

Introduction

This is the submission by the Financial Ombudsman Service (“FOS”) to the Senate Economics References Committee’s inquiry into developments in the banking sector arising out of the impact of the global financial crisis and subsequent events (“GFC”).

This submission has been prepared by the office of FOS and does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessors in the resolution of disputes about financial services.

Information about FOS

FOS commenced operations on 1 July 2008. It is an independent dispute resolution scheme that was formed through the consolidation of three schemes:

- the Banking and Financial Services Ombudsman (“BFSO”);
- the Financial Industry Complaints Service (“FICS”); and
- the Insurance Ombudsman Service (“IOS”).

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre (“CUDRC”); and
- Insurance Brokers Disputes Ltd (“IBD”).

FOS is an external dispute resolution (“EDR”) scheme approved by ASIC. Membership of FOS is open to any financial services provider (“FSP”) carrying on business in Australia including providers not required to join a dispute resolution scheme approved by ASIC. Replacing the schemes previously operated by BFSO, FICS, IOS, CUDRC and IBD, FOS provides free, fair and accessible dispute resolution for consumers unable to resolve disputes with FSPs that are members of FOS.

Members of BFSO, FICS, IOS, CUDRC and IBD are now members of FOS. The members of those schemes included:

- BFSO – credit providers, mortgage brokers, payment system operators, Australian banks and their related corporations, Australian subsidiaries of foreign banks and foreign banks with Australian operations;
- FICS – life insurance companies, fund managers, friendly societies, stockbrokers, financial planners, pooled superannuation trusts, timeshare operators and other Australian FSPs;

- IOS – general insurance companies, re-insurers, underwriting agents and related entities of member companies;
- CUDRC – credit unions and building societies;
- IBD – insurance brokers, underwriting agents and other insurance intermediaries.

FOS and its predecessor schemes have over 20 years experience in providing dispute resolution services in the financial services sector, and it is estimated that FOS covers up to 80% of banking, insurance and investment disputes in Australia.

FOS provides services to resolve disputes between member FSPs and consumers, including certain small businesses, about financial services such as:

- banking;
- credit;
- loans;
- general insurance;
- life insurance;
- financial planning;
- investments;
- stock broking;
- managed funds; and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. FOS also monitors compliance with a number of industry codes of practice.

FOS is a not for profit organisation funded by its members, which are FSPs. It is governed by a board with an independent chair and:

- four “industry directors” appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry; and
- four “consumer directors” appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.

Submission

This submission provides information about disputes and dispute resolution that may assist the inquiry.

References to years in this submission are to years from 1 July to the following June 30. For example, 2010-11 is used to refer to the year from 1 July 2010 to 30 June 2011. There is an exception to this approach in Table 2 and related text, where references to calendar years appear.

1. Disputes

We received 30,283 disputes in 2010-11. This represents an increase of 27% from the previous year. From 2009-10 to 2010-11, credit disputes received increased by 44% and deposit taking disputes received increased by 61%.

We accepted 10,476 credit disputes in 2010-11. This was 3,180, or 44%, more credit disputes than we accepted in 2009-10. Consumer credit was the category of credit disputes that accounted for most of this increase.

From 2009-10 to 2010-11, consumer credit disputes accepted increased by 2,891, or 45%. The products that accounted for most of the 9,357 consumer credit disputes we accepted in 2010-11 were home loans (35%), credit cards (35%) and personal loans (16%). The central issue in 47% of the consumer credit disputes accepted in 2010-11 was "financial difficulty", the situation where a consumer cannot meet payment obligations in relation to financial services.

2. Financial difficulty disputes

A consumer in financial difficulty can request assistance from their FSP. For example, a borrower can ask their credit provider to delay debt enforcement or change payment obligations under a loan. The "financial difficulty disputes" referred to below often concern FSPs declining or failing to respond to requests for assistance.

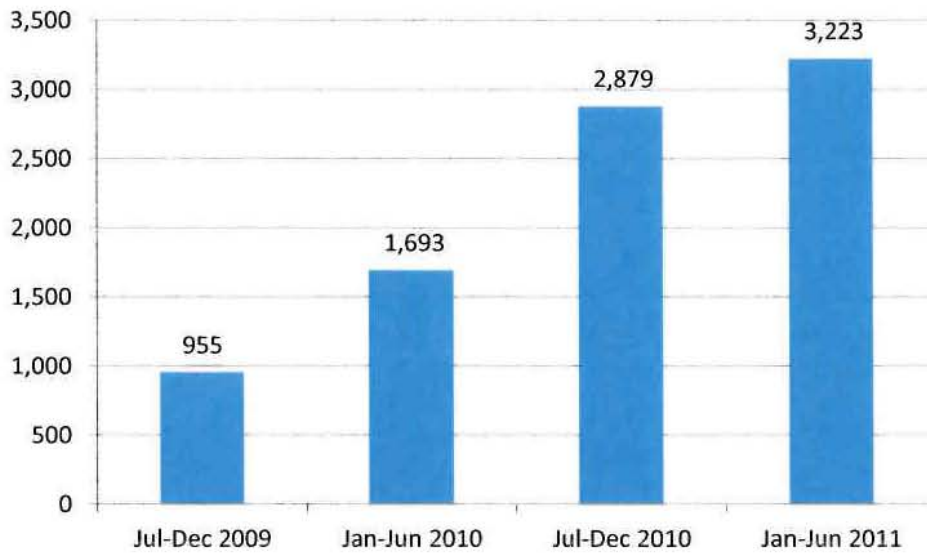
Section 72 of the National Credit Code¹ allows a consumer to apply for assistance where they are unable, due to illness, unemployment or other reasonable cause to meet their obligations under a credit contract but reasonably expect to be able to repay the debt if certain changes are made to the contract. The Code of Banking Practice and the Mutual Banking Code of Practice² introduce an additional obligation to help consumers overcome their financial difficulties. This additional obligation is incorporated in contracts between an FSP that subscribes to one of the codes of practice and their individual or small business customers. We also consider that FSPs that do not subscribe to either code of practice should conduct themselves in the manner contemplated by the codes, as they reflect good industry practice.

In recent years, there have been substantial increases in the number of financial difficulty disputes that we have received. We received 6,102 financial difficulty disputes in 2010-11, which represents a 130% increase from the 2,648 received in 2009-10. Figure 1 shows the financial difficulty disputes received in the four six month periods from July 2009 to June 2011.

¹ See Schedule 1 of the *National Consumer Credit Protection Act 2009*.

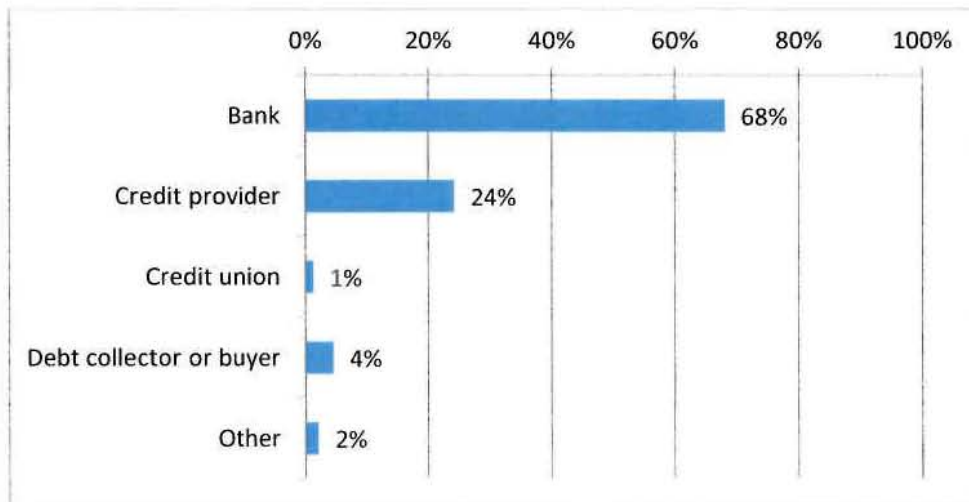
² These codes can be found on our website www.fos.org.au under "About Us".

Figure 1: Financial difficulty disputes received from July 2009 to June 2011



Most of the financial difficulty disputes that we received in 2010-11 related to consumer credit products – in particular, home loans, credit cards and personal loans. Our records identify the sales or service channel for 72% of the financial difficulty disputes received in 2010-11. They indicate, as shown in Figure 2, that most of the disputes related to banks.

Figure 2: Financial difficulty disputes received in 2010-11 by sales or service channel



Our latest annual review³ provides more detailed information about financial difficulty disputes received in 2010-11. Our recent records indicate that we received 4,368 financial difficulty disputes from July to December 2011. This was a 36% increase from the previous six months.

³ See pages 48 and 49 of our 2010-2011 Annual Review on www.fos.org.au, under "Publications"

3. Reasons for increase in financial difficulty disputes

We attribute the increase in financial difficulty disputes partly to the impact of the GFC. Other factors that account, or could account, for the increase include:

- the impact of a low interest rate environment in 2009-10 followed by an increase in interest rates placing pressure on consumers;
- the commencement of the *National Consumer Credit Protection Act 2009* ("NCCP") on 1 July 2010;
- the expansion of our jurisdiction on 1 January 2010;
- the increase in awareness of FOS and the services it provides; and
- consumers' lack of confidence in the internal dispute resolution ("IDR") processes of FSPs.

3.1 Commencement of NCCP

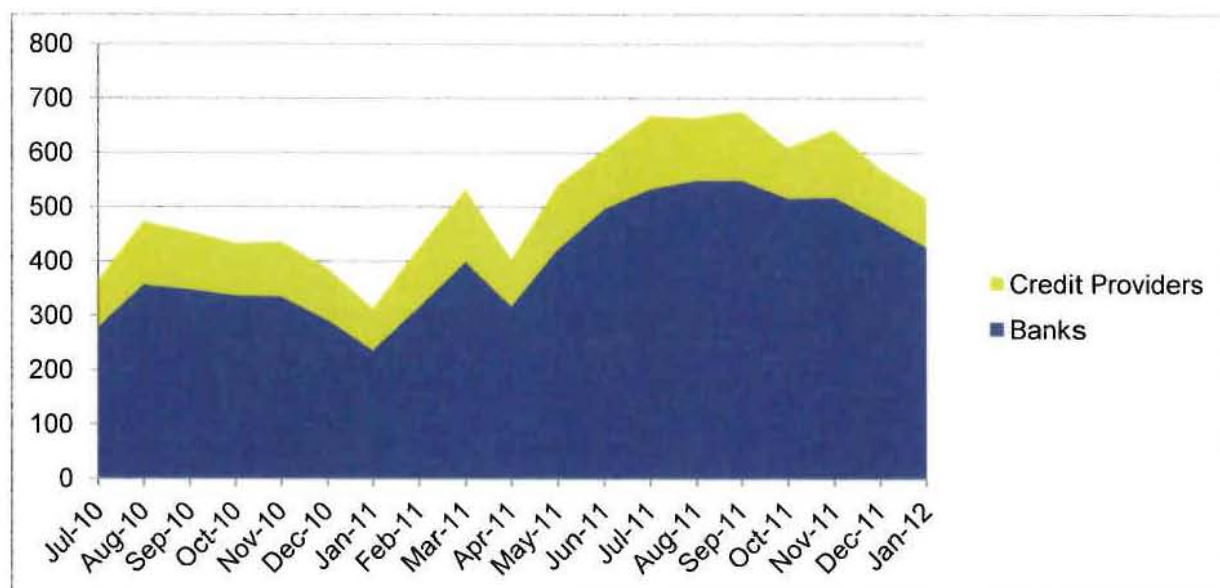
The NCCP introduced a new compulsory credit licensing regime. It requires credit providers, credit assistants and their representatives to be members of an EDR scheme approved by ASIC. This has increased our membership, as shown in Table 1.

Table 1: Credit providers and credit representatives – FOS members from 31 December 2009 to 31 December 2011

	31.12.09	30.6.10	31.12.10	30.6.11	31.12.11
Credit providers	245	599	747	805	843
Credit representatives	2	616	7,226	8,135	11,060

The membership increases shown in Table 1 coincided with increased receipt of financial difficulty disputes. However, our statistics indicate that the increase in disputes consisted mainly of increases in disputes about banks rather than the categories of members referred to in Table 1. Figure 3 shows these statistics for the period from July 2010 to January 2012. Its classifications "credit providers" and "banks" are based on primary member type.

Figure 3: Financial difficulty disputes received from July 2010 to January 2012



The NCCP also required default notices and credit guides to inform consumers of their right to take a dispute to an EDR scheme. While these measures heighten consumer awareness of FOS, they do not in themselves appear to have contributed to the increase in new disputes that we have received. When a dispute is lodged, we ask the consumer how they knew to lodge a dispute with FOS. If the credit guide and default notice changes had resulted in an increased use of FOS, we would have expected to see an increase in two categories, “referred by FSP” and “already knew about FOS”. However, these categories have remained relatively stable over the last two years.

We expect the NCCP to cause banks and other lenders to increase their focus on improving the quality of lending. We expect this to, over time, reduce the number of credit disputes.

3.2 Expansion of our jurisdiction

ASIC’s *Regulatory Guide 139 Approval and oversight of external dispute resolution schemes*⁴ sets out requirements that FOS has to meet to maintain approval as an EDR scheme under the *Corporations Regulations 2001* and the *National Consumer Credit Protection Regulations 2010*. Through Regulatory Guide 139, ASIC required us to expand our jurisdiction so that we could consider:

- debt disputes lodged after legal proceedings are issued (provided the proceedings are at an early stage);⁵ and

⁴ See asic.gov.au for Regulatory Guide 139.

⁵ This dispute resolution work is discussed in detail below.

- disputes about the variation of a credit contract regulated under the National Credit Code as a result of the consumer being in financial difficulty.⁶

This expansion occurred when our current Terms of Reference came into effect on 1 January 2010. Our Terms of Reference⁷ stipulate the disputes that we can consider.

3.3 Processes of FSPs

If a consumer lodges a dispute with us, our Terms of Reference prevent the FSP from commencing or proceeding with certain recovery action against the consumer while we consider the dispute⁸. A consumer in financial difficulty who requests assistance from their FSP may also lodge a dispute for “insurance”, to stop recovery action in case their direct negotiations with the FSP are not successful.

FSPs need to ensure that they have clearly understood processes for dealing with customers in financial difficulty and that the customers trust that the processes will be followed. On websites of FSPs, it is often difficult to find information about how the FSP deals with a financial difficulty request and what happens with debt collection activity while the request is considered.

4. Time lags between events and related disputes

There are, naturally, time lags between an event such as the GFC, resulting financial difficulty for consumers, and the referral of related disputes to FOS. For example, a consumer may struggle to meet payment obligations under a loan for some time before contemplating changing the obligations. Also, a dispute may go through an FSP's IDR processes before it is referred to us. We in fact encourage consumers to use IDR where this may allow disputes to be resolved without escalation to EDR.

The GFC continues to have an impact at present. Given this and the time lags explained above, we may continue to receive disputes related to the GFC for some time.

5. Dispute resolution

The increase in disputes discussed above has placed demands on FSPs in the banking sector. FSPs bear the cost of EDR. The increase in disputes has, for example, increased:

⁶ In view of these significant changes, this submission does not compare numbers of financial difficulty disputes over recent years with data for periods before 2009-10. It is difficult to draw conclusions from such a comparison.

⁷ See Section B and paragraph 13.1 of our Terms of Reference on www.fos.org.au under “About Us”

⁸ See paragraph 13.1 of our Terms of Reference and the relevant Operational Guidelines on www.fos.org.au under “About Us”.

- the need for banking FSPs to devote resources to EDR, including staff to cover larger workloads and deal with more consumers stressed by financial difficulty; and
- the imperative for the FSPs to improve the efficiency and effectiveness of their IDR processes, to reduce the number of disputes referred to EDR.

Anticipating and responding to recent developments, we have enhanced our dispute resolution processes. Parties to disputes have had to adapt to changes in our processes, which are explained further below.

As well as resolving disputes, we assist parties with many aspects of dispute resolution. For example, we provide:

- training – online and through seminars and other presentations; and
- information – through our telephone services, publications including fact sheets, brochures and our quarterly “Circular” and other material on our website.⁹

5.1 Specialised financial difficulty team

In September 2009, we established a specialised financial difficulty team to deal with the anticipated increase in financial difficulty disputes. The team aims to resolve disputes as quickly as possible, with the emphasis on negotiation and conciliation. It has had particular success through telephone conciliation conferences (“TCC”). Our experience indicates that, where a solution has not been found through negotiation, a TCC often enables parties to find a way forward and resolve disputes ultimately.

The specialised financial difficulty team includes lawyers and staff who have worked previously as financial counsellors or in the financial sector. All are trained mediators with extensive experience in conducting conciliation discussions. We have recently introduced a feedback mechanism that lets us monitor how our conciliation services are perceived by the FSPs and consumers who use the services.

Table 2 shows the number of TCC conducted by the team for financial difficulty disputes in the calendar years 2010 and 2011. From 2010 to 2011, the number of TCC conducted increased by 106%. Our figures for 2012 up until May 24 show a further increase in the rate of TCC conducted. We are continuing to work towards finding ways to further increase volumes of TCC conducted to resolve disputes.

Table 2: Telephone conciliation conferences conducted in 2010 and 2011

Calendar year	TCC conducted	Resolved by TCC	Resolution rate	TCC conducted per month
2011	379	290	77%	32
2010	184	135	73%	15

⁹ See www.fos.org.au under “Resolving Disputes”, “Events”, “Publications” and “Members”.

5.2 Disputes lodged after legal proceedings are issued

As mentioned above, an amendment to our Terms of Reference on 1 January 2010 allowed us to consider disputes lodged after debt recovery legal proceedings are issued, but before the proceedings have progressed beyond the lodging of a defence ("Legal Proceedings Disputes"). ASIC required this change to address concerns raised by consumer representatives, and limited the expansion of EDR jurisdiction to give FSPs greater certainty and contain their legal costs.

We treat Legal Proceedings Disputes as urgent and expedite the dispute handling process for them provided the FSP meets the shorter timeframes imposed for expedited disputes. However, where an FSP does not meet those shorter timeframes, we "de-expedite" the dispute and no longer treat it as urgent. TCCs are compulsory if the dispute is not resolved after the initial referral to the FSP. To benefit from the expedited process, FSPs need to be able to fulfil its more stringent requirements.

Further information about Legal Proceedings Disputes is set out below. The information is for the two year period ending 31 December 2011.

- Legal Proceedings Disputes received
We received 3,039 of these disputes.
- Resolution times
83% of Legal Proceedings Disputes that remained expedited were resolved within 90 days.
41% of Legal Proceedings Disputes were de-expedited.
Of the de-expedited disputes, 40% were resolved within 90 days. This indicates that expediting Legal Proceedings Disputes results in more timely resolution.
- Outcomes
The two most prevalent outcomes of Legal Proceedings Disputes were:
 - resolved by FSP - 43%; and
 - outside our Terms of Reference - 34%.Of the Legal Proceedings Disputes that were outside our Terms of Reference, 63% had already been dealt with by a court.
- TCCs
11% of Legal Proceedings Disputes progressed to a compulsory TCC. The conferences resolved 80% of these disputes.
- Discontinued disputes
6% of Legal Proceedings Disputes were discontinued. 24% of the discontinuances were due to the consumer's failure to participate in the compulsory TCC.

- Types of disputes
97% of Legal Proceedings Disputes related to credit products. Of those, 85% related to financial difficulty.

ASIC is currently reviewing the jurisdiction of EDR schemes in relation to Legal Proceedings Disputes. In December 2011, ASIC issued a consultation paper to invite comments on whether the jurisdiction should be changed¹⁰. We made a written submission in response to the paper and are continuing to provide information and comments to ASIC. Detailed information about Legal Proceedings Disputes is provided in our written submission and its attachment, which is a statistical report. The submission and the attachment are on ASIC's website.

6. Conclusion

The GFC has been a factor contributing to a large increase in the number of disputes involving FSPs in the banking sector received by FOS, particularly disputes relating to financial difficulty. Regulatory changes, greater awareness of FOS and other factors explained above have also contributed to the increase.

We have enhanced and adapted our dispute resolution processes to deal with the changes. Banking FSPs have also had to handle higher numbers of disputes while dealing with other significant pressures in recent years.

We consistently emphasise that FSPs need to ensure that their IDR processes are accessible, efficient and effective and trusted by their customers. IDR processes that operate well reduce the need for EDR. We assist parties to disputes with many aspects of dispute resolution, and with EDR in particular. This work includes helping FSPs to improve their dispute resolution capability.

In our view, FSPs with well designed and resourced dispute resolution arrangements will be better placed to face any adverse events in future.

¹⁰ Consultation Paper 172 *Review of EDR jurisdiction over complaints when members commence debt recovery legal proceedings*. See www.asic.gov.au for Consultation Paper 172 and submissions in response to it.