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Competition in Australia's Financial System inquiry
Productivity Commission
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Competition in Australia's Financial System

The Credit and Investments Ombudsman (**CIO**) welcomes the opportunity to make a submission in relation to the above review.

About CIO

CIO is one of only two ASIC-approved external dispute resolution (**EDR**) schemes for financial services in Australia, the other being the Financial Ombudsman Service (**FOS**).

CIO, like FOS, is an independent industry-funded EDR scheme. It is a not-for-profit organisation established as a public company limited by guarantee. It provides consumers with a free and impartial dispute resolution service as an alternative to legal proceedings for resolving complaints with their financial services providers (**FSPs**).

CIO has more than 25,000 FSP members, about 95% of which are sole traders and small businesses; in other words, they hail from the smaller end of town.

CIO operates predominantly in the credit sector. Its membership includes non-bank lenders, mutual banks, credit unions, building societies, finance brokers, debt purchasers and collectors, timeshare providers, financial planners and credit reporting bodies.

In the overwhelming majority of cases, CIO's facilitation results in both the consumer and the FSP agreeing to a mutually acceptable and fair outcome. If the parties are unable to agree on an appropriate outcome, CIO can and will investigate the dispute further and make a decision based on the particular facts of the dispute. The decision is binding on the FSP if the consumer or small business accepts it.

When resolving disputes, CIO has regard to relevant legal principles, industry codes of practice, good industry practice and fairness in all circumstances.

AFCA

Treasury released exposure draft legislation, an explanatory memorandum, a consultation paper and a fact sheet (**EDR framework documents**) for the establishment of a single Ombudsman scheme to be known as the Australian Financial Complaints Authority (**AFCA**). AFCA is intended to become operational on 1 July 2018. From that date, it will receive all new consumer complaints in the sector to the exclusion of CIO, FOS and the Superannuation Complaints Tribunal (**SCT**) – these three schemes will only deal with legacy complaints from that date.

A Bill establishing AFCA is expected to be introduced into Federal Parliament imminently.

CIO opposes the establishment of the 'one-stop shop' for financial disputes, including superannuation disputes, to replace CIO, FOS and the SCT.

Our reasons are as follows:[1]

1. Old wine in a new bottle

[1] Other detailed reasons are set out in our response to the Ramsay Review: http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20into%20EDR/Submissions/PDF/Credit%20and%20Investments%20Ombudsman%20Service%20Submission.ashx

Despite being trumpeted as something entirely new and designed to ensure 'that consumers and small business have access to free, fast and binding dispute resolution',[2] AFCA has essentially the same powers and jurisdictions as CIO, FOS and the SCT.

For example, the exposure draft legislation prescribes certain key features and regulatory oversight under which AFCA will operate. But these are virtually the same as CIO, FOS and SCT's:

(a) The SCT already possesses the 'additional powers' that are being given to AFCA for superannuation complaints.

(b) To meet those few key requirements that CIO and FOS do not already comply with, CIO and FOS need only amend their existing terms of reference to allow them to increase their monetary limits and compensation caps, appoint an independent assessor, conduct more frequent independent reviews and use panels to decide certain types of cases.

(c) As for regulatory oversight, the proposal to allow ASIC to issue 'directions' to the scheme operator to undertake specific measures adds little, if anything. ASIC already has the power to revoke CIO or FOS' approval if they do not meet ASIC's requirements. This constitutes a far greater incentive for CIO and FOS to comply with ASIC's requirements than the power to issue 'directions'.

(d) More significantly, if only one scheme is authorised by the Minister, as is proposed, it is inconceivable that the Minister would revoke AFCA's authorisation and leave tens of thousands of consumers with absolutely no redress against financial firms other than through costly legal proceedings.

Stakeholders would be entitled to ask: what then is the sanction for poor performance or non-compliance by AFCA?

[2] http://sjm.ministers.treasury.gov.au/media-release/044-2017/

2. No economic basis

The proposal to establish AFCA is not supported by economic analysis, sound argument or evidence:[3]

(a) The Ramsay Report on which the proposal is based does not demonstrate any cost benefits to replacing CIO, FOS and the SCT with AFCA.

(b) The Report's assertion that multiple EDR schemes result in increased costs for the regulator is flawed. [4] On the contrary, the proposal to establish AFCA has led the government to announce in the budget papers that an additional $4.3 million will be made available to ASIC over four years in relation to its work with AFCA.

(c) Being a non-statutory monopoly, AFCA will be far less accountable and transparent to its stakeholders than a statutory scheme that is subject to appropriate checks and balances.

(d) AFCA will eliminate the benefits which the existing two ASIC-approved ombudsman schemes (CIO and FOS) currently provide: better consumer outcomes through benchmarking,[5] service quality comparison, innovation with better processes and services and pressure to keep costs down.

(e) Compared to firms in more competitive markets, a typical not-for-profit monopoly will tend to charge more for its services and spend it on bloated staff numbers, higher managerial salaries, excessive executive

[3] Economic analysis of the Ramsay Interim Report by ACIL Allen Consulting, January 2017

[4] Page 8, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20into%20EDR/Key%20Documents/PDF/EDR%20Review%20Final%20report.ashx

[5] This is discussed in detail in CIO's response to the Ramsay Interim Report: http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20into%20EDR/Submissions/PDF/Credit%20and%20Investments%20Ombudsman%20Service%20Submission.ashx

remuneration, lavish offices and other wasteful spending.[6]

(f) AFCA will also damage the prospects for increased competition in financial services. While the cost of having complaints heard by an ombudsman scheme which is inefficient (which typically can be expected where the body is a monopoly) may not be a significant cost to the major banks and insurers, it certainly will be for smaller players who operate on much thinner margins. Costs impede the latter's ability to compete on price, especially in the early stages of development.

(g) Unlike a conventional monopoly where buyers can walk away if the quality of the service is low or prices charged by the monopolist are high, financial services providers will have no choice but to remain members of AFCA given that membership is mandatory.

This is not a problem under the current two ASIC-approved scheme model because competitive tension between CIO and FOS means that they have to be responsive and accountable to financial firms who can credibly threaten to take their membership to the other scheme.

3. The current arrangement – two EDR schemes

While a proliferation of EDR schemes may not be ideal, CIO is of the firm view that the current arrangements offer better outcomes for consumers.

Scheme benchmarking

Having two ASIC-approved EDR schemes allows each scheme to benchmark their performance against the other (**scheme benchmarking**), and this produces better consumer and industry outcomes.

Indeed, the independent and periodic reviews of EDR schemes compare each of the schemes, and in doing so, recommend one scheme implement particular

[6] Managerial Discretion and Expense Preference Behaviour, Robert Y Awh and Walter J Primeaux, Jr.

improvements seen in the other.[7] This can only raise best practice in EDR. It cannot be achieved under a single EDR scheme model.

Without the stimulus of EDR benchmarking and a comparative discipline, turnaround times, service levels, innovation and continuous improvement would suffer and there would be less incentive to keep costs in check and run the scheme efficiently.

The present two-scheme EDR model in Australia has spurred productivity growth and created a self-sustaining process for continual reform and reassessment. That process drives ongoing benefits for the sector and for consumers, primary producers and small businesses.

Innovation

The innovations and improvements resulting from scheme benchmarking directly and empirically contradict any suggestion that multiple schemes might engage in a 'race to the bottom'.

CIO was the first EDR scheme to undertake a number of best practice initiatives:

- dealing with financial hardship complaints, even in relation to non-regulated loans (this significant reform led to a major change in the case profiles of both CIO and FOS - financial hardship complaints historically make up about 30% of all disputes received by CIO and FOS),
- requiring an FSP to discontinue or not commence enforcement action while the complaint is open with CIO,
- dealing with financial hardship complaints even when legal proceedings have commenced,
- dealing with complaints received after default judgment has been entered in certain circumstances,
- reviewing fees and charges (rather than relying on the FSP's 'commercial judgement' exemption),

[7] See, for example, FOS' Independent Review 2013, pages 25 (para 3), 39 (para 3), 44 (last para), 60 (second last para), 75 (para 5), 76 (para 3), 132 (last para) and 133 (second last para): https://www.fos.org.au/custom/files/docs/independent-review-final-report-2014.pdf

- effectively managing credit repair firms and debt management companies that take advantage of vulnerable and disadvantaged consumers, and
- expelling an FSP from membership (and this has significant implications for its ability to meet its ASIC-imposed licence conditions) where it refuses to implement a remediation programme recommended by CIO for the resolution of a systemic issue.

Indeed, CIO's Independent Review concluded that CIO 'has been an innovator and policy leader in the area of consumers confronting financial hardship and has developed its own very successful approach to dealing with financial hardship complaints'[8] and that 'there is no doubt that CIO has done some fine work for consumer rights and has in some cases been bolder than others in acting in the public interest'.[9]

Competition among Ombudsmen

There are some who take the position that there should be no competition at all between ombudsmen in the same industry sector. They go so far to say that 'financial services' as whole should only have one EDR scheme to prevent the perceived drawbacks of competition.[10] This position ignores the benefits to both consumers and industry of having at least two 'competing' EDR schemes.

It should be pointed out that there is no empirical evidence of consumer confusion as to which ASIC-approved EDR scheme consumers should take their complaints.

ASIC's own submission to the Ramsay Review notes that there is a lack of evidence of consumers being 'shopped around schemes or potentially never getting to the scheme that can help them'.

Nor is there evidence of forum shopping or arbitrage by FSPs (for instance, where an FSP selects an EDR scheme with a reputation for leniency).

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[8] Page 4: http://www.cio.org.au/cosl/assets/File/Independently%20Review%202012%20(The%20Navigator%20Group).pdf

To the extent that FSPs compare different schemes and 'shop' them, comparisons are made based on service levels, value and the ease of doing business – not bias to business or perceived laxity.

Those FSPs that have joined CIO from FOS have done so for a number of reasons; for example, their location in the same city as CIO has meant that they can meet with CIO on a regular basis more conveniently and economically; their competitors are existing members of CIO and they are inclined to be in the same scheme as their cohort; or they are of the view that a scheme that was formed essentially for the non-bank sector is more appropriate for them.

Accordingly, although there is some movement between the two schemes, scheme shopping by FSPs is not a live issue. In any event, to limit any potential abuse, CIO and FOS have entered into a Memorandum of Understanding which allows each scheme, before accepting an applicant as a member, to consult with the other about whether the applicant has paid a consumer any compensation that may have been awarded by the scheme, whether any complaints are open, whether any systemic issues have been identified and whether any fees are outstanding.[11]

Nor are we are not aware of any statistical or substantial evidence of substantive differences in consumer outcomes between CIO and FOS.

Indeed, the Ramsay Report itself concedes that 'it is difficult to make an assessment of the extent to which the current system produces inconsistent outcomes for consumers'[16] We note that both schemes must satisfy the requirements of ASIC's Regulatory Guide 139 which promotes minimum standards across EDR schemes to achieve "parity of schemes and equal treatment of complaints".[17]

[9] Page 13: http://www.cio.org.au/cosl/assets/File/Independently%20Review%202012%20(The%20Navigator%20Group).pdf

[10] http://www.anzoa.com.au/assets/anzoa-policy-statement_competition-among-ombudsman-offices.pdf

[11] http://www.cio.org.au/cosl/assets/File/MOU%20between%20FOS%20and%20COSL.pdf

The Ramsay Report suggests that competition between EDR schemes may lead to unnecessary duplicative costs and an inefficient allocation of resources for industry and for the regulator.

With respect, that is akin to saying that Australia would be better off with a single provider of financial services or a single supermarket operator.

Any benefit gained by removing duplication will be more than offset by increased bureaucracy and a lack of accountability to stakeholders – a common trait amongst monopolies.

Absence of checks and balances

Because monopolies, by definition, do not face any competitive pressures, a single EDR scheme would be far less accountable and transparent than a statutory scheme to its stakeholders. A statutory scheme is subject to important checks and balances and, in the absence of these, the only check on the broad discretions and powers of a non-statutory scheme is the existence of two EDR schemes operating in the same sector in competition with each other.

There is no precedent anywhere in the developed world for a single *non-statutory* EDR scheme for financial services, as is being proposed by the Ramsay Report.[12]

In the absence of the sorts of checks and balances that apply to a statutory scheme, the only check on the broad discretions and powers of CIO and FOS is the existence of two schemes operating in the same sector in competition with each other.

4. Case study of a not-for-profit member-based monopoly

To appreciate the kind of allegations that can be levelled against a not-for-profit member-based organisation that enjoys a monopoly (in the same way that AFCA will), one only has to look at recent media reports about the board

[12] A single scheme is contrary to international trends in financial services alternative dispute resolution: France has three financial services schemes dealing with different product groups, banking, investment and

and management of CPA Australia, a company also limited by guarantee.[13]

AFCA, being also a member-based non-for profit organisation which enjoys a monopoly, will not be immune from allegations of governance dysfunction, particularly since its directors will be appointed by the board itself, not by its members.

For example, what would prevent AFCA directors from giving themselves hefty or undeserved pay increases? How would directors be removed for poor performance where there is no possibility of directors being voted out? What incentive would the board have to keep costs down and operate the scheme efficiently in circumstances where its members have no say as to how the budget is framed or how the scheme is run?

Further, the AGM attendance of not-for-profits is notoriously low and, as a result, controversial resolutions are often passed without adequate member engagement.

5. Additional powers for the SCT

The draft exposure bill contemplates AFCA being given some statutory powers to allow it to manage superannuation complaints. These powers are the same as those the SCT currently possesses, namely:

- the power to join certain third parties to a superannuation complaint,
- the power to obtain information and documents which are relevant to a superannuation complaint, and
- the power to require people to attend conciliation conferences to assist in the resolution of a superannuation complaint.

While we question the constitutionality of providing a private company (as opposed to a statutory body) with statutory powers, we consider that no

insurance respectively. Germany has eleven schemes with cross-cutting jurisdictional cleavages across product types and institutional structures. Italy has three, cross-cutting along product lines, as does Spain.

[13] Rear Window, Australian Financial Review, 6 June 2017: http://www.afr.com/brand/rear-window/why-is-cpa-australia-hoarding-91-million-20170605-gwkzda?

distinction should be drawn between superannuation complaints and non-superannuation complaints in terms of these additional powers.

Non-superannuation complaints can also involve third parties who are not members of the EDR scheme but may have an interest in the outcome of a complaint. For example, a third party beneficiary under a life insurance policy (held outside superannuation) will have an interest in the death benefit under the policy. Why should the scheme not be empowered to join such a third party to the complaint or obtain information and documents from them, or require them to attend a conciliation conference?

Similarly, in terms of complaints about primary producer and small business loans and guarantees, the EDR scheme should be able to join or obtain information and documents from third parties such as valuers, investigative accountants and receivers.

More generally, there is no logical reason for superannuation complaints to be treated differently from non-superannuation complaints. For example, life insurance policies that are held outside superannuation are likely to be of similar amounts to life policies held within superannuation. Amounts guaranteed in relation to a credit facility are often more than the average superannuation balance in retirement.

Further, it would not be efficient for an EDR scheme to apply different processes depending on whether or not the complaint relates to superannuation. Doing so would hinder even more the scheme's ability to move staff resources from one area (e.g. banking) to another (e.g. superannuation). Training staff to work in multiple areas, so they can handle different types of disputes as the need arises, while desirable, is a costly exercise.

6. Monetary limits

CIO has reservations about the proposal to increase the compensation cap to $1 million.

In the case of credit facilities, for example, while we accept that amounts borrowed have increased dramatically over the last few years in particular,

the loss a borrower (as opposed to a guarantor) typically suffers will not be the amount of the loan, but rather the costs of the loan (interest and fees, for example), or the difference between what was lent and what should suitably have been lent, or the loss of some equity in an asset used to secure a loan.

Where such a loss amounts to anything close to $1 million, it is likely that it will have been incurred in relation to an underlying credit facility or facilities of some significant magnitude, entered into as part of a transaction that is either unusual or complex such that the dispute may be better considered by a court.

Perhaps this is why the monetary limits and compensation caps in other jurisdictions are much less than that of CIO and FOS', and certainly significantly less than the amounts being proposed. To name a few:

- UK Financial Ombudsman Service: Compensation limit is £150,000 (but can *recommend* more).
- Canadian Ombudsman for Banking Services and Investments: Monetary limit is C$350,000, but decisions are non-binding on both parties.
- New Zealand's Banking Ombudsman Scheme: Monetary limit is NZ$200,000.
- Singapore's Financial Industry Dispute Resolution Centre: Monetary limit, depending on the type of claim, is S$50,000 to S$100,000.
- Telecommunications Industry Ombudsman: Total value of any action it requires by the provider must not exceed A$50,000.
- Energy and Water Ombudsman Victoria: Compensation limited to A$20,000, or if both parties agree, an amount of no more than A$50,000.

In terms of the implications for competition in prescribing a $1 million compensation cap, only large FSPs like the banks and insurers are in a position to meet such awards. Smaller FSPs, the majority of whom are CIO members, can be put out of business or face exorbitant increases in their professional indemnity insurance premiums, for awards of substantially less.

That is not to say that smaller FSPs should be excused from paying appropriate compensation. Rather, if this level of compensation were to be applied, the EDR process should be significantly more robust. The reality is that an EDR scheme's inability to subpoena a third party to attend as a witness or produce documents, join third parties, cross-examine witnesses and take evidence on oath means that its decisions are only ever going to be made 'on the papers'. This severely hampers its ability to investigate and determine, with the appropriate level of rigour and confidence, complex disputes or claims for large compensation amounts.

We would be happy to discuss our submission with you further.

Raj Venga
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