in Australia but continues to demonstrate growth. Mortgage and finance brokers have filled a clear gap in the market, being viewed as providers of comprehensive, and convenient credit advice to clients. Representing a panel of lenders, they offer customers a range of products and tailor mortgages to specific needs. Generally, these factors have contributed to demand growth in the industry.

Mortgage and finance brokers provide a distribution network right across the country, often in areas where there are no bank branches. As mainly small businesses or sole operators, each mortgage and finance broker accesses on average 1,000 customers per year, and it is conservatively estimated that the industry as a whole directly engages with over 1.9 million customers per year. Mortgage and finance brokers are strong drivers of competition in the mortgage lending market, providing many small lenders and originators with a 'shop front' to compete against the larger bank branch networks.

It is estimated that around 17,000 mortgage and finance brokers operate in Australia.[1] In September 2015, *Comparator Business Benchmarking* found that local brokers' market share then stood at 53.6 per cent for home loans written compared with 70 per cent for the UK (in 2016)[2], 27 per cent for Canada, less than 40 per cent in the US and 25 per cent in New Zealand. Industry participants[3] agree that within five years, brokers will account for 60 per cent market share in Australia based on prevailing growth trends.

MFAA Commentary on the Interim Report

The MFAA rejects key elements of the Ramsay Review's interim report, including its principle recommendation *"that there should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO."*

The proposed single industry Ombudsman scheme for financial, credit and investment disputes – excluding superannuation – is recommended to replace the Credit and Investments Ombudsman (CIO) and the Financial Ombudsman Service (FOS). This would create a massive new monopoly, only benefiting a handful of large banks, and ignoring the needs of tens of thousands of small businesses and financial services providers, including mortgage and finance brokers.

The key justification for this move is to resolve alleged customer confusion around which scheme (FOS or CIO) to lodge a given complaint with. The interim report found:

> The existence of multiple schemes that have overlapping jurisdictions contributes to consumer confusion and makes it more challenging to achieve and be seen to achieve comparable outcomes for consumers with similar complaints.[4]

The MFAA contends that there is no such confusion, as the vast majority of MFAA members, whether licensed brokers or credit representatives, are members of the CIO. Equally, mortgage and finance brokers make up the vast majority of CIO members. In addition, MFAA mortgage and finance brokers that deal in regulated finance, such as home loans, have a statutory requirement to clearly disclose their EDR scheme provider and its contact details in their disclosure documents when they provide credit assistance to any customer. Similarly, mortgage and finance brokers dealing in regulated or unregulated credit, are required to clearly disclose the same details under the MFAA's Code of Practice.[5] Any alleged confusion, particularly when a matter involves both schemes, could be easily resolved through the establishment of an industry funded complaint call centre.

The confusion argument is significantly undermined by the review panel itself, which actually ignores the area where most potential confusion exists – between the Superannuation Complaints Tribunal and FOS. In this case the panel recommended that two separate EDR schemes remain, with the SCT

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[1] IBISWorld, *Mortgage Brokers in Australia: Market Research Report*, August 2016, p. 1, http://www.ibisworld.com.au/industry/default.aspx?indid=1821

[2] IRESS, *Intermediary Mortgage Survey 2016*, p. 7, https://www.iress.com/files/1214/5995/3077/UK_IRESS_IMS_2016_FINAL.pdf.

[3] Ernst & Young, *Observations on the Value of Mortgage Broking*, May 2015, p. 2, https://www.mfaa.com.au/IndustryInformation/Documents/1527742_MFAA_Broker%2020Study_final_email.pdf#search=observations%20on%20the%20value.

[4] Interim Report of the Review into Dispute Resolution and Complaint Framework, 6 December 2016, p. 98

[5] Mortgage & Finance Association of Australia, MFAA Code of Practice, 4 September 2016, p. 6, https://www.mfaa.com.au/AboutUs/Governance/Pages/Code-of-Practice.aspx

transitioning into an industry ombudsman scheme for superannuation disputes. In effect it is stating that the way to resolve the confusion between the jurisdictions of FOS and the SCT is to recreate the current EDR model for financial services complaints – a multi-provider model.

The MFAA is extremely concerned about this inconsistency, and believes that if a competitive environment for EDR in superannuation remains fit for purpose, then the same should definitely be the case in the wider market for financial and credit services. Moreover, the review panel fails to make the case that customer confusion between FOS and the CIO exists in any meaningful way, nor does it demonstrate any customer detriment from such alleged confusion.

The review also references the 'public debate calling for speedier, low cost methods for resolving financial disputes', and claims that this highlights the importance of this issue for many Australians. The MFAA contends that this is not in fact a public debate, but rather a political one, which has its origins in the call by certain Coalition MPs for the establishment of a single statutory tribunal. This call is in response to deficiencies in the major banks' handling of small business complaints, and is designed to address the power imbalance between bank and small business customer. Ironically, the interim report does little to directly resolve this issue, and the MFAA can only assume that the recommendation to establish a single, monopoly, provider for EDR in financial services is a political compromise dressed up as an alternative to a statutory tribunal.

This recommendation also goes against the vast majority of the evidence provided to the review, and is designed to fix a problem that does not exist. The case for change has not been made either in the interim report, nor in the evidence provided to the panel.

The MFAA has called on the panel, led by Professor Ian Ramsay, to consider the needs of Australian businesses beyond the major banks in developing final policy recommendations. Specifically, the entirely relevant work performed by the Credit and Investments Ombudsman, and the extremely good fit the CIO has with both small financial service providers and the needs of their customers has been entirely glossed over.

The vast majority of MFAA members are members of the CIO, and find that the CIO performs a relevant function for smaller financial and credit services providers, as it has the specific expertise, and leadership focus, relevant to their businesses. Even if the proposed monopoly scheme were to have a division allocated to deal solely with mortgage and finance brokers, the leadership of the scheme would still be focused on the needs of the major financial service providers. This will mean that the incredibly important strategic focus of the organisation would be much more closely aligned to the major banks, with the needs of small providers being largely ignored.

Such an outcome will mean that the strategic focus, fee structures, standard practices and future innovation will be set to accommodate the largest members and the resolution of their higher profile disputes. The expertise and leadership inherent in the CIO will be lost, and the needs of mortgage and finance brokers and their customers will be treated as a minor subset of the wider industry.

The MFAA represents over 12,600 brokers, most of whom are small businesses and sole traders, who in turn serve hundreds of thousands of small businesses and consumers. Indeed, in regional areas, brokers are often the only business providing financial services, since the major banks have pulled branches out of so many country towns.

The needs of mortgage and finance brokers are very different to those of the big banks, and the disputes which arise in the mortgage and finance broker market are significantly different from

those of the big banks in both scale, systemic importance and potential customer impact. A monopoly scheme would necessarily be focused on the needs and mediation practices of the big banks, since they generate the most complaints and would pay the bulk of the new scheme's fees. Adverse findings from a monopoly scheme focused on the big end of town could end a broker's business, and we don't believe such a scheme would have the expertise to deal with disputes appropriately.

The MFAA is also disappointed that much of the compelling evidence provided to the review by the industry, and indeed the CIO, has either been entirely ignored, or ruled out of hand without any significant analysis. Rather, the review relies heavily on the anecdotal evidence provided by consumer representatives, who only represent a small proportion of complainants. No effort has been made to reach out directly to customers to assess their needs first hand, nor has any economic analysis of the efficiency of the current schemes been undertaken.

Equally, the impact on the financial services industry of the establishment of a large monopoly for EDR has not in any way been assessed. Concerns raised about such a monopoly have simply been brushed off, with ASIC and the review panel claiming that competition provides no benefits in EDR:

> Where it is the financial firms (and not the consumers) that have a choice of scheme for dispute resolution, it is not clear that competitive tension drives innovation and better outcomes for consumers.[6]

Such claims are without merit, and again ignore the weight of industry evidence. One simply needs to look at the weight of evidence around the negative impact on pricing and innovation in monopoly environments. This situation would be exacerbated in the EDR environment as such a monopoly would have a guaranteed market, as financial service providers would be forced to join it regardless of its conduct or effectiveness.

The MFAA fears that forcing our members to join a massive, slow, monopolistic bureaucracy – would mean that they would have to contribute to a scheme that does little to help them resolve disputes equitably, appropriately and efficiently.

The MFAA encourages the Ramsay Review's panel and the Federal Government to consider the needs of all Australian financial services providers, in the interests of fostering competition and a robust financial services sector.

We would like to see the needs of consumers and small businesses served by creating an effective set of policy recommendations around dispute resolution. A massive monopolistic bureaucracy set up to serve the big banks – the source of the majority of complaints – does nothing to support Australian growth and competition.

MFAA assessment of the interim report against the Review's core principles

Analysis of Interim Report summary table page 145

Efficiency – *A complaints resolution framework should provide outcomes in an efficient manner*

The interim report does not firstly make the case that either FOS or the CIO are inefficient in the application of their EDR functions. Nor does it provide any evidence that the creation of a monopoly

[6] Ibid, p. 101

for EDR will lead to greater efficiencies. It claims that jurisdiction overlaps lead to delays in resolving some disputes. The MFAA can only support the evidence provided by both the CIO and FOS that where there is overlap, the current MoU and operating principles ensure that delays are minimised.

Equally, there is no evidence that establishing a single EDR monopoly will improve efficiency. It is assumed that the single EDR will have several divisions. Its establishment will simply move the jurisdictional overlap from between schemes to between departments, with no guarantee that they will be more efficiently resolved.

Of a more worrying nature, one of the claimed benefits of a monopoly is that the scheme will have "the capacity to reallocate resources as priority areas shift"[7]. Given the profile nature of the large bank disputes, and the influence they will have over scheme strategy, this 're-allocation' is only likely to go one way – away from smaller FSP disputes, to the disputes of big banks.

Equity – *Complaints should be treated fairly*

The Review Panel pins its equity argument on the alleged consumer confusion between the current schemes. The MFAA contends that no significant confusion exists. It also contends that where it does exist, it is resolved quickly and at no detriment to the customer. Even the Interim Report claims that *"it is difficult to measure consumer confusion"*[8], and acknowledges the effectiveness of the current MoU between CIO and FOS. Therefore, the MFAA does not believe that there is any equity benefit from the recommendation to establish a single scheme.

Moreover, the MFAA believes that there will be an equity detriment to many financial service providers, including mortgage and finance brokers, if resources are 're-allocated' away from the resolution of their disputes in favour of the big banks.

Complexity – *Given individuals can possess low levels of financial literacy and behavioural biases, a complaints resolution framework should have minimal complexity*

The review panel again claims the only complexity benefit comes from the removal of confusion. The MFAA contends that this is both simplistic and inaccurate. As there is no evidence of genuine customer confusion or detriment, the Review Panel should not contend that there is any inherent complexity from the existence of two schemes. The MFAA also believes that the establishment of a large, monopolistic bureaucracy is much more likely to lead to more rather than less complexity, because the efficiencies produced by the competitive tension inherent in the current market for EDR will be removed.

Transparency – *A complaints resolution framework should be transparent and open.*

The Review Panel contends that the *"presence of competition between schemes may provide incentives to minimise financial disclosure (due to price competition), which reduces financial transparency"*[9]. There is absolutely no evidence presented in the interim report to support this statement, nor is there any evidence that this practice currently occurs. If it were to occur, it could easily be resolved by ASIC acting against breaches due to the lack of such statutory disclosure as part of its oversight role.

[7] Ibid, p 145
[8] Ibid, p 96
[9] Ibid, p 145

This statement entirely misses the point. A monopoly provider is much more likely to be less transparent as it does not have to compete for business. This has been seen in almost all monopoly industries. The advent of competition means that the appetite for information amongst customers is heightened as they desire comparative data to support their purchase decision.

Accountability – *A complaints resolution framework should ensure decision makers account for their actions to users and the wider public.*

The Review Panel claims that the lack of consistency in reporting between the schemes makes it difficult to compare the schemes and monitor their effectiveness. Again there is no evidence to support this claim. Equally, one does not fix reporting problems by abolishing competition and establishing a less genuinely accountable monopoly. This potential issue could easily be resolved by empowering ASIC to establish consistent reporting standards.

The MFAA believes that accountability should be measured in terms of responsiveness to both the complainants (customers) and member financial service providers. The MFAA believes that a monopoly will be much less accountable because, regardless of outcomes, all financial service providers will be forced to join the scheme. It is entirely reasonable to assume that once the competitive pressure of members being able to switch between schemes is removed, a scheme will become much less responsive to their needs.

Comparability of outcomes – *A complaints resolution framework should ensure that consumers receive comparable outcomes*

The Review Panel believes that due to a differing approach and criteria for decision making, this compromises comparability of outcomes. The MFAA contends that this differing approach reflects the different nature of the disputes covered by CIO versus those handled by FOS. It also reflects the differing impact of such disputes on members. While a minor financial dispute involving a big bank handled by FOS will have little impact on the bank should it go against them, a similar dispute handled by the CIO in relation to a mortgage or finance broker could end their business should it be incorrectly dealt with. This means that the CIO needs to be much more focused on due process, and demonstrating such due process to its members.

A monopoly scheme is likely to apply a single 'one size fits all' approach to processes. While this may resolve the comparability of outcomes issue, it will mean that the processes suitable for dealing with a big bank are likely to be applied to small businesses including mortgage and finance brokers. This will undermine mortgage and finance broker confidence in EDR processes generally, and, more specifically, will undermine the effectiveness of the mediation process.

Regulatory costs – *The regulatory settings for a dispute resolution framework should, as appropriate, utilise market forces and avoid creating moral hazards*.

The Review Panel claims that the removal of duplication in regulating, and indeed running, two schemes will reduce supervision costs for ASIC and member costs. This assertion does not in any way reflect the common practice of monopolies. It also ignores the Review's core principle that regulatory setting should utilise market forces and avoid creating moral hazards. The creation of a monopoly will entirely remove all market forces, and any downward pressure on member costs.

In terms of the creation of moral hazards – or irresponsible risk taking – the removal of choice will make this more rather than less prevalent. This will likely be reflected in decision making or outcomes, or both. As FSPs cannot vote with their feet, the EDR could make risky or 'creative'

decisions without this impacting their business. This will undermine member confidence in decision making and the wider confidence in the EDR environment.

Conclusion

The MFAA is disappointed by the findings of the Review Panel as articulated in its interim report. The Panel was established to assess EDR as it interacts with both complainants (customers) and member financial service providers. The Panel has largely based its findings on the agendas of, and evidence given by, small consumer representative organisations, not the customers they represent. More importantly, it has ignored almost all of the evidence and views provided by EDR members.

The MFAA does not support the establishment of a monopoly EDR scheme. The panel has not adequately made the case for change, and has pinned its recommendations to alleged customer confusion, which it acknowledges is difficult to measure. It has not provided any analysis that such alleged confusion leads to customer detriment, nor has it provided evidence that a monopoly will be in any way less confusing to customers – as cases are shifted internally between departments.

The MFAA believes that the only effective EDR system is one which has the support of its members. One which is not supported by members, or is forced upon them, will only lead to the degradation of successful mediation principles.

The MFAA would like to thank you again for the opportunity to respond to the interim report of the Review of the financial system external dispute resolution and complaints framework, and should you have any questions regarding this submission, please do not hesitate to contact us.

Yours sincerely

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Cynthia Grisbrook
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