Min-it Software

Financiers Association of Australia

Joint Submission –

TREASURY Consultation –
Establishment of the Australian Financial Complaints Authority

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Background Information

This submission is made on behalf of the Financiers Association of Australia ("FAA") and Min-IT Software clients.

The Financiers Association of Australia ("FAA") and Min-it Software ("Min-IT") welcomes the opportunity to submit this submission on Treasury's consultation on extending unfair contract terms to small businesses.

The FAA, having been established since the 1930's, is an organisation for individuals and companies involved in the fields of finance and credit provision. The FAA's members are either non-ADI credit providers, providing loans up to $5,000 over terms of up to 2 years, mortgage financiers or business financiers.

Aside from the software produced in-house, specifically by or for franchised organisations, Min-IT Software is a leading loan management software supplier to the micro-lending sector of the Australian market. Additionally, it has a number of clients providing motor vehicle finance as well business loans and consumer leases.

The vast majority of Min-IT's clients are not affiliated with any industry association.

We thank Treasury for allowing us the extension of time to make this submission.

Introduction

Given the author's current state of ill-health, we have chosen not to respond to all questions as it has not been possible to contact sufficient members or clients sufficient to obtain a view in some cases.

Having read this consultation paper and knowing the Government has already tabled the *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Bill 2017* ("the enabling Bill") before the Senate, what is very clear is that unless the Transition Team get it right, industry will get nothing better, and probably worse, than we have now and paying dearly for it. We trust our comments will assist the Transition Team and Dr Edey.

This consultation paper has been framed so that whilst certain questions have been asked, some of the content is presented as a *fait accompli* when it actually demands some response.

Board Make-up

For example, the Board make-up is to comprise an independent chair plus

- directors with experience in carrying out the types of businesses operated by the members; and
- directors with experience in representing consumers.

As stated on page 21 of the paper, the Minister will appoint a minority of the initial directors, including the initial Chair. Ministerial authority to appoint directors will lapse six months after the date of authorisation (proposed section 1051(3) (e)).

In an email to the FAA from Treasury, we were asked to nominate potential interim Board members but the email states "[a]s a general principle, in order to avoid any suggestion of conflict of duty, there is a preference that a director with experience in the industry should not currently hold a managerial or executive office in a financial services business and would not act as a representative of any professional association, or association representing financial services."

In other words, anyone currently in the industry or having significant industry knowledge is to be excluded but yet the intending Board member would need to have current knowledge of what's happening. This restriction does not appear to apply to consumer representatives and in our response to Treasury's email, we suggested this should equally apply to the consumer advocacy sector in the interests of fairness. Unfortunately, due to the very nature of those who are being excluded, the Minister may find appointing equal numbers quite a challenge.

As the Minister's power to appoint interim members lasts only for 6 months, we consider it would be useful, if only from a transparency perspective, for members of the Transition Team and/or Dr Edey to meet representatives of industry organisations and discuss ' members' concerns about the make-up of the Board.

Our other issue is the Board members will appoint others to it. This replicates what occurs with CIOL and the industry representatives appointed to that EDR provider's Board are very friendly with the consumer advocates. There is no diversity and no potential for controversy. Like-minded people appoint others of a similar nature. We argue this is a conflict of interest because of the lack of diversity. In our opinion, the industry needs to appoint its own Board representatives.

If the Transition Team believes there is consultation with industry bodies, it is sadly mistaken. Representing SACC, MACC, AOCC credit providers and lessors, there are five representative organisations and to our knowledge, no one from any of them has ever been consulted by either of the 2 existing EDR providers.

Given the wide-ranging business interests of the FAA members and our own clients, we believe a Board of 13, with a minimum of 11 rather than 9 directors is likely to provide the required breadth of knowledge and expertise for the AFCA Board, given its diverse coverage. Whilst acknowledging this is a large number, the Board make-up will have to represent two distinct sectors, one relating to Superannuation and the other to Financial Services and all that encompasses.

Funding Comment

On page 25, the paper notes the 2 basic funding models currently operating:

- solely membership based (along the lines of SCT funding where levies are collected by APRA based on fund size);
- a combination of membership fee plus a case related component (as used by both FOS and CIO).

We believe the preferred fee model should be the existing membership fee based on the size of the business, plus fees for case resolution. In this way, smaller licence holders do not subsidise larger ones and those generating the most complaints pay the most in case resolution fees. Although most of our members and clients are members of CIOL, we are aware that many ACL holders have moved across to FOS as their model has proven to be more cost effective.

Systemic Issues

The AFCA is required to look for and report systemic issues to ASIC. Whilst this requirement is part of the enabling Bill at s.1052E (1) (a), no industry representative body is likely to suggest to its members that 'complaints' be handled by the AFCA. As part of ASIC Taskforce Papers 7 and 8, ASIC is seeking new powers to punish those that make any mistake. This is hardly conducive to a good relationship.

As lenders and lessors have to pay for any investigation by ASIC under the guise of an external audit, for those members and clients that continue after the introduction of the proposed National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017 ("the draft Bill"), any claim of a systemic issue, spurious or legitimate, could be the straw that breaks the camel's back. Most external audits start at a minimum cost of around $5,000 and can easily exceed $15,000. If the requirement is for an audit every quarter or even bi-annually, as has occurred in some instances, this is a significant impost on the financial viability of many businesses. With reduced income and increasing costs, the inevitable will occur but this appears to be exactly what Government is intending. The unintended consequences and financial exclusion will not be the worry of the AFCA apart form its own falling revenue stream.

ASIC Powers

The establishment of the AFCA was not our preferred choice and rather than have a Court provide its judgement under established separation of powers, the Government has gone with the Ombudsman model so that it could try and avoid a Royal Commission.

The Ramsay Report identified failings in the current system but the replacement has no obvious safeguards. For example, it's likely there will be little case law possible because ASIC will want everything to be controlled via the AFCA. That means the AFCA's decisions are going to be even more like pseudo-legislation than we have now.

The problem for industry is in addition to the AFCA reporting systemic issues, ASIC essentially controls the AFCA. The paper acknowledges on page 18, for example, that any 'material changes' (whatever these might be) in respect of the Terms of Reference must be approved by the regulator.

Under s.1052E of the enabling Bill, the AFCA must report to ASIC:

1. if it "becomes aware, in connection with a complaint under the AFCA scheme, that... a serious convention of any law **may** have occurred..."; and
2. "if... the parties to a complaint made under the AFCA scheme agree to a settlement of the complaint, and ...AFCA **thinks** that the settlement may require investigation".

(My bolding of "may" and "think".)
If the AFCA doesn't do something ASIC thinks it ought to have done, based on what's been proposed, it can issue a direction order under the Corporations Act or even take it to Court to enforce the order.

This is far worse than occurs now under either EDR provider. This paper provides no elucidation as to what or how ASIC will determine a "serious contravention" but "may" or "thinks" should not be indicators to ASIC to impose needless costs on a legitimate entity without any investigation of their own.

For this reason, the role of the Assessor may be crucial.

AFCA Construction

We have been advised by another industry representative that the enabling Act does not prescribe any opportunity for the AFCA or its "members" to report to the Minister after the Authorisation process has been completed. It has been suggested that the Minister, after getting Parliament to create the AFCA, may not have control over it and that there will be no Parliamentary reporting requirement unless the Minister chooses to make it part of the Authorisation process. If this is correct, we urge the Minister to ensure this occurs. Parliament has created the AFCA and it needs to have Ministerial and Parliamentary oversight.

Question1

Are there any other principles that should be included in the guiding principles for AFCA's establishment?

We note both the guiding principles and the enabling Bill exclude the need for transparency.

Transparency is critical to 'members' and this could take the form of ensuring, for example:

a. that the reasons provided by the consumer for lodging a dispute be considered for relevance before automatically escalating the matter to a more expensive level of determination;
b. that there is no automatic presumption of honesty by the consumer and dishonesty by the 'member';
c. that the decisions of any state consumer court or tribunal in regard to the complaint be recognised as finalising a matter;
d. that when a 'member' claims a complaint is trivial or vexatious, it be properly investigated prior to any escalation;
e. a client and FAA member have suggested the case managers not rely on email but actually pick up the phone and talk to the people involved; and finally
f. the Terms of Reference provide for a proper appeal mechanism.

Question 4

Are there any anticipated effects on firms that will be disproportionate to any increase in specific increased monetary limits?

On page 8, we note the Government "indicated that there would be further consultation on the sub-limits — referred to in this paper as specific limits — such as the limit for general insurance broking." We suggest this isn't enough as it's already difficult enough to obtain professional indemnity insurance for non-ADI credit providers and lessors and the policies are written in such a way that making a claim and getting paid out on it is almost impossible.

To date, we are aware of only a handful of claims ever having been attempted and as far as we are aware, there has yet to be a single successful claim. Consequently, the professional indemnity insurance policies offered are a good premium earner for the insurers and brokers alike but offer less than satisfactory cover for the insured.

Question 5

What measures may assist in ensuring AFCA's decision making processes promote consistency, while:

- deciding each case on its merits based on the facts and circumstances of the complaint; and
- maintaining the objective of achieving fairness and flexibility to adapt to changed circumstances?

Just as there is case law, the AFCA should be required to publish its decisions and full reasoning so that 'members' are aware of what's

occurring. This will improve transparency, if not fairness.

If a decision seems awry, industry representatives should be able to take the matter up with the AFCA Assessor and request further information and/or review so they can advise their members.

Question 6

Are there any other principles that may assist in ensuring AFCA provides fair, efficient, timely and independent decisions?

From what we've seen to date, where the 2 existing EDR providers fail is:

1. recognising the ACL or AFSL holder must obey the legislation. The starting point should be has this occurred, not what excuse can we find to say it hasn't? All too often, members and clients are reporting back that even though they have complied fully with the NCCP Act, the National Credit Code or Regulations at the time of contract creation, the FOS or CIOL case manager has looked for any excuse to make the lender pay compensation. If the ACL or AFSL holder has acted correctly, then there is no case to answer and the matter must be found in favour of the 'member'.
2. listening to both sides of the complaint and acting fairly. Our members and clients are telling us, all too often, that their argument is simply ignored. What we're seeing is the dispensing of social justice, whereby the lender is made to pay up at any cost simply because the case manager wants to find a way to satisfy the complainant. The argument is the lender is rich and can afford it.

If a lender doesn't like the decision, particularly with CIOL, there's no independent umpire or panel to review the decision. In matters of dispute, there needs to be a totally independent process that can review the decision rather

than what we see now which is the rubber-stamping of the case manager's decision. We are aware of a number of instances with CIOL whereby it has completely ignored legislation because it didn't suit the case manager's views.

Question 7

To what extent should these principles be reflected in the Terms of Reference, while allowing for operational flexibility?

In our view, every principle should be reflected in the Terms of Reference.

Question 8

How should AFCA balance the advantages of using panels in certain circumstances against efficiency and service implications including cost and timeliness of its decision making?

Despite the Ramsey Report recommending "that AFCA utilise expert decision making panels to resolve disputes where appropriate, noting the advantages including access to consumer and industry expertise in a particular product or sector " we have yet to see any instance of this occurring with the one EDR provider that apparently does use panels, FOS.

We can see the benefit of a panel but do question one point and that concerns the matter of a "systemic issue". CIOL in particular likes to make any complaint systemic because it means the EDR provider will then charge the lender further fees. This is an area of significant conflict of interest and in our view, one that CIOL has used to its advantage as a blackmail tool numerous times.

In our view, it would be relatively easy to make almost all complaints "systemic" because it's easy to twist facts to suit the situation after the event. Lenders know

people lie. They catch them out daily; the problem for a lender is the EDR provider's case management staff believes every word a consumer tells them.

Question 9

Are there other factors that should be taken into account when considering whether a panel should be used?

It has not been possible to communicate with sufficient members and clients to obtain their views so we will make no comment.

Question 10

How best can AFCA provide clear guidance about to users about when a panel should be used?

It has not been possible to communicate with sufficient members and clients to obtain their views so we will make no comment.

Question 11

Apart from the review of the impact of the higher compensation cap, are there other aspects of AFCA's operations that should be subject to independent review within the first three years of its commencement?

The AFCA has no track record and so its performance regarding efficiency, effectiveness, accountability, fairness and independence should be reviewed annually for at least the first 5 years. We regard an initial review after 3 years far too long.

Question 12

How and where should the charter of the independent assessor be defined? Who should be able to make a complaint to the independent assessor?

1. The charter should be defined by the AFCA Board, and have regard to current audit standards.
2. It should be subject to Ministerial approval and include detailed references to efficiency, effectiveness, fairness, transparency, accountability and compliance.
3. The charter should be presented annually to Parliament along with the AFCA annual report.
4. All complainant consumers, members as well as industry representative bodies should have a right to complain to the independent assessor.

Question 13

What safeguards should be put in place to ensure the assessor remains 'independent' (for example, should there be restrictions on early termination of the independent assessor)?

In our view, the assessor should be:

a. appointment by the Minister;
b. appointed for a term of no more than 2 years after which time there must be no opportunity for re-appointment for at least 4 years.

Essentially, the position is a contracted position for 2 years tenure. By ensuring no re-appointment for a period of 4 years, this will allow no bias to creep in, even in the short term.

Question 14

Should the independent assessor have guaranteed direct access to the AFCA Board?

Absolutely.

Question 15

What other reporting arrangements should be in place (for example, if there is serious misconduct or a systemic issue)?

In the event that serious misconduct or a system issue is found, if the complaint is about an ACL or AFSL holder who is a member of an industry representative organisation (such as the FAA), the assessor should be able to contact that body's administrators. This is because in such an event, it's likely that industry body's Rules will have been broken and the organisation may want to take disciplinary action against the member.

Question 16

Should the independent assessor publish their findings in each case on an anonymised basis?

There is merit in this, providing it's circulated to all 'members'.

Question 17

What should happen if AFCA disagrees with the independent assessor's decision?

What is not clear in this question is who in the AFCA will disagree with the decision. We presume it will not be the Board but those administering the

AFCA. In such circumstances, we believe the matter should first be presented to the Board and if there is still an impasse, then the Board considers allowing the matter be taken to a Court by agreement.

Question 18

When should a review of the functions and operation of the independent assessor be undertaken?

We see no reason why the same conditions suggested in response to question 11, i.e., reviewed annually for at least the first 5 years.

Question 19

Do existing exclusions from FOS and CIO jurisdictions present any unreasonable barriers to accessing the schemes?

We don't believe so.

Question 20

Is there more that could be done so that complaints lacking substance are excluded from being dealt with by AFCA?

Absolutely. Our members and clients have numerous stories of utterly vexatious claims that have been imposed on them.

When a complaint is made to the AFCA, assuming the matter has been to IDR first, there needs for some kind of review or screening process to occur that will allow the 'member' to show the consumer's claim is either:

a. vexatious or trivial;

b. a repetition of a complaint already dealt with by AFCA (or whilst 'members' are required to be 'members' of both the AFCA and their existing EDR provider, either FOS or CIOL); or
c. simply an attempt by a so-called 'credit repair company' to blackmail the 'member' into removing an adverse credit report listing by claiming, for example, no Default Notice was ever received by the complainant, and seeking solely to impose AFCA costs on the 'member'.

Question 21

What, if any, further practices should be adopted to ensure the correct balance between accessibility to the scheme and ensuring that complaints not appropriate for consideration by an EDR scheme are excluded?

The AFCA officer initially assessing the complaint should have the ability to make personal contact with both parties and request further information if required. If necessary, the ACL or AFSL holder should have the opportunity of providing further evidence to the officer before a decision is made to escalate the complaint.

Question 22

What requirements relating to accessibility should be included in AFCA's terms of reference?

It has not been possible to communicate with sufficient members and clients to obtain their views on this question so we will make no comment.

Question 23

Having regard to the current FOS terms of reference and CIO rules, what principles and topics are of sufficient ongoing significance that they should be addressed in the AFCA terms of reference?

Given our members and clients report that neither EDR actually does what the Terms of Reference or Rules state on a consistent basis in every case, we believe that FOS' Terms of Reference are the more appropriate of the two but they must be applied consistently otherwise we will end up with more of the same as we have now, except under a new name.

We recommend that Dr Edey should meet with relevant industry stakeholder organisations and come up with new and meaningful Terms of Reference that would reflect what the Government wants it to do.

Question 24

Are there any matters not currently included in the FOS terms of reference/CIO rules that warrant inclusion in AFCA's terms of reference?

In our view, based on what members and clients have reported, it is essential that it states borrowers are responsible for their own decisions and actions. The Minister has stated this herself [1]and it is fundamental to contract law.

Our members and clients are fully entitled to hold borrowers to account where,

[1] ABC *Television, 2016. 7.*30, Interview between Leigh Sales and Kelly O'Dwyer, 4 April 2016 where the Minister said "We of course believe in accountability and in people taking responsibility for their actions, but also providing them with information by which they can make positive choices. But at the end of the day, people are responsible for their own decisions. That's a fundamental tenet." Transcript available online http://www.abc.net.au/7.30/content/2015/s4437077.htm viewed 5 May 2016.

assuming the contract has the relevant legislated disclosures and the parties have freely signed without harassment, and all other legislated requirements (such as relating to responsible lending and loan suitability) have been met, then the signatures of the parties bind them to the terms of the contract.

Question 28

What measures could be put in place to secure sufficient knowledge of how different parts of the industry operate, while avoiding the representative tag for directors?

Ultimately, industry knowledge gained over many years is what will count.

Question 29

What measures should be put in place to ensure the AFCA Board appropriately balances the considerations of currency of director knowledge of particular industry sectors, conflict of interests, and breadth of competencies required?

With the Minister's method of Board selection, we see no measures that have been put in place to either manage or overcome the risks. It will therefore be up to the Board to decide. The Minister may, though, consider it appropriate and/or prudent to have the ability to dismiss the Board or a Board member in the event of irreconcilable conflict.

Question 31

Are there additional functions or responsibilities of the AFCA board that are not reflected in the constitutions of the existing schemes?

This question took us by surprise as it begs the question "What functionality other than an EDR is the AFCA Transition Team considering?" In our view, the AFCA is to be established to be an EDR scheme provider and that's all it should do.

Question 32

What benchmarks should AFCA have in relation to matters addressed in the ASX corporate governance principles, including:

- board renewal;
- diversity;
- procedures for assessing board performance;
- management of conflicts of interest or of duty on the part of directors and executive staff; and
- remuneration policy?

We consider the following should apply:

Board renewal

Maximum 4 or 6 year terms, with only half of the Board to exit at any time. No board member to be able to have 'back-to-back' terms,

Diversity

Allow the 'members' to appoint their own representative Board members.

Board Performance Assessment

1. Assessor and auditor to report both to the Board and the Minister;
2. The Board to allow members to attend AGM's;
3. The Board to allow questioning and demand answers of the Board at any AGM; and

4. Consult with industry representatives;

Conflict of Interest Management

1. Any conflict of interest by any Board member declared; and
2. AFCA to publish and clearly define procedures to manage conflict of interest.

Remuneration

Should be based on:

1. Actual performance, rather than number of staff being managed;
2. Similar work (and not necessarily those of the current EDR providers); and
3. Salary with no bonus structure.

The author has experience as an internal auditor of a variety of bonus systems and found that, in general, they encourage mis-management or bias.

Question 33

Should the Constitution or governing rules provide that neither the board nor individual directors can direct a decision-maker with regard to the outcomes of a particular dispute or class of disputes?

Absolutely.

Question 34

In addition to matters identified in paragraphs 1-3 above, what other material should a company seeking authorisation to operate the AFCA scheme provide to demonstrate that it has satisfied the requirements of

adequate funding and sufficient funding flexibility?

The fact that this question has been raised in this consultation suggests Treasury considers the AFCA could sub-contract its activities to one or both of the existing EDR providers. If a sub-contracting role is taken, it is unclear as to how the AFCA could delegate its statutory powers but it would allow the AFCA to circumvent any question of accountability of its fees. If the sub-contractor needs to increase its fees, it's not directly responsible to the AFCA's 'members'. We note now the significance of the Minister's media release of 22 August 2017 appointing Shane Tregillis, Chief Ombudsman of FOS to the Transition team[2].

Using say FOS in this manner would amount to a takeover. If this occurs, whilst it may save the jobs of those currently working for FOS, given the current level of dissatisfaction with the current 2 EDR providers, the industry will view it with serious concern. Unlike the UK's Financial Ombudsman Service which appears to be more transparent and honest in its dealings with its members, the current case management staff are imbued with a pro-consumer advocate stance and few cases are found in favour of the 'member'.

Question 35

Are there any principles beyond those identified in paragraph 2 above that should underpin AFCA's funding model?

The funding model needs to be totally transparent to those that will ultimately pay

[2] O'Dwyer, K, MP, 2017. *AFCA transition team reference panel established* Media Release, 22 August 2017. Available online http://kmo.ministers.treasury.gov.au/media-release/082-2017/ viewed 23 November 2017

for everything it does; the ‘members’. Anything less will be totally unsatisfactory.

Question 36

Should the funding arrangements for superannuation and non-superannuation disputes be separate and distinct, given the very different nature of these disputes?

Absolutely.

Question 37

If an interim funding arrangement were put in place, what features should it have and when would it be appropriate to transition to a long-run funding model?

Rather than demanding full payment of an annual fee in one payment, the AFCA should consider allowing for either monthly or quarterly payments rather than demanding an annual fee upfront.

Given the uncertainties with the industry that include ASIC ‘s funding requirements, the possibility of increased ACL and AFSL fees, further penalties, etc., no long term funding model should be considered for at least 5 years to allow for the industry sectors to consolidate.

Question 38

What special considerations might need to be factored into an interim funding model to balance the need for adequate resources (certainty) with the principles (accuracy)?

Given the contents of the draft Bill that will significantly affect SACC and consumer lessors significantly if enacted as drafted, we believe the AFCA needs to consider the financial situation of these 'members' and allow for either monthly or quarterly payments rather than demanding an annual fee upfront.

Depending on what the annual cost might be, this may need to continue for a period of up to 2 years given they must also retain membership with FOS or CIOL.

Unless the draft Bill is changed to allow sector viability, many of the current lessors and SACC lenders will likely exit the industry so the AFCA must factor in a diminished income from the start. That might mean the AFCA needs to consider the CIOL model rather than the FOS model for funding. Under the CIOL model, it attempts to collect 80% of its operational funding from membership fees with the balance being made up by case management fees.

Question 39

Who are the key stakeholders AFCA is accountable to? What is the key objective and measure of importance to each stakeholder?

We will not comment on the Government's objectives as this ombudsman scheme is being railroaded on to industry despite a Senate's committee's recommendation that echoed our own that a Tribunal with court-like powers be set up.

Besides any affected consumers, we have previously stated that the current EDR scheme providers ignore their 'members'. 'Members' are seen purely as a cash

cow that must pay for any decisions made. Some industry participants would argue they feel a nuisance for having the audacity to challenge the case manager. As such, most members will consider the cost of the scheme, fairness and the use of case law as being the critical elements.

Question 40

In addition to the accountability measures in the Bill, are there additional measures that should be embedded in AFCA's Constitution and/or terms of reference or reflected in ASIC guidance to ensure accountability to stakeholders?

There are 3 things missing from the existing EDR system that need to be incorporated into the Constitution and/or Terms of Reference.

'Members':

a. should have the opportunity of nominating its own industry representatives to the Board;
b. must be provided with a full set of financial accounts with salaries, honorariums, and all costs incurred; and
c. must have access to a forum to present grievances and comment, with the assessor and/or auditor present, at AGM's.

Question 41

Are there other conditions that could be put in place to ensure the scheme is accountable to members in relation to fees?

Ideally, we believe the AFCA should allow industry organisations to engage an independent auditor to review the financial accounts of the AFCA in the event of announced price increases and be able to report to the AFCA's "members" after

investigating the proposed fee increase.

At the very least, prior to the AFCA considering any fee amendment and notifying the Minister, it should:

a. consult with industry organisations on the need for the fee change; and
b. give sufficient advance notice of not less than 1 month.

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