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House of Representatives Standing Committee on Economics

Review of the four major banks (second report)

Australian Bankers' Association

ABA11QW: Please provide any submission you made to the Ramsay Review of External Dispute Resolution Schemes (including submissions in response to the interim report).

Answer: Attached are the ABA's submissions to the Ramsay Review of External Dispute Resolution Schemes (including submissions in response to the interim report).

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10 October 2016

Professor Ian Ramsay
Chair, Independent Expert Panel
c/o EDR Review Secretariat
Financial System Division
The Treasury
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PARKES ACT 2600
By email EDRreview@treasury.gov.au

Dear Professor Ramsay

Review of External Dispute Resolution and Complaints Schemes

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide this submission to the Independent Expert Panel's review of the financial system external dispute resolution framework (**Review**)[1] and to respond to the Issues Paper released on 9 September 2016 (**Issues Paper**). We also appreciate the opportunity to have participated in the recent roundtables in Sydney and Melbourne.

With the active participation of 25 member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community, to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

Introductory comments

The banking industry acknowledges that it can do better in ensuring outcomes that are in the best interests of consumers and that customers have confidence in the culture and conduct of banks. Banks are already taking steps to this end, but more needs to be done.

The first step is to ensure bank practices meet the highest standards of ethical behaviour and that any issues are quickly raised and addressed. The banking industry's reform package announced in April includes various initiatives, including on remuneration structures in retail banking, whistleblowing protections and a review of the Code of Banking Practice to strengthen standards for customers. There is also a review of small business standard contract terms under the Unfair Contract Terms legislation.

The second step is to improve the internal mechanisms for dealing with customer issues. This is being effected through the establishment of a dedicated customer advocate in each bank and improvements to complaint handling and remediation programs.

The third step, explored in this submission, is to improve the external dispute resolution (**EDR**) system. It is to be hoped that improved complaints handling and internal dispute resolution (**IDR**) practices should lead to a reduced need and recourse to EDR. But when it is needed, the EDR system must work as efficiently and quickly as possible to resolve disputes and achieve fair outcomes, and to show that justice has been done.

The simplest and easiest system for customers of all financial institutions – not just banks but also credit unions, building societies, smaller credit providers, insurance providers, superannuation funds – would be a 'one stop shop'. Customers cannot be expected to understand and navigate the complexities of the current arrangements.

[1] https://consult.treasury.gov.au/financial-system-division/dispute-resolution/

The ABA suggests that the choice of EDR body – whether it is an ombudsman, tribunal or another entity – should be principles-based and focused on achieving the best system for customers and small businesses.

It is critical that the EDR arrangements are open to all consumers who cannot readily and fairly access the formal legal system. The banking industry has committed to exploring a widening of access to EDR arrangements for customers and small businesses.

We consider that the process for determining eligibility for EDR can be improved and we propose some modification of the existing terms of reference and the definition of a small business to achieve these outcomes.

It is also critical that a last resort compensation scheme be available so that customers receive restitution and compensation when things go wrong.

Making it right when things go wrong

The banking industry is committed to making it easier for customers when things go wrong. Effective and efficient complaint handling and dispute resolution is at the heart of improving consumer outcomes and increasing community trust and confidence in the financial services sector.

As part of the banking industry's commitment to protect consumer interests, increase transparency and accountability and build trust and confidence in banks, the ABA announced a range of initiatives on 21 April 2016 (see media release at **Attachment A** which contains full detail of the initiatives). These initiatives include:

- Enhancing existing complaints handling processes by establishing a dedicated customer advocate in each bank to ensure that customers and small businesses have a voice, and that complaints are appropriately escalated and responded to in a timely way
- Supporting the broadening and strengthening of external dispute resolution schemes with a view to increasing eligibility thresholds for customers and small businesses
- Working with ASIC in expanding its review of customer remediation programs to cover all types of financial advice and financial products, and
- Evaluating a last resort compensation scheme and identifying an appropriate model.

In aggregate, these initiatives aim to ensure internal and external programs address customer concerns, make it easier for customers when things go wrong, and increase trust and give people confidence that when things do go wrong, banks will do the right thing.

The ABA believes this Review provides a complementary process to improve the EDR framework so that all the avenues for resolution of customer complaints are operating to the maximum benefit of consumers.

Financial systems dispute resolution

Simple, accessible and effective EDR plays a valuable role in enabling customers and small businesses to bring and resolve disputes with financial services providers (**FSPs**). EDR offers an important and accessible alternative to the court system as it is free for customers to access, does not require formal legal representation, and resolves disputes in a less adversarial way than the court system.

EDR works best in conjunction with effective complaints handling and IDR programs. IDR programs are an important element of the FSP's overall relationship with its customers and manage a wide variety of complaints, including those that have not resulted in monetary loss. Many customers have their complaints successfully resolved though IDR.

The Code Compliance Monitoring Committee reports that banks recorded 1,226,093 complaints in 2014–15. Banks resolved 92.9% of all recorded complaints in under five business days. Only 1.1% of complaints took more than 45 days to resolve.[2]

In the same year, FOS accepted 11,913 disputes about banks, indicating that just 0.0097% of complaints about banks were accepted by FOS. FOS operates processes to refer disputes back to the FSP for resolution in certain circumstances.

As a case study, in the last financial year, one major bank received 140,000 complaints from retail and small business customers. This represented 600 complaints per day and 0.03% of total customer interactions. Of the 0.03% of customer interactions that result in a complaint, over 40% of these were resolved at the first point of contact. 80% of the remaining complaints were resolved within five business days by specialist complaints handling teams. Of the initial 140,000 complaints, 705 complaints were accepted by FOS.

We recognise that some customers have not had their complaints properly resolved through either IDR or EDR. In addition to the banking industry initiatives to improve IDR, we strongly support the Government's review of the EDR system.

Our comments are designed to assist the Independent Expert Panel's consideration of the following aspects of financial system external dispute resolution:

- Principles for revising the framework of EDR schemes to make EDR simpler, more accessible and more effective
- Expanding the small business jurisdiction of EDR schemes, and
- Supporting the introduction of a last resort compensation scheme for certain uncompensated losses.

We have also set out commentary on a number of technical issues relating to EDR in **Attachment B.**

Revising the framework of EDR schemes

The existing EDR schemes, the Financial Ombudsman's Service (**FOS**), the Credit and Investments Ombudsman (**CIO**) and the Superannuation Complaints Tribunal (**SCT**) currently play an important role in handling consumer issues and disputes with banks and other FSPs.

We note that consumers are also supported by state-based schemes, including mandatory and voluntary farm debt mediation schemes, consumer protection agencies, small business commissioners, and other ombudsmen responsible for resolving disputes with creditors.

However, there is complexity in having three alternate EDR bodies, some with overlapping jurisdictions, as well as other state-based options for resolving disputes in the financial services sector. This complexity can make EDR difficult for consumers to navigate, may lead to differences in process and decisions for comparable disputes, and duplicates administrative structures, funding models and governance.

We support consideration of a better integrated EDR framework, developed having regard to the principles outlined below.

Guiding principles

Seven key principles and outcomes are proposed to guide the Review – efficiency, equity, complexity, transparency, accountability, comparability of outcomes and regulatory costs.

The ABA supports a principles-based approach. The proposed principles and outcomes are appropriate and comprehensive. However, we suggest that the principle of "equity" be expressed as "accessibility"

[2] http://www.ccmc.org.au/cms/wp-content/uploads/2015/11/CCMC-Annual-Report-2014-15-web-version.pdf p15.

and explained as reflecting other accessibility factors in addition to cost, and that "complexity" be expressed as "simplicity", embodying the objective of developing a simpler framework.

In terms of determining whether a scheme effectively meets the needs of users, we consider that the Benchmarks for Industry Based Customer Dispute Resolution[3] are the appropriate reference point.

The overarching objective of the Review should be to achieve a better integrated EDR framework that provides simple, accessible and efficient dispute resolution for customers and small businesses.

Simplicity

The EDR process should be simple and easy for consumers to access, navigate and understand. A revised EDR framework should have a singular or simple path for resolution of disputes. Alternative processes or legal requirements may apply given the type of customer or nature of dispute, however, these processes should operate in an integrated way, which provides a consistent consumer experience.

This singular or simple path could be achieved through introducing an overarching gatekeeper or 'one stop shop' covering the existing schemes, creating a single body, or integrating existing schemes by standardising the way customers and small businesses access the schemes and harmonising internal operating policy and process. A single body, or integration of the schemes should seek to achieve:

- Clarity for consumers on where to go for accessing EDR to resolve a dispute
- More rapid allocation of disputes to the appropriate resolution pathway, ending the transfer of disputes between schemes or forums
- Standardised regulatory oversight and approval of the operation of the EDR scheme(s)
- Standardisation of operating policy and process, leading to improved efficiency, and
- Rationalisation of industry and government funding models and allocation of adequate resources.

Accessibility

The EDR system should be readily accessible to customers and small businesses. Current arrangements to ensure accessibility for customers and small businesses should be reinforced and continuously improved to ensure the following design features:

- *Free for consumers:* EDR should continue to remain free for the customer or small business to access.
- *Remove information asymmetry:* EDR schemes should continue to make available simple information about their processes, provide information to suit consumers with disabilities or languages other than English, and operate community outreach programs and provide information in community languages. FSPs should continuously improve the way they integrate EDR into their complaints handling policies and procedures, and to let customers and small businesses know about their rights to access EDR at key times[4].
- *Ensure appropriate support for consumers:* The role of 'for profit financial difficulty companies' (including debt management firms and credit repair agencies) should be examined to ensure consumers are appropriately represented and protected, including in their representations with EDR schemes but also more broadly.[5]

[3] http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/benchmarks_ind_cust_dispute_reso/Documents/PDF/benchmarks_ind_cust_dispute_reso.ashx

[4] The ABA notes that the banking industry commitment to have a Customer Advocate in each bank will provide an avenue for identifying improvements with customer communications about complaints handing and IDR as well as access to EDR. http://www.bankers.asn.au/media/media-releases/media-release-2016/new-voice-for-customers-in-complaints-with-banks

[5] For more details, we suggest the Panel refer to ASIC's report 465 *Paying to get out of debt or clear your record: The promise of debt management firms*.

- *Enduring funding for financial counselling services:* Financial counsellors are an essential public service. They provide independent and free advice and information to individuals and families during difficult financial and emotional times and help clients deal with managing multiple debts, including from mainstream financial institutions, other lenders (including payday lenders), other creditors (including retailers, utilities and telecommunications companies). An enduring model of Government funding for financial counselling services is required to ensure the services continue to make a significant difference for many Australians experiencing financial difficulties.

Effectiveness

Resolution of disputes through EDR should be fast, allow flexibility, be supported by appropriately skilled and funded resources and ensure satisfactory resolution of disputes for customers and small businesses.

To enable speedy and satisfactory dispute resolution, a revised EDR framework needs to be designed to ensure the following:

- *Adaptability:* Ability to amend governance structures, revise terms of reference, review operating processes and reallocate resources so that the scheme can continue to evolve and respond to emerging issues.
- *Flexibility:* Allows for a broad range of negotiated (and imposed) outcomes to individual disputes.
- *Capability:* Is equipped with appropriate financial resources and organisational capability to resolve disputes with varied and complex features.

Jurisdiction and monetary limits

The jurisdiction of EDR schemes needs to be sufficiently broad to ensure EDR is accessible to customers and small businesses and compensation is meaningful, taking account of EDR's mandate to resolve less complex disputes.

We support EDR schemes having an appropriate jurisdiction to consider and make determinations in relation to financial products and credit provided by a FSP to a small business.

In addition, we support an increase in the monetary limits of the EDR scheme to ensure the appropriate disputes are heard and compensation is meaningful. We believe:

- Customers and small businesses should be able to bring complaints up to the value of $1 million, and
- The EDR scheme should be able to make awards up to $1 million.

We have provided more information on changes to jurisdiction and increases of monetary limits in **Attachment B**.

Farm debt mediation

Farm Debt Mediation (**FDM**) is a specialised mediation process that allows a farmer and their FSP to negotiate a better financial outcome. Mediators are trained to understand the unique and complex circumstances affecting farming operations and agri-business lending.

The ABA believes that FDM should remain a separate EDR scheme. We support the implementation of a nationally consistent farm debt mediation model across Australia and have been working with the Australian Government and agricultural organisations on legislative options.

The banking industry's preferred model is for national farm debt mediation legislation based on the NSW legislation. The NSW Farm Debt Mediation Act was introduced in 1994 and provides a mechanism for the efficient and equitable resolution of farm debt disputes, without acting as a constraint on agri-business lending in NSW.

Last resort compensation scheme

The banking industry recognises that some consumers of financial services and products have suffered losses because of inappropriate advice or poor conduct and where a financial adviser or particular product issuer has failed, not maintained adequate compensation arrangements and/or their business has become bankrupt or insolvent.

While bank customers would not need to seek redress from a last resort compensation scheme and we acknowledge the recommendations of the St John Report[6], we consider a scheme is important to build trust and confidence in the financial services sector and ensure consumers of financial products are treated fairly, have adequate information, and avenues for redress and protections.

The ABA is continuing to work with banks on evaluating the establishment of the scheme and the various operational details, and this has not yet been completed. However, the ABA supports a scheme with the following design principles:

- *Limited liability scheme*: The scheme should pay compensation (capped) to consumers of financial products and services (retail clients as defined by the law) where professional indemnity (**PI**) insurance is insufficient to meet claims (e.g. where fraud is a policy exemption), the business is bankrupt or insolvent (and run off cover in unavailable) and where an approved EDR body determination is made. The scheme is not intended to cover market-linked investment losses.
- *Priority of claims*: The scheme must be a last resort, and alternative compensation arrangements should be pursued initially, including resorting to the financial resources or capital reserves of the AFS licensee.
- *Industry-wide and mandatory*: The scheme should require all AFS licensees who offer a financial product to a retail client to be a member and contribute to the scheme, as a condition of their licence (with the exception of deposits and general insurance which are covered by the Financial Claims Scheme (**FCS**)). A number of options for establishing the scheme are available, including delegated legislation, regulation rather than statute, licensee conditions, and/or a combination[7].
- *Prospective*: The scheme should cover consumers of financial products who receive an approved EDR body determination in their favour. We do not support a scheme applying retrospectively.

The ABA also recognises that additional operational details will need to be worked through, including eligible claims, compensation cap, scheme funding model and calculation factors (i.e. the risk profile of the AFS licensee's operating model), governance arrangements for the scheme, and penalties and disincentives for AFS licensees availing of the scheme.

In addition to the design principles, the ABA supports a scheme being accompanied by other reforms to improve the quality of financial advice and consumer protections. We believe improvements should include:

- *Professionalisation of financial advice*: The new framework to raise education, ethical and professional standards should be introduced as an important underpinning of ethical behaviour across the financial services sector.

[6] Australian Government, *Compensation arrangements for consumers of financial services*, April 2012. http://futureofadvice.treasury.gov.au/content/consultation/compensation_arrangements_report/downloads/Final_Report_CACFS.pdf

[7] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the scheme.

- *PI insurance*: The cost, availability and coverage of PI insurance should be expanded, including run-off cover, insolvency, fraud and other misconduct.
- *Disclosure and financial literacy*: The scheme should be well understood by consumers of financial products so that it is clear that the scheme is a last resort and not intended to cover investment losses (i.e. product failure or market conditions).
- *Regulation and regulatory activities:* ASIC should require an annual assurance statement from all AFS licensees that they meet their licence obligations, including compliance with ASIC's *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees* [RG126] and *Regulatory Guide 166: Licensing: Financial requirements* [RG 166].

The ABA notes that our remarks on a last resort compensation scheme are based on consideration of the existing EDR system, and if this were to fundamentally change, this would likely impact on the efficacy of this proposed scheme.

Closing remarks

The ABA and our member banks are strongly committed to making sure the EDR system is improved and works well now, and into the future.

The ABA would welcome the opportunity to discuss these issues further with the Panel.

In the meantime, if you have any questions in relation to this submission, please do not hesitate to contact me or Diane Tate, Executive Director – Retail Policy on (02) 8298 0410 or dtate@bankers.asn.au.

Yours sincerely

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Attachment A – Industry announcement: Banks act to strengthen community trust

Sydney, 21 April 2016: Australia's banks will today begin to implement comprehensive new measures to protect consumer interests, increase transparency and accountability and build trust and confidence in banks.

"This package aims to address consumer concerns about remuneration, the protection of whistleblowers, the handling of customer complaints and dealing with poor conduct," Australian Bankers' Association Chief Executive Steven Münchenberg said.

"Customers expect banks to keep working hard to make sure they have the right culture, the right practices and the right behaviours in place.

"That's why the banks will immediately establish an independent review of product sales commissions and product based payments, with a view to removing or changing them where they could result in poor customer outcomes," he said.

"Banks will also improve their protections for whistleblowers to ensure there is more support for employees who speak out against poor conduct.

"This plan delivers immediate action to make it easier for customers to do business with banks, including when things go wrong. For example, improved complaints handling and better access to external dispute resolution, as well as providing compensation to customers when needed," he said.

The plan, parts of which are subject to regulatory approval or legislative reform, will be overseen by an independent expert.

"We recognise the importance of having an impartial third party to oversee this process," Mr Münchenberg said.

"The industry has appointed Gina Cass-Gottlieb, Gilbert + Tobin Lawyers, to lead the work on establishing the governance arrangements around the implementation of the plan, the review process, public reporting, and the selection of an independent expert to oversee implementation of this initiative.

"The banks also support the Federal Government's review of the Financial Ombudsman Service, who is the independent umpire for customer complaints, to ensure it has the power and scope required to deal with a variety of issues that currently fall outside its thresholds," he said.

"Trust is at the centre of banking and is critical for the stability of our financial system. The strength of our banking sector got us through the global financial crisis. Since then banks have done a lot of work in improving customer satisfaction, strengthening their balance sheets, and making it easier for customers to do their banking wherever and whenever they want.

"The plan also responds to a range of expert reports and public inquiries that have identified key areas of reform, including the Financial System Inquiry.

"Banks recognise the importance of the community discussion about the delivery of banking and financial services, and are pleased to put forward this plan," Mr Münchenberg said.

A copy of the industry statement is below. For more information visit betterbanking.net.au

Contact: Stephanie Arena 0477 470 677 or Nic Frankham 0435 963 913

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Industry Statement

Australia's banks understand that trust is critical to a strong and stable banking and financial services sector. We acknowledge that we have a privileged role in the economy. Our customers, shareholders, employees and our communities rightly expect the behaviour of banks to meet high ethical standards as we look after their financial needs.

For some years now banks have been responding to community feedback to improve customer service and our industry's contribution to the community more broadly. This has been largely successful. While all banks have customer satisfaction ratings above 80%, we acknowledge there is more to do. We continue to implement wide ranging reforms that have already been agreed through the inquiries, reviews and consultations undertaken over recent years.

Subject to regulatory approval, we are committing to a further six actions to make it easier for customers to do business with us and to give people confidence that when things go wrong, we will do the right thing.

We understand the importance of independence and transparency. To ensure this, the industry has appointed Gina Cass-Gottlieb, Gilbert + Tobin Lawyers, to lead the work on establishing the governance arrangements around the implementation of the plan, the review process, public reporting, and the selection of an independent expert to oversee implementation of this initiative. This initial stage will take a month. We will publish public quarterly reports on our progress, with the first report within three months of this announcement.

We believe these actions will further lift standards and transparency across the banking and financial services sector and bolster the existing strength of the regulatory framework.

1. Reviewing product sales commissions

- Building on the 'Future of Financial Advice' reforms, we will immediately establish an independent review of product sales commissions and product based payments with a view to removing or changing them where they could lead to poor customer outcomes. We intend to strengthen the alignment of remuneration and incentives and customer outcomes. We will work with regulators to implement changes and, where necessary, seek regulatory approval and legislative reform.
- Each bank commits to ensure it has overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices.

2. Making it easier for customers when things go wrong

- We will enhance the existing complaints handling processes by establishing an independent customer advocate in each bank to ensure customers and small business have a voice and customer complaints directly relating to the bank, and the third parties appointed by the bank, are appropriately escalated and responded to within specified timeframes.
- We support a broadening of external dispute resolution schemes. We support the Government's announcement to conduct a review into external dispute resolution, including the Financial Ombudsman Service conducting a review of its terms of reference with a view to increasing eligibility thresholds for retail and small business customers.
- We will work with ASIC to expand its current review of customer remediation programs from personal advice to all financial advice and products.

- We will evaluate the establishment of an industry wide, mandatory last resort compensation scheme covering financial advisers. We support a prospective scheme being introduced where consumers of financial products who receive a FOS determination in their favour would have access to capped compensation where an adviser's professional indemnity insurance is insufficient to meet claims.

3. Reaffirming our support for employees who 'blow the whistle' on inappropriate conduct

- We will ensure the highest standards of whistleblower protections by ensuring there is a robust and trusted framework for escalating concerns. We will standardise the protection of whistleblowers across banks, including independent support, and protection against financial disadvantage. As part of this, we will work with ASIC and other stakeholders.

4. Removing individuals from the industry for poor conduct

- We will implement an industry register which would extend existing identification of rogue advisers to any bank employees, including customer facing and non-customer facing roles. This will help prevent the recruitment of individuals who have breached the law or codes of conduct.

5. Strengthening our commitment to customers in the Code of Banking Practice

- We will bring forward the review of the Code of Banking Practice. The Code of Banking Practice is the banking industry's customer charter on best practice banking standards, disclosure and principles of conduct. The review will be undertaken in consultation with consumer organisations and other stakeholders, and will be completed by the end of the year.

6. Supporting ASIC as a strong regulator

- We support the Government's announcement to implement an industry funding model. We will work with the Government and ASIC to implement a 'user pays' industry funding model to enhance the ability for ASIC to investigate matters brought to its attention.
- We will also work with ASIC to enhance the current breach reporting framework.

ENDS

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Attachment B – Technical considerations

In approaching the review of the EDR framework, we suggest there are a number of technical aspects requiring close consideration.

Overseas models

The United Kingdom Financial Ombudsman Service (**UKFOS**) was established under the *Financial Services and Markets Act* 2000.[8] Its statutory function is to resolve – quickly and with minimum formality – disputes between financial businesses and their customers, as an alternative to the courts.

The company that administers the scheme, Financial Ombudsman Service Limited, takes the form of a company "limited by guarantee and not having a share capital". The powers and functions of the scheme operator are set out in company's legal constitution.

An example of a 'one-stop shop' scheme, UKFOS has successfully brought together several voluntary complaint schemes to be the mandatory EDR body for the UK financial services sector.

UKFOS covers all firms and activities that are authorised by the Financial Conduct Authority and includes firms holding a consumer credit licence in what was formerly the consumer credit jurisdiction. UKFOS is a compulsory statutory scheme rather than a voluntary sign up scheme. Ombudsman decisions are binding on the business but not the consumer – consumers remain free to take court proceedings.

UKFOS embodies features which meet some of the principles outlined in the Issues Paper, including:

- *Simplicity (or lack of complexity):* UKFOS amalgamated eight previous EDR schemes into a single 'one stop shop' for consumers, small businesses, charities and trusts. The Financial Conduct Authority's handbook sets out jurisdiction and how UKFOS (and businesses) should handle complaints.
- *Transparency:* Through its website and annual review, UKFOS publishes significant information about its activities. Following a review of its strategy in 2008, UKFOS publishes a significant amount of information about how it handles cases and makes decisions, including technical information about its approach.
- *Equity:* The service is free to consumers and provides a readily accessible alternative to the courts.

We believe UKFOS provides an appropriate benchmark for rationalisation of the Australian EDR schemes.

Scheme features

Structure – Ombudsman Service or Tribunal?

Both Ombudsmen's services and Tribunals are useful mechanisms for alternative dispute resolution. In assessing the preferred structure of an EDR scheme for financial system external dispute resolution, we believe the following considerations should be taken into account:

- *Adaptability:* The structure should allow for the ability to readily amend governance structures, revise terms of reference, review operating processes and reallocate resources so that the scheme can continue to evolve and respond to emerging issues.

[8] Further information on the underpinning of statutory functions and powers can be found here: http://www.financial-ombudsman.org.uk/about/official-documents.html

- *Flexibility:* The structure should allow the arbiter discretion for a broad range of negotiated (and imposed) outcomes to individual disputes as well as discretion to exclude complaints for various reasons, subject to clearly articulated criteria. For example, the complaint may lack substance or be vexatious, or the unique circumstances of the case mean may mean that it should be addressed in other ways, such as via the court system.
- *Complexity of underlying legal arrangements:* The underlying legal arrangements for a tribunal generally require legislation and can be more complex than those required for an ombudsman. The time that will be required to set up each structure, including parliamentary and government processes, should be considered to ensure any new arrangements are available to consumers as quickly as possible.
- *Effect of determinations:* The structure may impact the effect of determinations and how they bind the parties. The ABA sees merit in the current FOS/CIO approach.
- *Funding model*: The structure should ensure fair, transparency and flexible funding to ensure adequate allocation of resources. The ABA recognises an FSP user pays model is more effective.
- *Place in Administrative Law framework and rights of appeal:* The ultimate goal of the EDR system should be to satisfactorily resolve disputes. The structure may affect whether, and how, determinations could be review or appealed.
- *Regulatory approval and oversight:* The structure may affect who will oversee and approve the EDR scheme(s). Options include reporting through parliamentary committees or regulatory approval and regulatory oversight. We suggest that regulatory oversight, such as the current FOS/CIO arrangements is appropriate.

The ABA notes there has been support expressed in some quarters for a banking tribunal. The ABA would welcome further engagement on the form of external dispute resolution body that would best deliver simple, accessible and efficient dispute resolution for customers and small business.

Integration of existing structures

The ABA believes there may be merit in considering a partial rationalisation of the existing framework, merging the ASIC approved ombudsmen (FOS and CIO) into one body alongside the SCT on a statutory basis. This would recognise the overlaps in the corporate governance, funding and type of disputes processed by the Ombudsmen and the different set up and ambit of the SCT. There are certain differences in the empowerment, structure and effect of determinations between FOS/CIO and the SCT that would be complex to resolve. We note this reform would continue the consolidation of schemes, which has occurred in the past 15 years. We also note that FOS has an organisational structure with a chief ombudsman and lead ombudsman covering banking and finance, general insurance and investment and advice.

Scheme governance

To ensure the EDR scheme operates effectively and efficiently, and to ensure transparency and accountability, we suggest the EDR scheme governance arrangements take account of the following:

- *Performance and reporting:* We suggest clear performance benchmarks and key performance indicators (**KPIs**) should be set alongside a simple, public, reporting framework so FSPs, consumers and the government can be reassured that EDR is meeting its objectives in a cost effective and efficient manner. These KPIs should include efficiency and productivity measures and the principles in ASIC's *Regulatory Guide 139: Approval and oversight of external dispute resolution schemes* [RG139][9].

[9] http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-139-approval-and-oversight-of-external-complaints-resolution-schemes/

- *Clarity, transparency and consistency:* Provisions should be made for publication of determinations and case studies on how the EDR has assessed and applied its jurisdiction.
- *Third party stakeholders:* The terms of reference should enable EDR schemes to involve and request available information from relevant third parties, where the information is relevant to proper determination of the case. Separately, the terms of reference should also allow for consideration of third party stakeholder interests, such as other customers and employees.
- *Funding model:* We suggest a funding model based on FSP user pays.

Internal processes and continuous improvement

To ensure the EDR scheme continues to meet the needs of consumers, we suggest the EDR scheme design takes account of the following:

- Regular internal hindsight reviews of case handling and determinations, including assessing alignment with terms of reference, precedent, jurisdiction and operating policy and process. The ABA suggests the findings should contribute to continuous improvement.
- Enhanced guidance for stakeholders on the rationale behind decisions, including greater transparency on the facts and considerations, the consideration of precedent to help ensure consistency of remediation outcomes and improve stakeholder understanding.
- Ensuring sufficient technical expertise in all areas including capacity to adapt to developments in products and services.
- Enabling a cooperative and efficient approach on matters where legal action has already commenced.
- Increased use of digital communications.

Jurisdiction

The ABA supports EDR schemes having an appropriate jurisdiction to consider and make determinations in relation to financial products and credit provided by a FSP to a small business. The standing of a small business should be assessed against a clear definition of 'small business' that takes into account:

- The number of employees;
- Business turnover;
- Size of the loan or investment for business purposes, and
- Total credit exposure of the business group.

The ABA suggests that a test is important to assess if the size of the business and its financial position mean the court system is better placed to adjudicate the dispute. This will improve the efficiency and access to EDR for small businesses and reflects the intention that EDR is an alternative dispute resolution process for disputes, other than those that are more suited to be heard in court.

There are a number of small business tests used for legal and commercial purposes. For this purpose, the ABA's submission to FOS on expanding the small business jurisdiction, proposes the following small business test.

A business is not a small business if one of the following conditions is met:

- The number of employees is 20 people or more, or 100 people or more if the business is or includes the manufacture of good (full-time equivalent); or
- Annual business turnover is $5 million or more; or
- Size of loan for business purposes is $3 million or more; or
- Total credit exposure of the business group, including related entities, to all credit providers is $3-$5 million or more.

The ABA is seeking the opportunity to discuss this proposal further with FOS, in particular an appropriate total credit exposure condition.

The ABA's submission to FOS is available upon request.

Eligibility thresholds and monetary limits

The ABA supports an increase to the eligibility thresholds and monetary limits of EDR schemes to ensure EDR is accessible to customers and small business and compensation is meaningful, taking account of EDR's mandate to resolve disputes other than those that are more suited to be heard in court. We believe:

- Customers and small businesses should be able to bring complaints up to the value of $1 million, and
- The EDR scheme should be able to make awards up to $1 million.

The rationale for monetary limits on both the size of claims (eligibility threshold) and amounts of compensation (compensation cap) reflects the intention that EDR is an alternative dispute resolution process for small disputes. It has always been accepted that it is appropriate for larger disputes to continue to be resolved through the court system or private mediation.

Any move to increase the monetary limits should be taken with care and after due consideration of the effect of the existing limits. There is also a risk that higher monetary limits lead to more complexity, increased likelihood of adversarial approaches from the parties, and more risk for all parties in the event of error.

The ABA believes the eligibility thresholds and monetary limits proposed above strike the right balance.

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14 November 2016

Professor Ian Ramsay
Chair, Independent Expert Panel
c/o EDR Review Secretariat
Financial System Division
The Treasury
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Dear Professor Ramsay

Last resort compensation scheme – design features

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide further comments to the Independent Expert Panel's review of the financial system external dispute resolution framework (**Review**)[1] on the high level design features of a last resort compensation scheme. These comments are in addition to our submission to the Review, dated 10 October 2016.

Introductory comments

In April 2016, the Australian banking industry announced a package of initiatives to protect consumer interests, increase transparency and accountability, and build trust and confidence in banks.[2] As part of this announcement, banks committed to making it easier for customers when things go wrong, including evaluating the establishment of an industry wide, mandatory last resort compensation scheme covering financial advisers.

The ABA, our members and the Financial Ombudsman Service (**FOS**), have been working with the Australian Investments and Securities Commission (**ASIC**), the Treasury, Consumer Action Law Centre (**CALC**), Financial Services Council (**FSC**), Financial Planning Association (**FPA**), and AMP, through a consultancy facilitated by Oliver Wyman, to develop the high level design features of a last resort compensation scheme (scheme).

The banking industry's position on the high level design features of a scheme is being shared through the Oliver Wyman consultancy and is set out below.

Integrated response

Managing the risk to consumers of unpaid determinations requires a multifaceted response. The introduction of a scheme must be accompanied by other initiatives to reduce the likelihood of unpaid determinations, both to ensure the scheme is truly a last resort, and to ensure the long term viability and success of a scheme. An assessment of the root cause of unpaid determinations should consider what additional risk management initiatives are required, some of these initiatives are proposed below.

- **Professionalisation of financial advice:** The new framework to raise education, ethical and professional standards is as an important underpinning of ethical behaviour across the financial services sector. We acknowledge the work being undertaken by the Government and look forward to the legislative package being passed early next year.

[1] https://consult.treasury.gov.au/financial-system-division/dispute-resolution/
[2] http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust

- **Professional Indemnity (PI) insurance:** The cost, availability and coverage of PI insurance should be reviewed, and mechanisms to manage exclusions for insolvency, fraud and other misconduct considered. Work should be undertaken to improve the availability of PI insurance, including access to and affordability of run-off cover. Additional work should be undertaken to provide policy holders with education in relation to the duty of disclosure, claims notification requirements and the effect of replacing policies.
- **Regulation and regulatory activities:** ASIC should require an annual assurance statement from all Australian Financial Services licensees (licensees) that they meet their licence obligations, including compliance with ASIC's *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees* [RG126]. ASIC should review the financial requirements for financial advice licensees under *Regulatory Guide 166: Licensing: Financial requirements* [RG 166].[3]
- **Appropriate enforcement powers for ASIC:** Establishing the scheme should be accompanied by additional provisions to:
    - Publish the details of licensees that do not comply
    - Give appropriate powers for ASIC to take enforcement action against persons responsible for the licensee's failure to comply (this may extend beyond the adviser to directors / managers in certain circumstances)
    - Stop non-complying licensees from operating, and
    - Prevent those persons from establishing a new financial services or credit assistance business.

  Appropriate enforcement powers for ASIC should specifically address the risk of licensees winding up their businesses with the intention of avoiding paying an EDR determination.

The design of the scheme should take account of these additional arrangements and build in incentives for licensees to better manage risk. For example, funding calculations could assess the risk of the licensee or look at specific measures such as the quality of PI insurance cover. This could operate in a similar way to the PI insurance underwriting process.

Consumer focus

Consumers should have a clear understanding of the intent of the scheme, particularly regarding the type of claims the scheme will consider and the circumstances in which the scheme will respond.

The scheme should provide a meaningful solution for consumers, provide certainty with clear terms of reference, and avoid overly legalistic interpretations of products and services that exclude some consumers without a clear policy basis.

Last resort

The ABA believes the scheme should operate as a last resort to compensate customers that have suffered loss as a result of a breach of obligations or malpractice by their financial adviser, where the financial adviser cannot or will not pay compensation, and after all other compensation and enforcement mechanisms have been exhausted.

Generally, we would expect that a customer would resort to the financial adviser (and through the financial adviser the PI insurer), the financial resources of the financial adviser, and to have explored enforcement options.

[3] http://download.asic.gov.au/media/3278616/rg166-published-1-july-2015.pdf

Further analysis is required to assess when a claim would be considered by the scheme, based on where the licensee is up to in administration or insolvency proceedings, and whether payments could be recovered by the scheme through the liquidation process. As an example, the Fair Entitlement Guarantee legislation sets out the circumstances where a payment will be 'advanced' for payment to employees and provides for recovery of advances.[4]

Prospectiveness

The scheme should be prospective, with the design process considering the timing of commencement of the scheme and appropriate event and cut-off dates for claims.

A retroactive scheme introduces significant complexity and may compromise the ability to successfully design and implement the scheme in a timely way.

A separate process should be run to consider any response for the current unpaid FOS determinations. We do not support the banks being expected to cover these losses caused by other licensees.

Financial advice failures

The scheme should be designed to meet uncompensated losses arising from failures of financial advice, specifically, losses that arise as a result of services provided in the context of the customer's relationship with a financial adviser. This would include losses relating to inappropriate financial advice as well as malpractice, such as administrative errors or advice on unregulated products, for example.

According to FOS data as at October 2016, the top categories of Financial Services Providers with unpaid determinations are:[5]

- Financial planners and advisers: 57%
- Operators of Managed Investment Schemes: 11%
- Credit providers: 9%

Unpaid determinations represent more than 18% of all Investments and Advice (I&A) determinations, whereas overall compliance with FOS determinations is 99.97%. The value of unpaid determinations is almost one-quarter (23%) of the compensation awarded by I&A.

We believe designing the scope to cover financial advice failures will address the source of a majority of unpaid determinations, while making the scheme more sustainable and simpler to design and implement. A simpler and more sustainable scheme stands a greater chance of being established in a timely way.

The scheme design process should consider the impact of aligning the scope to cover financial advice failures in order to avoid unintended consequences, such as businesses moving to 'no advice' models.

Jurisdiction

The scheme should pay compensation in respect of unpaid determinations of ASIC approved External Dispute Resolution (**EDR**) schemes.[6] The size of disputes and quantum of compensation awards considered by the scheme should align with, or be no greater than, EDR jurisdictional limits.

The scheme design process should consider whether unpaid court awards should be included, to avoid distorting consumer choices in relation to the forum their dispute is heard in. Consideration of court awards should only include claims where the size and nature of the dispute would have come within the terms of reference and jurisdictional limits of the approved EDR.

[4] See Part 2, Eligibility for advance and Part 5, Recovery of advance: https://www.legislation.gov.au/Details/C2012A00159
[5] FOS Circular Oct 2016 https://www.fos.org.au/fos-circular-27-home/fos-news/unpaid-determinations-update.jsp
[6] Approved in accordance with the Corporations Regulations and ASIC Regulatory Guide 139: *Approval and oversight of external dispute resolution schemes*.

Structure, governance and processes

The structure of the scheme should be developed through flexible, industry based processes, with appropriate legislative underpinning to ensure all financial advisers contribute to the scheme. A largely industry based process will ensure the scheme can be established in a timely way, and to enable flexibility to adjust its remit, terms of reference and processes over time.

The governance arrangements should include:

- A board, with representation including an independent chair, a legal expert and an equal number of industry and consumer representatives
- A claims management / assessment panel, and
- Sufficient resources to respond to claims as they arise, but not to operate on a full time basis or have remit for additional works.

The scheme should have discretion to review cases to ensure they fit within the scheme's scope and terms of reference (which may differ from the EDR scheme) but should not have discretion to review the merits of the claim or reduce the amount of compensation awarded by the EDR.

Funding

Levies

Broadly, the ABA supports the levy structure proposed by FOS[7] comprising:

- A prefunded establishment levy, based on borrowings from industry
- Prefunded management levies to support the operation of the scheme and repay establishment levies, and
- Prefunded compensation levies.

There should be certainty as to the amount of annual levies, with provisions made to 'smooth' payments from the scheme in the event of a major failure or large scale losses that exceed reserves, including proportionally reducing compensation and staggering distributions.

The scheme design should contemplate the ability to borrow from industry or government if scheme reserves are exhausted due to a major event. Provisions should also be made to manage excess funds as they accumulate.

Calculation

Contributions should be appropriately risk weighted, taking into account:

- The risk profile of the operating model
- The scope of the licensee's PI insurance (exclusions), and
- Other risk management arrangements put in place by the licensee.

The funding calculation should encourage best practice risk management by licensees. For example, funding calculations could assess the risk of the licensee or look at specific measures, such as the quality of PI insurance cover. This could operate in a similar way to the PI underwriting process.

[7] Updated Proposal to Establish a Financial Services Compensation Scheme, FOS, May 2015

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Given the complexity of the design issues, the ABA welcomes the opportunity to discuss these issues with the Panel, prior to the finalisation of the Panel's issues paper. The ABA will contact the EDR Review Secretariat to arrange a suitable time.

In the meantime, if you have any questions in relation to this letter, please do not hesitate to contact me or Christine Cupitt, Policy Director – Retail Policy on (02) 8298 0416 or ccupitt@bankers.asn.au.

Yours sincerely

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01 February 2017

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Chair, Independent Expert Panel
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Dear Professor Ramsay

Review of financial system's external dispute resolution and complaints framework – Interim report

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide this submission to the Independent Expert Panel's review of the financial system external dispute resolution framework (Review)[1] and to respond to the Interim Report released on 6 December 2016 (Interim Report). This submission is in addition to the ABA's response to the issues paper, dated 10 October 2016, and our supplementary response on the design features of a last resort compensation scheme, dated 14 November 2016.

With the active participation of 25 member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community, to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

Introductory comments

In April 2016, the Australian banking industry, in acknowledging there is more to do to promote good customer outcomes and to demonstrate sound practices so customers have confidence in the culture and conduct of banks, announced a package of initiatives to protect consumer interests, increase transparency and accountability, and build trust and confidence in banks.[2]

This include initiatives making it easier for customers when things go wrong, being:

- Enhancing existing internal complaints handling processes by establishing a dedicated customer advocate in each bank to ensure that retail and small business customers have a voice, and that complaints are appropriately escalated and responded to in a timely way.
- Supporting the broadening and strengthening of external dispute resolution (**EDR**) schemes with a view to increasing eligibility thresholds for retail and small businesses customers.

1 https://consult.treasury.gov.au/financial-system-division/dispute-resolution/
2 http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust

- Working with ASIC in expanding its review of remediation programs to cover all types of financial advice and products; and
- Evaluating a last resort compensation scheme and identifying an appropriate model.

In aggregate, these initiatives aim to ensure internal and external programs address customer concerns, make it easier for customers when things go wrong, and increase trust and give people confidence that when things do go wrong, banks will do the right thing.

The ABA believes this Review provides a complementary process to improve the EDR framework so that all the avenues for resolution of customer complaints are operating to the maximum benefit of consumers.

Response to the Interim Report

Our submission sets out high level design principles and proposed design features for a revised EDR and complaints framework for consideration by the Panel.

Specific responses to the recommendations and observations of the Interim Report are set out in Appendix 1, together with responses to the information requests in Appendix 2. Our detailed comments on the design of a last resort compensation scheme (scheme) are included in Appendix 3.

The ABA notes the overlap in the terms of reference between this review and other Government processes and reviews. We advise we have provided comments on EDR jurisdiction for small business credit disputes to the Small Business Loans Inquiry ('Carnell Inquiry') and the Financial Ombudsman Service (**FOS**) through its public consultation process.

Financial services dispute resolution

Simple, accessible and effective EDR plays a valuable role in enabling retail and small business customers (together, 'customers') to bring and resolve disputes with financial services providers (FSPs).

The ABA believes that EDR offers an important and accessible alternative to the court system as it is free for customers to access, does not require formal legal representation, and resolves disputes in a less adversarial way than the court system.

EDR works best in conjunction with effective complaints handling and Internal Dispute Resolution (IDR) programs. IDR programs are an important element of the FSP's overall relationship with its customers and manage a wide variety of complaints, including those that have not resulted in monetary loss. Many customers have their complaints successfully resolved though IDR.

But when EDR is needed to resolve a problem, the system must work as efficiently and quickly as possible to resolve disputes and achieve fair outcomes for customers.

Design principles

The ABA supports an EDR system with the following design principles. The EDR system must have the confidence of all parties; banks and other FSPs and consumers.

Simplicity

The EDR process should be simple and easy for customers to access, navigate and understand.
A revised EDR framework, which the banking industry supports, should have a single or simple path for resolution of disputes. Alternative bodies, processes or legal requirements may be required given the type of customer or nature of the dispute, however, these processes should operate in an integrated way.

Where more than one EDR scheme is in operation, the EDR framework should promote clarity and certainty for consumers by:

- Offering a single or simple path to EDR through an overarching gatekeeper, or ensuring clarity for consumers to be directed on where to access EDR to resolve a dispute.
- Minimising overlaps in terms of reference.
- Enabling more rapid allocation of disputes to the appropriate resolution pathway, ending the transfer of disputes between schemes or forums.
- Standardising regulatory oversight and approval of the operation of the EDR scheme(s).
- Standardising operating policy and process, leading to improved efficiency, and
- Rationalising industry and government funding models and allocation of adequate resources.

Accessibility

The EDR system should be readily accessible. Current arrangements to ensure accessibility for customers should be reinforced and continuously improved to ensure the following design features:

- **Free for consumers***:* EDR should continue to remain free for the customer to access, including retail and small businesses.
- **Remove information asymmetry***:* EDR schemes should continue to make available simple information about their processes, provide information to suit consumers with disabilities or languages other than English, and operate community outreach programs and provide information in community languages. FSPs should continuously improve the way they integrate EDR into their complaints handling policies and procedures, and to let retail and small business customers know about their rights to access EDR at key times[3].
- **Transparency***:* EDR schemes should ensure their communications with FSPs and consumers are clear throughout the process. It is important for all parties to be engaged and kept up-to-date with proceedings, and determinations should be clearly explained to the FSP and the consumer.

Effectiveness

Resolution of disputes through EDR should be fast, allow flexibility, be supported by appropriately skilled and funded resources and ensure satisfactory resolution of disputes for customers.

To enable speedy and satisfactory dispute resolution, a revised EDR framework needs to be designed to ensure the following:

- **Adaptability***:* Able to amend governance structures, revise terms of reference, review operating processes and reallocate resources so that the scheme can continue to evolve and respond to emerging issues.
- **Flexibility***:* Allows for a broad range of negotiated (and imposed) outcomes to individual disputes.
- **Capability***:* Is equipped with appropriate financial resources and organisational capability to resolve disputes with varied and complex features.

[3] The ABA notes that the banking industry commitment to have a Customer Advocate in each bank will provide an avenue for identifying improvements with customer communications about complaints handing and IDR as well as access to EDR. http://www.bankers.asn.au/media/media-releases/media-release-2016/new-voice-for-customers-in-complaints-with-banks

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Design features

Small business disputes

The EDR framework should continue to cater for disputes brought by small businesses.

As well as products created specifically for the small business market, many small businesses use 'retail' financial and credit products, such as general insurance, credit cards and transaction accounts designed for the 'retail market'. These disputes should be heard by the EDR schemes that hear similar disputes brought by retail customers to ensure simplicity and clarity for small businesses on where to go to have their disputes heard and maintain efficiencies.

Expanding the EDR eligibility thresholds and monetary limits for both retail and small business credit disputes, is a way to ensure the EDR Framework remains fit-for-purpose to support small businesses.

Jurisdictional limits and compensation caps

The ABA supports an increase to the eligibility thresholds and monetary limits of EDR schemes to ensure EDR is accessible to customers and that compensation is meaningful, taking account of EDR's mandate to resolve disputes other than those that are more suited to be heard in court.

General jurisdiction

We propose:

- Customers should be able to bring disputes up to the value of $1 million, and
- The EDR scheme should be able to make awards up to $1 million.

Small business credit disputes

We support increasing the eligibility thresholds and monetary limits for small business credit disputes.

That increase should be accompanied by a revised test for small business, to ensure the ongoing efficiency and accessibility of EDR schemes for genuine small businesses and reflect the intention that EDR is an alternative dispute resolution process for small and less complex disputes.

The standing of a small business should be assessed against a clear definition of 'small business' that takes into account:

- The number of employees
- Business turnover
- Size of the loan or investment for business purposes, and
- Total credit exposure of the business group.

The test should be quick and simple to apply, to ensure efficiency and accessibility. We note concerns about introducing new criteria in addition to the number of employees, however we believe that these additional criteria can be identified readily through information held by the FSP and the applicant, at least as easily as identifying the number of employees.

Expanding the criteria beyond the number of employees is critical to ensure the small business test is future proofed in the context of increasing automation and the digital economy, where large businesses can operate with comparatively few staff members.

There are a number of small business tests used for legal and commercial purposes. For the purpose of expanding the EDR small business credit jurisdiction, we propose the following small business test.

A business is not a small business if one of the following conditions is met:

- The number of employees is 20 people or more, or 100 people or more if the business is or includes the manufacture of goods (full-time equivalent)

- Annual business turnover is $5 million or more
- Size of loan for business purposes is $3 million or more, or
- Total credit exposure of the business group, including related entities, to all credit providers is $3-$5 million or more.

A business would not be small if any one of the conditions was satisfied. So, for example, a business with only 19 employees but with an annual turnover of $15 million would not be classified as a small business. In such a case, the court system is better placed to consider the matter.

The revised test for small business should apply together with the following jurisdictional limits:

- Small businesses should be able to bring credit disputes up to the value of $1 million
- The EDR scheme should be able to make awards in relation to credit disputes up to $1 million, and
- The credit facility limit should be $3 million.

Debt recovery proceedings in respect of facilities up to $3 million should be prohibited while a dispute is being considered by FOS.

The rationale for monetary limits on both the size of claim and amount of compensation reflects the intention that EDR is an alternative dispute resolution process for small disputes and customers who do not have the resources to use the court system. This ensures EDR resources, and therefore speedy resolution of claims, are available to those customers who most need them.

Importantly, the quantum of eligibility limits and compensation caps should not expand EDR jurisdiction to very complex and high value business matters, where determinations are binding on the FSP and there is no right of appeal on the substance of the determination.

Farm debt mediation

Farm Debt Mediation (**FDM**) is a specialised mediation process that allows a farmer and their FSP to negotiate a better financial outcome. Mediators are trained to understand the unique and complex circumstances affecting farming operations and agri-business lending.

The ABA believes that FDM should remain separate to the EDR schemes.

We support the implementation of a nationally consistent farm debt mediation model across Australia, and have been working with the Australian Government and agricultural organisations on legislative options. We have also been working with State governments as they look to adopt mandatory models, similar to NSW and Victoria.

Enduring funding for financial counselling services

Financial counsellors are an essential public service. They provide independent and free advice and information to individuals and families during difficult financial and emotional times and help their clients deal with debt problems, including from mainstream financial institutions, other lenders (including payday lenders), and other creditors (including retailers, utilities and telecommunications companies). We recognise the importance of the work financial counsellors do in helping people through incredibly challenging times often due to a change in their circumstances, such as loss of employment or relationship breakdown, or health related issues.

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The ABA supports an enduring model of government funding for financial counselling services to ensure these services continue to make a significant difference for many Australians experiencing financial difficulty and facing other economic and social challenges. It is important for the government to provide funding for financial counsellors' casework. Additionally, we have recently announced an initiative to work with financial counsellors to support the setup of a new debt repayment service to help people manage multiple debts[4]. This initiative aims to achieve better customer outcomes by helping people get control of their finances and debts including from non-bank lenders and creditors.

Consultation and transition

The reforms proposed in the draft recommendations are complex, involve potentially significant legal and regulatory changes and will require significant government and industry effort and resources to put into effect. We support building in sufficient transitional timeframes, particularly in relation to new industry reporting obligations.

Last resort compensation scheme

The ABA supports establishing a mandatory, prospective compensation fund that covers individuals and small businesses who have received poor financial advice, and have not been paid a determination made by an ASIC-approved EDR scheme, due to the validated insolvency or wind up of financial advice businesses, where all other redress avenues have been exhausted.[5]

A detailed analysis of the design features of a last resort compensation scheme is set out in Appendix 3.

Closing remarks

The ABA and our member banks are strongly committed to making sure the EDR system is improved and works well now, and into the future.

The ABA would welcome the opportunity to discuss these issues further with the Panel.

In the meantime, if you have any questions in relation to this submission, please do not hesitate to contact me or Christine Cupitt, Policy Director – Retail Policy on (02) 8298 0416 or christine.cupitt@bankers.asn.au.

Yours sincerely

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[4] http://www.bankers.asn.au/media/media-releases/media-release-2016/we-hear-you-banks-announce-more-changes-to-make-banking-better

[5] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the scheme.

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Appendix 1 – Response to draft recommendations and observations

	Draft recommendation	Industry position
1	**A new industry ombudsman scheme for financial, credit and investment disputes** There should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO.	The ABA supports a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes). The merits of establishing a new body to replace the existing ombudsmen should be weighed against the potential time and cost savings of merging FOS and CIO. Alternatively, a single or simple path to EDR through an overarching gatekeeper, or ensuring clarity for consumers to be directed on where to access EDR to resolve a dispute, should be adopted ('one-stop-shop').
2 / 3	**Consumer monetary limits and compensation caps** The new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation. **Small business monetary limits and compensation caps** The new industry ombudsman scheme for financial, credit and investment disputes should provide small business with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.	The ABA supports increasing monetary limits and compensation caps to ensure appropriate access to EDR by retail and small business customers. *General jurisdiction* We believe: • Retail and small business customers should be able to bring disputes up to the value of $1 million, and • The EDR scheme should be able to make awards up to $1 million. *Small business credit disputes* We believe: • Small businesses should be able to bring credit disputes up to the value of $1 million. • The EDR scheme should be able to make awards in relation to credit disputes up to $1 million. • The credit facility limit should be $3 million. Debt recovery proceedings in respect of facilities up to $3 million should be prohibited while a dispute is being considered by an approved EDR scheme.

	Draft recommendation	Industry position
		A revised small business credit jurisdiction should be accompanied by a revised small business test. Specifically, a business is not a small business if one of the following conditions is met: • The number of employees is 20 people or more, or 100 people or more if the business is or includes the manufacture of good (full-time equivalent); or • Annual business turnover is $5 million or more; or • Size of loan for business purposes is $3 million or more; or • Total credit exposure of the business group, including related entities, to all credit providers is $3-$5 million or more. A business would not be small if any one of the conditions was satisfied. The terms of reference of an ASIC-approved EDR should provide for regular indexation.
4	**A new industry ombudsman scheme for superannuation disputes** SCT should transition into an industry ombudsman scheme for superannuation disputes.	The body of this submission proposes principles in relation to simplicity, accessibility and effectiveness of the new EDR and disputes framework. The EDR framework should promote clarity and certainty for consumers by offering a single or simple path to EDR through an overarching gatekeeper, or ensuring clarity for consumers on where to access EDR to resolve a dispute. We note it will be complex to transition the SCT into an industry ombudsman scheme for superannuation disputes. Complexities include: • Affirming the binding nature of determinations and enforcement mechanisms • Reconciling unlimited compensation caps (under SCT) with the principle of EDR hearing smaller, less complex disputes, and • Unwinding the SCT legislation and making provisions for RSEs to be member of EDR. Government will need to be sufficiently resourced to conduct detailed industry consultation and develop the framework for a new superannuation ombudsman.

	Draft recommendation	Industry position
		Consistent with the principle of simplicity, the terms of reference of any new superannuation ombudsman, should avoid overlapping with the jurisdiction of other ombudsmen to provide certainty for customers and avoid confusion arising through multiple forums.
5	**A superannuation code of practice** The superannuation industry should develop a superannuation code of practice.	The ABA has no comment on this recommendation.
6	**Ensuring schemes are accountable to their users** Both new schemes should be required to meet the standards developed and set by ASIC. At a minimum, ASIC's regulatory guidance should require the schemes to: • Ensure they have sufficient funding and flexible processes to allow them to deal with unforeseen events in the system, such as an increase in complaints following a financial crisis or natural disaster; • Provide an appropriate level of financial transparency to ensure they remain accountable to users and the wider public; • Be subject to more frequent, periodic independent reviews and provide detailed responses in relation to recommendations of independent reviews, including updates on the implementation of actions taken in response to the reviews and a detailed explanation when a recommendation of an independent review is not accepted by the scheme; and • Establish an independent assessor to review the handling of complaints by the scheme but not to review the outcome of individual disputes. In addition, ASIC's regulatory guidance should require the new scheme for financial, credit and investment disputes to regularly review and update its monetary limits and compensation caps so that they remain relevant and fit-for-purpose over time.	The ABA supports, in principle, the recommendations to revise ASIC's *Regulatory Guide 139: Approval and oversight of external dispute resolution schemes* [RG139]. Requirements relating to internal governance, such as independent reviews, should allow sufficient flexibility to target resources to address specific risks or issues, and manage costs. ASIC's standards should maintain the character of EDR schemes, in particular that they are industry based and independent.

	Draft recommendation	Industry position
7	**Increased ASIC oversight of industry ombudsman schemes** ASIC's oversight powers in relation to industry ombudsman schemes should be enhanced by providing ASIC with more specific powers to allow it to compel performance where the schemes do not comply with EDR benchmarks.	The ABA supports, in principle, the recommendation for increased ASIC oversight of industry ombudsman schemes. Any enhanced supervision requirements should maintain the character of EDR schemes, in particular that they are industry based and independent.
8	**Use of panels** The new industry ombudsman schemes should consider the use of panels for resolving complex disputes. Users should be provided with enhanced information regarding under what circumstances the schemes will use a panel to resolve a dispute.	The ABA suggests that the further use of panels, as they are currently comprised, be approached with caution. Flexibility should remain to use panels only in relation to some product types and some dispute types. The EDR should maintain transparent criteria or guidance on when panels will be used. As well as additional costs, members have advised anecdotally that panels can affect the timeliness of EDR decisions, impacting efficiency.
9	**Internal dispute resolution** Financial firms should be required to publish information and report to ASIC on their IDR activity and the outcomes consumers receive in relation to IDR complaints. ASIC should have the power to determine the content and format of IDR reporting.	The ABA supports, in principle, the recommendation for FSPs to publish information and report to ASIC on their IDR activity and the outcomes customers receive in relation to IDR complaints. We suggest that the design of any further reporting obligations take into account the recommendations arising from other Government reviews and processes. We also suggest that that the design of any further reporting obligations take into account existing reporting obligations (e.g. CCMC reporting), and seek to utilise existing reporting for this purpose. We note there will be significant complexity and costs to industry in developing systems to provide information in a form determined by ASIC. Noting that there is currently no standardised format for IDR reporting, industry will need sufficient time to both consult on any new form and implement any required changes.

	Draft recommendation	Industry position
		The ABA is currently working with our member banks on designing a reporting framework associated with the banking reform program, which includes metrics for the dedicated customer advocate. With a particular focus on improving complaint handling and IDR and access to EDR, we encourage this work to be leveraged with any further reporting obligations.
10	**Schemes to monitor IDR** Schemes should register and track the progress of complaints referred back to IDR.	As above, the ABA supports, in principle, the recommendation for improved reporting on IDR activity. We also suggest that the design of any further reporting obligations take into account existing practice, such as current FOS processes, and seek to utilise existing reporting for this purpose. Consultation will be required on how to operationalise any new requirements.
11	**Debt management firms** Debt management firms should be required to be a member of an industry ombudsman scheme. One mechanism to ensure access to EDR is a requirement for debt management firms to be licensed.	The ABA supports the recommendation for debt management firms to be required to be a member of an industry ombudsman scheme. The role of 'for profit financial difficulty companies' (including debt management firms and credit repair agencies) should be examined to ensure consumers are appropriately represented and protected, including in their representations with EDR schemes but also more broadly. A decision to license debt management firms should be based on a detailed assessment of the benefits to consumers and the proposed detail of the licensing regime. EDR membership may be one outcome of licensing, but should not be the determining driver. Other factors including the benefits and costs of regulation and improved consumer protection should be given close consideration. We would support a review considering licensing for debt management firms, but also suggest the Panel consider other options, at least in the first instance, to require debt management firms to become members of an ASIC-approved EDR scheme.

Appendix 2 – Response to information requests

	Information requests (Members to review and provide written feedback)	Industry response
5.74	Should the national consumer credit protection law be extended to small businesses?	*Improving EDR access for small business* The ABA supports small business customers having appropriate access to EDR. We suggest that the Panel consider all options, to ensure such access, including the merits of requiring non ACL lenders to become members of an ASIC-approved EDR scheme.[6] However, improved access to EDR for small business customers could be achieved without extending the national consumer credit protection (NCCP) law to small business. We support strong competition in the lending market and note that many small businesses are currently well serviced by ACL lenders including banks, credit unions and building societies and a number of equipment leasing and financing businesses. Small businesses may also choose to obtain credit through a non ACL lender. The Panel could also consider requirements to give greater prominence to the fact EDR is not currently available with loans from particular lenders. *Extending NCCP to small business* There are existing consumer protections available to small businesses, including unfair contract term (UCT) protections for small businesses, requirements of the *ASIC Act* and industry standards, including the provisions of the Code of Banking Practice (COBP). Many banks extend some aspect of NCCP to small business customers, such as including the approach to hardship and access to dispute resolution. Any decision to modify the framework for small businesses should identify where concerns or gaps exist and consider specific regulatory responses to address those concerns or gaps. The direct application of retail responsible lending obligations to small businesses would be inappropriate, as it would not take into account the inherently different nature of business lending. In particular, the serviceability assessment, loan suitability and income verification processes each operate differently between retail and small business lending.

[6] We note that the majority of members support non ACL lenders being members of an EDR scheme, some members have policy concerns about this approach to improving EDR access for small business.

	Information requests (Members to review and provide written feedback)	Industry response
		Any decision to extend NCCP to small business should take account of the impact of the complete NCCP framework, including: • Application of responsible lending criteria • More detailed regulated disclosures and documentation • Special provisions for managing loans and the relationship with the creditor (e.g. enforcement, collection and dispute resolution), and • Licensing and regulatory oversight. The decision would also need to weigh up any new consumer protection benefits, against the significant implementation and ongoing compliance costs of extending the regime. Importantly, the NCCP regime was developed to protect the interests of consumers, when obtaining credit for domestic purposes; applying NCCP to small business could trigger significant unintended consequences in relation to the cost and availability of credit to small business. In particular, the responsible lending obligations under NCCP may not be appropriate measures for lending to small businesses. For example, the responsible lending obligations require collection of individuals' income and living expenses as a minimum step for consumer lending, and may not be relevant for small business lending. Furthermore, responsible lending obligations require the assessment and verification of income, which can be challenging from a practical perspective and even irrelevant for start-up businesses or newer small businesses which may require capital for expansion. *Example - Role of security in business lending* In business lending, financial assessment for lending to a newly established business (ie start-ups) is generally based largely on the strength of guarantees and security provided by the founders of such business (ie directors giving a person guarantee and security over their real property). Under the NCCP Act, the value of security is not sufficient for the suitability assessment of a loan and the assessment needs to be based at some point on income (which may be negligible for some time).

	Information requests (Members to review and provide written feedback)	Industry response
		Application of these rules would severely restrict the ability of the banks to lend to start ups and increase the prevalence of unregulated lenders.
5.152	Should schemes be provided with additional powers and, if so, what additional powers should be provided? How should any change in powers be implemented?	The ABA believes that new powers to compel documents should be approached with caution, having regard to existing duties of confidentiality, privacy laws and other influencing factors, such as confidentiality in situations of financial abuse (elder abuse, family violence). However, we are supportive of the Panel investigating powers consistent with the SCT and UK FOS. In relation to compensation, we believe EDR is a forum to obtain compensation for losses. Consistent with the purpose of EDR, it is not a forum for the award of punitive damages or imposing quasi fines.
5.171	Does EDR scheme membership by credit representatives provide an additional or necessary layer of consumer protection that is not already met through the credit licensee's membership?	The ABA does not believe individual EDR membership by ACRs is necessary for consumer protection. We believe the model should align with the AFS licensing regime, which requires only the AFSL to be a member.
6.22	What should be the monetary limits and compensation caps for the new scheme? Should they be different for small business disputes? What principles should guide the levels at which the monetary limits and compensation caps are set? What indexation arrangements should apply to ensure the monetary limits and compensation caps remain fit-for-purpose?	Our position on eligibility thresholds and compensation caps is set out in the body of our submission (pp4-5). For disputes other than small business credit disputes, the eligibility thresholds and compensation caps should be the same for retail and small business customers. The rationale for monetary limits on both eligibility thresholds and amounts of compensation caps should reflect the intention that EDR is an alternative dispute resolution process for small disputes. The EDR scheme terms of reference should provide for regular indexation of eligibility thresholds and compensation caps against CPI. Semi-regular indexation should also be completed, having regard to factors such as average mortgage size, interest rates, average super balance, etc.
6.66	On what matters should ASIC have the power to give directions? For example, should ASIC be able to give directions in relation to governance and funding arrangements and monetary limits?	The ABA has no comment on this recommendation.

	Information requests (Members to review and provide written feedback)	Industry response
6.76	What IDR metrics should financial firms be required to report on? Should ASIC publish details of non-compliance or poor performance IDR, including identifying financial firms?	As noted above, the ABA supports, in principle, the recommendation for improved reporting on IDR activity. The design of the improved reporting should take into account: • Existing practices, such as FOS benchmarking and CCMC reporting • Current variations in the implementation of RG165 and interpretations of 'complaint' • Metrics that take into account the business context and the size of the business (number of customers, volume of transactions etc.) such a percentages, rather than raw volumes; and • Appropriate implementation timeframes given practical and technology (systems) constraints.

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Appendix 3 – Last Resort Compensation Scheme

The ABA[7] supports establishing a mandatory, prospective compensation fund that covers individuals and small businesses (together 'customers') who have received poor financial advice, and have not been paid a determination made by an ASIC-approved EDR scheme due to the validated insolvency or wind up financial advice businesses, where all other redress avenues have been exhausted (LRCS).

Basis for the banking industry's support for a LRCS

The ABA's support for a LRCS is part of our strong support for the overall reform program to improve the quality of financial advice and rebuild consumer trust and confidence in financial advisers and through that, the financial services industry, more generally.

The ABA believes a LRCS represents the final element of a significant reform program already underway to professionalise the financial advice industry, including implementation of the Future of Financial Advice (**FOFA**) reforms and higher professional, ethical and education standards.

Establishing a LRCS covering financial advice is an important part of financial advisers forming a profession and access to the LRCS is a benefit arising from seeking advice from an authorised financial adviser.

The ABA accepts that risks arise in relation to establishing a LRCS, including potential moral hazard, and possible distortions in government and regulator behaviour. We also accept that other steps should be taken to manage the risk of unpaid determinations in relation to financial advisers.

While accepting these arguments, we believe they are outweighed by the industry's support for the professionalisation of financial advice and the need to rebuild consumer trust and confidence in financial advice.

Other initiatives to manage risk for consumers

The ABA believes that managing the risk to consumers of unpaid determinations requires a multifaceted response. The introduction of a LRCS must be accompanied by other measures and reforms to reduce the likelihood of unpaid EDR determinations, both to ensure the LRCS is truly a last resort, and promote the long term viability and success of a LRCS.

An assessment of the root cause of unpaid determinations should consider what complementary risk management measures are required. Such initiatives should improve conduct in financial services, and ensure FSPs are accountable for meeting financial requirements and maintaining adequate compensation arrangements.

The ABA's support for a LRCS is based on a number of risk management measures and reforms intended to improve the regulatory framework. We consider these measures are essential to the proper introduction and functioning of a LRCS.

Some of the complementary measures will also be advocated by the ABA through the ASIC Enforcement Review.

Professionalisation of financial advice

The new legislative framework to raise education, ethical and professional standards for financial advisers should be introduced as an important underpinning of ethical behaviour across the financial services sector. Access to a LRCS, is an important feature of the professionalisation of financial advice and is intended to complement these broader reforms.

[7] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the LRCS.

Professional indemnity insurance

Industry should work with professional indemnity (**PI**) insurers to examine improving the cost, availability and coverage of PI insurance, including mandatory run-off cover for licensees, and responses to insolvency, fraud and other misconduct. Industry should introduce additional financial planner education in relation to the duty of disclosure, notification and settlement requirements, and the effect of replacing policies.

Regulation and regulatory activities

ASIC should require an annual assurance statement from all AFS licensees that they meet their licence obligations, including compliance with ASIC's *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees* [RG126]. ASIC should review the compensation requirements under RG126 to ensure they remain fit-for-purpose.

ASIC should also review the financial requirements for financial advice licensees under *Regulatory Guide 166: Licensing: Financial requirements* [RG 166], to consider whether capital requirements for AFSLs with a financial advice authorisation remain sufficient. Sufficient resources to compensate clients and meet any insurance deductible payments should form part of the resources required for an orderly wind down of a financial advisory business.

AFS licensing criteria

The past conduct of a person as a manager of a financial services business, including whether that business had unpaid EDR determinations, should be part of ASIC's AFS licensing and credit licensing assessment.

Appropriate enforcement powers for ASIC

Establishing the LRCS should be accompanied by additional provisions to:

- Publish the details of licensees that do not comply
- Give appropriate powers for ASIC to take enforcement action against persons responsible for the licensee's failure to comply (this may extend beyond the adviser to directors / managers in certain circumstances)
- Stop non-complying licensees from operating, and
- Prevent those persons from establishing a new financial services or credit assistance business.

Appropriate enforcement powers for ASIC should specifically address the risk of licensees winding up their businesses with the intention of avoiding paying an EDR determination.

Design process, resources and consultation

The design process for a LRCS will be necessarily complex, involve a large number of stakeholders from across industry and government, and will need to be based on detailed financial modelling and sound public policy.

We suggest that any observations or recommendations in relation to a LRCS should include sufficient timeframes and allocation of government resources to drive the right outcomes and ensure the success and long term viability of a LRCS.

Design principles

Consumer focus

The ABA believes that consumers should have a clear understanding of the intent of the LRCS, particularly regarding the type of claims the LRCS will consider and the circumstances in which the LRCS will respond. The purpose of the LRCS should be well communicated to consumers, so it is clear that the LRCS is not intended to cover market-linked investment losses.

The LRCS should provide a meaningful solution for customers, provide certainty with clear terms of reference, and avoid overly legalistic interpretations of financial advice services that exclude some customers without a clear policy basis.

Last resort

The LRCS should operate as a last resort to compensate customers who have received poor financial advice, and have not been paid a determination made by an ASIC-approved EDR scheme due to the validated insolvency or wind up of the financial advice businesses, where all other redress avenues have been exhausted.

Generally, we would expect that a customer would resort to the financial adviser (and through the financial adviser the PI insurer), the financial resources of the financial adviser, and to have explored legal enforcement options. Evidence will be required (possibly from a registered liquidator or administrator) that the assets of the financial advice business will not cover the determination.

Prospectiveness

The LRCS should be prospective, with the design process considering the timing of the effective date of the LRCS and appropriate event and cut-off dates for claims, to minimise distortions in consumer and financial adviser behaviour.

A prospective LRCS aligns with other improvements to consumer capability and decision making about financial advice, such as financial capability initiatives from banks and regulatory initiatives such as ASIC's financial advice tool kit.

We do not support the LRCS covering unpaid determinations made before the effective date, including the current unpaid FOS determinations. These determinations are the result of a combination of regulatory and conduct failures which are being addressed through the new professional standards framework and not a direct result of the absence of a last resort compensation scheme.

Simplicity

The design and scope of the LRCS should be simple, to avoid complicated and costly eligibility assessments and promote consumer understanding for the place of the scheme. Assessment based on defined licence conditions and defined classes of financial products should be preferred. This will also enable targeted used of regulated disclosures to explain the availability and role of the LRCS to customers.

The LRCS should also be designed, to the extent possible, to minimise distortions in consumer, adviser and regulator behaviour.

It should also be designed to complement other professional and risk management structures such as a professional scheme for limited liability or maintaining alternative, approved compensation arrangements.

Design features

Scope

The LRCS should cover failures that arise in the context of a relationship where personal advice on Tier 1 products, and / or general advice on Tier 1 products is provided to retail customers. The failure could relate to *Corporations Act* breaches, fraud, negligence, misrepresentation and administrative errors connected with the advice relationship. For example, losses arising from failure by the financial adviser to implement the financial advice where the client clearly instructs their adviser to do so.

The LRCS should cover general advice provided by financial advisers, product manufacturers and robo-advisers, as well as personal advice to avoid market distortions and take account of the low level of consumer understanding of the difference between personal and general advice. The LRCS is not intended to cover retail bank staff providing retail banking services.

The LRCS should not cover businesses that only provide dealing or arranging services, such as securities dealers or derivatives dealers, nor should it cover research houses that publish reports containing general advice.

Addressing the biggest risk of unpaid determinations

Advice and investments determinations represent the largest proportion of unpaid determinations. As at October 2016, the top categories of non-compliant FSPs are:

- Financial planners and advisors: 57%
- Operators of Managed Investment Schemes: 11%
- Credit providers: 9%

Additionally, FSPs categorised as Investment and Advice have the lowest determination compliance rate. Unpaid determinations represent more than 18% of all Investments and Advice determinations, whereas overall compliance with FOS determinations is 99.974%. The value of unpaid determinations is almost one-quarter (23%) of the compensation awarded by Investments and Advice.

Simplicity

The scope of financial advice has a clear policy basis, and place in the professional standards framework for financial advisers. We believe that consumers will understand the scope and have certainty if the scheme covers financial advice failures.

Addressing a broader scope of services will involve a broader range of stakeholders, more complexity and may reduce the prospects of the LRCS's success. Where consumer protection issues arise in relation to these other services, other reforms should be considered first to address poor conduct and risk for consumers, rather than extending the LRCS scope as a first move.

Dealing and arranging services and research houses

We note the support from some stakeholders to include research houses and businesses that provide dealing and arranging services, without financial product advice, such as such as securities dealers or derivatives dealers. We do not support the inclusion of research houses nor dealing / arranging businesses as that would be inconsistent with our view that the LRCS is an important part of financial advisers forming a profession and access to the LRCS is a benefit arising from seeking advice from an authorised financial adviser.

Registered Managed Investment Schemes

The ABA notes the support from some stakeholders for including registered managed investment schemes (**RMIS**) in the LRCS, and pooling contributions and risk, across financial advice and RMIS. We note the argument that this would require contributions across the 'value chain' and increase the accountability of RMIS operators.

However, we do not support the inclusion of RMIS in the LRCS for the following reasons:

- Inclusion of RMIS is not part of an integrated reform program to improve RMIS. We note recent activity to increase the financial requirements for RMIS and ASIC's recent consultation on risk management practices of responsible entities however the risk of RMIS is primarily based on economic factors, not behavioural ones.
- Advice-based investor harm arises due to behavioural failures and these risks are being mitigated through the professionalisation of financial advice. In contrast, the financial risks arising from RMIS are fundamentally different from advice-based financial harm and are likely to grow with the rise of non-bank financial activity utilising RMIS (for example, peer-to-peer lending). These risks are largely related to the investment models of RMIS and are difficult to mitigate.
- We do not think the exclusion of claims based on investment performance would be sufficient to manage such risks to the LRCS as many claims could be based on maladministration (which is easy to plead).
- The risk profiles of RMIS vary significantly. RMIS can include Australian index funds, international share funds, commercial property finds and agricultural ventures. We believe that a risk weighted contribution model should apply to these schemes, and note that this would involve significant complexity and time to design. This would significantly hamper the introduction of a LRCS in the immediate term.
- Inclusion of RMIS could introduce a new connection between prudentially regulated banks and the investment and shadow banking sector. This could pose a systemic risk to depositors as the LRCS could transmit losses from non-prudentially regulated activities (eg a property downturn during a crisis) to banks. Such connections between shadow banking and regulated banking are a key concern for international policy makers, with a trend towards limiting them, rather than increasing them.
- Related to this, there may be significant operational risk and provisioning required to take account of the exposure of the LRCS (and therefore its contributors) to the failures of RMIS. This has Basel compliance implications that are yet to be fully investigated by the banks. Even if LRCS contributions are capped at the individual contributor level, it is conceivable that the fall-out of a crisis could see contributors come under strong pressure to ensure the LRCS is adequately capitalised to cover all unpaid determinations. This liability could have material implications for the capital requirements of banks.

Tier 1 financial products

Financial advice covered by the scheme should be on Tier 1 financial products.[8] These are more complex investment products, which can have the greatest impact on the financial outcomes for a customer.

Compulsion

The LRCS should require all AFS licensees who offer financial product advice to a retail client to be a member and contribute to the LRCS. The LRCS should be mandatory. Compulsion should be underpinned by a legislative or regulatory requirement, and the operation of the LRCS itself should be industry based.[9]

[8] As defined in ASIC RG146, http://download.asic.gov.au/media/1240766/rg146-published-26-september-2012.pdf

[9] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the LRCS.

Jurisdiction

The LRCS should pay compensation in respect of unpaid determinations of ASIC-approved EDR schemes.[10] The size of disputes and quantum of compensation awards considered by the LRCS should align with, or be no greater than, EDR jurisdictional limits.

In principle, the LRCS should be designed to avoid distortions. This would lend to the LRCS being able to pay claims in respect of unpaid court awards. However, we do not support including court awards as:

- The number of potentially impacted customers is estimated to be small, yet will require complex rules to cater for them, compromising simplicity
- The exposure is hard to quantify and may compromise the quality of financial modelling and ultimately the success of the LRCS
- The LRCS may be opened up to unpaid class action awards, which are based on claims that would not otherwise go through EDR.

Structure, governance and processes

The structure of the LRCS should be developed through flexible, industry based processes, with appropriate legislative underpinning to ensure all financial advisers contribute to the LRCS. A largely industry based process will ensure the LRCS can be established in a timely way, and to enable flexibility to adjust its remit, terms of reference and processes over time.

The governance arrangements should include:

- A board, with representation including an independent chair, a legal expert and an equal number of industry and consumer representatives
- A claims management / assessment panel, and
- Sufficient resources to respond to claims as they arise, but not to operate on a full time basis or have remit for additional works.

The LRCS should have discretion to review cases to ensure they fit within the LRCS's scope and terms of reference (which may differ from the EDR scheme) but should not have discretion to review the merits of the claim or reduce the amount of compensation awarded by the EDR.

The establishment of the LRCS should be mindful of the overall findings about the EDR system, and appropriately fit together with an improved EDR framework.

If the EDR framework moves to one ASIC approved EDR scheme, we support further investigating the EDR scheme providing the administrative services for the LRCS and collecting funding levies. Suitable arrangements can be developed to manage any actual or perceived conflicts of interest.

Funding

Levies

Broadly, the ABA supports the levy structure proposed by the FOS[11] comprising:

- A prefunded establishment levy, based on borrowings from industry
- Prefunded management levies to support the operation of the LRCS and repay establishment levies, and
- Prefunded compensation levies.

[10] Approved in accordance with the Corporations Regulations and ASIC Regulatory Guide 139: *Approval and oversight of external dispute resolution schemes*.

[11] Updated Proposal to Establish a Financial Services Compensation Scheme, FOS, May 2015

There should be certainty as to the amount of annual levies, with provisions made to 'smooth' payments from the LRCS in the event of a major failure or large scale losses that exceed reserves, including proportionally reducing compensation and staggering distributions overtime.

The LRCS terms of reference and remit of the board should require regular review and indexation of levies, taking account of historical claims data and forward projections, to ensure the LRCS remains suitably capitalised.

We do not support industry being required to provide uncertain and uncapped post event funding to 'top up' the LRCS if the reserves are exhausted. This introduces uncertainty for all contributors (from small businesses to large institutions) and could have capital implications for banks. In the event LRCS reserves are exhausted, an additional formal process should be undertaken to prospectively review levies to ensure they are adequate going forward. Provisions should also be made to manage excess funds as they accumulate.

Calculation

Funding contributions will need to be calculated, taking into account different advice models, such as general advice representative models, product manufacturers that provide financial advice, and robo-advice businesses.

Two options could be considered.

1) Contributions should be appropriately risk weighted, taking into account:
    - The risk profile of the operating model
    - The scope of the licensee's PI insurance (exclusions), and
    - Other risk management arrangements put in place by the licensee.
2) Contributions are calculated on a per adviser / licensee basis, similar to the ASIC industry funding model, noting that the amounts will be different to that model.

Ideally, the funding calculation should encourage best practice risk management by financial advisers. For example, funding calculations could assess the risk of the financial adviser's business model or look at specific measures, such as the adequacy of compensation arrangements. However, there will be complexity and cost in designing and applying a risk based calculation. Using PI premiums as a proxy will not suit all business models and may unfairly disadvantage some financial advisers whose premiums are higher due to factors other than the risk profile of their business.

More investigation is required to determine whether the benefits may be outweighed by the cost and complexity of a risk weighted system.

Intersection with other professional and risk management structures

The introduction of a scheme should work in an integrated way with other regulatory, professional and risk management structures, so as to actively encourage improved practice and professionalism at the level of individual advisers and practices.

Specifically, the scheme should be designed to complement intersecting regulatory regimes that strengthen consumer protection, including the possible approval of a professional standards scheme (limiting liability) that would then bring regulatory assistance under Professional Standards Legislation, or from a commercial perspective, the possible creation of discretionary mutual funds by groups of market participants that might bring certainty to compensation for advice based consumer losses. One complementary measure would be to provide a discount on levies for participants in a regulated professional standards scheme or contributors to an approved discretionary mutual fund.

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15 March 2017

Professor Ian Ramsay
Chair, Independent Expert Panel
c/o EDR Review Secretariat
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email: EDRreview@treasury.gov.au

Dear Professor Ramsay

Review of financial system's external dispute resolution and complaints framework – supplementary response to Interim Report

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide additional comments to the Independent Expert Panel's review of the financial system external dispute resolution framework (Review)[1] following the consultation roundtables convened Wednesday 15 March.

This letter is in addition to our response to the Interim Report dated 1 February 2017, the ABAs response to the issues paper dated 10 October 2016, and our supplementary response on the design features of a last resort compensation scheme, dated 14 November 2016.

With the active participation of 25 member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community, to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

Recommendations of the small business and family enterprise ombudsman

We refer to the Panel's confirmation at the roundtables that it will expressly consider recommendations 11 and 13 of the Small Business Loans Inquiry Report by the Small Business and Family Enterprise Ombudsman. We have set out specific comments on those recommendations below.

Recommendation 11

11) The banking industry must fund an external dispute resolution one-stop-shop with a dedicated small business unit that has appropriate expertise to resolve disputes relating to a credit facility limit up to $5 million.

The EDR process should be simple and easy for customers to access, navigate and understand. A revised EDR framework, which the banking industry supports, should include an integrated single ombudsman for financial and credit disputes (other than claims within the terms of reference on the Superannuation Complaints Tribunal or a future Superannuation Ombudsman).

That integrated, single ombudsman, which will be funded by levies on members, should provide an experience that is closer to a 'one stop shop'.

[1] https://consult.treasury.gov.au/financial-system-division/dispute-resolution/

To further improve access, The ABA supports broadening access to EDR by small business through the following jurisdictional limits:

- Small businesses should be able to bring credit disputes up to the value of $1 million
- The EDR scheme should be able to make awards in relation to credit disputes up to $1 million, and
- The credit facility limit should be $3 million and the business otherwise meets the definition of a 'small business'.

A $3 million lending threshold will capture a very high percentage of small businesses, with one major bank estimating a $3 million total facility limit would include 98% of the total number of all their business customers (including institutional customers).

Businesses with lending above $3 million tend to be larger and more sophisticated businesses, with more complex lending arrangements and the ability to access legal advice, and the court system if necessary, to resolve disputes.

The ABA notes that only Australian Financial Services (**AFS**) licensees, unlicensed product issuers, unlicensed secondary sellers, Australian credit licensees and credit representatives are required to participate in an EDR scheme. Some commercial credit providers, who lend to small businesses but do not provide consumer credit, are currently not required to be members of an EDR scheme. Consequently, where a small business borrower is unable to resolve a dispute with a credit provider who is not a member of an EDR scheme they have no alternative but to take the matter to court which, for many small businesses, will be prohibitively expensive.

We suggest that the Panel consider options to ensure small businesses have access to an EDR scheme in respect of all financial services they receive. This would ensure the EDR scheme provides a true 'one-stop-shop' service to small business customers and a genuine alternative to the courts.[2]

However, we do not believe it is necessary to extend the national consumer credit protection (**NCCP**) law to small business for this purpose as the needs and requirements of small business borrowers differ from individual customers. Rather, we suggest that the Panel review other options for expanding EDR membership requirements to ensure that all credit providers providing services to small business customers are required to be members of an EDR scheme.

Alternatively, the Panel could consider increased disclosure requirements to give greater prominence to the fact EDR is not currently available with loans from particular lenders.

Recommendation 13

13) External dispute resolution schemes must be expanded to include disputes with third parties that have been appointed by the bank, such as valuers, investigating accountants and receivers, and to borrowers who have previously undertaken farm debt mediation.

Third parties

The ABA has a number of concerns about this recommendation.

Firstly, it is not clear how compulsory participation in an EDR process for third parties might be achieved or what the benefits would be. Currently FOS' powers to compel participation in the FOS process are based on a contractual agreement between FOS and its members, driven by obligations set out in the *Corporations Act* and *National Consumer Credit Protection Act*. Further clarification is

[2] We note that the majority of members support non ACL lenders being members of an EDR scheme, some members have policy concerns about this approach to improving EDR access for small business.

required as to how valuers, investigating accountants and receivers will be compelled to be an EDR member.

Banks would have significant concerns about the principle and practicality of requirements being placed on banks to ensure the participation of those entities in the EDR process, or assuming liability where an EDR determination is made against the third party.

Secondly, valuers, investigative accountants and receivers are contracted to provide an expert and independent opinion to a bank, based on specific subject matter expertise and methodologies. It is not clear what criteria an EDR scheme would use to assess or re-evaluate a professional opinion provided on a point-in-time basis. The EDR scheme would require a qualified expert to reassess the information retrospective basis.

Thirdly, if independent expert opinions were subject to scrutiny through an EDR process, it is likely that the cost and complexity of providing the opinions will increase. Further, banks would not want to see a matter resolved with a customer only to have the customer seek to revisit the issue by lodging a dispute against third party. In the EDR environment, where access is free for consumers, there is little deterrent for consumers to seek to lodge disputes against as many parties as possible.

Finally, these third parties are professional advisers and are subject to separate legal and professional obligations in their own right. They are bound by the ethical and professional standards requirements of their own professional bodies, e.g. the Australian Property Institute, Australian Restructuring, Insolvency and Turnaround Association, Institute of Chartered Accountants Australia, CPA Australia. In addition, receivers and insolvency practitioners are also bound by specific provisions of the *Corporations Act* and are regulated by ASIC.

Farm debt mediation

The ABA supports a nationally consistent approach to farm debt mediation (FDM). FDM is a specialised EDR process, tailored to deal with the nature and complexity of farm debt disputes. Where a farmer has been through the FDM process and reached an agreement with their bank in relation to a facility, allowing subsequent complaints to FOS about the same facility will undermine any agreement reached during the FDM process and prolong the ultimate resolution of the farmer's concerns.

The ABA believes that customers should only get access to one EDR process. We recommend instead that farmers should be given the option to make an informed decision about which dispute resolution form they wish to access.

Integration of ombudsman schemes for financial and credit disputes

Simple, accessible and effective EDR plays a valuable role in enabling retail and small business customers (together, 'customers') to bring and resolve disputes with financial services providers.

The ABA believes that EDR offers an important and accessible alternative to the court system as it is free for customers to access, does not require formal legal representation, and resolves disputes in a less adversarial way than the court system.

The ABA supports moving to one industry ombudsman scheme for financial product and credit disputes. The advantages of one integrated scheme include simplicity for consumers and the ability to rationalise one aspect of the complex regulatory and co regulatory framework that sits around financial and credit services.

We encourage the Panel to consider an integration mechanism that prioritises efficiency and manages costs, in particular to manage the impact on fees for small business EDR members, such as financial planners and mortgage brokers.

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Standardised IDR Reporting

The ABA supports, in principle, the recommendation for FSPs to publish information and report to ASIC on their IDR activity and the outcomes customers receive in relation to IDR complaints.

We suggest that the design of any further reporting obligations takes into account the recommendations arising from other Government reviews and processes.

We also suggest that that the design of any further reporting obligations takes into account existing reporting obligations (e.g. Code of Banking Practice, General Insurance Code of Practice, etc), and seek to utilise existing reporting for this purpose.

We note that there will be significant complexity and costs to industry in developing systems to provide information in a form determined by ASIC. Given that there is currently no standardised format for IDR reporting, industry will need sufficient time to both consult on any new form and implement any required changes. The form of IDR reporting should be flexible and technology neutral.

If the Panel would like to discuss any of the matters raised in this submission, please contact either myself or Christine Cupitt, Policy Director – Retail Policy on (02) 8298 0416 or christine.cupitt@bankers.asn.au.

Yours sincerely

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- Working with ASIC in expanding its review of remediation programs to cover all types of financial advice and products; and
- Evaluating a last resort compensation scheme and identifying an appropriate model.

In aggregate, these initiatives aim to ensure internal and external programs address customer concerns, make it easier for customers when things go wrong, and increase trust and give people confidence that when things do go wrong, banks will do the right thing.

The ABA believes this Review provides a complementary process to improve the EDR framework so that all the avenues for resolution of customer complaints are operating to the maximum benefit of consumers.

Response to the Interim Report

Our submission sets out high level design principles and proposed design features for a revised EDR and complaints framework for consideration by the Panel.

Specific responses to the recommendations and observations of the Interim Report are set out in Appendix 1, together with responses to the information requests in Appendix 2. Our detailed comments on the design of a last resort compensation scheme (scheme) are included in Appendix 3.

The ABA notes the overlap in the terms of reference between this review and other Government processes and reviews. We advise we have provided comments on EDR jurisdiction for small business credit disputes to the Small Business Loans Inquiry ('Carnell Inquiry') and the Financial Ombudsman Service (**FOS**) through its public consultation process.

Financial services dispute resolution

Simple, accessible and effective EDR plays a valuable role in enabling retail and small business customers (together, 'customers') to bring and resolve disputes with financial services providers (FSPs).

The ABA believes that EDR offers an important and accessible alternative to the court system as it is free for customers to access, does not require formal legal representation, and resolves disputes in a less adversarial way than the court system.

EDR works best in conjunction with effective complaints handling and Internal Dispute Resolution (IDR) programs. IDR programs are an important element of the FSP's overall relationship with its customers and manage a wide variety of complaints, including those that have not resulted in monetary loss. Many customers have their complaints successfully resolved though IDR.

But when EDR is needed to resolve a problem, the system must work as efficiently and quickly as possible to resolve disputes and achieve fair outcomes for customers.

Design principles

The ABA supports an EDR system with the following design principles. The EDR system must have the confidence of all parties; banks and other FSPs and consumers.

Simplicity

The EDR process should be simple and easy for customers to access, navigate and understand.
A revised EDR framework, which the banking industry supports, should have a single or simple path for resolution of disputes. Alternative bodies, processes or legal requirements may be required given the type of customer or nature of the dispute, however, these processes should operate in an integrated way.

Where more than one EDR scheme is in operation, the EDR framework should promote clarity and certainty for consumers by:

- Offering a single or simple path to EDR through an overarching gatekeeper, or ensuring clarity for consumers to be directed on where to access EDR to resolve a dispute.
- Minimising overlaps in terms of reference.
- Enabling more rapid allocation of disputes to the appropriate resolution pathway, ending the transfer of disputes between schemes or forums.
- Standardising regulatory oversight and approval of the operation of the EDR scheme(s).
- Standardising operating policy and process, leading to improved efficiency, and
- Rationalising industry and government funding models and allocation of adequate resources.

Accessibility

The EDR system should be readily accessible. Current arrangements to ensure accessibility for customers should be reinforced and continuously improved to ensure the following design features:

- **Free for consumers***:* EDR should continue to remain free for the customer to access, including retail and small businesses.
- **Remove information asymmetry***:* EDR schemes should continue to make available simple information about their processes, provide information to suit consumers with disabilities or languages other than English, and operate community outreach programs and provide information in community languages. FSPs should continuously improve the way they integrate EDR into their complaints handling policies and procedures, and to let retail and small business customers know about their rights to access EDR at key times[3].
- **Transparency***:* EDR schemes should ensure their communications with FSPs and consumers are clear throughout the process. It is important for all parties to be engaged and kept up-to-date with proceedings, and determinations should be clearly explained to the FSP and the consumer.

Effectiveness

Resolution of disputes through EDR should be fast, allow flexibility, be supported by appropriately skilled and funded resources and ensure satisfactory resolution of disputes for customers.

To enable speedy and satisfactory dispute resolution, a revised EDR framework needs to be designed to ensure the following:

- **Adaptability***:* Able to amend governance structures, revise terms of reference, review operating processes and reallocate resources so that the scheme can continue to evolve and respond to emerging issues.
- **Flexibility***:* Allows for a broad range of negotiated (and imposed) outcomes to individual disputes.
- **Capability***:* Is equipped with appropriate financial resources and organisational capability to resolve disputes with varied and complex features.

[3] The ABA notes that the banking industry commitment to have a Customer Advocate in each bank will provide an avenue for identifying improvements with customer communications about complaints handing and IDR as well as access to EDR. http://www.bankers.asn.au/media/media-releases/media-release-2016/new-voice-for-customers-in-complaints-with-banks

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Design features

Small business disputes

The EDR framework should continue to cater for disputes brought by small businesses.

As well as products created specifically for the small business market, many small businesses use 'retail' financial and credit products, such as general insurance, credit cards and transaction accounts designed for the 'retail market'. These disputes should be heard by the EDR schemes that hear similar disputes brought by retail customers to ensure simplicity and clarity for small businesses on where to go to have their disputes heard and maintain efficiencies.

Expanding the EDR eligibility thresholds and monetary limits for both retail and small business credit disputes, is a way to ensure the EDR Framework remains fit-for-purpose to support small businesses.

Jurisdictional limits and compensation caps

The ABA supports an increase to the eligibility thresholds and monetary limits of EDR schemes to ensure EDR is accessible to customers and that compensation is meaningful, taking account of EDR's mandate to resolve disputes other than those that are more suited to be heard in court.

General jurisdiction

We propose:

- Customers should be able to bring disputes up to the value of $1 million, and
- The EDR scheme should be able to make awards up to $1 million.

Small business credit disputes

We support increasing the eligibility thresholds and monetary limits for small business credit disputes.

That increase should be accompanied by a revised test for small business, to ensure the ongoing efficiency and accessibility of EDR schemes for genuine small businesses and reflect the intention that EDR is an alternative dispute resolution process for small and less complex disputes.

The standing of a small business should be assessed against a clear definition of 'small business' that takes into account:

- The number of employees
- Business turnover
- Size of the loan or investment for business purposes, and
- Total credit exposure of the business group.

The test should be quick and simple to apply, to ensure efficiency and accessibility. We note concerns about introducing new criteria in addition to the number of employees, however we believe that these additional criteria can be identified readily through information held by the FSP and the applicant, at least as easily as identifying the number of employees.

Expanding the criteria beyond the number of employees is critical to ensure the small business test is future proofed in the context of increasing automation and the digital economy, where large businesses can operate with comparatively few staff members.

There are a number of small business tests used for legal and commercial purposes. For the purpose of expanding the EDR small business credit jurisdiction, we propose the following small business test.

A business is not a small business if one of the following conditions is met:

- The number of employees is 20 people or more, or 100 people or more if the business is or includes the manufacture of goods (full-time equivalent)

- Annual business turnover is $5 million or more
- Size of loan for business purposes is $3 million or more, or
- Total credit exposure of the business group, including related entities, to all credit providers is $3-$5 million or more.

A business would not be small if any one of the conditions was satisfied. So, for example, a business with only 19 employees but with an annual turnover of $15 million would not be classified as a small business. In such a case, the court system is better placed to consider the matter.

The revised test for small business should apply together with the following jurisdictional limits:

- Small businesses should be able to bring credit disputes up to the value of $1 million
- The EDR scheme should be able to make awards in relation to credit disputes up to $1 million, and
- The credit facility limit should be $3 million.

Debt recovery proceedings in respect of facilities up to $3 million should be prohibited while a dispute is being considered by FOS.

The rationale for monetary limits on both the size of claim and amount of compensation reflects the intention that EDR is an alternative dispute resolution process for small disputes and customers who do not have the resources to use the court system. This ensures EDR resources, and therefore speedy resolution of claims, are available to those customers who most need them.

Importantly, the quantum of eligibility limits and compensation caps should not expand EDR jurisdiction to very complex and high value business matters, where determinations are binding on the FSP and there is no right of appeal on the substance of the determination.

Farm debt mediation

Farm Debt Mediation (**FDM**) is a specialised mediation process that allows a farmer and their FSP to negotiate a better financial outcome. Mediators are trained to understand the unique and complex circumstances affecting farming operations and agri-business lending.

The ABA believes that FDM should remain separate to the EDR schemes.

We support the implementation of a nationally consistent farm debt mediation model across Australia, and have been working with the Australian Government and agricultural organisations on legislative options. We have also been working with State governments as they look to adopt mandatory models, similar to NSW and Victoria.

Enduring funding for financial counselling services

Financial counsellors are an essential public service. They provide independent and free advice and information to individuals and families during difficult financial and emotional times and help their clients deal with debt problems, including from mainstream financial institutions, other lenders (including payday lenders), and other creditors (including retailers, utilities and telecommunications companies). We recognise the importance of the work financial counsellors do in helping people through incredibly challenging times often due to a change in their circumstances, such as loss of employment or relationship breakdown, or health related issues.

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The ABA supports an enduring model of government funding for financial counselling services to ensure these services continue to make a significant difference for many Australians experiencing financial difficulty and facing other economic and social challenges. It is important for the government to provide funding for financial counsellors' casework. Additionally, we have recently announced an initiative to work with financial counsellors to support the setup of a new debt repayment service to help people manage multiple debts[4]. This initiative aims to achieve better customer outcomes by helping people get control of their finances and debts including from non-bank lenders and creditors.

Consultation and transition

The reforms proposed in the draft recommendations are complex, involve potentially significant legal and regulatory changes and will require significant government and industry effort and resources to put into effect. We support building in sufficient transitional timeframes, particularly in relation to new industry reporting obligations.

Last resort compensation scheme

The ABA supports establishing a mandatory, prospective compensation fund that covers individuals and small businesses who have received poor financial advice, and have not been paid a determination made by an ASIC-approved EDR scheme, due to the validated insolvency or wind up of financial advice businesses, where all other redress avenues have been exhausted.[5]

A detailed analysis of the design features of a last resort compensation scheme is set out in Appendix 3.

Closing remarks

The ABA and our member banks are strongly committed to making sure the EDR system is improved and works well now, and into the future.

The ABA would welcome the opportunity to discuss these issues further with the Panel.

In the meantime, if you have any questions in relation to this submission, please do not hesitate to contact me or Christine Cupitt, Policy Director – Retail Policy on (02) 8298 0416 or christine.cupitt@bankers.asn.au.

Yours sincerely

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[4] http://www.bankers.asn.au/media/media-releases/media-release-2016/we-hear-you-banks-announce-more-changes-to-make-banking-better

[5] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the scheme.

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Appendix 1 – Response to draft recommendations and observations

	Draft recommendation	Industry position
1	**A new industry ombudsman scheme for financial, credit and investment disputes** There should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO.	The ABA supports a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes). The merits of establishing a new body to replace the existing ombudsmen should be weighed against the potential time and cost savings of merging FOS and CIO. Alternatively, a single or simple path to EDR through an overarching gatekeeper, or ensuring clarity for consumers to be directed on where to access EDR to resolve a dispute, should be adopted ('one-stop-shop').
2 / 3	**Consumer monetary limits and compensation caps** The new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation. **Small business monetary limits and compensation caps** The new industry ombudsman scheme for financial, credit and investment disputes should provide small business with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.	The ABA supports increasing monetary limits and compensation caps to ensure appropriate access to EDR by retail and small business customers. *General jurisdiction* We believe: • Retail and small business customers should be able to bring disputes up to the value of $1 million, and • The EDR scheme should be able to make awards up to $1 million. *Small business credit disputes* We believe: • Small businesses should be able to bring credit disputes up to the value of $1 million. • The EDR scheme should be able to make awards in relation to credit disputes up to $1 million. • The credit facility limit should be $3 million. Debt recovery proceedings in respect of facilities up to $3 million should be prohibited while a dispute is being considered by an approved EDR scheme.

	Draft recommendation	Industry position
		A revised small business credit jurisdiction should be accompanied by a revised small business test. Specifically, a business is not a small business if one of the following conditions is met: • The number of employees is 20 people or more, or 100 people or more if the business is or includes the manufacture of good (full-time equivalent); or • Annual business turnover is $5 million or more; or • Size of loan for business purposes is $3 million or more; or • Total credit exposure of the business group, including related entities, to all credit providers is $3-$5 million or more. A business would not be small if any one of the conditions was satisfied. The terms of reference of an ASIC-approved EDR should provide for regular indexation.
4	**A new industry ombudsman scheme for superannuation disputes** SCT should transition into an industry ombudsman scheme for superannuation disputes.	The body of this submission proposes principles in relation to simplicity, accessibility and effectiveness of the new EDR and disputes framework. The EDR framework should promote clarity and certainty for consumers by offering a single or simple path to EDR through an overarching gatekeeper, or ensuring clarity for consumers on where to access EDR to resolve a dispute. We note it will be complex to transition the SCT into an industry ombudsman scheme for superannuation disputes. Complexities include: • Affirming the binding nature of determinations and enforcement mechanisms • Reconciling unlimited compensation caps (under SCT) with the principle of EDR hearing smaller, less complex disputes, and • Unwinding the SCT legislation and making provisions for RSEs to be member of EDR. Government will need to be sufficiently resourced to conduct detailed industry consultation and develop the framework for a new superannuation ombudsman.

	Draft recommendation	Industry position
		Consistent with the principle of simplicity, the terms of reference of any new superannuation ombudsman, should avoid overlapping with the jurisdiction of other ombudsmen to provide certainty for customers and avoid confusion arising through multiple forums.
5	**A superannuation code of practice** The superannuation industry should develop a superannuation code of practice.	The ABA has no comment on this recommendation.
6	**Ensuring schemes are accountable to their users** Both new schemes should be required to meet the standards developed and set by ASIC. At a minimum, ASIC's regulatory guidance should require the schemes to: • Ensure they have sufficient funding and flexible processes to allow them to deal with unforeseen events in the system, such as an increase in complaints following a financial crisis or natural disaster; • Provide an appropriate level of financial transparency to ensure they remain accountable to users and the wider public; • Be subject to more frequent, periodic independent reviews and provide detailed responses in relation to recommendations of independent reviews, including updates on the implementation of actions taken in response to the reviews and a detailed explanation when a recommendation of an independent review is not accepted by the scheme; and • Establish an independent assessor to review the handling of complaints by the scheme but not to review the outcome of individual disputes. In addition, ASIC's regulatory guidance should require the new scheme for financial, credit and investment disputes to regularly review and update its monetary limits and compensation caps so that they remain relevant and fit-for-purpose over time.	The ABA supports, in principle, the recommendations to revise ASIC's *Regulatory Guide 139: Approval and oversight of external dispute resolution schemes* [RG139]. Requirements relating to internal governance, such as independent reviews, should allow sufficient flexibility to target resources to address specific risks or issues, and manage costs. ASIC's standards should maintain the character of EDR schemes, in particular that they are industry based and independent.

	Draft recommendation	Industry position
7	**Increased ASIC oversight of industry ombudsman schemes** ASIC's oversight powers in relation to industry ombudsman schemes should be enhanced by providing ASIC with more specific powers to allow it to compel performance where the schemes do not comply with EDR benchmarks.	The ABA supports, in principle, the recommendation for increased ASIC oversight of industry ombudsman schemes. Any enhanced supervision requirements should maintain the character of EDR schemes, in particular that they are industry based and independent.
8	**Use of panels** The new industry ombudsman schemes should consider the use of panels for resolving complex disputes. Users should be provided with enhanced information regarding under what circumstances the schemes will use a panel to resolve a dispute.	The ABA suggests that the further use of panels, as they are currently comprised, be approached with caution. Flexibility should remain to use panels only in relation to some product types and some dispute types. The EDR should maintain transparent criteria or guidance on when panels will be used. As well as additional costs, members have advised anecdotally that panels can affect the timeliness of EDR decisions, impacting efficiency.
9	**Internal dispute resolution** Financial firms should be required to publish information and report to ASIC on their IDR activity and the outcomes consumers receive in relation to IDR complaints. ASIC should have the power to determine the content and format of IDR reporting.	The ABA supports, in principle, the recommendation for FSPs to publish information and report to ASIC on their IDR activity and the outcomes customers receive in relation to IDR complaints. We suggest that the design of any further reporting obligations take into account the recommendations arising from other Government reviews and processes. We also suggest that that the design of any further reporting obligations take into account existing reporting obligations (e.g. CCMC reporting), and seek to utilise existing reporting for this purpose. We note there will be significant complexity and costs to industry in developing systems to provide information in a form determined by ASIC. Noting that there is currently no standardised format for IDR reporting, industry will need sufficient time to both consult on any new form and implement any required changes.

	Draft recommendation	Industry position
		The ABA is currently working with our member banks on designing a reporting framework associated with the banking reform program, which includes metrics for the dedicated customer advocate. With a particular focus on improving complaint handling and IDR and access to EDR, we encourage this work to be leveraged with any further reporting obligations.
10	**Schemes to monitor IDR** Schemes should register and track the progress of complaints referred back to IDR.	As above, the ABA supports, in principle, the recommendation for improved reporting on IDR activity. We also suggest that the design of any further reporting obligations take into account existing practice, such as current FOS processes, and seek to utilise existing reporting for this purpose. Consultation will be required on how to operationalise any new requirements.
11	**Debt management firms** Debt management firms should be required to be a member of an industry ombudsman scheme. One mechanism to ensure access to EDR is a requirement for debt management firms to be licensed.	The ABA supports the recommendation for debt management firms to be required to be a member of an industry ombudsman scheme. The role of 'for profit financial difficulty companies' (including debt management firms and credit repair agencies) should be examined to ensure consumers are appropriately represented and protected, including in their representations with EDR schemes but also more broadly. A decision to license debt management firms should be based on a detailed assessment of the benefits to consumers and the proposed detail of the licensing regime. EDR membership may be one outcome of licensing, but should not be the determining driver. Other factors including the benefits and costs of regulation and improved consumer protection should be given close consideration. We would support a review considering licensing for debt management firms, but also suggest the Panel consider other options, at least in the first instance, to require debt management firms to become members of an ASIC-approved EDR scheme.

Appendix 2 – Response to information requests

	Information requests (Members to review and provide written feedback)	Industry response
5.74	Should the national consumer credit protection law be extended to small businesses?	*Improving EDR access for small business* The ABA supports small business customers having appropriate access to EDR. We suggest that the Panel consider all options, to ensure such access, including the merits of requiring non ACL lenders to become members of an ASIC-approved EDR scheme.[6] However, improved access to EDR for small business customers could be achieved without extending the national consumer credit protection (NCCP) law to small business. We support strong competition in the lending market and note that many small businesses are currently well serviced by ACL lenders including banks, credit unions and building societies and a number of equipment leasing and financing businesses. Small businesses may also choose to obtain credit through a non ACL lender. The Panel could also consider requirements to give greater prominence to the fact EDR is not currently available with loans from particular lenders. *Extending NCCP to small business* There are existing consumer protections available to small businesses, including unfair contract term (UCT) protections for small businesses, requirements of the *ASIC Act* and industry standards, including the provisions of the Code of Banking Practice (COBP). Many banks extend some aspect of NCCP to small business customers, such as including the approach to hardship and access to dispute resolution. Any decision to modify the framework for small businesses should identify where concerns or gaps exist and consider specific regulatory responses to address those concerns or gaps. The direct application of retail responsible lending obligations to small businesses would be inappropriate, as it would not take into account the inherently different nature of business lending. In particular, the serviceability assessment, loan suitability and income verification processes each operate differently between retail and small business lending.

[6] We note that the majority of members support non ACL lenders being members of an EDR scheme, some members have policy concerns about this approach to improving EDR access for small business.

	Information requests (Members to review and provide written feedback)	Industry response
		Any decision to extend NCCP to small business should take account of the impact of the complete NCCP framework, including: • Application of responsible lending criteria • More detailed regulated disclosures and documentation • Special provisions for managing loans and the relationship with the creditor (e.g. enforcement, collection and dispute resolution), and • Licensing and regulatory oversight. The decision would also need to weigh up any new consumer protection benefits, against the significant implementation and ongoing compliance costs of extending the regime. Importantly, the NCCP regime was developed to protect the interests of consumers, when obtaining credit for domestic purposes; applying NCCP to small business could trigger significant unintended consequences in relation to the cost and availability of credit to small business. In particular, the responsible lending obligations under NCCP may not be appropriate measures for lending to small businesses. For example, the responsible lending obligations require collection of individuals' income and living expenses as a minimum step for consumer lending, and may not be relevant for small business lending. Furthermore, responsible lending obligations require the assessment and verification of income, which can be challenging from a practical perspective and even irrelevant for start-up businesses or newer small businesses which may require capital for expansion. *Example - Role of security in business lending* In business lending, financial assessment for lending to a newly established business (ie start-ups) is generally based largely on the strength of guarantees and security provided by the founders of such business (ie directors giving a person guarantee and security over their real property). Under the NCCP Act, the value of security is not sufficient for the suitability assessment of a loan and the assessment needs to be based at some point on income (which may be negligible for some time).

	Information requests (Members to review and provide written feedback)	Industry response
		Application of these rules would severely restrict the ability of the banks to lend to start ups and increase the prevalence of unregulated lenders.
5.152	Should schemes be provided with additional powers and, if so, what additional powers should be provided? How should any change in powers be implemented?	The ABA believes that new powers to compel documents should be approached with caution, having regard to existing duties of confidentiality, privacy laws and other influencing factors, such as confidentiality in situations of financial abuse (elder abuse, family violence). However, we are supportive of the Panel investigating powers consistent with the SCT and UK FOS. In relation to compensation, we believe EDR is a forum to obtain compensation for losses. Consistent with the purpose of EDR, it is not a forum for the award of punitive damages or imposing quasi fines.
5.171	Does EDR scheme membership by credit representatives provide an additional or necessary layer of consumer protection that is not already met through the credit licensee's membership?	The ABA does not believe individual EDR membership by ACRs is necessary for consumer protection. We believe the model should align with the AFS licensing regime, which requires only the AFSL to be a member.
6.22	What should be the monetary limits and compensation caps for the new scheme? Should they be different for small business disputes? What principles should guide the levels at which the monetary limits and compensation caps are set? What indexation arrangements should apply to ensure the monetary limits and compensation caps remain fit-for-purpose?	Our position on eligibility thresholds and compensation caps is set out in the body of our submission (pp4-5). For disputes other than small business credit disputes, the eligibility thresholds and compensation caps should be the same for retail and small business customers. The rationale for monetary limits on both eligibility thresholds and amounts of compensation caps should reflect the intention that EDR is an alternative dispute resolution process for small disputes. The EDR scheme terms of reference should provide for regular indexation of eligibility thresholds and compensation caps against CPI. Semi-regular indexation should also be completed, having regard to factors such as average mortgage size, interest rates, average super balance, etc.
6.66	On what matters should ASIC have the power to give directions? For example, should ASIC be able to give directions in relation to governance and funding arrangements and monetary limits?	The ABA has no comment on this recommendation.

	Information requests (Members to review and provide written feedback)	Industry response
6.76	What IDR metrics should financial firms be required to report on? Should ASIC publish details of non-compliance or poor performance IDR, including identifying financial firms?	As noted above, the ABA supports, in principle, the recommendation for improved reporting on IDR activity. The design of the improved reporting should take into account: • Existing practices, such as FOS benchmarking and CCMC reporting • Current variations in the implementation of RG165 and interpretations of 'complaint' • Metrics that take into account the business context and the size of the business (number of customers, volume of transactions etc.) such a percentages, rather than raw volumes; and • Appropriate implementation timeframes given practical and technology (systems) constraints.

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Appendix 3 – Last Resort Compensation Scheme

The ABA[7] supports establishing a mandatory, prospective compensation fund that covers individuals and small businesses (together 'customers') who have received poor financial advice, and have not been paid a determination made by an ASIC-approved EDR scheme due to the validated insolvency or wind up financial advice businesses, where all other redress avenues have been exhausted (LRCS).

Basis for the banking industry's support for a LRCS

The ABA's support for a LRCS is part of our strong support for the overall reform program to improve the quality of financial advice and rebuild consumer trust and confidence in financial advisers and through that, the financial services industry, more generally.

The ABA believes a LRCS represents the final element of a significant reform program already underway to professionalise the financial advice industry, including implementation of the Future of Financial Advice (**FOFA**) reforms and higher professional, ethical and education standards.

Establishing a LRCS covering financial advice is an important part of financial advisers forming a profession and access to the LRCS is a benefit arising from seeking advice from an authorised financial adviser.

The ABA accepts that risks arise in relation to establishing a LRCS, including potential moral hazard, and possible distortions in government and regulator behaviour. We also accept that other steps should be taken to manage the risk of unpaid determinations in relation to financial advisers.

While accepting these arguments, we believe they are outweighed by the industry's support for the professionalisation of financial advice and the need to rebuild consumer trust and confidence in financial advice.

Other initiatives to manage risk for consumers

The ABA believes that managing the risk to consumers of unpaid determinations requires a multifaceted response. The introduction of a LRCS must be accompanied by other measures and reforms to reduce the likelihood of unpaid EDR determinations, both to ensure the LRCS is truly a last resort, and promote the long term viability and success of a LRCS.

An assessment of the root cause of unpaid determinations should consider what complementary risk management measures are required. Such initiatives should improve conduct in financial services, and ensure FSPs are accountable for meeting financial requirements and maintaining adequate compensation arrangements.

The ABA's support for a LRCS is based on a number of risk management measures and reforms intended to improve the regulatory framework. We consider these measures are essential to the proper introduction and functioning of a LRCS.

Some of the complementary measures will also be advocated by the ABA through the ASIC Enforcement Review.

Professionalisation of financial advice

The new legislative framework to raise education, ethical and professional standards for financial advisers should be introduced as an important underpinning of ethical behaviour across the financial services sector. Access to a LRCS, is an important feature of the professionalisation of financial advice and is intended to complement these broader reforms.

[7] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the LRCS.

Professional indemnity insurance

Industry should work with professional indemnity (**PI**) insurers to examine improving the cost, availability and coverage of PI insurance, including mandatory run-off cover for licensees, and responses to insolvency, fraud and other misconduct. Industry should introduce additional financial planner education in relation to the duty of disclosure, notification and settlement requirements, and the effect of replacing policies.

Regulation and regulatory activities

ASIC should require an annual assurance statement from all AFS licensees that they meet their licence obligations, including compliance with ASIC's *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees* [RG126]. ASIC should review the compensation requirements under RG126 to ensure they remain fit-for-purpose.

ASIC should also review the financial requirements for financial advice licensees under *Regulatory Guide 166: Licensing: Financial requirements* [RG 166], to consider whether capital requirements for AFSLs with a financial advice authorisation remain sufficient. Sufficient resources to compensate clients and meet any insurance deductible payments should form part of the resources required for an orderly wind down of a financial advisory business.

AFS licensing criteria

The past conduct of a person as a manager of a financial services business, including whether that business had unpaid EDR determinations, should be part of ASIC's AFS licensing and credit licensing assessment.

Appropriate enforcement powers for ASIC

Establishing the LRCS should be accompanied by additional provisions to:

- Publish the details of licensees that do not comply
- Give appropriate powers for ASIC to take enforcement action against persons responsible for the licensee's failure to comply (this may extend beyond the adviser to directors / managers in certain circumstances)
- Stop non-complying licensees from operating, and
- Prevent those persons from establishing a new financial services or credit assistance business.

Appropriate enforcement powers for ASIC should specifically address the risk of licensees winding up their businesses with the intention of avoiding paying an EDR determination.

Design process, resources and consultation

The design process for a LRCS will be necessarily complex, involve a large number of stakeholders from across industry and government, and will need to be based on detailed financial modelling and sound public policy.

We suggest that any observations or recommendations in relation to a LRCS should include sufficient timeframes and allocation of government resources to drive the right outcomes and ensure the success and long term viability of a LRCS.

Design principles

Consumer focus

The ABA believes that consumers should have a clear understanding of the intent of the LRCS, particularly regarding the type of claims the LRCS will consider and the circumstances in which the LRCS will respond. The purpose of the LRCS should be well communicated to consumers, so it is clear that the LRCS is not intended to cover market-linked investment losses.

The LRCS should provide a meaningful solution for customers, provide certainty with clear terms of reference, and avoid overly legalistic interpretations of financial advice services that exclude some customers without a clear policy basis.

Last resort

The LRCS should operate as a last resort to compensate customers who have received poor financial advice, and have not been paid a determination made by an ASIC-approved EDR scheme due to the validated insolvency or wind up of the financial advice businesses, where all other redress avenues have been exhausted.

Generally, we would expect that a customer would resort to the financial adviser (and through the financial adviser the PI insurer), the financial resources of the financial adviser, and to have explored legal enforcement options. Evidence will be required (possibly from a registered liquidator or administrator) that the assets of the financial advice business will not cover the determination.

Prospectiveness

The LRCS should be prospective, with the design process considering the timing of the effective date of the LRCS and appropriate event and cut-off dates for claims, to minimise distortions in consumer and financial adviser behaviour.

A prospective LRCS aligns with other improvements to consumer capability and decision making about financial advice, such as financial capability initiatives from banks and regulatory initiatives such as ASIC's financial advice tool kit.

We do not support the LRCS covering unpaid determinations made before the effective date, including the current unpaid FOS determinations. These determinations are the result of a combination of regulatory and conduct failures which are being addressed through the new professional standards framework and not a direct result of the absence of a last resort compensation scheme.

Simplicity

The design and scope of the LRCS should be simple, to avoid complicated and costly eligibility assessments and promote consumer understanding for the place of the scheme. Assessment based on defined licence conditions and defined classes of financial products should be preferred. This will also enable targeted used of regulated disclosures to explain the availability and role of the LRCS to customers.

The LRCS should also be designed, to the extent possible, to minimise distortions in consumer, adviser and regulator behaviour.

It should also be designed to complement other professional and risk management structures such as a professional scheme for limited liability or maintaining alternative, approved compensation arrangements.

Design features

Scope

The LRCS should cover failures that arise in the context of a relationship where personal advice on Tier 1 products, and / or general advice on Tier 1 products is provided to retail customers. The failure could relate to *Corporations Act* breaches, fraud, negligence, misrepresentation and administrative errors connected with the advice relationship. For example, losses arising from failure by the financial adviser to implement the financial advice where the client clearly instructs their adviser to do so.

The LRCS should cover general advice provided by financial advisers, product manufacturers and robo-advisers, as well as personal advice to avoid market distortions and take account of the low level of consumer understanding of the difference between personal and general advice. The LRCS is not intended to cover retail bank staff providing retail banking services.

The LRCS should not cover businesses that only provide dealing or arranging services, such as securities dealers or derivatives dealers, nor should it cover research houses that publish reports containing general advice.

Addressing the biggest risk of unpaid determinations

Advice and investments determinations represent the largest proportion of unpaid determinations. As at October 2016, the top categories of non-compliant FSPs are:

- Financial planners and advisors: 57%
- Operators of Managed Investment Schemes: 11%
- Credit providers: 9%

Additionally, FSPs categorised as Investment and Advice have the lowest determination compliance rate. Unpaid determinations represent more than 18% of all Investments and Advice determinations, whereas overall compliance with FOS determinations is 99.974%. The value of unpaid determinations is almost one-quarter (23%) of the compensation awarded by Investments and Advice.

Simplicity

The scope of financial advice has a clear policy basis, and place in the professional standards framework for financial advisers. We believe that consumers will understand the scope and have certainty if the scheme covers financial advice failures.

Addressing a broader scope of services will involve a broader range of stakeholders, more complexity and may reduce the prospects of the LRCS's success. Where consumer protection issues arise in relation to these other services, other reforms should be considered first to address poor conduct and risk for consumers, rather than extending the LRCS scope as a first move.

Dealing and arranging services and research houses

We note the support from some stakeholders to include research houses and businesses that provide dealing and arranging services, without financial product advice, such as such as securities dealers or derivatives dealers. We do not support the inclusion of research houses nor dealing / arranging businesses as that would be inconsistent with our view that the LRCS is an important part of financial advisers forming a profession and access to the LRCS is a benefit arising from seeking advice from an authorised financial adviser.

Registered Managed Investment Schemes

The ABA notes the support from some stakeholders for including registered managed investment schemes (**RMIS**) in the LRCS, and pooling contributions and risk, across financial advice and RMIS. We note the argument that this would require contributions across the 'value chain' and increase the accountability of RMIS operators.

However, we do not support the inclusion of RMIS in the LRCS for the following reasons:

- Inclusion of RMIS is not part of an integrated reform program to improve RMIS. We note recent activity to increase the financial requirements for RMIS and ASIC's recent consultation on risk management practices of responsible entities however the risk of RMIS is primarily based on economic factors, not behavioural ones.
- Advice-based investor harm arises due to behavioural failures and these risks are being mitigated through the professionalisation of financial advice. In contrast, the financial risks arising from RMIS are fundamentally different from advice-based financial harm and are likely to grow with the rise of non-bank financial activity utilising RMIS (for example, peer-to-peer lending). These risks are largely related to the investment models of RMIS and are difficult to mitigate.
- We do not think the exclusion of claims based on investment performance would be sufficient to manage such risks to the LRCS as many claims could be based on maladministration (which is easy to plead).
- The risk profiles of RMIS vary significantly. RMIS can include Australian index funds, international share funds, commercial property finds and agricultural ventures. We believe that a risk weighted contribution model should apply to these schemes, and note that this would involve significant complexity and time to design. This would significantly hamper the introduction of a LRCS in the immediate term.
- Inclusion of RMIS could introduce a new connection between prudentially regulated banks and the investment and shadow banking sector. This could pose a systemic risk to depositors as the LRCS could transmit losses from non-prudentially regulated activities (eg a property downturn during a crisis) to banks. Such connections between shadow banking and regulated banking are a key concern for international policy makers, with a trend towards limiting them, rather than increasing them.
- Related to this, there may be significant operational risk and provisioning required to take account of the exposure of the LRCS (and therefore its contributors) to the failures of RMIS. This has Basel compliance implications that are yet to be fully investigated by the banks. Even if LRCS contributions are capped at the individual contributor level, it is conceivable that the fall-out of a crisis could see contributors come under strong pressure to ensure the LRCS is adequately capitalised to cover all unpaid determinations. This liability could have material implications for the capital requirements of banks.

Tier 1 financial products

Financial advice covered by the scheme should be on Tier 1 financial products.[8] These are more complex investment products, which can have the greatest impact on the financial outcomes for a customer.

Compulsion

The LRCS should require all AFS licensees who offer financial product advice to a retail client to be a member and contribute to the LRCS. The LRCS should be mandatory. Compulsion should be underpinned by a legislative or regulatory requirement, and the operation of the LRCS itself should be industry based.[9]

[8] As defined in ASIC RG146, http://download.asic.gov.au/media/1240766/rg146-published-26-september-2012.pdf

[9] The ABA notes that one member bank holds the view that only AFS licensees that are judged not to be able to meet claims from their own financial resources should fund the LRCS.

Jurisdiction

The LRCS should pay compensation in respect of unpaid determinations of ASIC-approved EDR schemes.[10] The size of disputes and quantum of compensation awards considered by the LRCS should align with, or be no greater than, EDR jurisdictional limits.

In principle, the LRCS should be designed to avoid distortions. This would lend to the LRCS being able to pay claims in respect of unpaid court awards. However, we do not support including court awards as:

- The number of potentially impacted customers is estimated to be small, yet will require complex rules to cater for them, compromising simplicity
- The exposure is hard to quantify and may compromise the quality of financial modelling and ultimately the success of the LRCS
- The LRCS may be opened up to unpaid class action awards, which are based on claims that would not otherwise go through EDR.

Structure, governance and processes

The structure of the LRCS should be developed through flexible, industry based processes, with appropriate legislative underpinning to ensure all financial advisers contribute to the LRCS. A largely industry based process will ensure the LRCS can be established in a timely way, and to enable flexibility to adjust its remit, terms of reference and processes over time.

The governance arrangements should include:

- A board, with representation including an independent chair, a legal expert and an equal number of industry and consumer representatives
- A claims management / assessment panel, and
- Sufficient resources to respond to claims as they arise, but not to operate on a full time basis or have remit for additional works.

The LRCS should have discretion to review cases to ensure they fit within the LRCS's scope and terms of reference (which may differ from the EDR scheme) but should not have discretion to review the merits of the claim or reduce the amount of compensation awarded by the EDR.

The establishment of the LRCS should be mindful of the overall findings about the EDR system, and appropriately fit together with an improved EDR framework.

If the EDR framework moves to one ASIC approved EDR scheme, we support further investigating the EDR scheme providing the administrative services for the LRCS and collecting funding levies. Suitable arrangements can be developed to manage any actual or perceived conflicts of interest.

Funding

Levies

Broadly, the ABA supports the levy structure proposed by the FOS[11] comprising:

- A prefunded establishment levy, based on borrowings from industry
- Prefunded management levies to support the operation of the LRCS and repay establishment levies, and
- Prefunded compensation levies.

[10] Approved in accordance with the Corporations Regulations and ASIC Regulatory Guide 139: *Approval and oversight of external dispute resolution schemes*.

[11] Updated Proposal to Establish a Financial Services Compensation Scheme, FOS, May 2015

There should be certainty as to the amount of annual levies, with provisions made to 'smooth' payments from the LRCS in the event of a major failure or large scale losses that exceed reserves, including proportionally reducing compensation and staggering distributions overtime.

The LRCS terms of reference and remit of the board should require regular review and indexation of levies, taking account of historical claims data and forward projections, to ensure the LRCS remains suitably capitalised.

We do not support industry being required to provide uncertain and uncapped post event funding to 'top up' the LRCS if the reserves are exhausted. This introduces uncertainty for all contributors (from small businesses to large institutions) and could have capital implications for banks. In the event LRCS reserves are exhausted, an additional formal process should be undertaken to prospectively review levies to ensure they are adequate going forward. Provisions should also be made to manage excess funds as they accumulate.

Calculation

Funding contributions will need to be calculated, taking into account different advice models, such as general advice representative models, product manufacturers that provide financial advice, and robo-advice businesses.

Two options could be considered.

1) Contributions should be appropriately risk weighted, taking into account:
    - The risk profile of the operating model
    - The scope of the licensee's PI insurance (exclusions), and
    - Other risk management arrangements put in place by the licensee.
2) Contributions are calculated on a per adviser / licensee basis, similar to the ASIC industry funding model, noting that the amounts will be different to that model.

Ideally, the funding calculation should encourage best practice risk management by financial advisers. For example, funding calculations could assess the risk of the financial adviser's business model or look at specific measures, such as the adequacy of compensation arrangements. However, there will be complexity and cost in designing and applying a risk based calculation. Using PI premiums as a proxy will not suit all business models and may unfairly disadvantage some financial advisers whose premiums are higher due to factors other than the risk profile of their business.

More investigation is required to determine whether the benefits may be outweighed by the cost and complexity of a risk weighted system.

Intersection with other professional and risk management structures

The introduction of a scheme should work in an integrated way with other regulatory, professional and risk management structures, so as to actively encourage improved practice and professionalism at the level of individual advisers and practices.

Specifically, the scheme should be designed to complement intersecting regulatory regimes that strengthen consumer protection, including the possible approval of a professional standards scheme (limiting liability) that would then bring regulatory assistance under Professional Standards Legislation, or from a commercial perspective, the possible creation of discretionary mutual funds by groups of market participants that might bring certainty to compensation for advice based consumer losses. One complementary measure would be to provide a discount on levies for participants in a regulated professional standards scheme or contributors to an approved discretionary mutual fund.