



## **Senate Economics Legislation Committee ('the Committee')**

### **Inquiry into the Treasury Laws Amendment (Putting Consumers First – Establishment of the Australia Financial Complaints Authority) Bill 2017 ('the Bill')**

#### **Submission by Credit Corp Group Limited ('Credit Corp')**

**29 September 2017**

#### **Executive Summary**

The review and consultation process undertaken to formulate the Bill has been flawed. The Committee can take no comfort in the fact that the Bill was recommended by an independent expert panel (Ramsay Panel) or that it may only receive a limited number of industry submissions critical of the Bill. The process to date has been designed to ignore and exhaust all industry opposition.

In its present form the Bill will promote an inefficient and uncompetitive financial system which has the potential to reduce the living standards of all Australians and damage economic growth by compromising the ability of the financial system to meet the needs of its users.

The Bill subjects all financial services providers, other than those in the superannuation industry, to uncertain and unpredictable decision-making by an unaccountable single private body.

Uncertainty in decision-making by the proposed Australian Financial Complaints Authority ('AFCA') will serve to increase compliance costs and inhibit product and service delivery innovation as operators attempt to deal with uncertain and unpredictable compliance requirements.

The proposed AFCA will be an unaccountable monopoly provider which, in the absence of external controls, will impose excessive costs on financial services providers.

Uncertain decision-making and the imposition of excessive monopoly-provider costs will damage competition in the market for financial services. In particular, smaller and more innovative financial services businesses which do not enjoy the benefits of scale, incumbency and government support will be least able to absorb costs and limitations associated with uncertainty. AFCA will enhance the market power of major incumbents and decrease competition in the market for financial services.

To address these substantial shortcomings Credit Corp recommends the following amendments to the Bill:

1. Decisions for all complaints, not just superannuation complaints, should be in conformance with the law

2. Legislated governance controls should be imposed to ensure accountability for costs and a competitive financial services market, including:

- Election of separate industry directors for each industry segment to ensure the representation of smaller financial services businesses.
- Financial and remuneration disclosure in accordance with that applicable to listed public companies.
- Detailed disclosure of expenses, particularly expenses not directly related to the resolution of complaints, including marketing, promotion, outreach and sponsorships.
- Annual company member voting on the financial statements and the remuneration report, with a 75% majority requirement and provision for a board spill motion in the event of two successive failures to achieve such a majority.

## **Company Profile**

Credit Corp is Australia's largest provider of sustainable financial services to the credit impaired consumer segment. The company has been listed on the Australian Securities Exchange since 2000 and forms part of the S&P ASX 200. Credit Corp employs 1,000 Australians and the face value of its total receivables is \$6 billion across 850,000 consumers.

Credit Corp has a proven track record of promoting financial inclusion.

In our core business of debt purchasing we work with consumers who have, for various reasons, found themselves in default of their credit obligations. We agree affordable repayment plans with our customers and improve their credit standing over several years as a pathway to financial inclusion. We maintain the most successful hardship program in the industry with a current portfolio of \$1.3 billion of defaulted consumer credit obligations, restructured into sustainable repayment arrangements across 160,000 individual customer accounts.

In our consumer lending business we provide the cheapest and most sustainable loan products to consumers with limited borrowing alternatives. All of Credit Corp's products feature interest and fee rates below the caps applicable to mainstream consumer lending. To date, Credit Corp has helped 150,000 Australians avoid higher cost and unsustainable products through its market leading alternatives.

Credit Corp has an impeccable compliance record. Despite being the largest and longest-established debt purchaser in Australia, we have never been the subject of a regulatory order or undertaking. We have one of the lowest rates of external dispute resolution complaints in the industry. We work cooperatively with consumer advocacy groups on matters of industry concern and have a long term partnership with Kildonan Uniting Care.

## **The process undertaken to formulate the Bill has been flawed**

The review and consultation process undertaken to formulate the Bill has been flawed. The Committee can take no comfort in the fact that the Bill was recommended by an independent expert panel (Ramsay Panel) or that it may only receive a limited number of industry submissions critical of the Bill. The process to date has been designed to ignore and exhaust all industry opposition.

The Ramsay Panel was, from the outset, immediately aligned with the consumer movement's long-held agenda for the creation of a single financial services industry ombudsman scheme. Two of the three panel members have had long histories of association with the consumer movement. The panel did not contain a single individual with any relevant industry experience in dealing with financial services complaints.

The Ramsay Panel called for two sets of written submissions. On each occasion industry groups provided detailed facts and data in support of the present multiple scheme model and recommendations to enhance the consistency and certainty of scheme decision-making. The Ramsay Panel simply ignored the overwhelming industry evidence and unquestioningly adopted the position articulated in the consumer group submissions. This was notwithstanding that consumer groups were involved in just a few per cent of complaints made to the existing schemes.

Despite a requirement to analyse overseas experience, the Ramsay Panel failed to even note that there is no other jurisdiction in the world with a single private financial services industry ombudsman scheme. In every other country with non-statutory financial services industry ombudsman schemes there is a multiple scheme model. The Ramsay Panel simply rejected the absence of any evidence that multiple schemes in Australia degraded consumer outcomes together with the findings of a credible overseas review with the words "the Panel is not convinced".

Roundtable sessions with industry provided no opportunity for proper debate and discussion. Members of the expert panel simply requested industry participant feedback. Members of the panel explicitly declined to respond to questions from industry. There was no indication of any genuine interest on the part of the Ramsay Panel to have its positions tested through oral debate.

The Ramsay Panel did not even consider the major financial planning, life insurance and farm lending scandals which prompted the government to commission the review. The Ramsay Panel did not in any way indicate how a single ombudsman scheme would have either prevented the scandals or provided more timely and appropriate compensation to victims.

In addition to the provision of two submissions to the Ramsay Panel, industry was required to make further submissions to Treasury on the first draft Bill. These submissions were required to be lodged by 14 June 2017 but were withheld from publication for more than three months until just a few days ago. A review of these submissions shows that, with the exception of the major financial services incumbents, industry was united in advocating that any single ombudsman scheme must be subject to legislated rule of law and governance protections. The final Bill shows that, once again, industry submissions have been ignored.

Throughout the process there has been additional private consultation with the consumer movement. For example, Credit Corp has learned that changes made to the draft Bill were discussed and agreed with consumer representatives but no such consultation was afforded to industry.

The final insult to industry arrived in the form of the Minister's announcement of the AFCA transition team reference panel on 22 August 2017. The transition team comprises a former public servant, existing ombudsman scheme staffers and members of the consumer movement but is utterly devoid of any industry representation whatsoever. The precise details of what is supposed to be a single industry scheme which will bind industry to its decisions, effectively make financial services law and will be entirely funded by industry will be formulated by a team without any industry representation.

The vast majority of industry has simply been ignored into submission by a thoroughly despotic process and no longer has the energy or inclination to carry on. Industry is resigned to the fact that AFCA will play into the hands of the major financial services incumbents by imposing unacceptably

high costs and dysfunctional decision-making outcomes on smaller financial services operators who will be unable to absorb them. The ultimate reduction in financial services competition does not seem to be of any concern to the government as it has not sought to undertake any economic impact analysis.

## **Uncertain and unpredictable decisions damage competition**

Certainty in the law, regulation and judicial outcomes are critical preconditions for a competitive and efficient market. We have seen uncertainty in law and policy over many years have a detrimental impact on the national energy market, to the point where Australians now face some of the highest energy costs in the world and increasingly unreliable supply.

It is only when regulation and judicial outcomes are certain that industry has the confidence to invest and innovate to the benefit of all Australians. Certainty reduces the barriers to entry and decreases the costs of compliance. Certainty provides the parameters for product and service delivery innovation. Certainty reduces risk and allows new entrants to raise capital more cheaply and compete with major incumbents by employing lean cost structures and narrow profit margins.

The financial services industry already suffers from some of the most complex and onerous regulation facing any industry. All around the world, the wave of regulation introduced since the global financial crisis has produced a more concentrated financial services market dominated by inveterate incumbents. It is only recently that we are starting to see the potential for technology and innovation to challenge this dominance. The parliament must take care to ensure that regulatory complexity is not supplemented by judicial uncertainty to extinguish the prospects for a more competitive financial services market.

At best, uncertain decision-making will damage competition. At worst, uncertain decision-making may result in the withdrawal of financial services from entire consumer and business segments, with dire consequences for the economy and the living standards of all Australians.

## **The Bill will exacerbate uncertainty**

The two existing ombudsman schemes enjoy wide decision-making discretions. The terms of reference of both the Financial Ombudsman Service ('FOS') and the Credit and Investments Ombudsman ('CIO') provide that decision-making is subject to fairness in all the circumstances taking into account good practice, industry codes and any relevant legal principles. Even when the existing schemes seek to apply the law, they can do so incorrectly without accountability. The contractual nature of ombudsman scheme membership means that decisions are not practically amenable to appeal through the courts.

There are numerous examples of unpredictable ombudsman decision-making by the existing schemes. These can be found in many of the submissions to the Ramsay Panel. A brief list of examples is summarised below:

1. Ombudsman determinations that any form of repayment forbearance exercised by a lender represents a contractual variation, which means that a customer's credit bureau file cannot be updated to show that the account is in arrears. This is at odds with the position under Privacy Law, the view taken by the prudential regulator (APRA) and will serve to undermine the agenda to promote data sharing to stimulate competition in the consumer credit market.

2. The use by ombudsman of subsequent income tax assessments in responsible lending cases, rather than the verification data available at the time the credit decision was made.
3. The application of Australian Banker's Association ('ABA') Code of Banking Practice provisions in decisions affecting non-banks which do not undertake the activities of banks.
4. Consumer hardship contractual variations incorporating discounts in the principal amounts outstanding and reductions in contractual interest rates. Notwithstanding that such impositions are at odds with section 72 of the National Credit Code.
5. Holding a bank liable for the majority of the loss suffered by an account holder who transferred large sums to an overseas fraudster in circumstances where the name of the account to which the money was transferred was not the same as any name on the relevant alert list published by the authorities.

For all non-superannuation complaints the proposed AFCA will have the same decision-making discretion enjoyed by FOS and CIO. AFCA will have the power to create novel principles and the freedom to inconsistently impose such principles on industry without being subject to any form of review or scrutiny.

AFCA will have even less accountability than the existing ombudsman schemes for certain and predictable decision-making. Both FOS and CIO are subject to accountability imposed by the ability of member financial firms to move to an alternative scheme when decision-making proves too unpredictable. As a single monopoly scheme AFCA will not be subject to any such accountability and will enjoy wholly unfettered decision-making discretion.

This unfettered discretion will be complemented by expanded jurisdiction, with the ability of the scheme to set its own dispute limits and compensation caps. The starting point for consumer complaints will be a doubling in the dispute limit to \$1 million and the absence of any limits or compensation caps in the context of a mortgage over a guarantor's home.

It is without global precedent for any ombudsman scheme, let alone a private monopoly scheme, to exercise such decision-making discretion over disputes involving such large amounts. If the Bill is passed Australia will be the only country in the world with a single private industry financial services ombudsman scheme. This is because no other country would risk ceding legislative and judicial power over such a critical industry to an unaccountable private body.

## More certain decision-making

To address the uncertainty and unpredictability of decision-making contemplated by the Bill, Credit Corp recommends that provisions presently quarantined to superannuation complaints be extended to apply to all disputes.

**Credit Corp recommends that proposed section 1055(7)(a) requiring that all decisions must not be contrary to the law should be extended to all disputes.**

Extending these provisions will provide for more certain and predictable decisions in the interest of a more competitive financial system to the benefit of all Australians.

There is no cohesive logic for limiting the above provision to superannuation complaints. Financial services are used by all Australians. More Australians have bank accounts than superannuation. Every working Australian making a contribution to superannuation will require access to some form of credit throughout their life.

The idea that superannuation complaints should be subject to more certainty because they involve larger amounts is not supported by the facts.

While it is not contemplated that superannuation disputes will be subject to any monetary limits or compensation caps the reality is that many non-superannuation complaints will involve amounts in excess of the majority of superannuation complaints. The present average superannuation balance at retirement is less than \$300,000. This is significantly lower than the proposed minimum consumer dispute limit of \$1 million and the minimum consumer compensation cap of \$500,000. It is also significantly lower than the proposed small business dispute limit of \$5 million and the minimum business compensation cap of \$1 million.

Much seems to be made in the explanatory materials about the unique involvement of third parties in superannuation disputes. The example of the interest of a dependent in a death benefit is highlighted. However, there is no difference between the interest of a dependent in a death benefit within superannuation and an interest in a death benefit on a life insurance policy held outside superannuation. Furthermore, third parties will regularly have an interest in a credit or investment dispute. Many investments take the form of an interest in a trust and involve dealings with a trustee, which is identical to the arrangement for superannuation. The distinction is artificial and without any basis in fact.

There is no logic to a “one-stop-shop” dispute resolution scheme applying completely different processes and decision-making principles to different industry segments. There will be no consistency and efficiency in such a scheme. Rather than a “one-stop-shop” it will be an unwieldy conglomerate operating according to different rules. Users will rightly question why similar complaints will be subject to vastly different processes and outcomes depending on whether or not the dispute involves the superannuation system. This irrational bifurcation is unacceptable in the context of the reasons for establishing a single monopoly scheme.

All disputes should be subject to decisions which are not contrary to the law.

## **High costs and inefficiency damage competition**

It is well-established that high regulatory costs act as a barrier to entry and favour large entrenched incumbents in any market.

Smaller and more innovative operators invariably look to disrupt established markets through price competition. These operators look to exploit lean cost structures and narrow profit margins to undercut incumbents. Increased regulatory costs bear heavily on such businesses, because they have no ability to absorb such impositions and must immediately pass them on to consumers in the form of higher prices.

Larger incumbents with market power can absorb increased regulatory costs for a period of time. Incumbents can temporarily absorb cost increases within a large cost structure while they wait for their smaller competitors to fall away.

## **The proposed AFCA will be unaccountable for costs and efficiency**

AFCA will operate as a private monopoly provider. Any party operating in the financial services industry will be required to be a member of AFCA and will be required to fund its operations.

AFCA will have no incentive to keep costs down. Like all monopolies, without external controls, it will exhibit expense preference behaviour. Excessive amounts may be spent on board and executive remuneration, office facilities, travel and matters not directly connected with the business of resolving disputes, including marketing and promotion.

We have recently seen national media reporting alleging excessive remuneration, self-serving promotion expenditure, poor governance and inadequate disclosure in the example of the professional accounting body CPA Australia. The Bill contains no measures or controls to prevent scandalous conduct within AFCA.

As a monopoly AFCA will have no incentive to operate efficiently. There will be no alternative scheme for members to join and no alternative from which to benchmark any aspect of efficiency. In fact, it will be in AFCA's monopoly interests to encourage the lodgement and escalation of unmeritorious disputes as funding will be reliant on an escalating complaint fee model. If more complaints escalate for formal decisions the scheme will receive increased funding, regardless of the merits or outcomes of disputes.

The lack of accountability for costs and efficiency will be exacerbated by an unaccountable governance structure. As a private ombudsman scheme AFCA will resemble FOS and CIO, where the requirement for equal numbers of consumer and industry directors will likely mean that directors will be appointed by the board itself. The board will be self-perpetuating.

It is also likely that the board will be over-represented by individuals more closely aligned with the dominant financial services segments and their incumbents. There is unlikely to be any representation from smaller industries and members. In particular, those smaller members looking to increase market competition are likely to be unrepresented.

AFCA will also be subject to the limited financial disclosure requirements of a private company. Despite being a very large monopoly, as is the case for CIO and FOS, there will not be the sort of detailed disclosure of board and executive remuneration required by publicly listed companies in Australia. There will be no requirement for members to vote on remuneration and no consequences for the board if members disapprove.

## **More accountability for costs and efficiency**

To address the absence of any accountability for costs and efficiency by AFCA, Credit Corp proposes legislated governance controls within the Bill.

**Industry directors should be directly elected from each industry segment from the votes of members in each segment. Each industry director should be subject to re-election every two years.**

**The independent chairman should be appointed by a separate majority of both industry and consumer directors. No independent chairman should remain in office without commanding a separate majority of consumer and industry directors.**

**All directors, including the chairman, should be subject to a maximum term of 6 years.**

**Financial reporting requirements should be equivalent to those required for a publicly listed company. This will include a detailed remuneration report disclosing all aspects of the remuneration of directors and key management personnel.**

**Additional financial reporting requirements detailing expenses by expenditure category, with a focus on those expenses not directly related to the business of resolving disputes. In particular, detailed disclosure of overhead, administration, marketing, promotion, outreach and sponsorship expenditure should be required.**

**Annual member votes on the financial statement, remuneration report and expenditure report with a 75% majority voting requirement. If such a majority is not achieved in two successive annual votes a motion to spill all directors will be put to the members.**

It is important that AFCA is accountable to all financial services industry participants, not just the major incumbents. Under the present arrangements the interests of smaller members are recognised by the industry directors of CIO who possess backgrounds in mortgage broking, independent wealth management, debt collection and non-bank lending. This contrasts with the much larger FOS, where the present industry director backgrounds are limited to the major banking, insurance and wealth management institutions. Without controls to ensure appropriate board representation from smaller members AFCA will be overwhelmed by the interests of the major financial services incumbents.

These controls will ensure that AFCA does not exclusively serve the interests of the major financial services incumbents to the detriment of smaller operators. They will encourage confidence in AFCA by all industry members, not just the dominant incumbents. In doing so, the controls will preserve and enhance competition in the market for financial services.

The controls will also promote accountability for costs, efficiency and performance. Unless industry directors are subject to regular election by members they will not be accountable to industry. If directors serve for excessive terms they will become too closely aligned with the internal interests of AFCA management and staff, rather than the interests of consumers and industry.

As experience over the last ten years has shown, nothing sharpens corporate accountability more than a democratic vote of members with public consequences. Voting on remuneration and implementation of the 'two strikes' rule for publicly listed companies has proven to be critical to the control of corporate largesse. In the context of the creation of a private monopoly adopting the same control should be considered as a mandatory requirement. Many of these proposed measures are based on the governance standards imposed on listed public companies under the Corporations Act. Others are based on recognised standards of governance adapted to the nature of a monopoly private ombudsman scheme.

Why shouldn't AFCA be subject to the highest standards of governance? Unlike most corporations AFCA will operate as a monopoly. Unlike all corporations membership of AFCA will be compulsory. Unlike many other corporations AFCA will levy fees on its members and issue judicial determinations which will bind members. Unlike any publicly listed corporation members who are unhappy with standards of governance and accountability for costs and efficiency cannot simply sell their shares and move elsewhere.