



Credit and Investments Ombudsman

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Committee Secretary
Select Committee on Lending to Primary Production Customers
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Select Committee inquiry into lending to primary production customers

The Credit and Investments Ombudsman (**CIO**) welcomes the opportunity to make a submission to the Inquiry.

About CIO

CIO is one of only two ASIC-approved external dispute resolution (**EDR**) schemes for financial services in Australia. The key objective of CIO is to provide consumers with a no-cost alternative to legal proceedings for resolving disputes with financial services providers (**FSPs**) who are members of CIO. In resolving disputes, CIO has regard to relevant legal principles, industry codes of practice, good industry practice and fairness in all circumstances.

CIO is a not-for-profit public company which receives no government subsidy, and its operations are funded entirely by membership and complaint fees levied on its FSP members.

CIO has more than 23,000 members and operates predominantly in the credit sector. Its membership comprises non-bank lenders, mortgage brokers, debt purchasers, credit reporting bureaus, time share operators and small amount lenders, among others.

CIO does not have any banks as its members. These are members of the Financial Ombudsman Service (**FOS**).

Ramsay Review

CIO has a keen interest in any debate about the future of the two ASIC-approved EDR schemes in the finance sector – CIO and FOS.

As the Committee will be aware, the government has commissioned a review, led by Professor Ian Ramsay, to examine if any changes need to be made to the EDR architecture in financial services.

The Review's interim report (**Ramsay Report**) recommends that a single non-statutory ombudsman scheme should replace CIO and FOS - the so-called small 't' tribunal. We expect the final review to be in similar terms.

The Report is conspicuously silent about how the proposed single Ombudsman scheme will address any of the major banking scandals that have occurred since the GFC, and which have caused public outrage, invited the scrutiny of numerous parliamentary inquiries, prompted calls for a Royal Commission, and spurred the Government to commission the Ramsay review in the first place.

We cannot see how the proposed single EDR scheme, even with increased monetary limits and regulatory oversight, will deal with banking scandals any differently from the way FOS has in the past. (These scandals occurred in areas where FOS presently enjoys a virtual monopoly.)

This is particularly relevant because FOS has indicated that the FOS model, culture and approach should be maintained in the new EDR scheme.

The fact is a single non-statutory EDR scheme will not be able to prevent or address any of the bank scandals we have seen in the past. Nor will it have the necessary powers to deal with primary producer or small business disputes with banks.

This is because, like CIO and FOS, the single non-statutory EDR scheme will not be able to subpoena a third party to attend as a witness or produce documents; it will not be able to join third parties, cross-examine witnesses, take evidence on oath,

investigate criminal fraud or impose penalties. Only a court or statutory tribunal can do this.

For the same reason, in the context of primary producer or small business loans and guarantees, the single EDR scheme will not be able to bind valuers, investigative accountants and receivers to its decisions, nor will it be able to enforce any decision against them.

No evidence of problems cited

The Ramsay report found that CIO and FOS perform well against the Review's own core principles. Indeed, the report praised the schemes as having:

'...shown themselves to be innovative and adaptive to changes in the financial system, changes in consumer expectations, and changing products and services'.¹

In other words, there is no market failure, dysfunction or failure of regulation of the kind that prompted the United Kingdom to bring together twelve schemes to establish a single statutory scheme, the UK Financial Ombudsman Service (**UK FOS**).

While CIO, being a strong advocate for continual reform and reassessment, readily accepts that there is always room for improvement (the capacity for which is often best revealed by comparing the two existing schemes against each other), we do not consider that the Ramsay Report has made a case for a single non-statutory EDR scheme.

Indeed, according to the economic analysis by ACIL Allen Consulting:

- (a) The proposal to introduce a single EDR scheme is not supported by economic analysis, sound argument or evidence. The Ramsay Report does not demonstrate any cost benefits to replacing CIO and FOS with a single scheme.
- (b) None of the perceived problems identified in the Ramsay Report would be addressed by introducing a single scheme. In fact, a single scheme would

¹ http://treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20into%20EDR/Key%20Documents/PDF/EDR_interim.ashx

create problems that do not currently exist.

- (c) A single scheme would see the loss of the benefits the existing two schemes currently provide: price competition, service quality comparison, pressure to keep costs down, and innovate with better processes and services.
- (d) A monopoly not-for-profit organisation, such as the single EDR scheme being proposed, can cause the same amount of economic damage as a monopoly for-profit organisation, by charging more and spending the proceeds on bloated staff numbers, excessive executive compensation, lavish offices and other wasteful spending – as well as providing poor service.

It is painfully ironic that the major banks will be the big winners of the Ramsay review – a review specifically commissioned in view of the scandals attributed to them. They know the review is a diversion to avoid a Royal Commission.

The banks, who are members of FOS, will benefit from a single EDR scheme because their EDR costs will be subsidised by the influx of more than 23,000 smaller FSPs (who are presently members of CIO) being forced to join a single scheme.

Smaller and more innovative FSPs, including fintech disrupters, operating on thinner margins and not having the benefits of scale and incumbency, will be least able to absorb or pass on any increased cost that may result from an inefficient single scheme monopoly.

The major banks, invariably the largest generators of complaints, also benefit from a single scheme because the scheme will, as a matter of efficiency, tailor its processes to deal with their large volume of complaints, at the expense of smaller FSPs.

It is therefore not surprising that the existing two EDR scheme model is strongly supported by peak industry bodies representing the interests of competitors to the major banking incumbents, as well as individual firms, including leading fintechs seeking to disrupt the Australian financial services landscape to the benefit of consumers. They understand that the proposed single scheme will damage the

prospects for increased competition in financial services and will lack the checks and balances that apply to a statutory scheme.

It is disappointing that the Report places little or no weight on submissions made by these industry bodies in support of the existing two EDR scheme model. Their members represent the overwhelming majority of the financial services industry and are a crucial source of competition to the major banks.

It should come as no surprise that the peak industry body for the banks is the strongest supporter of a single EDR scheme that none of its competitors support.

Fit for purpose

CIO and FOS are fit for purpose. Each scheme was designed to deal with 'Mum and Dad' complaints, as well as straight-forward small business disputes not involving large sums of money. That they do this very well has been acknowledged by consumer advocates, independent reviews conducted in relation to each scheme, and Ramsay's Ramsay Report itself.

CIO and FOS were never intended, nor are they equipped, to expose bad behaviour by assigning and publicising moral culpability to, or imposing penalties on, FSPs. That is beyond their remit, as it will be beyond the remit of a single non-statutory EDR scheme. Only a commission of inquiry will achieve this.

Primary producers and small business

CIO and FOS are extremely effective in dealing with 'Mum and Dad' complaints. Indeed, about 94% of the complaints lodged with CIO and FOS are lodged by individuals.

However, given both schemes lack the powers of a statutory scheme, their ability to deal fairly and effectively with primary producer or small business loans is limited, even if their monetary limits and compensation caps were to be expanded.

For example, unlike a statutory scheme, neither CIO nor FOS can subpoena documents, verify discovery by affidavit, summon witnesses, take evidence on oath,

cross-examine witnesses on the statements or documents they have given, or investigate criminal fraud.

Primary producer or small business and complicated loans involving large sums of money are more appropriately dealt with by a tribunal.

Primary producers and small businesses will be no better off under a single EDR scheme which lacks the appropriate powers and expertise to deal effectively with their complaints.

The Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) or a small business tribunal should be empowered to investigate and adjudicate primary producer and small business disputes that are outside the existing jurisdictional limits of EDR schemes or, alternatively, to investigate and adjudicate ALL primary producer and small business disputes, to the exclusion of the existing schemes.

The Ramsay Report rejects this proposal. But CIO's position is consistent with the recommendation of the Parliamentary Joint Committee Inquiry into the Impairment of Customer Loans that, in order to address the vulnerability of small business and commercial borrowers, the ASBFEO act as a small business loans dispute resolution tribunal where gaps in the EDR schemes remain.

The current arrangement – two EDR schemes

While a proliferation of EDR schemes may not be ideal, CIO is of the firm view that the current arrangements offer better outcomes for consumers.

Scheme benchmarking

Having two ASIC-approved EDR schemes allows each scheme to benchmark their performance against the other (**scheme benchmarking**), and this produces better consumer and industry outcomes.

Indeed, the independent and periodic reviews of EDR schemes compare each of the schemes, and in doing so, recommend one scheme implement particular improvements

seen in the other.² This can only raise best practice in EDR. It cannot be achieved under a single EDR scheme model.

Without the stimulus of EDR benchmarking and a comparative discipline, turnaround times, service levels, innovation and continuous improvement would suffer and there would be less incentive to keep costs in check and run the scheme efficiently.

The present two-scheme EDR model in Australia has spurred productivity growth and created a self-sustaining process for continual reform and reassessment. That process drives ongoing benefits for the sector and for consumers and primary producers and small businesses.

Innovation

The innovations and improvements resulting from scheme benchmarking directly and empirically contradict any suggestion that multiple schemes might engage in a 'race to the bottom'.

CIO was the first EDR scheme to undertake a number of best practice initiatives:

- dealing with financial hardship complaints, even in relation to non-regulated loans (this major reform led to a major change in the case profiles of both CIO and FOS - financial hardship complaints historically make up about 30% of all disputes received by CIO and FOS),
- requiring an FSP to discontinue or not commence enforcement action while the complaint is open with CIO,
- dealing with financial hardship complaints even when legal proceedings have commenced,
- dealing with complaints received after default judgment has been entered in certain circumstances,
- reviewing fees and charges (rather than relying on the FSP's 'commercial judgement' exemption),

² See, for example, FOS' Independent Review 2013, pages 25 (para 3), 39 (para 3), 44 (last para), 60 (second last para), 75 (para 5), 76 (para 3), 132 (last para) and 133 (second last para): <https://www.fos.org.au/custom/files/docs/independent-review-final-report-2014.pdf>

- effectively managing credit repair firms and debt management companies that take advantage of vulnerable and disadvantaged consumers, and
- expelling an FSP from membership (and this has significant implications for its ability to meet its ASIC-imposed licence conditions) where it refuses to implement a remediation programme recommended by CIO for the resolution of a systemic issue.

Indeed, CIO's Independent Review concluded that CIO 'has been an innovator and policy leader in the area of consumers confronting financial hardship and has developed its own very successful approach to dealing with financial hardship complaints'³ and that 'there is no doubt that CIO has done some fine work for consumer rights and has in some cases been bolder than others in acting in the public interest'.⁴

Competition among Ombudsmen

There are some who take the position that there should be no competition at all between ombudsmen in the same industry sector. They go so far to say that 'financial services' as whole should only have one EDR scheme to prevent the perceived drawbacks of competition.⁵ This position ignores the benefits to both consumers and industry of having at least two 'competing' EDR schemes.

It should be pointed out that there is no empirical evidence of consumer confusion as to which ASIC-approved EDR scheme consumers should take their complaints.

ASIC's own submission to the Ramsay Review notes that there is a lack of evidence of consumers being 'shopped around schemes or potentially never getting to the scheme that can help them'.

Nor is there evidence of forum shopping or arbitrage by FSPs (for instance, where an FSP selects an EDR scheme with a reputation for leniency).

³ Page 4:

[http://www.cio.org.au/cosl/assets/File/Independently%20Review%202012%20\(The%20Navigator%20Group\).pdf](http://www.cio.org.au/cosl/assets/File/Independently%20Review%202012%20(The%20Navigator%20Group).pdf)

⁴ Page 13:

[http://www.cio.org.au/cosl/assets/File/Independently%20Review%202012%20\(The%20Navigator%20Group\).pdf](http://www.cio.org.au/cosl/assets/File/Independently%20Review%202012%20(The%20Navigator%20Group).pdf)

⁵ http://www.anzoa.com.au/assets/anzoa-policy-statement_competition-among-ombudsman-offices.pdf

To the extent that FSPs compare different schemes and 'shop' them, comparisons are made based on service levels, value and the ease of doing business – not bias to business or perceived laxity.

Those FSPs that have joined CIO from FOS have done so for a number of reasons; for example, their location in the same city as CIO has meant that they can meet with CIO on a regular basis more conveniently and economically; their competitors are existing members of CIO and they are inclined to be in the same scheme as their cohort; or they are of the view that a scheme that was formed essentially for the non-bank sector is more appropriate for them.

Accordingly, although there is some movement between the two schemes, scheme shopping by FSPs is not a live issue. In any event, to limit any potential abuse, CIO and FOS have entered into a Memorandum of Understanding which allows each scheme, before accepting an applicant as a member, to consult with the other about whether the applicant has paid a consumer any compensation that may have been awarded by the scheme, whether any complaints are open, whether any systemic issues have been identified and whether any fees are outstanding.⁶

Nor are we are not aware of any statistical or substantial evidence of substantive differences in consumer outcomes between CIO and FOS.

Indeed, the Ramsay Report itself concedes that 'it is difficult to make an assessment of the extent to which the current system produces inconsistent outcomes for consumers'¹⁶ We note that both schemes must satisfy the requirements of ASIC's Regulatory Guide 139 which promotes minimum standards across EDR schemes to achieve "parity of schemes and equal treatment of complaints".¹⁷

The Ramsay Report suggests that competition between EDR schemes may lead to unnecessary duplicative costs and an inefficient allocation of resources for industry and for the regulator.

With respect, that is akin to saying that Australia would be better off with a single provider of financial services or a single supermarket operator.

⁶ <http://www.cio.org.au/cosl/assets/File/MOU%20between%20FOS%20and%20COSL.pdf>

Any benefit gained by removing duplication will be more than offset by increased bureaucracy and a lack of accountability to stakeholders – a common trait amongst monopolies.

Unlike a conventional monopoly where buyers can walk away if the quality of the service is low or prices charged by the monopolist are high, FSPs will have no choice, given scheme membership is mandatory, but to remain members of the monopoly EDR scheme proposed by the Ramsay Report.

This is not a problem under the current two scheme model because competitive tension between CIO and FOS means that they have to be responsive and accountable to FSPs who can credibly threaten to take their membership to the other scheme. It would be disastrous if there was only a single scheme.

Absence of checks and balances

Because monopolies, by definition, do not face any competitive pressures, a single EDR scheme would be far less accountable and transparent than a statutory scheme to its stakeholders. A statutory scheme is subject to important checks and balances and, in the absence of these, the only check on the broad discretions and powers of a non-statutory scheme is the existence of two EDR schemes operating in the same sector in competition with each other.

There is no precedent anywhere in the developed world for a single *non-statutory* EDR scheme for financial services, as is being proposed by the Ramsay Report.⁷

In the absence of the sorts of checks and balances that apply to a statutory scheme, the only check on the broad discretions and powers of CIO and FOS is the existence of two schemes operating in the same sector in competition with each other.

⁷ A single scheme is contrary to international trends in financial services alternative dispute resolution: France has three financial services schemes dealing with different product groups, banking, investment and insurance respectively. Germany has eleven schemes with cross-cutting jurisdictional cleavages across product types and institutional structures. Italy has three, cross-cutting along product lines, as does Spain.

Sincerely,

Raj Venga
Chief Executive Officer and Ombudsman