**Establishment of the Australian Financial Complaints Authority - a response to the consultation paper, by Catherine Wolthuizen and Philip Cullum**

**20 November, 2017**

**About us**

This submission is made in a personal capacity by Catherine Wolthuizen and Philip Cullum. We are consumer advocacy, regulation and dispute resolution experts, with extensive experience in the UK and Australia in a range of sectors, including but not limited to financial services.

**Catherine Wolthuizen** is the Independent Customer Advocate at NAB, where her role includes making decisions about complex and sensitive complaints and advising on how to improve complaints handling and the customer experience. She is also an Ombudsman at the Financial Ombudsman in the UK, where she has made decisions in around 2,500 cases, and an independent consumer representative to the Financial Ombudsman Service in Australia. She was previously Head of Market Affairs at FOS in the UK. She has had senior roles in two Australian consumer organisations, and is a former chair of the Consumer Federation of Australia, as well as running two advocacy organisations based in the UK. She was a member of the Legal Services Consumer Panel in England and has recently been appointed to the Board of the Consumer Policy Research Centre.

**Philip Cullum** is a senior adviser to an Australian economic regulator, working on strategy, governance and engagement. He was previously a Partner at the British energy regulator Ofgem, where his role included approving the appointment of the Energy Ombudsman scheme operator and regulation of energy retailers' complaints handling. In 2015 he had a year’s secondment to the Australian Competition and Consumer Commission. He has had senior roles in three UK consumer bodies, including Deputy Chief Executive of the National Consumer Council. He is a former member of the UK government's independent Regulatory Policy Committee and the Civil Aviation Authority’s consumer panel, he was a panel member for a review of the UK’s Financial Services Authority, and he remains a member of the Southern Water customer advisory panel in England.

**Principles for a high-performing EDR scheme**

Our work has given us insight into the main principles that typically characterise the design and operation of high-performing external dispute resolution (EDR) schemes. We consider that the key features are:

* Single scheme with mandatory membership for all businesses in a market and regulatory sanctions for non-compliance with decisions
* Clear remit to focus on fair consumer outcomes and contribute to the improvement of industry practices and regulatory approaches
* Free for consumers to use the scheme, with decisions binding on member businesses
* Expertise built up over time but also the ability to step back and observe how a market is working for consumers, without being unduly constrained by past practice and deep familiarity with industry norms
* Clear communication by the EDR scheme of its high-level expectations on key topics, which frame decisions in individual cases
* Effective link with regulator, so that lessons are fed back from the EDR scheme to inform regulatory prioritisation, policymaking and interventions
* Effective funding approach, which adopts 'polluter pays' principle as far as possible, gives the EDR scheme operator the ability to plan resources properly, and does not create an adverse incentive for businesses to buy off complainants who might otherwise go to the EDR scheme
* Accessible to all consumers, not just those who have higher levels of consumer skills and greater confidence
* Scheme operator is itself held accountable for its service performance and the substantive quality of its decision-making, with independent oversight, comparable performance measures and consumer-centred standards. In the worst case, an appropriate third party should be able to remove its licence to operate.

**Issue 1: Monetary and compensation limits**

It has been argued that monetary limits for EDR schemes are necessary to ensure that cases are considered in the right forum. For example, EDR schemes may not always have the necessary skills, resources and processes to make a multi-million dollar award to a consumer or small business, and such cases might more appropriately be handled through court action or by a regulator.

But limits can be a very blunt tool to achieve this objective and should not be used simply to protect businesses from the consequences of their own failures. They can operate to consumers’ detriment in two key ways:

* The monetary cap can exclude consumers from EDR who have little recourse to alternative means of resolving their dispute;
* The compensation cap can deny consumers appropriate restitution of their losses, even where a complaint has been fully upheld on its merits.

***Detriment arising from inflexible application of the monetary cap***

In setting limits, particular account needs to be taken of the scale of certain kinds of standard consumer products (such as mortgages) and the difficulties many consumers may have using the legal system.

We consider that if a monetary cap is to be applied, this should be done with discretion, to take account of the circumstances of the consumer and the nature of the complaint. As indicated above, a monetary cap aims to filter out those disputes which would be more appropriately dealt with in court. This assumes the consumers in such disputes have the means and confidence to engage in litigation to pursue their interests.

But many complaints which are deemed outside FOS terms of reference are brought by ordinary consumers. They have little or no experience of litigation and by the time losses have been incurred, little financial ability to take legal action. A monetary cap is therefore a blunt tool with which to filter out the minority of complainants who could and would go to court. Its application should be tempered with careful discretion so as to avoid the real harm which comes from excluding consumers who would otherwise be eligible for EDR, if their losses were not so serious.

Without the ability to exercise discretion, and allow complaints which would otherwise be OTR, there is a further serious risk of cementing loss and compounding detriment. If a business knows a consumer is unlikely and unable to pursue legal recourse, this gives them a significant advantage in consideration of a complaint or negotiation of a settlement. This raises the risk that a business will ‘game’ the EDR system, waiting for the complaint to be rejected as OTR and then quietly closing it, not offering a settlement or resolution in the knowledge the consumer cannot afford to take the matter any further.

***Detriment arising from inflexible application of the compensation cap***

It will be difficult for an EDR scheme to show it has achieved a fair outcome where compensation limits prevent appropriate restitution of the loss suffered by a consumer. We consider that the existence of compensation caps undermine the objective of EDR to restore trust and confidence among consumers of financial services. If a consumer can demonstrate they have suffered a loss as a result of a business’ error, that loss should be fully compensated, with interest payable for the loss of use of funds.

We appreciate that EDR is not designed for consumers and small businesses who have the ability to go to court to have their matter determined in more formal proceedings. And compensation limits are a means of discouraging such potential EDR users from drawing on EDR scheme resources which would be better deployed on smaller, more straightforward matters. But we query the need for both a monetary and a compensation cap. If a consumer’s claim is allowed under a monetary cap (or as an exemption to it on the grounds of fairness), there should be no reason to prevent recovery of losses if their complaint is upheld.

If a compensation cap is to be included in the design of the new EDR scheme, we would argue that at the very least, consumers should be able to limit their claim to the extent of loss permissible under the compensation cap. It does not appear that this is currently the case at FOS, where a consumer who has suffered losses in excess of that cap will have the entire complaint excluded, rather than their claim limited to the amount recoverable under the cap. That a consumer who has suffered a loss as a result of a business error cannot even bring their complaint to EDR because of the magnitude of that error feels very unfair. As a minimum, consumers who cannot go to court should have some chance of recovering some of their losses if it is found that the business was responsible for them, and EDR rules should not operate to prevent this.

***Detriment arising from aggregation of losses***

We are also aware of serious detriment caused by the aggregation of losses within a complaint which results in a matter being deemed OTR. Repeated instances of the same problem, raised by the same consumer, are treated as a single complaint, therefore making it more likely that the limit is exceeded and so outside FOS’s terms of reference.

This can be most clearly observed in complaints involving unauthorised transactions, where the cumulative losses arising from a pattern of use of the account are in excess of the monetary and compensation limits. But each unauthorised withdrawal from an account potentially represents a standalone failure by the bank to verify instructions, mandate and identity.

FOS’ current approach is to aggregate losses in such cases, and where these exceed the monetary cap, to deem the complaint as being outside its terms of reference. While such arrangements may offer some administrative benefits, we consider that this approach lacks a real focus on consumer experience, unduly favours the business over the consumer and causes consumer harm. We recommend that this approach should not be transferred to the new financial EDR scheme.

**Issue 2: Enhanced decision-making**

We support the view that EDR schemes should make decisions on the merits and circumstances, with the objective of achieving fairness for individual consumers.

We recommend the following principles to assist in ensuring AFCA provides fair, efficient, timely and independent decisions:

* AFCA should develop and consult on its high-level expectations of businesses on key topics, which can then frame decisions in individual cases. These ‘strategic stances’ would provide a direction of travel rather than be binding, and they would support consistent and open decision-making
* Industry expert advice can help identify outliers but must not be used in such a way that it legitimises industry-wide bad behaviour. (We consider this in more detail in relation to issue 3, below.)
* When ordering redress, the EDR scheme should aim to put the consumer back in the position that they would have been in had the business’ failure not occurred. We regard this principle as fundamental to fair and proper EDR scheme decisions, and we are concerned that it does not yet appear to be applied uniformly in financial services EDR in Australia
* AFCA should be subject to a time limit for handling cases, so that consumers can have more certainty about what they can expect from the EDR service. The EU dispute resolution directive requires cases to be handled within 90 days. UK FOS applies this timeframe from the point at which it has enough information to consider the case.

**Issue 3: Use of panels**

One of us is a FOS panel member and has observed first-hand how this mechanism can add significant value, including the involvement of people with an industry background. EDR schemes often develop their own ‘jurisprudence’ in-house, led by very senior members of staff who have been with the organisation for a long time. We consider that the development of ‘strategic stances’ on key issues should be an open and engaging process, and we also support the involvement of consumer and industry experts in tripartite panels assessing particularly challenging or strategically significant cases.

We do however have three concerns about this model, which are not arguments against it but rather issues to be wary of:

* The use of Panels does not mean that other mechanisms for opening up the discussion about EDR approaches on particular cross-cutting issues are unnecessary. They are complementary not alternatives
* Our experience is that industry panellists can often add substantial insight into what should be considered to be normal industry practices and standards, which can for example be valuable in cases centred on the quality of financial advice. But there is a danger that in other settings such advice may have the effect of legitimising bad practice. It is useful for spotting and assessing outliers but it can be positively harmful if a bad practice is common across the entire industry (for example, where credit policy settings were inappropriate at the time loans were being written, resulting in systemic unsuitable lending). It is imperative that EDR schemes are clear about when and how to use industry advisers: they should primarily be for identifying abnormal practice, not for making assessments of whether a particular practice is substantively appropriate. Inevitably the views of advisers with an industry background will be framed by cross-industry practice – this is both a strength and a weakness.
* The insight provided by industry and consumer panellists and advisers should not be binding on the AFCA decision-maker. Just as the current FOS terms of reference set out the factors which a decision-maker should ‘have regard to’ when considering a dispute, so too should the advice and input from an expert adviser. This is crucial to ensuring that the decision-making process remains truly independent.

**Issue 4: Ensuring accountability through independent reviews**

AFCA should periodically commission and publish independent quantitative and qualitative research with complainants who were eligible to use the EDR scheme but did not do so, in order to learn lessons about how to make the scheme more accessible. This should be done around every three years, with the first study being undertaken with the first 18 months of the new scheme’s operation. One of us was responsible for similar research commissioned by the British energy regulator Ofgem[[1]](#footnote-1), which may prove a useful model on which to draw.

**Issue 5: independent assessor**

We support the appointment of an independent assessor, which is a role that appears to have worked well at the UK’s Financial Conduct Authority and at UK FOS. In order to ensure this function enhances trust and confidence in AFCA, effort should be made to ensure it is accessible to consumers who use the scheme as well as scheme members. It will also need to be made clear that the assessor’s role is about process, service and the quality of decision-making, rather than representing a further tier of substantive review.

The assessor should be appointed through a process of open advertisement and fair selection. They should both report periodically on their workload and findings and publish all their decisions.

**Issue 6: Exclusions from AFCA’s jurisdiction**

***‘Vexatious and frivolous’ complaints***

We are disappointed by the emphasis in this section on vexatious and frivolous complaints. While such complaints do undoubtedly exist and should be managed appropriately, they usually represent a tiny proportion of complaints made to EDR schemes. The characterisation of complainants as such is also highly subjective and can generally only be verified after a complaint has been accepted and investigated.

A useful example here is of so-called “No-PPI” claims to the UK FOS. These comprise a significant number of PPI complaints to the service, and generally come from consumers who do not trust their financial institution sufficiently to accept being told they never had a PPI policy with that institution. While some industry representatives in the UK would characterise these complaints as vexatious and frivolous, they are not. Most consumers making these complaints to UK FOS believe they have a valid claim, and are motivated by this, not by any desire to cause mischief or cost to that financial institution.

It is also interesting to observe from the UK experience that claims that complaints are frivolous and vexatious often come from a smaller entities who tend to be more negative about the role of complaints and EDR relative to their business than businesses who more routinely deal with complaints and are more accepting of consumers’ right to bring them.

Where a consumer could genuinely be characterised as bringing ‘vexatious and frivolous’ complaints, there may well be underlying issues such as mental health problems driving this behaviour. We address the issue of accessibility below, but would argue here that a scheme should not be designed to exclude users, especially those who may have particular causes of vulnerability.

***Accessibility and consumers in vulnerable situations***

A far bigger issue is how consumers in vulnerable situations can access EDR schemes. Research on different schemes suggests that the majority of EDR users are the ‘usual suspects’ – that is, consumers with the time, education and confidence to bring a complaint - with a paradox that the people who most need help are least likely to access it.

We would encourage much greater emphasis on tackling this, with focus on inclusion rather than exclusion. We note the UK experience demonstrates that a market for intermediaries (claims management companies in the UK) will quickly open up where schemes are perceived as less accessible for consumers without the experience or confidence to use them without third party representation.

UK FOS has started conducting deeper research into the profile of consumers who use the service, and what they complaint about, to inform its outreach and consumer communications work and to improve accessibility. We consider should be incorporated into the operations of the new EDR scheme; that it should research use of the scheme and conduct appropriate outreach work to increase use among underrepresented segments of the population.

**Funding**

Allied to the accessibility issues set out above, we are concerned that the current funding and fee arrangements for FOS may create an incentive for businesses to manage costs by ‘buying off’ customers to limit referrals to EDR.

While businesses should of course seek to limit the number of EDR cases through good quality internal complaints handling and learning lessons from cases, our concern is about a more ‘economic’ approach, which involves identifying likely EDR cases and offering a settlement below the likely EDR fee, irrespective of the strength of their case. This might look like good news from a consumer perspective, but in fact it is strongly against the consumer interest, because (a) it cuts the flow of information about emerging issues to the EDR scheme and the regulator; (b) the business does not then learn from such cases; and (c) this may encourage an damaging culture around complaints within the business whereby they are viewed largely as a cost to the business which needs to be managed rather than a source of valuable insight.

The nature and level of fees set by the EDR scheme may have a bearing on this. There is a careful balancing act to be achieved here, between three elements:

* Businesses should generally bear the costs of their own bad behaviour, so they should pay for the number of EDR cases which relate to their business
* The EDR operator needs to have reliable and sufficient funding and good quality forecasting of likely cases, so that they can have the right resources in place.
* The case fees must not be so high as to incentivise the business to buy off complainants who threaten to go to the EDR scheme.

As a result, some EDR schemes have developed approaches involving a blend of an annual subscription and per-case fees, with higher fees charged for cases which are above the business’ forecast. This is designed to incentivise good quality forecasting, allow resource planning, and lower the marginal cost of cases within the forecast level.

For several years now, UK FOS has operated a model which charges the largest users of the service – the largest banks and insurers – a share of the operating costs of the scheme reflecting their use. This requires the business to make reliable projections of complaints figures for the coming year. The incentive to reduce complaints through good IDR is retained, as a refund of the annual fee will be payable for a business which comes in below the target, and a penalty will be charge for exceeding the target. Advantages of this model are that it moves those users away from seeing every case as a cost to be avoided, reduces administrative costs associated with per-case charging and allows both business and scheme to budget more effectively.

At the other end of the scale of use, it should still be possible for members (especially small business members) who have few complaints each year to be charged on a per-case basis on top of any annual subscription. It can also be helpful to allow a number of cases to be ‘case-fee-free’ to build support for membership of the scheme amongst those who may only receive a handful of complaints per year.

1. <https://www.ofgem.gov.uk/publications-and-updates/complaints-ombudsman-services-energy-%E2%80%93-research-report> [↑](#footnote-ref-1)