Review of the financial system external dispute resolution framework (Review)

Response by Credit Corp Group Limited (Credit Corp) to the Interim Report (Report)

27 January 2017

The recommendation to replace the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO) with a single ombudsman scheme for all financial, credit and investment disputes is seriously flawed.

There is no evidence that the problems cited in the Report are real and are causing harm.

There is no evidence that two schemes are causing consumer confusion.[1] The Australian Securities and Investments Commission (ASIC) noted that there was a lack of evidence of 'consumers being shopped around schemes or potentially never getting to the scheme that can help them'.[2]

The Report provides no basis on which to conclude that disputes with identical fact circumstances are producing incomparable outcomes across the schemes.[3] [4] [5] The fact that one scheme delivers a superior user experience in particular instances reflects the benefits of multiple schemes in driving continuous improvement, adaptability and innovation.[6]

The idea that two competing schemes impose higher costs on industry than a single monopolistic scheme is contrary to all economic theory and practice. It is well-established that monopolies are less accountable for costs and produce vastly less efficient outcomes for users.[7]

Similarly, it is unlikely that ASIC will reduce resources as a consequence supervising one scheme rather than two competing schemes. ASIC will lose the ability to benchmark one scheme against the other and rely on competitive tension for continuous improvement. It will be required to conduct its own research to identify necessary adaptations and devote resources to ensuring effective implementation by the single scheme. ASIC may also find itself in the position of a price regulator and budget approver for the scheme. Rather than reducing the burden on ASIC's costs, moving to a single scheme is more likely to be associated with an increase in regulatory costs.[8]

The conclusion that 'the Panel is not convinced that competition between the schemes is appropriate or provides the most effective outcomes for all users' is undermined by the evidence to the contrary. The Report makes the unsupported point that competition between the schemes does not drive innovation and produces ineffective outcomes for consumers because it is the firm, rather than the consumer, who chooses the scheme. All the evidence, however, suggests the opposite. Both schemes have demonstrated substantial innovation and expansion beyond the minimum jurisdiction over many years and both schemes continue to exhibit this tendency.[9] The Report provides no evidence for the conclusion reached and provides no explanation of the overwhelming evidence to the contrary.[10]

The single scheme recommendation poses substantial risks, which have been ignored in the Report. A single ombudsman scheme has the potential to reduce the living standards of all Australians and damage economic growth by compromising the ability of the financial system to meet the needs of its users.[11]

A single non-statutory private ombudsman scheme of the type proposed in the Report is entirely without precedent in the global financial services landscape.[12] This is for good reason.

Industry ombudsman schemes exercise exceptional power through the terms of their private contracts with members and it is only the freedom of firms to contract with an alternative scheme which controls this power. Under the private contract firms provide all the schemes' funding and are bound by the orders of the scheme with no effective rights of appeal. The schemes are not required to follow the law or apply the law correctly and are free to create novel law and impose it on member firms. The schemes effectively combine legislative, administrative and judicial functions within a single private body.[13] [14] In the context of mandatory scheme membership and the absence of an alternative scheme there are no limits to the ways these functions and powers are exercised and the economic harm they can cause.[15]

All consumers, not just those who lodge complaints, are users of ombudsman schemes and all consumers suffer when schemes are not accountable to industry. If ombudsman schemes are costly, over-compensate complaining consumers, provide incentives to lodge unmeritorious complaints or use their extensive legislative and judicial powers inappropriately all consumers suffer. Industry participants respond by adjusting prices to pass on costs, rationing the availability of necessary financial products and withdrawing from certain products and segments entirely to the detriment of all consumers and the economy.

A single ombudsman scheme, freed from accountability to industry and all consumers for economic consequences, will substantially reduce competition in the market for financial services. In particular, smaller and more innovative financial services businesses which do not enjoy the benefits of scale, incumbency and government support will be least able to absorb costs and the impacts of dysfunction. A single ombudsman scheme will enhance the market power of major incumbents and decrease competition in the market for financial services.[16]

The recommendation to create a single ombudsman scheme does not address any identifiable past, present or future need.

The Report concludes that the existing system of two schemes is generally working well.[17]

The Report makes no mention of the major financial planning, life insurance and farm lending scandals which caused the government to commission the Review, let alone provides any explanation of how granting a single ombudsman scheme monopoly jurisdiction would have been effective in dealing with the scandals. There is no indication that a single scheme would have either prevented the scandals or provided more timely and appropriate compensation to victims.

If there is to be a single scheme it must be a properly funded and resourced statutory tribunal. Only a tribunal will properly address the risks posed by a single dispute resolution scheme. A tribunal bound by legal principles and subject to appeal through the courts will be sufficiently accountable to industry, government and all consumers.[18]

Endnotes and Supporting Commentary

[1] There is no evidence that two schemes are causing confusion. There are substantial and effective controls which adequately prevent the scope for confusion. Financial services providers are required to notify customers of the EDR scheme to which they belong. Most of the prescribed documents required to be provided to customers must set out details of the provider's EDR scheme. The schemes' websites contain searchable lists of members. Protocols exist between the schemes to transfer complaints from one scheme to the other in circumstances where an initial approach is made to the wrong scheme.

[2] Australian Securities and Investments Commission, submission to EDR Review Issues Paper, paragraph 168, page 41

[3] There is no evidence that the schemes are producing incomparable outcomes. The Report admits that 'it is difficult to make an assessment of the extent to which the current system produces inconsistent outcomes for consumers' at paragraph 5.14. Presumably, this is because comparison of individual cases is extremely difficult. Each case will turn on a detailed analysis of the facts and circumstances, including the individual circumstances of the consumer and the application of fairness to those individual circumstances. In the context of a single scheme it would be equally difficult to conclude as to the consistency of outcomes provided by the single scheme across a range of disputes.

[4] Credit Corp is not aware of any evidence that the existence of alternative schemes has adversely affected the integrity and consistency of decisions. Credit Corp's experience as a member of the Financial Ombudsman Service (FOS) and subsequently the Credit and Investments Ombudsman (CIO) is that both schemes will reach similar conclusions in similar fact circumstances.

[5] There are strong and effective controls in place to ensure the integrity of ombudsman scheme decisions. From a governance perspective these include the requirement for an independent chairman and equal numbers of industry and consumer directors. Other controls include the requirement for an independent review against regulatory guide requirements and benchmarks every five years. There is close oversight by regulators with detailed quarterly reporting and periodic engagement. The publication of rules, guidance notes, decisions, systemic issues and complaint outcome statistics creates transparency and provides stakeholders with the material to challenge schemes in order to hold them to account.

[6] The Report takes a paradoxical view on innovation and adaptability. In assessing comparability of outcomes the Report suggests there is something wrong with some consumers receiving a superior process for a period of time. At other points the Report asserts the importance of innovation and adaptability. Ongoing improvement, regardless of the number of schemes, will involve change and will mean that consumers are subject to different processes. Without change there can be no innovation and no adaptability.

[7] Without an alternative for financial services providers there is little to motivate ombudsman management to operate efficiently and prevent a scheme from become an inward-looking and self-serving bureaucracy. It is only if firms can identify a more cost-effective and efficient alternative, more attentive to individual member concerns, that ombudsman management will be motivated to contain costs, put in place systems to minimise the scope for abuse (the pursuit of unmeritorious disputes by consumers or their paid advocates to obtain unjustified settlements from financial services providers faced with escalating ombudsman dispute fees) and remain accountable to individual financial services provider members.

[8] It is well-established that monopoly markets require much more regulatory oversight than competitive markets. Regulators of monopolies are required to regulate prices and service levels. This takes place in markets including energy and airports.

[9] CIO has taken leadership in mandating appropriate responses to consumer hardship and the management of complaints in circumstances where legal proceedings have commenced. FOS has taken leadership in the application of consumer hardship to credit reporting practices. FOS has also been a leader in identifying systemic issues and encouraging remediation by financial services providers. More recently, CIO has increased its focus on systemic issues and has taken the innovative step of amending its rules to enforce compliance with its systemic issue findings.

[10] While the Report reviews overseas experience, including multiple ombudsman scheme jurisdictions, such as Canada and New Zealand, it does not mention any assessments of ombudsman performance in these markets. A recent review by the New Zealand Ministry for Business, Innovation and Employment concluded that there was no evidence that multiple schemes did not produce appropriate consumer outcomes (New Zealand Ministry for Business, Innovation and Employment, Review of the Operation of the Financial Services Providers (Registration and Dispute Resolution) 2008 and the Financial Advisers Act 2008: Issues Paper, November 2015, p 34).

[11] The financial system plays a vital role in raising the living standards of all Australians, with its ultimate purpose being to facilitate sustainable economic growth by meeting the financial needs of its users (Commonwealth of Australia 2014, Financial System Inquiry Final Report, p xv). It is important that the financial system is subject to both market forces and effective regulation. In the context of dispute resolution 'consumers should be able to expect that financial products will perform in the way they are led to believe and, where they do not, have access to effective redress' (Report p 8), but no more than this. If dispute resolution over-compensates consumers, provides compensation in circumstances where there is no legitimate claim, provides incentives to lodge unmeritorious claims or sets inappropriate standards for financial firms market forces are undermined. This damages the ability of the financial system to meet its objective with all consumers suffering from higher costs, more limited access to the financial system and compromised economic activity.

[12] The Report reviews developments in overseas jurisdictions (Canada, New Zealand, Singapore and the United Kingdom). Both Canada and New Zealand operate with multiple private schemes. The scheme in Singapore is more appropriately described as a tribunal, rather than an ombudsman scheme, with the adjudication process 'modelled after that used by the Singapore Courts' applying 'issues of law and equity' (Report at paragraph A1.59, p 179). In the United Kingdom there is a single statutory scheme (FOS UK). As a statutory scheme FOS UK operates with more accountability to government and the courts than the private industry schemes of Australia, Canada and New Zealand. The directors of FOS UK are appointed by the government regulator. FOS UK's budget is approved by the government regulator. As a 'public body' FOS UK's decisions are subject to judicial review pursuant to part 54 of the Civil Procedure Rules 1998 (UK). It is also interesting to note that FOS UK operates with a lower compensation cap (equivalent to just A$250,000) and a flat complaint fee model (equivalent to A$900 per dispute) regardless of the stage at which disputes are resolved. These features suggest a more legalistic approach to dispute resolution and one which provides more incentives for firms to defend themselves from unmeritorious complaints, rather than over-compensating consumers without regard to merit to avoid escalating dispute fees.

[13] The terms of reference of FOS and CIO allow for broad decision-making discretion subject to fairness in all the circumstances, relevant legal principles, industry codes and good practice. Decisions of FOS and CIO are not practically amenable to judicial review because of the contractual nature of the relationship between members and the schemes (CIO submission to the EDR Review Issues Paper, pp 75 – 79). These broad discretions allow private industry schemes to create 'legislation' (such as CIO's early formulation of financial hardship obligations) and impose this 'legislation' on financial services provider members through their decision-making (judicial) process. The ability to levy fees and expel members for non-compliance with orders and unpaid fees represent the administrative powers of industry ombudsman schemes. The consequences of expulsion for financial firms are extreme as failure to retain EDR membership is a breach of licensing conditions.

[14] It is instructive to compare the remarkable concentration of powers, combined with the absence of accountability mechanisms, within industry ombudsman schemes with the organs of the state. In terms of power over firms: regulators are bound to apply the law and must enforce the law through the courts, parliamentary law-making is subject to constitutional constraints and judicial review and the courts are bound to apply the law and are subject to appeal. In terms of accountability: regulators are answerable to parliament, government ombudsman and the courts for their actions and the parliament is subject to the democratic process. The only accountability imposed on ombudsman schemes by member financial firms arises from the freedom to contract with an alternative scheme. In the context of a single scheme even this accountability is absent.

[15] It is important to note that private industry ombudsman scheme governance structures are less accountable than any public or private body corporate. The directors are not elected by members but are appointed by the board in consultation with the Ombudsman. The governance structures of private industry ombudsman schemes (such as FOS and CIO) are unaccountably self-perpetuating.

[16] Submissions to the review show that the major financial services incumbents and their industry associations support a single ombudsman scheme, while submissions by associations representing all other industry participants, including competitors to the major incumbents, show that they are in favour of retaining the present two scheme model. Industry associations, and individual participants, in favour of the present two scheme model comprise of members of both FOS and CIO. Industry support for the two scheme model is not limited to CIO members. These competing firms recognise the importance of an alternative in imposing accountability on both schemes.

[17] Report p 15

[18] It is Credit Corp's understanding that there are many examples of very efficient and effective tribunals, which combine the timeliness, accessibility and fairness of industry ombudsman schemes with the enhanced legal accountability required to properly control the substantial economic risks of a single EDR scheme.