

Inquiry into Australia's Consumer Policy
Framework and its Administration

Productivity Commission

Supplemental Submission By

Credit Ombudsman Service Limited

February 2008



SUBMISSION

Inquiry into Australia's Consumer Policy Framework and its Administration

1. Introduction

1.1 The Credit Ombudsman Service Limited ("COSL")

COSL has already made a substantial submission to the Inquiry¹ and need not introduce itself here.

1.2 This Submission

This supplemental submission mainly addresses Draft Recommendation 9.2 and the sections of the Draft Report which are relevant to the Recommendation.²

The Recommendation says, in part, that Australian Governments should improve the effectiveness of alternative dispute resolution (ADR) arrangements for consumers by encouraging further integration of financial ADR schemes, which would involve consolidating the existing financial ADR schemes into a single umbrella dispute resolution scheme for consumers, but with the option for existing schemes to retain their independence as arms within it.

Initially, our submission will take issue with some of the reasoning in the Draft Report in support of the recommendation and then raise some other issues to support the proposition that the costs of further integration of financial ADR services outweigh the putative benefits.

¹ No. 53 at <http://www.pc.gov.au/inquiry/consumer/submissions>

² Draft Report Vol 1 p 68

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2. What the Draft Report Says

The Summary of the Draft Report says:

Existing ADR schemes in the financial services area should be consolidated into a single, umbrella, dispute resolution scheme for consumers, but with the option for existing schemes to retain their independence as arms within this new entity. This would provide a common entry point for consumers, but preserve the flexibility in the current arrangements to tailor ADR approaches to the different issues that arise in individual financial services areas. To prevent further fragmentation, any new ADR providers in the sector should be included in this scheme, with the proposed arrangements also providing scope for future rationalisation of individual services within it.³

Interestingly, the Summary discussion emphasises the importance of the “common entry point”. In financial services, of course, this has already been achieved by all the ASIC-approved schemes becoming members of the FOS telephone call centre.

This raises the question: If the “common entry point” has already been achieved and the “flexibility in the current arrangements to tailor ADR approaches to the different issues that arise in individual financial services areas” should be preserved, then why should the existing schemes be consolidated into a single, umbrella dispute resolution scheme?

³ Draft Report Vol 1 p 39

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3. Where is the support for the umbrella scheme?

It is difficult to find where the Inquiry found support for its call for an umbrella scheme.

The Draft Report claims that:

There have been various calls for a similar kind of consolidation of the various ADR schemes in financial services into a body like the UK Financial Services Ombudsman (Allen Consulting Group 2005, p. 23; Pearce 2007).⁴

It should be noted that what the Allen's Report referred to was an independent review of the Insurance Ombudsman Service as required by ASIC's RG 139. Whilst it did recommend "that the Service continue to explore opportunities for efficiency by sharing administrative functions with other external dispute resolution schemes although this is not an obligation under RG 139", it did not make any recommendation for convergence into an "umbrella scheme".⁵

As to the measured remarks by the former Parliamentary Secretary Pearce, opening the FICS Annual Conference in March 2007 (as referred to in the Draft Report), he said:

By "convergence", I mean exploring the synergies between the various EDR bodies to make them as streamlined as possible. And to simplify their processes as much as possible....By convergence, I don't necessarily mean merging EDR schemes into a single body. But in some cases this may be the best alternative to maximise efficiency and lower costs.

⁴ Draft Report Vol 2 p 158

⁵ http://www.insuranceombudsman.com.au/pages/include/documents/2005/IOS_Final_Report.pdf at p ix

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*Rather, I recognise that differences in the nature of particular industry practices and complaints may present barriers to full convergence in its true sense. But while I recognise that convergence between the schemes may, in some cases, be a difficult task, this should not present any barriers to further discussions about leveraging the capabilities of these schemes.*⁶

This is hardly a call for “a body like the UK Financial Services Ombudsman”. The gap between the claims for these references and their actual content is surprising in such an important public policy document.⁷

Turning to the submissions to the Inquiry itself, of the 127 submissions received, some 19 refer to external dispute resolution in financial services. Of these, only two, that of ASIC and the BFSO, call specifically for a single dispute resolution scheme for financial services.

ASIC noted with approval the merging of BFSO, FICS and IOS, but says “...we have found the external dispute resolution schemes to provide an extremely useful service in resolving disputes...”⁸

BFSO, IOS and FICS made a joint submission and, not surprisingly, this submission says that “the Schemes would have no objection to future convergence of the operations of the ASIC-approved EDR Schemes”, but they do say that “...any future convergence should retain the industry based nature of the current system.”⁹

⁶ <http://www.chrispearcemp.com/speech.php?id=64>

⁷ It must be acknowledged that by 2 August 2007, Chris Pearce did note with approval that the Boards of BFSO, FICS and IOS had resolved to converge but this particular speech, although referred to in the ASIC Submission to the Inquiry, was not referenced in the Draft Report. It is still not a call for a single umbrella scheme provided there was a satisfactory single entry point for consumers.

⁸ ASIC Submission p 53

⁹ Joint Submission by BFSO, FICS, IOS p 17

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A summary of the other relevant submissions is as follows:

Submitting Stakeholder	Number of References to ADR/EDR	Comments on convergence
Legal Aid Qld	3	Industry operated EDR "very effective."
Insurance Council of Australia	1 page	IOS an example of a successful "industry support regulatory body."
TasCoss	1	"...ensure that all participants are signed up to an industry specific code/or dispute resolution scheme."
Cth Consumer Affairs Advisory Council	2 pages	"widen the field" and "close the gaps"
Lynden Griggs	7	No mention of convergence
MFAA	2 pages	Opposes convergence
AFCCRA (Aust Financial Counsellors)	1 paragraph	None
FCAQ (Qld FCs)	1 paragraph	None
Consumer Law Centre of ACT	3 paragraphs	No specific reference to convergence, support for COSL's responses.

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ANZ Bank	1 paragraph	None
Consumer's Federation of Australia	4 paragraphs	Close the gaps, increase coverage and have a single entry point...assumes some convergence.
Old Government	Just over 1 page	None
CHOICE	5 paragraphs	None except "single entry point for all consumer complaints" but is referring to Consumers Direct UK, not the UK FOS
Victorian Government	54	None
Centre for Credit and Consumer Law (Griffith Uni)	3 pages	See below
Consumer Action Law Centre	1 paragraph	None
Consumer Credit Legal Centre (NSW)	16	None
West Australian Govt	4	None
ACCC	20	None

Interestingly, the Centre for Credit and Consumer Law at Griffith University, a respected research centre which "aims to be a voice for consumers, and a centre of excellence for credit and consumer law issues"¹⁰ is quite circumspect about consolidation of EDR schemes saying:

¹⁰ <http://www.griffith.edu.au/centre/cccl/>

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However, in our view, while there may be some benefits to consolidation in the sector, the greatest priority should be reserved for (i) ensuring that all financial service providers, including credit providers must belong to an approved EDR scheme; and (ii) ensuring a seamless front-entry to dispute resolution schemes...¹¹

The CCCL submission goes on to say that:

Instead of consolidation, we believe that a more pressing challenge for the external dispute resolution schemes is the likelihood that they will be, in de facto manner, becoming law making bodies.¹²

It would therefore appear that the overwhelming majority of submissions to the Inquiry were either silent or non-committal about consolidation of EDR schemes in financial services into a single umbrella scheme.

Great weight has been given in the Draft Report to the opinions of only a few.

4. Who is confused?

The Draft Report gives as its first justification for the umbrella scheme, the possibility that consumers may be confused as to which of the existing schemes they should take their complaint.¹³

In support of this "problem", the Draft Report refers to "feedback to ASIC."¹⁴

¹¹ CCCL Submission, pp28-29

¹² Ibid p 29

¹³ Draft Report Vol 2 p 158

¹⁴ ibid

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However, looking at the ASIC Submission, this “feedback” is not from consumers but from “consumer advocates”.¹⁵

In fact, there is no empirical evidence in any published document of consumer confusion as to which scheme they should take their financial services complaint.

This is consistent with the UK experience. Despite a far more balkanised EDR environment for financial services in the UK in the late 1990's, there was still no evidence of actual consumer confusion, merely the perception that it might occur.¹⁶

As the Draft Report itself notes, “the biggest risk of consumer confusion arises when they (consumers) complain about a credit provider who is not a member of any service.”¹⁷ That is a matter for coverage not convergence.

The “common entry point” has already been achieved by the FOS Call Centre as noted by the Draft Report itself. Any confusion from then on is a matter for the performance of that centre.

5. Consistency is not consistently right

The second argument in the Draft Report in favour of an umbrella scheme is that “consolidation is more likely to lead to greater consistency among the ombudsmen, such as more consistent (and higher) ceilings on the value of transactions subject to ADR.”¹⁸

¹⁵ ASIC Submission p 53

¹⁶ R James and P Morris P, “The new Financial Ombudsman Service in the United Kingdom: has the second generation got it right?” in C Rickett and T Telfer, *International Perspectives on Consumers' Access to Justice* (Cambridge: CUP, 2003), at p 167

¹⁷ N 13 above

¹⁸ N13 p 158

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No one wants consumers to be denied access to ADR because the value of their complaint exceeds a monetary limit. The Draft Report cites the case of the \$100,000 limit for FICS but neglects to note that this limit did not apply to life insurance complaints which were acceptable to FICS up to \$250,000.

Some two weeks before the release of the Draft Report, FICS announced that its monetary limits for investment complaints would rise to \$150,000 and for life insurance matters to \$280,000.¹⁹

It is interesting to note that the Draft Report refers favourably to the COSL monetary limit of \$250,000.²⁰ Consistency, for its own sake, is of no value to consumers or industry if it imposes a "one size fits all" regime on situations which are substantially different.

Monetary limits, however, are one area which impacts on the availability of professional indemnity insurance. Without adequate PII cover, if the service provider is not a large corporation, or, in the case of corporate collapse, even if they are, consumers will frequently be left without an effective remedy whether they have a judgment from a court or a determination from an EDR scheme.

Compromising, in individual industry sector situations, on monetary limits so as to capture, by far, the majority of complaints in that sector while not "spooking" the PII insurers, is often the best way to ensure consumers are ultimately reimbursed for their losses. Consumers care less about the principle and more about "getting their money back." It is also the sort of strategy best pursued by an industry-specific scheme which is "light on its feet" and capable of customising innovative responses.

¹⁹ FICS Press Release 26/11/07

²⁰ N 18 above

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6. No economic benefits of an umbrella scheme

The possibility that “consolidation may produce some efficiency benefits from sharing overheads or adopting best-practice” is also canvassed in the Draft Report, but not with great conviction.²¹

The Draft Report itself speculates that the “present sharing of fixed overheads”²² may have brought about such efficiency benefits as can be achieved and, therefore, further consolidation may not produce much more.

The Draft Report also acknowledges that the cost differences per new contact between schemes “do not appear to be scale-related, suggesting that physical consolidation might not yield big scale benefits” or, perhaps, none at all.²³

If the benefits of harmonisation, cost sharing and a single entry point have already or mostly been achieved, as the Draft Report repeatedly acknowledges, there is no case for undermining the separate identities which seem to be so important for some industry groups.

7. Losing the flexibility of efficient responses to industry-specific issues

An EDR scheme, being industry funded, should be able to decide how best to levy its members, given its particular membership characteristics. For example, COSL's membership and complaint fees are the lowest amongst all ASIC-approved EDR schemes, primarily because of the size of its membership. At more than 8,000 members it is the largest EDR scheme in Australia.

²¹ *ibid*

²² Draft Report Vol 2 p 159

²³ *ibid*

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This allows COSL to rely primarily on its membership fees to support its operations. Other schemes rely primarily on complaint fees or a combination of complaint fees and membership fees.

One of the key findings of the triennial Independent Review of COSL's operations made it quite clear that a 'user pays' model for complaint fees was deeply resented by COSL's membership.²⁴ It found that complaint fees are often a shock to and represent a significant financial impost to small operators (95% of COSL's membership). It noted that in schemes that have large numbers of small operators, user-pays complaint fees are a huge source of friction with members.

Indeed, the Draft Report itself refers to the COSL's Review and its discussion of complaint fees as an example of the "case for maintaining separate identities for at least some of the entities for the time being".

The Reviewers, of Navigator Pty Ltd, suggested a medium term reduction in complaint fees as a strategy for improving relations with members.²⁵

Hence, COSL introduced a new and innovative fee structure for handling complaints about its members which significantly reduced the cost burden on its members, particularly the small ones, while allowing COSL to continue to provide as much coverage of the credit market as possible.

This was an Australian first.

From 1 February 2007, members of COSL received a 'one free complaint' voucher, and complaint fees were dramatically reduced by up to 75% for the first three complaints. The 'one free complaint' voucher can be used to offset the complaint fees that would normally apply to a complaint heard by COSL, up to and including

²⁴ Navigator Pty Ltd Independent Review of COSL 2006, p 42

²⁵ *ibid*

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a determination by the Credit Ombudsman. The Financial Services Ombudsman in the UK adopted a similar approach for its smaller members. Industry has responded very positively to this initiative.

It is doubtful if, under an umbrella model, COSL members will continue to receive the benefit of the free complaint voucher, low membership fees and deeply discounted complaint fees; in other words, a fair deal for members in exchange for their participation in the scheme for the benefit of consumers.

One also has to query if and to what extent COSL's large membership base would be cross-subsidising levies payable by members of an enlarged umbrella scheme. COSL can offer its members the free complaint voucher and new fee scale precisely because it has a large membership base and complaint fees do not represent a significant proportion of its revenue.

8. Losing the flexibility to respond better to consumers

COSL is clearly leading the way amongst EDR schemes in its responses to consumer credit issues. These responses have been praised by leading consumer advocacy groups.²⁶

COSL does and is prepared to look at whether fees and charges imposed by a lender amount to a penalty at common law or are unconscionable under section 72(I) of the Uniform Consumer Credit Code.

COSL also takes the view that it is entitled to consider a complaint from a consumer that a lender has not given effect to section 66 Credit Code which deals with financial hardship. Again, this benefits consumers enormously, particularly at a time of rising interest rates and evidence of mortgage stress.

²⁶ E.g. Consumer Law Centre of the ACT, Submission p.

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Both these positions have been eschewed, so far, by the BFSO as being either “commercial considerations” or “policy matters.”

The flexibility and indeed alacrity with which COSL was able to assess these issues and develop considered policy response and guidelines will be difficult, if not impossible, to achieve in a large bureaucratic organisation such as the “umbrella scheme” envisaged by the Draft Report recommendation.

9. Loss of industry support and co-operation

COSL has built its industry support and relationships largely without a statutory requirement for its members to participate in an EDR scheme.

COSL does not support the continuation of this position and accepts and agrees with the recommendations in the Draft Report calling for increased coverage for EDR and the compulsion for all providers of financial services, including credit and credit broking, to be members of an ASIC-approved scheme.

However, as was noted by the Navigator review,²⁷ many of COSL's members differentiate themselves substantially from the banking sector and other sectors who are members of the BFSO and, who will be members of the new merged FOS entity after 1 July 2008.

It must be noted that COSL's responses to consumer credit issues over the last 12 months have been the subject of robust debate at Board level, but have resulted in unanimous Board support, including industry representatives who take it on themselves to “sell” the changes to their members.

²⁷ N 23 p 10

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All participants in industry based EDR, including those in the BFSO, FICS and IOS, value the importance of such industry and consumer group co-operation and its pivotal role in the success of EDR in financial services in Australia.²⁸

This will be very difficult to maintain if COSL's large numbers of small members are forced into a huge converged polyglot bank-dominated umbrella entity.

10. Conclusion

COSL urges the Commission to reconsider its Recommendation 9.2 in the Draft Report and to couch its approach to EDR in the financial services sector in ways that reflect more closely the submissions it received.

Further, and with respect, COSL reminds the Commission that its Terms of Reference from the previous Treasurer specifically refer to "the need for consumer policy to be based on evidence from the operation of consumer product markets, including the behaviour of market participants"²⁹

There is a decided lack of support in the submissions and evidence, either in the submissions or gathered independently by the Commission, to support Recommendation 9.2 to the extent that it calls for an "umbrella scheme."

A "common entry point" has already been achieved through the FOS call centre. The schemes already engage in substantial co-operation and resource sharing.

²⁸ See the ANZ Submission and the joint BFSO, IOS and FICS submission to the Inquiry.

²⁹ Terms of Reference, p v

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Any further forced consolidation would place at risk the gains already made in one of the most successful consumer policy developments in Australian history: the cheap, efficient, fair and flexible resolution of consumer disputes by industry-based dispute resolution schemes.

It is not a case of "let sleeping dogs lie" but rather continue to "let a thousand flowers bloom."