Chapter 7

Financial Ombudsman Service and the Credit Ombudsman Service

7.1 In many instances, consumers took their complaints about the conduct of brokers or lenders to one of ASIC's approved external dispute resolution (EDR) schemes. According to many submitters, however, they were dissatisfied or disappointed with the management of their case by the relevant EDR scheme.[1] Based on personal experience, they found that the EDR process did not do 'nearly enough to help distressed people who had turned to them for help'.[2]

7.2 In this chapter, the committee examines the role and functions of the two ASIC-approved EDR schemes that have a pivotal role in dealing with complaints about financial services and credit institutions.

Background

7.3 Under statute, holders of credit licenses and AFS licenses are required to be members of an ASIC-approved EDR scheme as a condition of their licence.[3] EDR schemes provide an alternative dispute resolution mechanism that operates outside the court system. Their specific functions within the broader financial services and new national credit regulatory regimes are to provide:

- a forum for consumers and investors to resolve complaints (or disputes) that is quicker and cheaper than the formal legal system; and
- an opportunity to improve industry standards or industry conduct and to improve relations between industry participants and consumers/investors.[4]

7.4 Currently, two ASIC-approved EDR schemes operate—the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service (COSL).[5] The benefits for borrowers seeking redress through the EDR process include:

- free access;

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1 See for example, *Submissions 26* and *84*.

2 See for example, Name withheld, *Submission 35*, p. 1.

3 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 17.

4 See ASIC, *Regulation Impact Statement, Dispute resolution requirements for consumer credit and margin lending'*, May 2010, paragraph 42.

5 The current regulatory architecture of the financial services complaints resolution system has its origins in the 1997 Wallis Inquiry, which identified the need for low-cost means to resolve disputes. See Financial Ombudsman Service, *Submission 193*, p. 3.

- the EDR schemes' broad remit to make decisions based on the additional factors of what is fair and reasonable and good industry practice;
- resolutions may include financial compensation; and
- decisions bind the lender but not the borrower.[6]

7.5 An EDR scheme means that consumers do not have to pursue a formal, expensive and often daunting process through the courts.[7] In summary, the EDR framework is intended to provide a way for complaints between financial services or credit providers and their clients to be resolved in a quick, effective and efficient way that is informal and does not follow the strict legal rules of evidence that apply in the courts.[8] They also free up ASIC and allow it to concentrate on the most serious transgressions and system-wide problems that have much broader implications for the financial services industry and consumers. As the Consumer Action Law Centre observed:

> Fewer demands will be made of ASIC's resources where consumers have effective, fair and accessible options to resolve dispute with business themselves.[9]

7.6 Thus FOS and COSL should be a vital part of any successful consumer protection framework. Indeed, Mr Brody, Consumer Action Law Centre, noted that the 'existence of free and independent external dispute resolution schemes is probably one of the greatest advances in consumer protection we have had in the last 20 years'.[10] Mrs Cox, Consumer Credit Legal Centre (NSW) Inc (CCLC), endorsed the view that the EDR schemes have a critical, valuable and important role. She noted that 'being able to send people to those schemes has been an amazing advance in consumer protection'. According to Mrs Cox:

> …the fact that we can now send people to a scheme and have the issue looked at after they have received a statement of claim is so valuable to the ordinary person out there who may have hit a bad patch and be struggling to pay a home loan, or who may have been completely done over in some sort of circumstance where they would have no hope of ever realistically approaching a court about it.[11]

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6 See ASIC, *Regulation Impact Statement: Dispute resolution requirements for consumer credit and margin lending*, May 2010, paragraph 57 and ASIC, *Submission 45.1*, p. 27.

7 COSL, *Submission 418*, p. 1.

8 Mr Raj Venga, Chief Executive Officer and Ombudsman, COSL, *Proof Committee Hansard*, 20 February 2014, p. 17

9 Consumer Action Law Centre, *Submission 120*, p. 9.

10 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, pp. 42–43.

11 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 43.

Financial Ombudsman Service

7.7 In 2008 three schemes—the Banking and Financial Services Ombudsman, the Financial Industry Complaints Service and the Insurance Ombudsman Service merged to form FOS. FOS now has more than 16,000 members including banks, credit unions, building societies, credit providers, general and life insurance companies and brokers, superannuation providers, fund managers, mortgage and finance brokers, financial planners, stockbrokers, investment managers, friendly societies, time share operators and authorised representatives.[12] They come under two broad categories:

- Licensees—financial services providers (FSPs) that hold an AFS licence or a credit licence; and
- Authorised Credit Representatives—businesses that represent a licensee.[13]

Credit Ombudsman Service

7.8 COSL has about 17,000 members comprising mainly finance brokers, non-bank lenders, mutual banks, credit unions, building societies, time share operators, small amount short term lenders, debt purchases and some financial advice firms. Members are drawn mainly from the 'small end of town' with more than 90 per cent being sole traders or small businesses of less than five individuals. COSL informed the committee that most 'pay day lenders', time share operators and debt purchasers in Australia are members.[14]

Criticisms of FOS and COSL

7.9 In respect of ASIC's role in relation to the EDR schemes, a number of submitters held that ASIC, as the regulator, had abrogated its duty.[15] One submitter suggested that ASIC failed to set proper guidelines for FOS and COSL and to use its powers to protect consumers where fraud and misrepresentation was 'so blatantly obvious to any outsider'.[16] Another suggested that ASIC had failed to assess whether the EDR framework was working well.[17]

7.10 Concerns about the EDR schemes' performance related to matters such as delays; perceived lack of independence (merely mouthpieces for the lenders); confusion between the responsibilities and jurisdiction of FOS and COSL; their failure to investigate fraud; the ceiling on compensation; and time restrictions because of statute of limitations.

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12 FOS, www.fos.org.au/members/search-for-members (accessed 31 January 2014).

13 FOS, www.fos.org.au/members/search-for-members (accessed 31 January 2014).

14 See for example, COSL, *Submission 418.*

15 See for example, *Submission 43.*

16 Name withheld, *Submission 26*, p. 1.

17 Name withheld, *Submission 184*, p. 5.

Timeliness

7.11 A number of submitters referred to the time taken by the EDR schemes to manage the process, for example to appoint a case manager.[18] They highlighted the critical importance of dealing with complaints expeditiously: that delay posed a risk for customers, especially those falling behind in repayments and under threat of losing their property. One submitter suggested that the current 'ordinary wait time' was two years.[19] The Consumer Action Law Centre also raised concern, shared by members of the industry, about delays.[20]

7.12 FOS acknowledged that a theme through some of the submissions was the need to improve the speed with which it deals with complaints. In its submission, FOS informed the committee that in 2013 it accepted and resolved some 24,000 disputes across its jurisdictions in banking, general insurance and life insurance and investments. It also dealt with 230,000 telephone inquiries from members of the general public.[21] According to FOS, it had seen 'a dramatic increase in the volume and complexity of disputes', which had affected its responsiveness.[22] FOS accepted that the number of disputes and the time taken to deal with them was a key challenge for the organisation. It informed the committee that it had been working hard to improve the timeliness of its dispute process, which remained at the forefront of its efforts to improve its performance.[23]

7.13 COSL explained that the time it takes to deal with a complaint depends on a number of different factors, including:

- the complexity of the complaint, including the evidence required to support each party's assertions,
- the need to allow each party the opportunity to respond to the other's statements and evidence, and
- the fact that it may need to extend the time within which a response is required.[24]

7.14 According to COSL, within 24 to 48 hours of receiving a complaint, it writes to the consumer and the financial services provider to inform them that it has received the complaint. It provides them with the contact details of the case manager

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18 See *Submissions 12*, *23*, *32*, *179*, *184* and *295*.

19 Name withheld, *Submission 217*, p. 1.

20 Mr Gerard Brody, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, pp. 42–43.

21 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 17.

22 FOS, *Submission 193*, p. 1.

23 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

24 COSL, *Submission 418*, p. 8.

responsible for dealing with the complaint. The case manager generally has full carriage of a complaint unless it is referred to the Ombudsman for determination at the end of the COSL process.

7.15 The overall workload also affects the time it takes COSL to deal with a complaint. COSL noted that with the number of complaints increasing year on year, it had implemented a number of initiatives to improve its timelines. To demonstrate that these initiatives had already yielded some positive results, COSL compared statistics for the 2012–13 financial year to the previous financial year, which showed there had been:

- an increase in complaints closed within a three month period from 56.8 per cent to 60.4 per cent; and
- an increase in complaints closed within a six month period from 76.2 per cent to 79.2 per cent.

7.16 COSL informed the committee that these results were achieved despite receiving a 28 per cent increase in complaints in the 2012–13 financial year, on top of the 38 per cent increase in the previous financial year. According to COSL, it would continue to look for ways to improve its timelines, which remained a top priority, 'without compromising the quality' of its decision-making.[25] While Mrs Cox of the CCLC cited some major problems with delay, she was hopeful that the schemes were working to resolve these issues.[26]

Independence of the EDR schemes

7.17 A number of submitters were under the impression that the EDR schemes lacked independence and served merely as mouthpieces for the lenders—'a lapdog to the banks'.[27] Some submitters argued that a conflict of interest was clear as the financial services providers pay for the schemes; have a large influence on policy; 'make the rules'; and have ready access to the schemes. For example, one submitter suggested that he became aware that FOS was:

> …funded by the banks! So what possibility is there of a person like me being properly represented through such an Ombudsman service?[28]

7.18 Borrowers also cited what appeared to them to be:

- collusion between FOS and the banks to stall the supply of loan application forms;
- banks not held to time frames that FOS imposed; and

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25 COSL, *Submission 418*, p. 8.

26 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 43.

27 Name withheld, *Submission 35*. See also *Submissions 48, 156* and Dr Evan Jones, *Submission 295*.

28 Name withheld, *Submission 77*.

- overly generous treatment toward the banks in allocating time for them to supply materials but threatening the claimant with loss of their claim should they fall short of imposed inequitable time frames.[29]

Funding of the external dispute resolution schemes

7.19 FOS understood the strong likelihood that aggrieved consumers may perceive an industry-based dispute resolution scheme funded by the industry as inherently biased.[30] Mr Shane Tregillis, Chief Ombudsman, FOS, explained that FOS was partly financed through membership fees for its industry members, which account for around 20 per cent of FOS's funding. Case fees provide the bulk of FOS's funding; that is, FOS charges the financial institution a fee based on the stage at which a dispute is resolved.[31]

7.20 Mr Tregillis stated that the payment system was largely a user-pays system structured so that clearly there were incentives for financial institutions:

- not to bring complaints to FOS, because they pay a fee based on the number of complaints; and
- to seek to resolve that complaint early in the process through agreement rather than going through our later stages.[32]

7.21 COSL's funding is also made up of a combination of membership and complaint fees levied on financial services providers. It noted that with about 17,000 members, most of its funding was derived from membership fees rather than complaint fees. It noted that the complaints it received and dealt with only accounted for about three per cent of its members: the overwhelming majority of its members did not pay any complaint fees. It could not understand the reason for submissions suggesting that its independence was compromised by the fact that it received complaint fees from financial services providers.[33]

Board membership and industry

7.22 The composition of the EDR schemes' boards also drew criticism from some people who had their case managed by FOS or COSL. One submitter told the committee that the boards were made up of 'the who's who of the banking and financial industry along with their lawyers/solicitors of which some are the very ones who take the borrowers to court to claim their family homes'.[34] Another remarked that

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29 See *Submissions 76*, *77*, *184*, *217* and *259.*

30 FOS, *Submission 193,* p. 10.

31 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 28.

32 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 28.

33 COSL, *Submission 418*, p. 6.

34 Name withheld, *Submission 43*.

it seemed 'strange that bank employees are board members of FOS'.[35] In their view the conflict of interest was obvious.

7.23 FOS cited a number of inbuilt mechanisms that 'ensure that the schemes operate independently and with fairness and accountability', including requirements for:

- an independent decision making processes—to preserve the Ombudsman's independence, the board does not interfere with decisions or get involved in the detail of cases which come before the Ombudsman; and
- an oversight body with equal representation of consumers and industry together with an independent chair.[36]

7.24 COSL acknowledged that some submitters expressed reservations about industry representatives being on its board. In this regard, however, it noted that ASIC 'requires a board of an EDR scheme to comprise an equal number of consumer and industry representatives and an independent chair.[37] It informed the committee that:

> The COSL Board is responsible for overseeing the operations of the Credit Ombudsman Service, for ensuring independent decision making by the Credit Ombudsman and staff of COSL, and for preserving the independence of the scheme and the COSL dispute resolution processes.[38]

7.25 Indeed, the relevant ASIC regulatory guide requires FOS and COSL to be independent of the industry or industries that provide their funding and constitute their respective membership. The guide explains that such a requirement means that the decision-maker(s) and/or the staff of the scheme are:

- entirely responsible for the handling and determination of complaints or disputes;
- accountable only to the scheme's overseeing body (which as noted above should comprise an equal number of consumer and industry representatives and an independent chair); and
- adequately resourced to carry out their respective functions.[39]

Committee view

7.26 The funding arrangements for the EDR schemes are appropriate and should not in any way compromise their independence. The equal number of consumer

35 Mr Neville Ledger, *Submission 347*.

36 *Submission 193*, p. 10 and FOS, www.fos.org.au/about-us/our-board (accessed 15 May 2014).

37 *Submission 418*, p. 6.

38 *Submission 418*, p. 7.

39 ASIC, *Approval and oversight of external dispute resolution schemes*, Regulatory Guide 139, June 2013, paragraphs 139.89 and 139.94.

representatives on the boards should also provide assurances that the schemes are independent of industry. That said, the committee encourages FOS and COSL to do their utmost to ensure that consumers are aware of the safeguards in place designed to secure their independence and are conscious of the need to maintain their reputations as independent and fair schemes.

Transparency

7.27 One submitter noted that the financial service provider or bank involved in any serious systemic issue is not identified in any required quarterly reporting to ASIC or named publicly. He argued that 'consumer information fundamental to the protection of consumer rights is purposely withheld from every member of the public'.[40] Likewise, Mr Peter Mair observed that while FOS's determinations are published, it does not identify institutions at fault. He stated further that apparently FOS is able to order refunds only to the policyholders that complain personally and 'does not make any open public comment on the character of malpractices it discovers'. In his assessment—'a reticence that protects the secrecy'.[41]

7.28 It should be noted that ASIC requires the EDR schemes' complaints and disputes handling and other procedures to accord with the principles of natural justice.[42] COSL noted:

> To ensure parties to a complaint are accorded procedural fairness, we provide written reasons for any decision we make about the merits of a complaint and provide the parties with a reasonable opportunity to respond to our decision.
>
> To ensure the soundness and integrity of our decision-making process, all written decisions are reviewed internally by senior case managers before being issued. If a consumer seeks a (further) review of the decision, COSL's Head of Dispute Resolution will undertake a further review.
>
> Almost all our case management staff are legally qualified, given that regard for relevant law is a key benchmark in our decision-making processes.[43]

7.29 FOS informed the committee that it deals with complaints on an individual basis working with the parties through cooperation. FOS publishes its findings to provide general information to assist the public understand its findings and general values but does not name the institution or the applicant.[44] Mr Tregillis explained:

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40 Name withheld, *Submission 192*.

41 Mr Peter Mair, *Submission 2*, p. 2.

42 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.110.

43 COSL, *Submission 418*, p. 7.

44 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 25.

> If you started to name individual entities in determinations, I think we would become a much more court-like, complicated, contested process.[45]

7.30 He noted that 'the essence of EDR was to be quick, easy and accessible, and to resolve most disputes by agreement'. According to Mr Tregillis, although the EDR schemes work well, there are always areas for improvement. He considered that the 'history of FOS, COSL and the other schemes is that we have always had to relook and innovate'.[46]

7.31 The Consumer Action Law Centre noted that the schemes could be encouraged to 'provide more effective guidance to complainants from both sides about how disputes are resolved'.[47] Another submitter noted people who go to FOS should understand clearly that, although it has ombudsman in its title, it is a dispute resolution body and cannot put the complainant's case together for them.[48]

Accountability and performance

7.32 FOS and COSL must also adhere to core principles that underpin accountability. They are required to report any systemic, persistent or deliberate conduct to ASIC. According to ASIC, serious misconduct may include 'fraudulent conduct, grossly negligent or inefficient conduct, and wilful or flagrant breaches of relevant laws'.[49] ASIC's understanding of 'systemic' relates to matters that 'have implications beyond the immediate actions and rights of the parties to the complaint or dispute'.[50] ASIC recognised that some systemic issues could involve the conduct of multiple scheme members and may 'include general trends that might not implicate individual scheme members, but might reflect, for example, the need for a change in our regulatory guidance'.[51] COSL explained:

> As a condition of ASIC's ongoing approval of COSL as an approved EDR scheme, we are required to report to ASIC, on a quarterly basis, any systemic issues or serious misconduct in relation to FSPs that we may identify while dealing with a complaint.[52]

7.33 Consistent with this view, COSL noted that a systemic issue may arise out of a single complaint that has implications which extend beyond the parties to the particular complaint, or from multiple complaints which are similar in nature.

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45 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

46 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

47 Mr Gerard Brody, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, pp. 42–43.

48 *Submission 473* (Confidential).

49 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.124.

50 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.119.

51 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.137.

52 COSL, *Submission 418*, p. 8.

COSL publishes information about systemic issues and serious misconduct it has identified in its *Annual Report on Operations*, which is available to stakeholders and the general public.[53]

Reporting performance

7.34 In addition to reporting on systemic matters and serious misconduct, FOS and COSL are required to collect data and report to ASIC about complaints and disputes. Their annual reports should also provide such information. COSL explained:

> We meet regularly with ASIC (on a quarterly basis at a minimum) to discuss, among other things, emerging issues or trends arising from the complaints we are dealing with. In this way, ASIC is able to effectively monitor and oversee our operations and ensure that we continue to meet the conditions of its ongoing approval of COSL as an approved EDR scheme.[54]

7.35 Both schemes are also required to undergo regular independent reviews.[55] FOS recently underwent such a review.

Identifying and reporting systemic issues

7.36 Mr Field noted FOS's evolving approach to dealing with what appears to be emerging systemic issues. He stated that although there were some protocols in place when he first started at the Ombudsman's office in 2002, FOS's approach to systemic issues was very different today compared to then. He stated:

> In fact, I think at that stage looking at systemic issues was very much in its embryonic stages. Staff at the office were probably unsure about how to raise and deal with a systemic issue. Over 2002 to 2010, that process developed, and the confidence in using the systemic issues process developed to where it is today. We now have quite a large team dealing with systemic issues. It was certainly a learning phase for everybody in dealing with that, including for our financial services members.[56]

7.37 COSL has similarly improved its reporting on systemic issues. Although formed in 2003, it was not until 2006 that COSL had a single ombudsman model. Mr Venga was of the view that COSL's reports on systemic issues are much better now than before.[57]

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53 COSL, *Submission 418*, p. 8.

54 COSL, *Submission 418*, p. 8

55 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.116 and FOS, *Submission 193*, p. 10.

56 Mr Philip Field, Lead Ombudsman, Banking and Finance, FOS, *Proof Committee Hansard*, 20 February 2014, p. 21.

57 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 21.

Committee view

7.38 The damage caused by poor lending practices during the 2000s underscores the importance of identifying and arresting such practices before they take hold. The EDR schemes are important early detectors and, while the committee is encouraged by the EDRs' promising assessment of their own reporting of serious and/or systemic issues to ASIC, they should be constantly looking for ways to strengthen this reporting regime.

Recommendation 4

7.39 The committee recommends that ASIC devote a section of its annual report to the work of the financial services and consumer credit external dispute resolution (EDR) schemes, accompanied by ASIC's assessment of the systemic and significant issues the EDR schemes have raised in their reports to ASIC. Further, the committee recommends that ASIC include in this commentary information on any action taken in response to the matters raised in these reports.

Jurisdiction, compensation and limitations

7.40 This section examines the evidence the committee received that focused on the EDR schemes' jurisdictions, the amounts of compensation they can award and other factors that limit the actions EDRs can take.

Confusion between FOS and COSL

7.41 One submitter referred to FOS 'passing the buck' to COSL, which in turn determined that FOS was 'the appropriate entity to investigate such issues'.[58] Another submitter also indicated that his case had gone from COSL to FOS back to COSL back to FOS back to COSL.[59] Ms Denise Brailey told the committee that cases are often 'used as a football, being tossed from one EDR to the other'.[60]

7.42 COSL explained that under its rules, it can exercise its discretion to decline to deal with a complaint if it is satisfied that a more appropriate forum should manage the matter such as a court, tribunal or another ASIC-approved EDR scheme.[61]

Committee view

7.43 Both EDR schemes should be aware of the need to facilitate referrals between them and have procedures and officers within their organisations responsible for expediting the transfer of cases and for keeping consumers briefed on progress.

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58 *Submissions 11* (Confidential) and *266*.

59 Name withheld, *Submission 266*, p. 2.

60 Banking and Finance Consumers Support Association, *Submission 156*, p. 23.

61 COSL, *Submission 418*, p. 4.

Jurisdiction—fraud and retail clients

7.44 Most complaints made to the committee centred on the loan application form and the inaction by ASIC and the respective EDR schemes to deal with what submitters believed was blatant fraud. One submitter informed the committee that:

> The EDR bodies of FOS and COSL which are licenced by ASIC are very much on song with each other, all refusing to acknowledge fraud. With COSL once fraud is mentioned the cases are closed instantly.[62]

7.45 Ms Brailey supported this view. She suggested that COSL states 'if it's fraud we cannot assist you'.[63]

7.46 According to COSL, the difficulty with fraud is determining whether it happened:

> In most of the cases we have seen where complainants allege that they have been the victim of a home loan fraud, the financial services provider usually denies having engaged in the alleged conduct (and/or asserts that it was the consumer who had in fact committed a fraud).[64]

7.47 COSL argued that an allegation of fraud is 'a very serious matter, capable of being the subject of both civil and criminal legal proceedings'. It explained that a claim of fraud in a civil action must still be determined according to the balance of probabilities. In this regard, COSL cited the approach taken by the courts, which have emphasised that the gravity of such allegations should be kept in mind and findings of fraud not made lightly. COSL stated:

> To prove a case of fraud in legal proceedings (or defend against such an allegation), parties are able to, among other things, issue subpoenas for the production of documents, give evidence under oath and cross-examine witnesses. This rigorous process of collating and testing the available evidence and its credibility enables the court to make a thorough assessment of each party's version of events and ultimately decide which is to be preferred (on the balance of probabilities).[65]

7.48 COSL noted that parties to a COSL complaint alleging fraud do not have access to these evidentiary mechanisms. Further, COSL is limited by its rules in terms of 'its ability to obtain information from the parties (and non-member third parties, who are invariably involved in the claims we have seen)'. According to COSL, an EDR scheme is not like a court:

> We cannot subpoena witnesses, we cannot cross-examine people and we cannot take evidence under oath. That makes it very difficult for us to

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62 Name withheld, *Submission 78*, p. 1.

63 Banking and Finance Consumers Support Association, *Submission 156*, p. 23.

64 COSL, *Submission 418*, p. 4.

65 COSL, *Submission 418*, p. 4.

> establish that level of fraud. That is why we tend not to look at it. That is the qualification.[66]

7.49 In its submission, COSL stated further that it would generally exercise its discretion not to deal with a complaint involving an allegation of fraud on the basis that it would be more appropriate for the complaint to be dealt with by a court. In doing so, it would have regard to:

- the gravity of an allegation of fraud;
- the limitations of the COSL process in terms of collating and testing each party's evidence to the degree of exactness required; and
- the availability of the courts as an alternate forum to deal with such claims.

7.50 According to COSL, however, it 'routinely considers whether, on their face, these complaints give rise to alternate claims—such as unconscionable conduct, unjust contract or misleading or deceptive conduct'. If COSL is satisfied there is an alternate claim that requires investigation, it advised that it would inform the parties of this and continue to deal with the complaint on this basis.[67]

7.51 As noted in Chapter 5, prior to the enactment of the National Credit Act, ASIC was also reluctant to deal with reported cases of fraud. It preferred to refer such matters to the relevant state and territory police forces.[68]

Committee view

7.52 The committee has concerns that a complaint of possible fraud, involving for example a forged loan application, may be lost in the process of determining whether the alleged conduct involved fraud or another form of wrongdoing. The committee understands the seriousness of an allegation of fraud but in cases where the alleged wrongdoing is of a less serious nature, the committee believes that the EDR organisations are equipped to resolve the dispute and should do so.

7.53 Where the allegation of fraud is of a most serious nature, the committee believes that the EDR schemes should refer the matter to ASIC immediately and also include the matter in their quarterly report. ASIC must then determine whether to refer the matter to the relevant police force. The committee is of the view that should the police decide not to act on the allegation, ASIC should take back responsibility for the matter. Essentially, the committee is concerned that complaints involving allegations of fraud are bouncing between agencies and no agency is taking responsibility for investigating these matters. The importance of acting on allegations of fraud is particularly evident when considering that allegations of forged and 'doctored

66 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 24.

67 COSL, *Submission 418*, p. 4.

68 ASIC, *Submission 45.1*, p. 26.

documents' were not confined to lending practices between 2002 and 2010 but were also evident in the Storm Financial case and, as will be seen later, the CFPL matter.

Statute of limitations

7.54 The CCLC noted that some of the consumers writing to the committee may be out of time with regard to their claims. In this regard, Mr Field of FOS informed the committee that there are time limits imposed by FOS's terms of reference. He stated that FOS 'can only consider a dispute about events that happened within six years. Some of those go back and are probably outside our terms of reference'.[69]

7.55 When taking account of Ms Brailey's argument that some loans are designed to fail four or five years after the loan is granted, the six year limit seems too restrictive. The committee believes that ASIC and the EDR schemes should consider whether the limit of six years is appropriate.

Compensation cap

7.56 Currently, FOS and COSL are able to award compensation for loss up to $280,000. They are, however, able to consider a complaint if the amount of compensation claimed is greater than the monetary compensation ceiling but does not exceed $500,000.[70] Some submitters, however, were of the view that the ceiling placed on eligibility was too low.[71] For example one submitter suggested that the maximum amounts for a dispute value of $500,000 and an award sum of $280,000 were 'grossly inadequate' and urgently needed to be increased.[72]

7.57 In their response to the compensation cap, the EDR bodies focused on the amount of compensation that was likely to be awarded, as COSL explained:

> …the fact that compensation is likely to exceed our monetary compensation limit does not in itself prevent us from dealing with a complaint; it only prevents us from making a compensation award for an amount in excess of that limit.[73]

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69 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 21.

70 FOS, *Submission 193*, p. 9 and Mr Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 21.

71 See *Submissions 79*, *153*, *156* and *285*.

72 Name withheld, *Submission 184*. See also Mr Errol Opie, *Submission 259*, who stated that cases which are closed and thrown out by FOS and COSL just because they exceeded the scheme's jurisdictional limit, must be re-opened and thoroughly investigated as they contain fraud.

73 COSL, *Submission 418*, p. 5.

7.58 Mr Field emphasised that it was not so much the amount of the loan but the amount of compensation that determines the jurisdiction to consider disputes. He stated:

> In most cases the amount of compensation actually payable will generally fall within our compensation cap of $280,000. Some borrowers want to have the whole of the loan written off. Where that amount exceeds $500,000 we are unable to consider the dispute under our terms of reference.[74]

7.59 But, according to Mr Venga, setting aside the loan is very rare and so the amount of compensation tends to be much less that the loan itself.[75] Thus, the EDR schemes do not consider the ceiling on compensation as being too low.

7.60 Mr Field referred back to the principle that underpins external dispute resolution schemes—to offer a service to consumers mainly and small businesses. Therefore, in his view, it was appropriate to have a limit somewhere. He noted that FOS deals with some very large loan claims but 'where you have got people with $5 million or $10 million loans, maybe they are better off dealt with in court'.[76] COSL agreed with this contention. It also noted that EDR schemes provide an alternative to court proceedings and are not bound by strict rules of evidence:

> Quite often, the parties to a complaint have differing and competing versions of events, with little or no documentary evidence in support. In these cases, we draw inferences and conclusions based on the information obtained from the parties and make findings of fact on the balance of probabilities.
>
> Given these limitations, we consider that some complaints are more appropriately dealt with by the more formal process of the courts, particularly if large sums of money are involved.[77]

7.61 COSL also noted that the ceiling did not tend to exclude consumers. As an example, it explained that in the 2012–13 financial year it was unable to deal with only two complaints because the likely compensation would have exceeded its monetary compensation limit. According to COSL, in the preceding financial year, there was only one such complaint; these figures represented 0.06 per cent and 0.04 per cent, respectively, of all the complaints COSL finalised in each of those years.[78]

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74 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 18.

75 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 25.

76 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 25

77 COSL, *Submission 418*, p. 5.

78 COSL, *Submission 418*, p. 5.

Awarding compensation and consumer expectations

7.62 With regard to compensation, a number of submitters were also highly critical of the method for assessing damages. According to Mr Field, FOS's approach to the assessment of loss is intended to ensure that borrowers are compensated fairly where they have been provided with a loan that, had their lender acted in a diligent and prudent way, they should not have received.[79] He explained that, where the lender was at fault in approving the loan, the borrower would be compensated for the purchase, sale and holding costs. He noted, however, that in most cases the borrower is unable to repay the loan which means that the loan is not written off and the borrower does not get to retain the property that they acquired with the loan proceeds. Mr Field elaborated that, in such cases, 'the property should be sold and used to repay the loan'.[80]

7.63 COSL reinforced the message that complaints upheld about irresponsible, unjust or unconscionable lending, 'rarely result in the entire loan being set aside'. In this regard, the law is conscious that a borrower must not be 'unjustly enriched'. COSL explained that applying this principle means that:

> …while the borrower may be relieved from their obligations under their loan contract (in whole or in part), they will be required to account to the lender for any benefit they have received as a result of obtaining the loan, so as to ensure the borrower does not obtain a 'windfall'.[81]

7.64 According to COSL, it takes account of whether the borrower 'has actually obtained some material benefit as a result of entering into the loan—for example, by purchasing a property (either as a home or for an investment), obtaining funds for personal spending or renovations, or refinancing to a lower interest rate'.[82] Mr Venga noted that at the end of the day borrowers have to be accountable for the benefit they obtained from the loan, 'whether it is by not paying rent or by having a house to live in and things like that'. He emphasised that this is what the law says, which in his opinion was 'quite fair'.[83]

7.65 In some cases, the EDR organisations may also apportion a share of the liability to the borrower, where it deems that the borrower in some way contributed to the loss.

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79 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 18.

80 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 18.

81 COSL, *Submission 418*, p. 6.

82 COSL, *Submission 418*, pp. 5–6

83 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 25.

Financial Ombudsman Service—recommendations and determinations

7.66 Taken together the complaints against the two EDR schemes in essence centre on their apparent lack of independence and their bias toward the credit providers at the expense of the consumer. In this regard, the committee notes that EDR complaints/disputes handling and other procedures are bound by the principles of natural justice.[84]

7.67 FOS decides each complaint before it on its merits having regard to the relevant law, good industry practice, codes of practice and previous FOS decisions.[85] In its determinations involving loans taken out before the National Credit Act's responsible lending obligations came into force, FOS has stated that:

> …the statutory responsible lending provisions reflect pre-existing obligations for lenders to exercise the care and skill of a diligent and prudent lender when making their credit assessment.[86]

7.68 For example, FOS would have regard to the provisions of the National Credit Code or its predecessor the UCCC. FOS would also have regard to a financial services provider's common law contractual duty and whether the particular circumstances of the case gave rise to a claim of unconscionable or misleading conduct under the ASIC Act and the applicable provisions of the Code of Banking Practice.

7.69 FOS has made a number of determinations on cases involving low doc loans and falsified loan application forms. FOS made it clear that it and its predecessor have held the long-standing view that 'low doc does not mean low care'. In its determinations, FOS has explained that if there is information provided to the financial services provider that 'a diligent and prudent lender would have (or should have) investigated further, then that investigation should have been undertaken':

> A failure to exercise the care and skill of a diligent and prudent lender may result in a finding of maladministration.[87]

7.70 In some instances, FOS has determined in favour of the borrower where it found that the lender engaged in maladministration because it did not act diligently or prudently in establishing that the borrower could service the loan.[88] For example, in one such determination, FOS stated:

> …it was incumbent upon the FSP [financial service provider], exercising due care and skill, to make inquiries about the Applicant's income to be able

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84 ASIC, *Approval and oversight of external dispute resolution schemes*, Regulatory Guide 139, paragraph 139.110.

85 FOS, *Determination: Case number 286455*, 19 November 2013, p. 16.

86 FOS, *Determination: Case number 254056*, 25 September 2013, p. 8.

87 FOS, *Determination: Case number 254056*, 25 September 2013, p. 9. See also FOS, *Determination: Case number 286455*, 16 November 2013, p. 6

88 FOS, *Determination: Case number 233936*, 29 April 2013, pp. 6–7.

> to repay the loan over the loan period. If it had done so, any adequate inquiry would have revealed that she…did not have the financial capacity to repay principal and interest repayments…[89]

7.71 FOS explained further:

> …the FSP's lending policy of not requiring independent verification of the Applicant's self-employment was contrary to good industry lending practice. Even though the FSP complied with its policy, by doing nothing more, it failed to exercise due care and skill in assessing the loan application. Its decision to lend $700,000 to the Applicant was maladministration in lending.[90]

7.72 FOS has also noted that:

> …a borrower's self-certification of financial information in a low doc loan application would not 'necessarily protect a financial services provider from a claim of maladministration in lending if the circumstances were such that a diligent and prudent banker ought to have made inquiries to verify that information, but chose not to do so.'[91]

7.73 When resolving a dispute, FOS takes into account what is fair and reasonable. Thus, FOS explained that where borrowers have contributed to their loss by failing reasonably to protect their own interests, it may be appropriate to apportion loss between the borrower and the financial services provider.[92] For example, FOS has found that 'a loan applicant who signs a loan application form in blank (or worse with false information) and then signs a loan contract and mortgage ought reasonably take some responsibility for their decision to apply for and enter into the loan contract'.[93] Thus in some cases FOS has determined that the borrower should share liability for his or her loss and assess the proportion of that liability. For example, in a determination FOS advised that:

> A person who applies for a loan (in the absence of some vitiating conduct on the part of the FSP) should give consideration to their own financial situation and how they believe they will be able to repay the loan. It is not sufficient for a loan applicant to, in effect, turn a blind eye as to how they will repay the loan;
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> A person who applies for a loan should take care to protect their own interests by not signing an incomplete or blank loan application. It is reasonable to assume that the reason why a lender is requesting details the loan applicant's financial position is because it will rely on the information

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89 FOS, *Determination: Case number 227019*, 29 May 2013, p. 14.

90 FOS, *Determination: Case number 227019*, 29 May 2013, p. 15.

91 FOS, *Determination: Case number 233936*, 29 April 2013 (involving loans taken out in 2008); FOS, *Determination: Case number 227019*, 29 May 2013, (involving loans taken out in 2006).

92 FOS, *Determination: Case number 233936*, 29 April 2013, p. 7.

93 FOS, *Determination: Case number 254056*, 25 September 2013, p. 13.

> provided to make an assessment about their capacity to repay and whether it needs to make any further inquiries;
>
> The loan applicant will have a further opportunity to protect their own interests when presented with the actual loan agreements. Again, absent some vitiating factor by the FSP, the loan applicant can decide not to sign the loan agreement.[94]

Loan agreement

7.74 It would seem that from FOS's viewpoint, the loan agreement, which forms the legal contract binding lender and borrower, is the critical document and not the loan application forms. The onus is thus on the lender to ensure that it acts diligently and responsibly when offering a loan. Irrespective of the information contained in the loan application form, it is the terms of the agreement on which the validity of the contract rests. Therefore, the information contained in the loan application may be correct but the terms of the contract unjust and vice versa.

7.75 The committee understands the sense of betrayal and outrage that borrowers have experienced when they learn that their loan application forms have been falsified. But they should look to the terms of their loan agreement as evidence that the lender acted unjustly or unfairly in offering a loan for which they clearly could not service and which placed their home or other assets in jeopardy.

7.76 As the committee found in Chapter 5, it would seem that on the face of the evidence some lenders, irrespective of the loan application form, should not have provided particular loans: they were unaffordable and likely to fail. In other cases, again irrespective of the loan application form, the borrower should have taken care before signing the actual loan contract to make sure that the repayments were sustainable and would not jeopardise the assets securing the loan.

7.77 While the loan contract itself is the key document, the act of tampering with an application form cannot be justified under any circumstances. The committee is of the firm view that, although the broker may have been the instigator, the lender is complicit if it turns a blind eye to such wrongdoing.

Committee view

7.78 Effective external dispute resolution schemes free up ASIC to concentrate on the most serious transgressions and system-wide problems that have much broader implications for the financial services industry and consumers. The EDR schemes are a key part of any successful consumer protection framework. During the inquiry, many submitters who believed they were victims of predatory lending were not only critical of ASIC but also of its approved EDR schemes: FOS and COSL.

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94 FOS, *Determination: Case number 227019*, 29 May 2013, pp. 15–16. See also FOS, *Determination: Case number 254056*, 25 September 2013, p. 13.

7.79 In many cases their criticism appeared unwarranted, but the submissions did identify a number of areas where the schemes could improve their performance, such as the time taken to manage a complaint. Clearly, this has been a problem for some time, however, both EDR schemes have indicated that they are committed to improvement in this area. Also, while accepting that an EDR process is intended to provide a low cost, less formal process to resolve complaints for consumers, the committee nonetheless is of the view that the caps on eligibility and compensation appear to be too low. There is a particular problem for small businesses seeking a resolution to a dispute that may breach the eligibility cap or in some other way not qualify under the EDR schemes' terms of reference.

7.80 The committee is also concerned about allegations of fraud and the likelihood of those of a less serious nature falling through the gaps. While certain claims, such as falsified information in loan application forms or forged signatures on such documents may be classified as less serious offences, they still warrant attention. In the committee's view, ASIC, together with FOS and COSL, should establish protocols to ensure that such allegations are not handed from one agency to another and then somehow abandoned in the process. Again, there should be some body, preferably the EDR schemes, responsible for dealing with complaints of less serious fraud involving tampered loan application forms including forged signatures.

7.81 Finally, although the committee notes the assurances by both EDR schemes that their reporting of systemic issues to ASIC is now much better, the committee believes ASIC could improve the overall transparency of this reporting regime and how it responds to significant matters contained in them.

Recommendation 5

7.82 The committee recommends that the Financial Ombudsman Service and the Credit Ombudsman Service set key performance indicators (KPIs) for meeting milestones in their management of a complaint, publish these milestones and KPIs on their website and report their performance against these KPIs in their annual reports.

Recommendation 6

7.83 The committee recommends that ASIC, in consultation with the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service (COSL):

- **consider amending the terms of reference for FOS and COSL so that the caps on the maximum value of a claim that the EDR schemes may consider and the maximum amount that can be awarded are increased and indexed to the consumer price index;**
- **examine the processes for reporting to ASIC matters of significance and emerging systemic issues with a view to improving the reporting regime;**
- **establish protocols for managing allegations of less serious fraud to ensure that such complaints do not get lost in the system and are recorded properly on ASIC's databases;**

- **improve the guidance provided to complainants so they fully understand that FOS and COSL are dispute resolution bodies and that complainants must prepare their own cases; and**
- **consider establishing special divisions in FOS and COSL to deal with small business complaints.**

7.84 Before the committee concludes its consideration of predatory lending, it draws attention to the current concerns of the Consumer Credit Legal Centre (NSW). The Centre noted that a consumer support group was giving advice to many consumers, who borrowed between 2001 and 2010, that 'would appear to be not well founded in law'. It stated:

> While some of these borrowers have definitely been adversely affected by poor lending practices, the remedies available at law at the time, and even now, are not as extensive as some borrowers have been led to believe. Many borrowers are being advised to stop making payments on their loans altogether and are risking the repossession of their properties as a result (in addition to possibly being liable for further interest, charges and enforcement expenses).[95]

7.85 The committee has detailed numerous cases where highly vulnerable people were taken advantage of by unscrupulous brokers and in some cases negligent lenders. The submitters rightly call for justice. Despite the harm caused through the misconduct of others, some complainants, however, do not appreciate the legal obstacles to achieving what they would term a 'fair deal'. Indeed, there are two areas in particular where their expectations do not match the likelihood of success: holding lenders to account for the misdeeds of brokers; and the level of compensation due to them.

7.86 In this regard, the committee underlines the following messages from the consumer advocacy associations, EDR schemes and ASIC that relate to lending practices before 2010:

- Brokers as agents for the lender—the courts have found that, barring special circumstances, a mortgage broker was the agent of the borrower and not the lender; the broker's actions were attributable to the borrower; and the knowledge of a broker could not necessarily be imputed to the lender.
- Contract—the loan agreement is the legal contract binding lender and borrower and therefore is the critical document, not the loan application forms. The loan application forms 'do not in any way create or bind the applicants to a loan contract' with the financial service provider. Nor do they 'create an obligation' on the provider that it must offer finance to the applicant.[96] FOS explained further:

95 CCLC, *Submission 194*, p. 15.

96 FOS, *Determination: Case number 323234*, 17 December 2013, p. 5.

> The existence of the errant signatures on the [loan application forms], do not void the subsequent…loan contracts offered by the FSP and accepted by the Applicants. The crucial question to be considered is whether a diligent and prudent lender would have approved the loans?[97]

- Compensation—while the borrower may be relieved from their obligations under their loan contract (in whole or in part), they will be required to account to the lender for any benefit they have received as a result of obtaining the loan, so as to ensure the borrower does not obtain a 'windfall'.[98] This means that a court or EDR process would take into account whether the borrower 'has actually obtained some material benefit as a result of entering into the loan; for example, by purchasing a property (either as a home or for an investment), obtaining funds for personal spending or renovations, or refinancing to a lower interest rate'.[99] As COSL noted—setting aside the loan is very rare and so the amount of compensation tends to be much less than the loan itself.[100]
- Standard of proof—what appears to be malfeasance to a borrower may be difficult to prove in a courtroom, thus borrowers who elect to pursue matters in court face the same barriers as ASIC in establishing that a lender's conduct was, for example, unconscionable or that fraud took place.[101]

Conclusion

7.87 This one case study of problems in consumer credit between 2002 and 2010 (when the new credit laws came into force) sets the groundwork for the report. It introduces a number of key issues that surface and resurface in different contexts throughout this work. They include:

- ASIC has limited powers and resources but even so appears to miss or ignore early warning signs of corporate wrongdoing or troubling trends that pose a risk to consumers;
- the financial services industry is dynamic with new products and business models regularly emerging, which requires ASIC to be alert to the changes and any risk they pose to consumers or investors;
- in this changing environment, there are always people looking to find ways to circumvent the law—ASIC needs to have the skills and industry experience to be able to match their ingenuity;

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97 FOS, *Determination: Case number 323234*, 17 December 2013, p. 5.

98 COSL, *Submission 418*, p. 6.

99 COSL, *Submission 418*, pp. 5–6.

100 See paragraph 7.59.

101 ASIC, *Submission 45.1*, p. 26.

- consumers trust their advisers, brokers and financial institutions to do the right thing by them to the extent that they may sign incomplete or blank documents, do not ask questions and do not seek second opinions—importantly such trust is open to abuse;
- consumers have unrealistic expectations of what ASIC can do and the extent to which the regulator is able to protect their interests or investigate their complaints;
- ASIC's communication with retail investors and consumers needs to improve significantly;
- the important role other participants in the financial services industry can have in assisting ASIC in its regulatory role, which then allows the regulator to concentrate its limited resources on serious and systemic matters; and
- some advisers or brokers targeting, deliberately and systematically, the more vulnerable members of the community, especially older Australians with assets but without high levels of financial literacy.

7.88 In the following chapters, the committee considers in depth another case study—the Commonwealth Financial Planning Limited matter—which elaborates on some of the issues already raised but in a different context.