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# Review of the Australian Financial Complaints Authority

Thank you for the opportunity to make submissions to assist this review.

## 1. About the MFAA

With more than 13,500 members, the MFAA is Australia's leading professional association for the mortgage broking industry, with membership covering mortgage and finance brokers, aggregators, lenders, mortgage managers, mortgage insurers and other suppliers to the mortgage broking industry. The stated purpose of the MFAA is to advance the interests of our members through leadership in advocacy, education and promotion. To achieve this aim, the MFAA promotes and advances the broker proposition to a range of external stakeholders, including governments, regulators and consumers, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development.

## 2. General

At the outset we would like to confirm that the MFAA strongly supports the function of external dispute resolution bodies. Indeed, before the Credit Code made EDR membership compulsory for entities providing credit services, the MFAA established COSL and made membership of COSL or FOS compulsory for its members.

It is essential that AFCA structures operate efficiently, fairly and openly and particularly considering the potential for the referral of matters to AFCA to increase as a result of mortgage brokers' Best Interests Duty (**BID**). The MFAA has commenced discussions with senior AFCA personnel regarding the implementation of BID and we now have a bi-monthly meeting to discuss issues and explore how we can work together as the key BID change is bedded down.

The BID is a principles-based duty that is complex and has no safe-harbour. Assessing BID could result in a broad spectrum of opinions based on a case manager's individual judgment of the customer's circumstances and the actions taken by the broker whilst providing credit assistance. Even in circumstances where a consumer sought a "low rate" as their key priority, assessing the outcome for that consumer does not only depend on whether the consumer received the low rate but depends on their overall circumstances including their credit position and the products for which that consumer would have qualified for at the time the credit assistance was provided.

The introduction of BID poses a risk to mortgage brokers being held responsible for not delivering "low cost" solutions to consumers that would not have qualified for such products. It is therefore important that the AFCA process is both procedurally fair to deal with such complexity and (as we have suggested in paragraph 4 below) that there is an appeal mechanism for decisions to be reconsidered when appropriate.

We wrote to Treasury (attention [redacted]) raising these concerns in connection with the development of the best interests duty law in our letter dated 12 November 2020 and have repeated much of that letter in this submission.

Quite apart from the new challenges presented by BID cases, there is concern that some case managers have limited legal and market practice experience. There is a perception that often they have limited experience and training in the areas they are dealing with. We hope that industry bodies will follow the MFAA initiative to try to address these concerns by working closely with AFCA.

### 3. Fairness of the fee structure

Our members report significant and ongoing concerns regarding the AFCA fee structure and the impact this has on the potential neutrality of AFCA staff (perceived or otherwise). As the arbiter of fairness, it is important that AFCA's own operations are fair and seen to be fair.

AFCA's cost recovery derives primarily from case fees levied on members. Members are liable for those fees even if the matter is determined in their favour. The unintentional consequence of this regime is that brokers and lenders often feel forced or are encouraged to pay unwarranted compensation to consumers because the amount paid for compensation may be less than the AFCA fee should the matter progress further without being settled. There is a risk that consumers (or at least their advisers) are aware of this situation and abuse it.

The initiative in the exposure draft of the National Consumer Credit Protection Amendment (Debt Management Services) Regulations 2021 which will require businesses to hold a credit licence if they provide debt management assistance to a consumer or provide credit reporting assistance to a consumer is a welcome initiative but will not wholly address this concern.

***Recommendation 1: There should be specific obligations on debt management assistance providers not to support unjustified claims in an attempt to assist consumers. This is required in addition to licensing of debt management assistance providers which alone will not curtail abuse of the AFCA system.***

The amount of compensation claimed against our members is usually very small – often $10,000 or less. Case fees can quickly exceed this amount. Our members report concern about the complex fee and case management structure that appears to vary from case to case with no clear guidelines. There is opportunity to simplify the fee and case management structure. Case fees should not be more expensive than the claim amount. The current fee structure gives rise to frivolous and baseless claims knowing that AFCA members will likely pay compensation rather than dispute a claim. For example, a complainant may choose to pursue the matter to final determination which will cost the broker ~$10K in costs, plus whatever compensation is decided.

***Recommendation 2: Case fees should be reviewed to be limited to the claim amount.***

***Recommendation 3: Claims should be promptly closed if consumers cannot clearly demonstrate financial loss.***

It is worth noting that according to the latest Industry Intelligence Service Report (11th Edition) produced by Comparator, 47% of mortgage brokers are sole operators working in small businesses. It is unfair that small broker businesses participate on unequal terms with other small businesses and consumers in the AFCA EDR process because finance brokers have to pay for the outcome regardless of whether they are at fault, while the complainant pays nothing. This is an imbalance that is inequitable and is exploited by consumers and their advisers.

The COSL regime produced a fairer result where specifically for finance brokers the membership fees were set at a level which created a pool of funds which enabled COSL to charge no case fees when the member was not at fault. There were limits on this so that if a single broker was subject to more than say three complaints a year, fees would commence – presumably based on the idea that if a broker is receiving a lot of complaints there is some issue even if those complaints were dismissed. Lenders can similarly be unfairly disadvantaged.

The MFAA has been provided with a number of cases which demonstrate that the current fee arrangement operates unfairly. A selection of those cases is attached with this letter. It is particularly concerning that AFCA in some cases appears to have been suggesting that the member pay compensation to the consumer despite asserting that the member is not at fault. We can appreciate that these statements may have been made to ensure the members were aware of the financial ramifications, but they do support the view that AFCA's fee model could be improved.

The AFCA process should provide an opportunity for all banks, planners and brokers to defend themselves against complaints in a fair and equitable manner. Currently, it only allows those that have 'deep pockets' to do this, whereas others are being forced (due to the size of the fees and pressure being exerted by AFCA) to make an offer to complainants in order to resolve complaints and minimise costs/damage to their business. AFCA costs charged to a broker can at times equate to more than 10% of a broker's gross annual earnings. This cost is difficult for a small business to bear particularly when they have been found to not be at fault but are still required to pay the AFCA fees regardless. This has opened the door for more vexatious or frivolous complaints to be made, as more unscrupulous people feel they can take advantage of the system.

It is important to remember that a large proportion of brokers are small businesses which will often need support just as much as consumers. We would appreciate the opportunity of working with AFCA to explore an amended funding model in order to provide that support.

***Recommendation 4: AFCA should explore alternate fee structures to reduce fees when the AFCA Member is not found at fault and which enable small cases to be handled at no cost to small Member's unless a finding is made against the Member.***

***Recommendation 5: Case managers should also have greater decision making power to ensure binding recommendations are swiftly made to prevent unnecessary escalation of matters.***

## 4. Right of appeal

AFCA can determine a complaint in favour of a consumer on the basis of general fairness even when the member has complied with all relevant laws. This provides AFCA with a huge amount of power because one person's view of fairness may be quite different from that of another.

There is generally no appeal available to AFCA members against an AFCA decision. However, consumers can still refer the matter to court. This situation does not satisfy the fairness test.

Given that views of fairness can differ, we believe that it is important for AFCA members to have access to a formal appeal process to be able to escalate decisions which members consider are not correct. We understand that in some circumstances AFCA will internally review a proposed finding on request from a member concerned about a preliminary view on a proposed finance disclosed by AFCA to the affected member. We note that Rule 16 currently provides for members to complain about AFCA's service and for that complaint to be reviewed by an independent assessor. We propose that members should have a similar right of review in respect of decisions by AFCA.

This is particularly important when considering the complex principles-based BID that has no safe-harbour and could result in a broad spectrum of opinions based on individual judgment of the customer's circumstances and the actions taken by the finance broker whilst providing credit assistance.

***Recommendation 6: Members should have a right of review in respect of a decision by AFCA. Members should not be liable for costs for the review if the original decision is amended in favour of the member.***

## 5. Rule of law

AFCA rule A14.2 provides 'When determining any other complaint [excluding a superannuation complaint], the AFCA Decision Maker must do what the AFCA Decision Maker considers is fair in all the circumstances having regard to:

a) legal principles,
b) applicable industry codes or guidance,
c) good industry practice; and
d) previous relevant Determinations of AFCA or Predecessor Schemes'

Concern has been expressed that a broker or financial firm may comply with the law and act in good faith yet still be found against on the basis of unfairness. Although 'unfairness' is not a relevant criteria under rule A14.2, acting 'efficiently, honestly, and fairly' is a condition of all credit licenses and so is considered under paragraph (a) of rule A14.2.

There is a concern that the assessment of fairness has a bias towards consumers. Of course, that is not always the case and setting standards for fairness is difficult. As we note above, people will usually have different views of what is fair.

Our members are concerned that there may be an element of 'the consumer is always right' in AFCA's decision making. Although a Member may have a degree of advantage over a consumer, the fact that one party has an advantage should not create a presumption of unfairness.

If licensees comply with the law, there should be a high bar before a finding of unfairness is made.

***Recommendation 7: If licensees comply with the law, there should be a high bar before a finding of unfairness is made.***

## 6. Unauthorised conduct by representatives

In the case of DH Flinders Pty Limited v Australian Financial Complaints Authority Limited [2020] NSWSC 1690 the court found that AFCA did not have jurisdiction on matters where an individual is acting outside of the scope of authority from their licensee.

Both the Corporations Act (s917B) and the National Consumer Credit Protection Act (s75) provide that a licensee is responsible for the conduct of its authorised representatives (AFSL) and credit representatives (respectively) irrespective of whether the representative's conduct is within the authority granted by the licensee. (As an aside, these sections are extraordinarily wide because they could be interpreted to mean any conduct at all and not just conduct in relation to financial services and credit activity respectively. While that limitation is implied, it would be good for that to be clarified.)

As a result of the case, AFCA changed their rules so that AFCA can hear a complaint regardless of whether the complaint is within or outside the individual's authority. This has wide ranging and potentially unfair ramifications for licensees and a particularly large impact on loan aggregators who often have many credit representatives.

We accept that licensees must accept responsibility for the conduct of representatives acting within their ostensible authority. In relation to credit licensees, that liability should be strictly limited to conducting 'credit activities' (as defined in the National Credit Act), and not extend to other activities such as financial advice, tax, or legal advice (or to take some extreme examples, civil or criminal disobedience).

For the avoidance of doubt, the limitation of licensees' liability to 'credit activities' should mean that licensees are not liable for their representatives' activity in relation to credit which is not regulated by the Credit Code. Like financial planning, certain types of unregulated credit falls within AFCA's jurisdiction but should not be sheeted home to a credit licensee who has only authorised regulated credit activities.

***Recommendation 8: AFCA's rules should be amended to limit liability of credit licensees for the conduct of their credit representatives to 'credit activities' as defined in the National Credit Act.***

## 7. Timely resolution of complaints

Significant concern has been expressed about the delay in finalising many matters. Whilst we readily appreciate the challenges AFCA has to meet dealing with the volume of complaints, it is essential that AFCA is properly resourced to minimise long delays. This is particularly so given the significant consumer damage that can occur as interest and costs increase consumers' debt, and losses that can occur in realising real estate security.

***Recommendation 9: Specific 'break points' should be established which trigger escalation and expedition of resolution of matters, especially when interest is accruing or a lender is subject to enforcement stand still.***

## 8. Specific questions raised in the consultation

In this section we respond to the question raised in the consultation.

***<u>Delivering against statutory objectives</u>***

***1. Is AFCA meeting its statutory objective of resolving complaints in a way that is fair, efficient, timely and independent?***

Whilst the MFAA strongly supports the function of external dispute resolution bodies, we feel that improvements are required as outlined above. This is particularly so in relation to the current AFCA fee structures to ensure that they operate efficiently and fairly and do not pose risk to broker businesses many of which are small businesses, and particularly when the broker has not been found to be at fault.

Some specific cases which appear not to have met that standard are summarised in Annexure 1.

***1.1. Is AFCA's dispute resolution approach and capability producing consistent, predictable and quality outcomes?***

Our members are concerned that the outcomes are not always quality outcomes – in the sense that the outcome is at times seen as unfair on Members. We believe actioning the nine recommendations made above will provide much fairer and better-quality outcomes.

To a large extent the unfair impact on Members is not ascertainable from AFCA's records because the unfair regime has created a practice where Members often pay money to consumers in response to spurious claims because AFCA's fees will significantly exceed the amount claimed. The unfairness is exacerbated when matters are not resolved in a timely fashion because of the significant internal costs incurred by Members.

The timeliness of resolution is even more important for consumers who are often burdened with significant additional interest and emotional stress while waiting for an outcome.

***1.2. Are AFCA's processes for the identification and appropriate response to systemic issues arising from complaints effective?***

Generally, yes

Because members are generally prevented from taking any enforcement action while a matter is at IDR or EDR, in certain cases speed of resolution is essential to ensure fairness to both consumers and members. Particularly where a loan is in default (especially mortgage loans), lenders and consumers can suffer significant loss if there is undue delay because of the accrual of interest and value of security. There should be a specific obligation on AFCA to deal with these matters promptly.

***1.3. Do AFCA's funding and fee structures impact competition? Are there enhancements to the funding model that should be considered by AFCA to alleviate any impacts on competition while balancing the need for a sustainable fee-for-service model?***

See our comments earlier in this letter. Smaller financial firms are much more susceptible than larger firms to inappropriate pressure to not contest a complaint because of the fee regime. The fairness of the existing fee structure requires review so that brokers do not feel compelled to be making a settlement offer where they do not believe they are at fault. At present mortgage brokers many of whom are sole operators participate in the AFCA EDR process on very different terms to consumers which leaves them exposed to being unfairly targeted with frivolous complaints.

***Please provide specific examples or case studies to support your responses. These may be provided to Treasury confidentially with any personal details of complainants and case references numbers omitted.***

See Annexure 1.

***Monetary jurisdiction in relation to primary production businesses***

***2. Do the monetary limits on claims that may be made to, and remedies that may be determined by, AFCA in relation to disputes about credit facilities provided to primary production businesses, including agriculture, fisheries and forestry businesses remain adequate?***

Yes

***Internal review mechanism***

***3. AFCA's Independent Assessor has the ability to review complaints about the standard of service provided by AFCA in resolving complaints. The Independent Assessor does not have the power to review the merits or substance of an AFCA decision. Is the scope, remit and operation of AFCA's Independent Assessor function appropriate and effective?***

See our proposal above that the function should be extended to an appeal process that allows a review of decisions and not just service levels.

***4. Is there a need for AFCA to have an internal mechanism where the substance of its decision can be reviewed? How should any such mechanism operate to ensure that consumers and small businesses have access to timely decisions by AFCA?***

See our proposal above that the review function should be extended to review of decisions and not just service levels. We are conscious of the need for complaints to be resolved promptly, and propose that any review regime should be structured to operate quickly. A power to reject frivolous referrals and referrals without substance should be included.

## 9. Conclusion

The MFAA extends its thanks to the Treasury for the opportunity to provide this submission. If you require further information, please do not hesitate to contact me on [redacted] or by emailing [redacted]

Yours sincerely

**Mike Felton**
Chief Executive Officer
Mortgage & Finance Association of Australia

**Annexure 1** (Note - Case Numbers and the aggregator member name have previously been provided to Treasury and can be provided again upon request)

## Cases received from MFAA aggregator member ……..

**Case Number: XXXXX**

**Scenario:**

A complaint was initially submitted via the IDR process, with allegations being made against the credit representative related to services and advice he had provided as a licensed real estate agent, authorised representative of an AFSL and a credit representative of the aggregator licensee.

The initial compensation claim amount was in excess of $700,000.

**Process:**

The aggregator licensee responded via their IDR process, highlighting the fact that the majority of allegations were related to services and advice provided under different licensing regimes (or prior to 2011, when our ACL started operation), and that we could only respond to the issues that were covered by our ACL authorisations.

In regard to the allegations that were specifically related to the aggregator's licence, it was found via our IDR process that there was no financial loss that had been caused to the complainants via the brokers conduct as a credit representative of the aggregator licensee.

**Outcome:**

The complainants did not accept our IDR response, and the complaint was escalated to the AFCA case management process. Throughout this process, AFCA agreed with the aggregator licensee's position that we could not be held responsible for the advice or services that had been provided outside of our ACL authorisations, and the complainants subsequently decreased their compensation claim substantially but to an amount that remained significant.

A conciliation call was held between the aggregator licensee (and the broker), AFCA, and the complainants (along with a representative).

No resolution was reached during this call, however the following day, the Case Manager contacted the aggregator licensee. During this phone call the Case Manager stated:

- If the Case Manager was to put recommendations in writing, they would find in the aggregator's favour.
- For the Case Manager to put recommendations in writing would incur a fee of $6,750.
- Based on his conversations with the complainants, the Case Manager did not feel that the complainants would accept the recommendations, and would ask for a final determination to be made.
- The fees incurred by the aggregator for a final determination would be $10,900 (approx.)
- Based on the assumption that the complainants would not accept the Case Manager's recommendations, and the costs involved in going to the final determination stage, the Case Manager asked whether the aggregator would be willing to make an offer to the complainants, in order to minimise costs.
- The Case Manager stated that if we were to make a 'reasonable' offer, they would talk to the complainants and encourage them to accept the offer.

In the end, despite being told by the Case Manager that the outcome would be in the aggregator's favour, an offer was made to the complainants, which was accepted by the complainants.

This offer was made purely because of the threat and size of the AFCA fees, and not based on any liability or fault with our credit representative.

**Case number: XXXXX**

**Scenario:**

A complaint was made against our credit representative, with the allegation being that they had misled the complainant in regard to the type of product and interest rate that would be available to him in relation to the purchase of an owner-occupied property.

The complainant also alleged that the conduct of the broker had caused settlement delays, resulting in penalty fees being paid by the complainant.

**Process:**

The complaint was initially responded to via our IDR process, finding that the broker's conduct had not caused any financial loss to the complainant.

The IDR process also identified that the broker had not misled the complainant, and evidence was provided to prove that these allegations were incorrect.

In order to try and resolve the complaint, an offer of $500 was made to the complainant in the IDR phase.

**Outcome:**

Complainant did not accept the aggregator licensee's IDR response, and the complaint was escalated to the AFCA Case Management process.

The case was moved a number of times to a number of different Case Managers, and ended up being treated as a complex case.

Throughout the case management phase, the aggregator received emails and calls from AFCA, where the Case Manager used the threat of increasing fees as a resolution tool (i.e. if you don't make an offer to resolve this complaint, fees will increase to $XXXXX).

The broker was part of a successful business, and took a principle-based stance, stating that he had done nothing wrong, and that he would rather pay AFCA fees than make any further offers to the complainant (other brokers/small business owners do not have this luxury).

The complaint progressed through the AFCA process, and the Preliminary Findings from the Case Manager were in the brokers/aggregator favour. The complainant did not accept these findings, and asked for a final determination.

The final determination was in the aggregator's favour, and we received an invoice for $10,900, which was passed on to the broker.

As noted above, not all brokers would have the luxury of being able to make a principle-based stance and bear the cost of having to pay $10,900 in AFCA fees (was partially reimbursed by PI).

It is aggregator's position that the threat of AFCA fees should not be used as a 'resolution' tool by Case Managers in order to encourage small business owners (i.e. brokers) to resolve a complaint

where there is no evidence of any fault or wrong-doing by them. This position has been discussed with multiple case managers.

The AFCA process should provide an opportunity for all banks, planners and brokers to defend themselves against complaints in a fair and equitable manner. At the moment, it only allows those that have 'deep pockets' to do this, whereas others are being forced (due to the size of the fees and pressure being exerted by AFCA) to make an offer to complainants in order to resolve complaints in order to minimise costs/damage to their business.

This has opened the door for more vexatious or frivolous complaints to be made, as more unscrupulous people feel they can take advantage of the system.

This takes everyone's time and effort away from those examples where there are actually legitimate complaints being made, and the complaint (and the complainant) does need our undivided attention.

I have included another couple of examples as well, these ones are more related to changes in the complainant as it moves through the process.