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12 October 2017

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
Parliament House
Canberra ACT 2600

Dear Mr Fitt

Inquiry into the Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Bill 2017

Further to your email of 10 October, please find attached some minor typographical and transcription error corrections made to the Proof Hansard transcript of evidence provided by the Financial Ombudsman Service (FOS) to the Committee at its hearing on 9 October, 2017.

In response to your email we also provide as Attachment A some additional information for the Committee's consideration including correcting some misunderstandings that may have arisen in other submissions or in evidence about FOS or general EDR practice. These are set out under the following main areas:

1. Decision-making by Ombudsman schemes
2. Small business disputes
3. Appeal mechanisms
4. Funding arrangements for existing schemes and AFCA

Finally, the Committee asked whether we could point to any precedent in any other jurisdiction that would be similar to AFCA as a single scheme. I responded that I thought this was the case for the Irish Ombudsman system. We refer the Committee to the Office of Financial Services and Pensions Ombudsman (FSPO) in Ireland which is in the process of being created through the amalgamation of two separate bodies, the Financial Services Ombudsman Bureau (FSOB) and the Office of Pensions Ombudsman of Ireland (OPO).

We would be happy to answer any follow-up questions that the Committee might have in regard to this submission or aspects of the legislation before it.

Yours sincerely

Shane Tregillis
Chief Ombudsman
Financial Ombudsman Service Australia

Attachment A: Additional information

The following sets out some additional information for the Committee's consideration. These are in the following four main subject matter areas:

1. Decision-making by Ombudsman schemes
2. Small business disputes
3. Appeal mechanisms
4. Funding arrangements for existing schemes and AFCA

Decision-making

(a) Decisions contrary to law

Some submissions (Credit Corp and ASDAA) to the Senate Committee have proposed that section 1055(7)(a) be extended to complaints other than superannuation complaints when AFCA is dealing with such complaints under Divisions 1 and 2. These submissions contend there is no reason why this provision should be limited to superannuation only complaints.

However, we would like to highlight that there are some important differences between the approach to decision making in these Divisions and that this proposal would have an unintended adverse impact on the effectiveness of the new scheme. There are some significant differences between AFCA's special role under Division 3 in relation to superannuation complaints and its general role under Divisions 1 and 2 in relation to all other complaints.

The role of statutory substitute decision maker which AFCA has under Division 3 is on a different basis to the redress-based complaints scheme role provided for in Divisions 1 and 2. Under Division 3 AFCA in making a decision is standing in the position of the trustee, insurer or RSA provider and in doing so cannot make a decision that would be in breach of the relevant laws, contracts and trust deeds and their processes that apply to a superannuation trustee.

Under Divisions 1 and 2, AFCA is charged with resolving a complaint after the fact in a way that is fair, efficient, timely and independent and AFCA may award such compensation or give such remedial direction as is fair and reasonable.

Moreover, to apply section 1055(7)(a) to disputes under Divisions 1 and 2 is likely to impair compliance with the mandatory requirement that complaints be resolved in a way that is fair, efficient, timely and independent.

The likely effect of proposals to extend the provision to all of AFCA's jurisdiction is that there will be far greater scope for and time taken up with threshold technical arguments about black letter technical legal rules even before a consideration could be given to whether or not those arguments affected the substantive fairness of the proposed resolution of the complaint. The result is that the decision making process would become slower and more legalistic to the detriment of fairness, and timeliness of resolution. There would be a flow on impact on the cost, and the efficiency and effectiveness of the scheme without a countervailing improvement to fairness of outcomes.

Flexibility in how these goals were to be achieved was a principal reason that the Ramsay Report gave for favouring a model based on the key elements of the industry based model of EDR for the structure of AFCA.

The various examples provided in support of this proposal in the submissions are not examples of where decisions have been contrary to or a breach of relevant laws. Rather they are examples of where views on application of the law to the facts of the dispute differ. As is often the case, there are competing legal principles that may be relevant, or the case law might not have kept pace with developments in industry practice. These are commented on below.

One example to illustrate why the approach proposed would be problematic is life insurance disputes relating to the recent issues about the use of outdated medical definitions. In some of the older contract cases, the courts have taken a very strict and technical legal approach even where some of the judges felt that this could result in an unfair outcome in some circumstances.

Under AFCA the insurer's duty of good faith and more recent developments in industry practice as set out in the recent Life Code should be able to be taken into account in how such disputes are resolved. ASIC has also made clear that it considers that life insurers should place greater emphasis on fairness in claims assessment rather than apply a strictly technical legalistic approach. Accordingly, AFCA should continue to focus on resolving the substantive issue in a dispute fairly and in a timely way taking into account both the applicable law and good industry practice rather than take a more legalistic and adversarial court like approach.

(b) Statements made by Credit Corp about unpredictable Ombudsman decision making

The statements below are made by Credit Corp in its submission to the Committee. They are broad statements referring to Ombudsman decision making in general, across existing schemes. We provide comments about our consistently applied practice in relation to these statements. We cannot, however, comment on potentially different practice applied by the Credit Investment Ombudsman. One of the strengths of a single scheme, as the Ramsay Panel pointed out, is that inconsistencies in decision-making approaches across multiple schemes will be minimised.

- *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.*

  In certain decisions, FOS has formed a view that where a hardship application had been agreed to by the lender, the repayment history information should reflect that the customer was meeting the agreement as varied rather than according to its original terms. This is based on what we consider the correct interpretation of the relevant provisions of the Privacy Act, not at odds with it. The current test case and other informal review mechanisms in the FOS Terms of Reference and Operational Guidelines provide a way for such differences to be sorted out where there is a concern that may have a significant impact on industry or consumers.

- *The use by ombudsman of subsequent income tax assessments in responsible lending cases, rather than the verification [of] data available at the time the credit decision was made.*

  FOS reviews tax returns for the years prior to the lending decision in order to ascertain what the borrowers actual position was, especially when the verification process was inadequate (e.g. if the lender had not ignored red flags and made further enquiries, what would they have discovered?)

- *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.*

  The Code is an indication of good industry practice in a number of areas, even if the lender is not a bank. FOS consistently applies the Code as the benchmark for good industry practice unless there is some good reason related to the specific dispute as why it should not do so.

- *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.*

  We are not aware of any FOS decision involving hardship alone where we have varied the contract to allow a reduction in the principal amount or a change in the interest rate. If such arrangements have been entered into then the FSP's may have offered these as solutions and we may have endorsed them as being better than what we could award.

- *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.*

  In a case where a customer was engaging in binary options trading, the FSP blocked payments to the name of the options company after receiving advice from ASIC. However the FSP did not block transactions to the same company name with a dot com on the end. We took the view that the names were sufficiently similar and should have been blocked as well.

Small business disputes

A number of issues were raised in submissions and at the hearing about the capacity of AFCA (or indeed existing schemes) to deal with disputes from small businesses which do not reflect actual existing practice of FOS.

(a) Requirement to compel information

Several submissions recommend that the powers available for the compulsion of information from third parties in relation to superannuation disputes, should extend to all disputes that AFCA will handle.

As a practical matter, additional powers have not been required under the current ombudsman model to ensure effective resolution of the vast majority of disputes. The issue of whether any additional powers should be given to the new EDR body was specifically considered by the Ramsay Panel. They concluded that the "Panel does not see a need for additional statutory powers to be provided to the single EDR body in relation to financial disputes other than superannuation disputes". (Final Report, 5.171) The contractual relationship between FOS and the financial firm, enables FOS to obtain information that relates to a third party engaged by the financial firm from the financial firm itself. If this information is not provided, FOS is able to draw an adverse inference against the financial firm. Our experience however, is that the financial firm, who has a contractual or agency relationship with the third party is able to obtain the information from the third party and provide it to FOS when requested.

In the exceptional circumstance where issues do arise, the scheme can refer matters of serious misconduct to ASIC.

However, should this broadening of information provision powers be considered helpful, we suggest first exploring whether this could be achieved through utilising AFCA's Terms of Reference (TOR).

AFCA's TOR could for example require a party to a complaint to do anything else that AFCA considers may assist AFCA's consideration of the complaint. This would specifically include the ability to require a financial firm to obtain information from its agents (such as valuers, real estate agents and other third parties). AFCA, through its Terms of Reference could also require a small business complainant to obtain information from its agents (such as receivers, liquidators, or administrators appointed over the complainant company).

In addition, this approach could be examined by an independent review once the effectiveness of AFCA's actual experience of utilising an expanded TOR along the lines outlined above for small business disputes has been assessed.

(b) Binding settlements

At the hearing on 9 October, Ms Scott from the ABSFEO stated that at FOS "there are existing settlements that haven't been paid out to small businesses, as far as we are aware".

We are unable to identify any small business applicants from our records of unpaid determinations.

(c) Court proceedings – ceasing enforcement action

Despite some suggestions to the contrary, we can confirm that if there are legal proceedings in train that have been initiated by a financial services provider and not gone beyond a defence, the provider is required to put those proceedings on hold until such time as FOS has made a decision on the dispute. There is no anticipated change to this requirement in the establishment of AFCA.

Statutory time-frames for small business disputes

The ABSFEO recommended that that a maximum timeframe (for example 6 months) for disputes to be resolved must be set.

Setting timeframes in legislation reduces the flexibility and approach a scheme could apply to decision-making. It runs counter to one of the key benefits of the scheme recommended by the Ramsay Review and as set out in the explanatory memorandum for the Bill (para 1.21p.10) on the importance of the flexibility for the AFCA Board once established to determine how AFCA operates.

We also know from significant experience, there will be circumstances where a small business, due to its own operational requirements, would be unable to comply with the provision of information within a defined time frame, to resolve its dispute.

A scheme's guidelines sets out time requirements for the provision of information from parties, and the scheme can exercise discretion in granting extensions to individuals, small businesses or financial firms to ensure consideration of all relevant material pertaining to a dispute.

FOS does agree, however, that the scheme should aim to resolve disputes within published targeted timeframes. For instance FOS has a target that 95% of disputes are closed in less than 180 days. Last financial year we achieved 91% against this target and our average time to close a dispute was 54 days, down from 62 days in the preceding year.

(d) Differential dispute considerations for small businesses

Our membership fees currently take into account the size of the firm.

However, we consider decisions need to be made on the merits of a dispute, based on the application of similar facts, law and principles and should not differ based on considerations such as a firm's size.

We agree with Mr Kirk from ASIC when he pointed out to the Committee, disputes consumers have with a small lender are not different in character to disputes they have with a big lender over the same loan transaction amount. The size of the lender should not be a variable in decision making, as this would have a discriminatory impact on consumers depending on which firm they transact with.

We refer to our submissions to the Ramsay review, Treasury consultation and this committee. More than 80% of FOS members are sole traders or small businesses and very few of them have disputes at FOS and as such do pay dispute fees. For most, they pay an annual membership fee of $350 only. Larger members pay higher membership fees (according to a number of factors). Dispute fees are paid only by those that have disputes at FOS.

Appeal mechanisms

Arguments have been put to the Committee about Financial Service Providers (FSPs) having the right to appeal to the Federal Court on questions of law. To do so would undermine the current fairness jurisdiction of External Dispute Resolution that has been a key feature of the current schemes and was strongly supported by the Ramsay Review in its recommendations and findings.

There is also a common misconception that it is not possible to challenge a FOS determination in court. FOS determinations can be challenged in state courts on grounds similar to formal judicial review that apply where:

- the decision was not made in good faith
- was the product of bias or dishonesty
- the Ombudsman or FOS panel misconceived the task which they were required to undertake (e.g. addressed the wrong question) or
- the decision was not made in conformity with the terms of the contract regulating the processes (the FOS Terms of Reference).

While FOS determinations can be challenged in the courts on these grounds, our approach as an EDR scheme is to encourage use of the co-operative review mechanisms or test case provisions in our Terms of Reference, set out above, to resolve any differences about the approach FOS has adopted to specific types of disputes.

FOS promotes openness and transparency in our decision making in a number of ways:

- Publishing FOS Approach documents in easy to understand terms.
- Holding regular open forums and meetings with stakeholders where our approach to particular types of disputes is explained.
- Encouraging financial firms, consumers and consumer organisations who may have concerns about the approach we take in our determinations to raise these concerns directly with the relevant Lead Ombudsman or the Chief Ombudsman, or discuss them during regular industry and consumer meetings.
- Recognising that in limited circumstances there may be value in a more formal review mechanism when current informal mechanisms cannot fully address concerns about our approach in decisions. Paragraph 10 of our Terms of Reference provides for FOS to place a dispute on hold while a matter is being considered by the courts. Test case provisions can be used if a financial firm thinks that a dispute involves an issue which may have important consequences for the firm's business (or financial firms generally) or involves an important point of law.
- Having a formal cooperative review mechanism to supplement the current informal approaches and test case provisions. The review mechanism does not allow determinations to be re-opened. Under the Terms of Reference, determinations are final decisions on specific disputes. The mechanism provides for an assessment of

whether FOS should continue to take an approach or modify it for future disputes. The formal review mechanism is set out in section 19A in our Operational Guidelines (fos.org.au/about-us/terms-of-reference).

If there were to be the ability for FSPs to appeal decisions of AFCA in the non-superannuation jurisdiction on questions of law, consumers and small businesses could be faced with getting a decision in their favour, accepting it, and then encountering an expensive court challenge. This would also impose unnecessary costs on the scheme that all its members would bear.

Funding arrangements for existing schemes and AFCA

It will be important for all members of AFCA that the funding arrangements are based on an agreed set of principles which the AFCA Board could apply.

In our submission to the Committee we questioned the validity of CIO public statements about the number of disputes AFCA will receive in its first year (some 117,000 and the first year cost of AFCA of $137m). We note Mr. Venga's comments to the committee that these were 'back of envelope figures'. Even these rudimentary calculations are flawed. Based on current dispute numbers AFCA is likely to receive at least 48,000 disputes in its first year and this could increase by around 20% to take account of the new jurisdictional limits. But Mr Venga has added '30,000 open complaints' to his calculation. There is no basis for this number or its inclusion in the dispute number forecast:

- FOS, (representing 83% of all disputes) had 7,427 open complaints on 1 July 2017, and is likely to have a similar amount at 1 July 2018. One quarter of the 30,000 figure stated by Mr Venga.

- There will always be dispute 'stock on hand' at the beginning and end of a reporting cycle. The inclusion of open disputes in the count at the beginning of the year, without subtracting open disputes at the end of the year, inflates overall dispute numbers (by 30,000 in this example).

- If a user pays principle underpins the AFCA fee model, as it does with the current FOS fee model, any increase in complaint costs arising from a higher volume of complaints, will be met by the firms that have the complaints against them (74 per cent of FOS income is generated directly from its complaint fees). It is proposed that the fee model for AFCA will be subject to consultation with industry. Any changes to its fees and charges will, as a requirement of its authorisation, be reported annually to the Minister.