CREDIT OMBUDSMAN SERVICE LIMITED

ABN 59 104 961 882

Credit Ombudsman Service Limited

Submission to the Productivity Commission Inquiry into Australia's Consumer Policy Framework and its administration

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11 May 2007

Executive Summary

Submission 1

Regulation of credit providers and finance brokers must mandate membership of an external dispute resolution scheme approved by ASIC under its PS139.

Submission 2

All dispute resolution schemes in the financial services sector should work towards jurisdictional limits which accord with the reality of consumer transactions, and which are periodically adjusted for inflation.

Submission 3

The existing co-operation between financial services EDR schemes should continue but, in the absence of empirical evidence to the contrary, there is no need for any regulation forcing convergence of the schemes.

Submission 4

The establishment of a statutory dispute resolution scheme for financial services would be a retrograde step in the development of the consumer policy framework in Australia.

Submission 5

Regulation of credit should ideally be a Commonwealth matter, both legislatively and for enforcement.

Submission 6

Industry-specific regulation of financial services is necessary in combination with generic legislation to form a complete matrix of consumer protection.

Submission 7

Self-regulatory industry Codes are the best way to achieve most industry specific regulation provided:

1. all stakeholders are involved in the development of the relevant Code;
2. the Code has mandated industry coverage;
3. all industry participants are members of an appropriate EDR scheme.

1. Introduction

1.1 The Credit Ombudsman Service Limited ("COSL")

The Credit Ombudsman Service is a free and independent external dispute resolution (EDR) scheme.

It provides consumers with an alternative to legal proceedings for resolving disputes with COSL Members operating in the credit marketplace.[1] It has approval from ASIC under Policy Statement 139 ("PS139") which covers EDR schemes for financial services providers.

COSL has more than 7,300 members (and covers about 16,000 loan writers), drawn from mortgage brokers, as well as some mortgage originators, non-bank lenders, aggregators, mortgage managers and finance brokers.[2]

In the March 2007 quarter alone, COSL received over 1,500 inquiries and complaints and finalised 64 complaints.

Over 90% of COSL inquiries and complaints are resolved by non-adjudicative means, that is by conciliation, although the Credit Ombudsman does exercise his power to make determinations, the terms of which are then published on its website www.creditombudsman.com.

Like all PS 139 approved schemes, COSL determinations bind its members but not consumers. Its services are funded by a combination of membership fees and case management fees paid by the members. It is free for consumers and is controlled by a board with equal representation from industry and consumer organisations and an independent chair.

1.2 This Submission

COSL is uniquely placed to monitor and comment on the consumer policy framework as it pertains to its own work and its members. COSL has made submissions recently to the Queensland Fair Trading Office about its proposed Code of Conduct for Finance Brokers; the Mortgage and Finance Association of Australia as it reviews its Code of Practice; and the Ministerial Council for Consumer Affairs on such topics as regulation of Finance Brokers.

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[1] COSL used to be called Mortgage Industry Ombudsman Service Limited (MIOS).

[2] COSL Annual Report 2005/6
http://www.creditombudsman.com.au/asset/Annual%2520Report%25202006.pdf at p 4.

This Submission will not address every question raised in the Issues Paper produced by the Inquiry. COSL will focus on those areas where it has particular knowledge and expertise, starting, obviously, with the questions raised about alternative dispute resolution for consumer disputes.

2. Dispute Resolution Mechanisms

2.1 Access and Effectiveness

The Issues Paper asks: *Are the current dispute resolution mechanisms and arbitration processes, including consumer tribunals, readily accessible and effective?*[3]

2.1.1 Effectiveness – industry coverage

The "effectiveness" criteria in ASIC PS139 is described as "having appropriate and comprehensive terms of reference and periodic reviews of its performance."[4]

COSL will only comment on the area of financial services, particularly the use of intermediaries in mortgage lending.

COSL members generally do not engage in "dealing" or "advising" on "financial products" and are not therefore required by the Corporations Act to hold Australian Financial Services (AFS) Licences, or become a member of an ASIC approved EDR scheme.[5]

However, if a non-bank lender or intermediary in mortgage lending is a member of the Mortgage and Finance Association of Australia (MFAA), they are generally required to become a member of an ASIC-approved EDR scheme such as COSL. The MFAA claims 80% coverage of the relevant industry.

Furthermore, most lenders and aggregators require intermediaries to become a member of the MFAA and/or an ASIC-approved EDR scheme such as COSL before they are "accredited" to sell their credit products.

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[3] Productivity Commission Inquiry into the Consumer Policy Framework and Administration Issues Paper ("the Issues Paper") p 21
[4] ASIC PS139.151
[5] *Corporations Act 2001* 912A

While some non-bank consumer credit providers are covered by COSL (and all bank, credit union and building society credit providers are covered by the Banking and Financial Services Ombudsman, the Credit Union Dispute Resolution Centre and the Financial Co-operative Dispute Resolution Scheme, respectively), there is a gaping hole in the coverage, and therefore the effectiveness, of the consumer dispute resolution regime in Australia.

Credit providers who are not also authorised deposit taking institutions requiring an AFS Licence or who are not MFAA members are not strictly required to be members of any external dispute resolution scheme. This also applies to those finance brokers who exclusively broker credit arrangements but are not members of the MFAA. The comprehensiveness and, therefore, the effectiveness of external dispute resolution in financial services in Australia, are undermined by this lack of coverage.

Submission 1: Regulation of credit providers and finance brokers must mandate membership of an external dispute resolution scheme approved by ASIC under its PS139

2.1.2 Effectiveness - jurisdictional limits

As from 21 February 2007, the COSL Rules allow it to accept complaints where the amount in dispute is up to $250,000. Whilst several ASIC approved EDR schemes have also raised their jurisdictional limits, there are some which have not or are only considering doing so. [6]

Clearly, the effectiveness of EDR is undermined if the monetary limits on jurisdiction do not reflect the reality of consumer transactions in the market place.

[6] This question is problematic for the Finance Industry Complaints Service which has a $250,000 limit for life insurance complaints only and a $100,000 on all other complaints and $6,000 per month for "income stream" products. These limits are currently the subject of a review. See http://www.fics.asn.au/monetary.asp ; The Financial Co-operatives Dispute Resolution Service still has a limit of $100,000 but is going through its first independent review which is likely to consider this issue.

Submission 2: All dispute resolution schemes in financial services work towards jurisdictional limits which accord with the reality of consumer transactions and which periodically adjust for inflation

2.1.3 Effectiveness – efficiency

The times taken to resolve complaints by COSL are impressive by comparison with courts and tribunals. In the March 2007 quarter, only 31% of current cases had been open for more than 180 days and 76% of cases closed had only been open for 179 days or less.

This submission will not canvass the published statistics of all the financial services schemes (or those in the telecommunications and utilities areas). It is clear, however, that the EDR schemes resolve disputes much quicker and cheaper than the courts or tribunals.

2.1.4 Access

COSL maintains a website and complaints can be lodged on-line, obviating the need to download, print, complete and return a complaints form. Telephone assistance is also available to complainants lodging their complaint on-line.

All ASIC-approved EDR schemes in the financial services sector maintain websites and facilitate complaints by fax, mail or on-line lodgement. All provide a telephone service to assist complainants.

2.2 Convergence of Schemes

One submission to the Inquiry talked about the possibility of a single overarching dispute resolution scheme for all financial services.[7]

The Parliamentary Secretary to the Treasurer, with responsibility for financial services, Hon. Chris Pearce said on 6 March 2007:

[7] Transcript, Brisbane 26 March 2007, p 213

> ***Convergence of EDR schemes:*** *I want an EDR system for the financial sector that is streamlined, efficient, practical and consumer-friendly. I appeal to the Chairs and representatives of the Boards to continue to work together to make the most of the synergies that can be garnered among individual EDR schemes for the benefit of consumers and businesses alike.*[8]

Clearly the goal of the "convergence" to which the Parliamentary Secretary refers, is efficiency, practicality and benefits for consumers and business.

The Commission has been charged by the Treasurer, when commissioning this Inquiry,

> *"to have particular regard to …the need for consumer policy to be based on* ***evidence*** *from the operation of consumer product markets, including the behaviour of market participants;"*[9]

There is no evidence that the existing financial services EDR sector, which is largely industry-based, has led to any consumer confusion, lack of access or lack of efficiency that would be somehow alleviated by the establishment of a single overarching financial services ombudsman scheme.

This is not to say that, on a voluntary basis, with the co-operation of their relevant industries, the existing schemes are not "pooling their resources" in ways which enhance efficiency and facilitate access.

All ASIC approved schemes for financial services and the Superannuation Complaints Tribunal share a common telephone answering service. Several share information technology systems and even corporate services. Several schemes, including COSL, already participate in jointly sponsored seminar and other educational programs.

Submission 3: The existing co-operation between financial services EDR schemes should continue but, in the absence of empirical evidence to the contrary, there is no need for any regulation forcing convergence of the schemes.

[8] Speech Opening the Finance Industry Complaints Service Conference, Melbourne.
[9] Issues Paper p 3

2.3 A Statutory Scheme?

The same submission referred to above, made reference to the UK Financial Services Ombudsman ("FSO"), which is a statutory scheme funded by levies imposed by the Financial Services Markets Act 1999 (UK) on industry.

This organisation has over 950 staff and a budget of over £43,500,000 Admittedly, in its last Annual Report, it dealt with 110,000 complaints.[10]

There are several arguments against adopting the UK approach in Australia:

1. The benefits of co-operation between the schemes are being achieved voluntarily and incrementally through the work of the existing non-statutory schemes in Australia.

2. The ASIC PS139 benchmarks which are applied to schemes in Australia seeking approval and which are regularly reviewed, promote standards of accountability, independence, effectiveness, access and fairness in ways that were not achieved by the balkanised and often industry-controlled EDR sector in the UK prior to the establishment of their FSO.

3. A statutory scheme would create a large bureaucracy that would:
   - not have the multiplicity of access points for consumer representation that the current structure affords;
   - not have specialised industry knowledge;
   - not have the sense of involvement and, therefore, support by the relevant industry groups;
   - be substantially more inflexible; and
   - not be capable of responding quickly to changes in relevant markets.

4. Most significantly, however, a statutory scheme would be more susceptible to judicial review on broader grounds than are available at resent.

A new "legalism" may creep into scheme processes and decision-making as they "look over their shoulders" at the courts[11].

[10] FOS Annual Report 2005/2006 p 12

[11] This is a fear expressed in relation to the UK Financial Services Ombudsman by James R and Morris P, "The new Financial Ombudsman Service in the United Kingdom: has the second generation got it right" in Rickett C and Telfer T *International Perspectives on Consumers' Access to Justice* (Cambridge University Press, 2003). at p 191

The UK Financial Services Chief Ombudsman was "sanguine" about this prospect in 2001.[12] In *Norwich & Peterborough Building Society v Financial Services Ombudsman*[13], however, one of his decisions was effectively overturned.

He was "less sanguine" in November of 2004, but said that "…but if we merely said we've taken account of the way the law runs in this area without trying to specify the view exactly where the law stands …then… I think in many cases we can avoid getting into serious trouble with the courts"[14]. Unfortunately, the FSO has been in the courts more than a dozen times since then.

In Australia, however, the very few attempts at judicial review of industry-based consumer dispute resolution schemes have, for the most part, been unsuccessful.[15] The vast majority of industry members accept the decisions of the various schemes.

Submission 4: The establishment of statutory dispute resolution scheme for financial services would be a retrograde step in the development of the consumer policy framework in Australia.

3. The Consumer Policy Framework

3.1 The Efficiency of Current Processes

COSL is concerned that the processes overseen by the Ministerial Council for Consumer Affairs ("MCCA") are too slow to respond to changes in the market and to submissions by industry and consumer groups alike.

[12] As reported by James and Morris see above.
[13] [2003] 1 All ER 6
[14] Personal Interview with Walter Merricks, Melbourne, November 2004. For a more thorough discussion of this problem see O'Shea P and Rickett, C "In Defence of Consumer Law: The Resolution of Consumer Disputes" (2005) 28:1 *Sydney Law Review* 139
[15] See O'Shea above.

This is not criticism of the work of the Standing Committee of Officials of Consumer Affairs ("SCOCA") or the Uniform Consumer Credit Code Management Committee ("UCCMC") or other bodies established by MCCA to review policy, engage in consultation and develop new regulation. It's just that there is too much of this work and it takes too long.

Some examples are:

- Consumer Credit Code Reform

  The Consumer Credit Code became effective on 1 May 1996. It was subjected to a Post-Implementation Review which made recommendations in 1999 which have, largely, been uniformly accepted as appropriate by governments, industry and consumer groups. Most of its recommendations are yet to be adopted into amendments to the Code itself, although, admittedly, recent progress has been made in the areas of pre-contractual disclosure and comparison rates.

  For instance, the Post-Implementation Review in 1999, clearly recommended the adoption of a simplified "Schumer box" style documentation of pre-contractual disclosure in consumer credit.

  It was 2005 before a Consultation Package for the new disclosure model was released. Twelve of the 20 submissions in response to the Consultation Package submitted that the new model be subjected to empirical testing.[16] Tenders to conduct the testing were called earlier this year and the project is unlikely to be completed before March of 2008. It will be, therefore, a decade since the Schumer Box style disclosure was first recommended for consumer credit in Australia before it is enacted in the Code.

[16] Qld Law Society, Small Business Development Corporation, Credit Union Industry Association, National Credit Union Association, Australian Bankers Association, Gadens Lawyers, Clayton Utz Lawyers, National Finance Federation, Australian Finance Conference, Centre for Credit and Consumer Law at Griffith University. The NSW Consumer Credit Legal Service was generally in favour of empirical testing but was concerned at delay in introducing the amendments.

- Finance Broker Reform

  COSL made a submission to MCCA and SOCA on finance broker reform in February, 2005. It is a State/Territory matter and there are a variety of regimes across the States/Territories. MCCA is trying to achieve a measure of uniformity. The Queensland Regulatory Impact Statement on a proposed Code of Conduct for Finance Brokers has only recently released and submissions are due shortly. Queensland is not waiting on the MCCA "uniformity" model, and will be enacting its own finance broker legislation sometime early in 2008.

3.2 Federal-State responsibilities – Long Term Reform

At the heart of some problems and delays is the distinction between Commonwealth responsibility in financial services (which covers banking, insurance, investment and any brokering or advice associated with those activities) and credit, which is a State/Territory matter.

Australia now has a national market for credit and, increasingly through the internet and otherwise, this is being manifested at all levels of the retail market. It is sensible that credit regulation be a federal matter and its enforcement be a matter for the federal regulator, probably ASIC.

Submission 5: Regulation of credit should be a Commonwealth matter, both legislatively and for enforcement.

4. Generic and Industry-Specific Regulation

4.1 The Question

The Issues Paper asks at p 19: *"What principles should guide the choice between generic and industry-specific regulation?"* as part of a discussion on the differences between generic consumer legislation such as the Trade Practices and the Fair Trading Acts and specific industry regulation such as the Consumer Credit Code and the various industry codes of practice.

4.2 Our response

COSL submits that both are necessary in most industries. Generic prohibitions on misleading and deceptive conduct, for instance, are vital to any functioning market but tend to operate best "after the event." They

provide means of redress and their effectiveness for consumers is limited by consumer's access to justice. They are most frequently used, not by private consumers, but by regulators such as the ACCC.

Industry-specific regulation performs two different tasks. Firstly, they "set the ground rules" for participation in a particular industry. One of these rules is the requirement to belong to an industry-based dispute resolution scheme.

Secondly, there are certain types of activities which have unique characteristics which can only be addressed on an industry basis. In credit, for instance, as long ago as 1972 in the Molomby Report, it has been recognised that some measure is required for the relief from payments due to of temporary hardship during the life of a loan. Molomby concluded that such variations were "usually" obtained from "reputable credit providers" and that the "practice of the reputable credit provider should be imposed on all."[17] This is the policy basis for section 66 of the Consumer Credit Code which has its predecessors in the earlier Credit Acts which, following Molomby, provided for a process of court ordered variations for hardship.[18]

No generic law prescribing "relief from hardship" in contracts could work across all industries and all situations. It would be difficult for consumers to use, for regulators to administer, for courts, tribunals or ombudsmen to interpret or business to accommodate in its costs structures. Yet, in credit, it works.

Submission 6: Industry-specific regulation of financial services is necessary in combination with generic legislation to form a complete matrix of consumer protection.

5. Industry Codes and co-regulation

5.1 Specific Interests and Knowledge

One of the best ways, in the experience of COSL, to develop and enforce industry-specific regulation is for it to be in the form of an industry code developed by the industry in consultation with its stakeholders.

[17] Molomby Committee Report para 5.7.13
[18] Section 74(1) of the Credit Acts of Vic, NSW, WA and the ACT.

The level of ownership of the Code provisions and its character, which such a level of self-regulation affords, leads to greater voluntary compliance and generally improves industry standards.

COSL has been involved in processes (referred to above) with its relevant industry bodies in the further development of their Codes. At this level, with the ombudsman, the industry representatives and the consumer representatives engaged, good consumer protection policy can be developed.

5.2 Co-regulation not self-regulation

There must be, however, in the experience of COSL, a "base-level" of industry regulation which is coercive and administered by the regulator. This should mostly involve "entry level" requirements and, as said above, "ground rules".

Key to these is:

- the requirement to subscribe to the relevant industry code, thus creating an incentive for greater participation in industry policy development and compliance; and
- mandated membership of an industry based dispute resolution scheme.

Submission 8: Self-regulatory industry Codes are the best way to achieve most industry specific regulation, provided:

1. **all stakeholders are involved in the development of the relevant Code;**
2. **the Code has mandated industry coverage;**
3. **all industry participants are members of an appropriate EDR scheme.**