

1 April 2021

Mr Danny Namgyal
Director
AFCA Review Secretariat
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600
Email: AFCAreview@treasury.gov.au

Dear Mr Namgyal

AFIA COMMENTS ON THE REVIEW OF THE AUSTRALIAN FINANCIAL COMPLAINTS AUTHORITY (AFCA) TERMS OF REFERENCE (TOR) AND GUIDANCE FOR SUBMISSIONS

The Australian Finance Industry Association (AFIA) welcomes the opportunity to provide feedback to the review of the Australian Financial Complaints Authority (AFCA) terms of reference (ToR) and guidance for submissions.

AFIA has excellent relationships with AFCA, especially the Chief Ombudsman, the Deputy Chief Ombudsman and lead ombudsmen. We want to acknowledge the availability of senior staff to work collaboratively and constructively with AFIA, particularly to answer discrete member queries and/or collaborate and run joint educational sessions to build awareness of systemic and emerging issues in complaints and dispute management.

We recognise that it has been a challenging time for AFCA. Integrating three organisations has required a new operating model and governance structure, resourcing and training their teams, setting-up new engagement programs, and developing corporate knowledge to ensure consistency of decision-making. They have had to do this while dealing with an increase in compliant activity¹ and implementing changes to work practices as a result of the COVID-19 pandemic.

Many AFIA members are subscribers of AFCA, including both consumer and small business financiers. For holders of an Australian Financial Services License (AFSL) or an Australian Credit Licence (ACL), this reflects a legislative requirement. For others, that operate outside the financial products or consumer credit regulated segments or only in the commercial or small business segments, AFCA membership is generally voluntary.

However, as part of AFIA's self-regulation strategy we have made AFCA membership a mandatory requirement for those members that are signatories to both AFIA's Online Small Business Lenders Code of Practice and the new Buy Now Pay Later Code of Practice, and we intend to embed the same requirement in similar codes in the future. Members in these sectors believe this is the right thing to do for business and customers, and understand that this also reflects community expectations.

¹ Annual Review | Australian Financial Complaints Authority (AFCA)

We believe this review is a timely opportunity to identify where further enhancements can be made to ensure AFCA is operating efficiently and effectively for all parties. Targeted changes will allow AFCA to achieve its vision of being a 'world class ombudsman service: raising standards and minimising disputes; meeting diverse community needs, and trusted by all'.

OUR RECOMMENDATIONS

AFIA's recommendations are directed by its guiding principles, which are:

- promoting access to and choice in consumer and business finance
- driving competition and innovation in Australia's financial services industry
- supporting greater financial, and therefore social, participation across our community.

We believe the following five recommendations would both improve the operations of AFCA and support the achievement of these principles:

1. Provide a mechanism to appeal a determination and establish the legitimacy of precedent. Determinations by AFCA can create precedent and compliance 'creep' for members, beyond legislative and regulatory requirements. Adopting this recommendation would ensure procedural fairness. This has the potential to support greater access to and choice in finance as new and existing financiers, who are not currently part of AFCA, may decide to join and launch products captured under its rules, and current members who joined AFCA 'voluntarily' would remain and not consider exiting the scheme.
2. Create a new process and a dedicated team for complaints related to the removal of credit enquiries and/or default listings. As part of this, implement a fairer funding model for these types of complaints. Currently, members with lower value accounts face a disproportionately higher fee per complaint than those members with more complex and higher value disputes. Adopting this recommendation would support competition and innovation as the funding model would be more scalable and would also ensure consumers' wellbeing is better protected, particularly from credit repair and debt management firms that promise customers certain outcomes, which may be misleading.
3. Strengthen the process, and use discretionary rules more often, to deal with a customer who is not participating in the process in good faith and/or to address those third parties (primarily credit repair and debt management businesses) who are misusing the current AFCA Rules to undermine the integrity of the credit reporting regime, at the cost of the members and for their own financial gain. Adopting this recommendation would ensure members remain committed to support access to and choice in finance and similarly, ensures consumers' wellbeing is better protected.
4. Improve consistency in decision-making, to build confidence in the complaint handling system. This would support greater economic participation across the community. Senior staff interventions in cases typically reach reasonable conclusions. Upskilling the broader AFCA team about when the AFCA rules apply and, importantly, do not apply, building broader legislation regulatory/jurisdictional understanding, and enhancing industry/product knowledge (in particular in small business lending), would reduce administrative complexities, reduce costs, and frustrations and delays for consumers and members.
5. Increase and provide better communications to the industry, especially in regard to systemic issues, complaints trends and emerging developments. Circulars are a useful tool to build knowledge for all parties and ensure the system is as effective and efficient as possible.

Attachment A provides our detailed response.

Attachment B is an outline of the current rights available to members to appeal a determination. AFIA Associate member, Piper Alderman has provided the content.

Attachment C is confidential to Treasury only. It should not be made public under any circumstances. It contains specific examples and case studies to support our responses.

CLOSING REMARKS

AFIA believes that all financial services providers and lenders should support their customers by offering the best products, services, and technologies, and we believe that is the intent of our members. However, sometimes things will go wrong. Therefore, it is important for good complaints and disputes management processes to be in place to ensure effective and efficient resolution of issues. In this context, it is important for AFCA to also ensure disputes are handled in a fairer, more efficient, timely and independent way.

AFIA has already discussed many of our recommendations with AFCA and we are encouraged that our feedback is being considered, with many recommendations being areas of focus for FY21 and beyond.

AFIA represents larger and smaller lenders, ADI and non-ADI lenders. Many of the contributing members to this submission would be available for a roundtable or further discussion to assist Treasury to better understand the feedback.

Should you wish to discuss our feedback further, or require additional information, please contact Karl Turner, Executive Director, Policy & Risk Management at karl@afia.asn.au or 02 9231 5877.

Yours sincerely

A handwritten signature in black ink that reads "Diane Tate". The signature is written in a cursive, flowing style.

Diane Tate
Chief Executive Officer

1. Is AFCA meeting its statutory objective of resolving complaints in a way that is fair, efficient, timely and independent?

1.1. Is AFCA's dispute resolution approach and capability producing consistent, predictable and quality outcomes?

Not yet.

While members have seen improvements in consistency of decision-making once complaints move to more senior staff, there is still work needed across the organisation.

We make the following recommendations:

- continue to focus on:
 - improving and upskilling the AFCA team on internal guides and standard operating practices about when the AFCA rules apply and do not apply – members advise that there are many instances when they go deep into the complaint process only to be advised that the issue under investigation is outside of the AFCA rules. Members also have had instances where AFCA staff expand their review beyond the original reason for a complaint in order to find other grounds to find against the financial institution. For example, where a complaint has already been reviewed under a previous scheme. This causes administrative complexities, additional costs, and frustrations and delays for customers and members.
 - building broader legislation/regulatory/jurisdictional understanding – member feedback is that some AFCA staff still apply consumer legislation/regulation to small business lending. We note that this is inconsistent with legislative and regulatory requirements and counter to the Federal Government's proposed changes to credit laws that make this distinction more explicit.
 - how it assesses what is 'fair' in a way that is clearly understood by all parties and stakeholders – members have examples where AFCA has:
 - applied current standards and guidelines to loans issued when the standards did not apply/were different. This retrospectivity undermines confidence in the system and causes additional administrative complexities and costs. Please see Attachment C for more confidential insight.
 - introduced new information to a decision process that was provided by a customer and not available or relevant when the member completed the underwriting assessment. Please see Attachment C for more confidential insight.
 - applied higher standards than required to small business loans – for example, by applying National Consumer Credit lending laws rather than 'due care and skill' as required under the ASIC Act as well as the 'prudent banker' test under the Banking Act. Please see Attachment C for more confidential insight.
 - applied standards that do not align with proportionate and scalable approaches adopted through legislative and regulatory requirements – for example, by applying the Australian Bankers' Association (ABA)'s Banking Code of Practice to all lenders, including non-ABA members. While this standard is appropriate for signatories to the ABA's Banking Code of Practice, this industry code was developed with the input of those members and reflects their business models.

Other industry codes, such as AFIA's, should be used more when complaints arise for these entities. Please see Attachment C for more confidential insight.

- not taken into account any reasonable 'benefit' gained by a customer when calculating a potential remedy.

- implement service level agreements (with customers and members) for timelines in which they can expect to hear back from AFCA.

Members are required to meet to timelines for responses. They are held accountable for meeting these through public report, and the same should be applied to AFCA. These timelines will naturally with the level and complexity of the complaint, but more frequent communication/better expectation management would allow members to better plan their own workloads and resourcing. An alternative to this is to develop a portal – maybe as part of the AFCA data cube – that shows members and customers where their complaint sits in the process.

- revise the process so that a complaint case is closed if neither the member nor AFCA has been able to contact a customer for more than 30 days.

Members have examples where some complaints have continued to escalate to CM2 (the conciliation stage) even though the customer has not provided any response to AFCA. The customer then does not attend the conciliation and the complaint is closed due to no response, but by this stage the member is charged a higher fee.

- improve the consistency of remedy/monetary award that is determined by an ombudsman and include a mechanism for this to be queried.

Members have examples where one ombudsman may award \$500 and another may award \$1,500 for the same topic.

- develop a standard/pro forma Deed of Release/settlement document that members can use. This would improve consistency in operational guidelines and assist both members and customers in finalising complaints.
- implement new rules – such as a 'Recommendation on reasonable offer'. This would operate to ensure that customers have an incentive to accept reasonable offers, and would support the surfacing of the real issues in dispute. It would also reduce the cost imposed on industry, which is ultimately passed on to customers in the form of higher costs for financial services.
- increase and provide better communications to the industry, especially on systemic issues, complaints trends and emerging developments. Circulars are a useful tool to build knowledge for all parties.
- create a new process, and a dedicated team, to focus on issuing short form determinations for complaints solely related to the removal of credit enquiries and/or default listings.

- As part of this, implement a fairer funding model for these types of complaints. Currently, members with lower value accounts face a disproportionately higher fee per complaint than those members with more complex and higher value disputes.

Members, as credit providers, are required to ensure that credit information and default information on credit files is properly recorded and maintained.

Members currently incur significant fees in credit default complaints, often in circumstances where the debt that is the subject of the dispute has been repaid. In these cases there is no economic benefit to the member in defending the listing.

In addition, some third parties are misusing the current AFCA Rules to undermine the integrity of the credit reporting regime and doing so at the cost of the members and their own financial gain.

Credit repair agencies lose their income stream if they do not get an outcome, so it is in some of their best interests to have the customer continue to escalate the matter within AFCA so that they increase the likelihood of payment. Members have examples where a customer was represented by a credit repair agency and was charged over \$1,200 to have a simple default removed.

- use discretionary rules more frequently to close cases when it is clear that a customer is not participating in the process in good faith, demonstrated by, but not limited to:
 - documentation has been fabricated
 - the complaint is vexatious
 - the customer is vexatious and/or is using a third party to stall contractual rights and remedies and potentially delay enforcement action – members have examples of a single customer making multiple complaints to AFCA, but each complaint being dealt with separately. This materially delayed enforcement of contractual rights.

A customer's ability to escalate a complaint with no substance delays fair resolution and incurs unnecessary costs for members. Unfortunately, sometimes this is the result of customers being misled by credit repair and debt management firms.

Members have examples where the same customer has raised multiple complaints with AFCA. There have been situations when AFCA has issued a determination in favour of the firm, but then allows a customer to raise a new complaint using the same material facts.

When attempting to have the case excluded for being Outside Terms of Reference (OTR), members often find that the AFCA Rules Team give the customer an additional opportunity to refine this new complaint. This can lead to new issues being raised which then allows the complaint to proceed.

In addition, sometimes AFCA's processes facilitate a customer using AFCA multiple times, as their processes can be siloed to one current complaint per issue. They do not always consider the previous dispute history, which leads to a poor outcome for both the customer and the financial firm.

Members also have examples where a customer was able to lodge consecutive complaints using the same material facts but as a different issue. For example, a customer lodged a complaint with AFCA regarding a privacy breach. The same complaint was then closed and reinstated various times for irresponsible lending, inappropriate debt collection and potentially poor lending. The initial AFCA complaint was lodged in June 2019, closed in September 2019, reinstated in September 2019, and then closed in January 2021 with a final decision in the member's favour.

Another member has noted over the past three months, 23 of their complaints received were from repeat AFCA customers.

Please see Attachment C for more confidential insight. This illustrates a situation where a complaint was ruled in favour of the member and a payment arrangement put in place but when the customer did not meet this arrangement and the member commenced legal proceedings, the customer raised another complaint to AFCA using the same material facts.

This took a further four months to be decided as being OTR, whereupon the customer raised another complaint using the same material facts. AFCA is still working through this third iteration. Currently, it has not allowed the member's request to see this as OTR so the member remains unable to commence legal proceedings.

1.2. Are AFCA's processes for the identification and appropriate response to systemic issues arising from complaints effective?

Members understand that several complaints of the same type or a single complaint may raise the question of whether there is a systemic issue (provided that the effect of the issue may clearly extend beyond a single customer²).

However, AFIA members have examples of AFCA raising a potential systemic issue based on its handling of separate complaints, where the potential issue identified was not part of the initial complaints.

One member highlighted a situation where they declined multiple personal loan applications from a customer. The customer complained and then AFCA alleged a potential systemic issue on the basis that the member should have been aware that (a) a broker had lodged a commercial loan application supported by false documents, and (b) the assets were for personal or domestic use, rather than for business purposes.

Another member has an example of AFCA raising systemic issues based on only one complaint. In this instance, AFCA raised a systemic issue, even though the preliminary determination found in the member's favour but was subsequently overturned at final determination. The member then received a notice for a possible systemic issue. The member confirmed to AFCA that this was a one-off case and all policies had been amended so that the issue could not occur again but AFCA chose not to accept this and proceeded to define it as a systemic issue.

We propose that, prior to AFCA raising a potential systemic notice, it should be very clear that the substance of the complaints is the same, rather than being of a potentially 'similar' nature.

² AFCA operational guidelines A17

We also propose that AFCA consider introducing a new communication, such as 'AFCA Circular' to provide insights into recent systemic issues. This will raise awareness of issues and support members' learning from others' experiences.

1.3. Do AFCA's funding and fee structures impact competition? Are there enhancements to the funding model that should be considered by AFCA to alleviate any impacts on competition while balancing the need for a sustainable fee-for-service model?

Members understand that finding a funding model which meets all stakeholders' needs is going to be a challenge.

However, the single fee schedule for all complaints (without regard to quantum or complexity of disputes) has the consequence that members with lower value accounts face a disproportionately higher fee per complaint stage than those members with more complex and higher value disputes. This is being exacerbated by the actions of credit repair firms mentioned above.

In addition, members recommend that, as a deterrent, there should be a cost incurred by a customer who chooses to progress with vexatious or unsubstantiated complaints.

In particular, AFCA should re-consider the funding model for complaints relating to credit enquiries and credit defaults.

As part of implementing our recommendation above around a new process/dedicated team who focus on issuing short form determinations for complaints solely related to the removal of default listings, we recommend that a revised funding model is adopted for these types of complaints.

2. Do the monetary limits on claims that may be made to, and remedies that may be determined by, AFCA in relation to disputes about credit facilities provided to primary production businesses, including agriculture, fisheries and forestry businesses remain adequate?

Members did not have any specific comments on this question. We recommend that this issue be considered further as part of a nationwide Farm Debt Mediation process.

3. AFCA's Independent Assessor has the ability to review complaints about the standard of service provided by AFCA in resolving complaints. The Independent Assessor does not have the power to review the merits or substance of an AFCA decision. Is the scope, remit and operation of AFCA's Independent Assessor function appropriate and effective?

AFIA believes that broadening the role of the Independent Assessor may be a solution to the current position, where a member is not able to appeal a determination. We believe an appeals process is critical to confidence in the system and to ensure procedural fairness.

4. Is there a need for AFCA to have an internal mechanism where the substance of its decision can be reviewed? How should any such mechanism operate to ensure that consumers and small businesses have access to timely decisions by AFCA?

Yes.

Associate member, Piper Alderman has provided an outline of the current rights available to members to appeal a determination – this is detailed in Attachment B.

There are a number of reasons why it is timely to review the current process and establish the legitimacy of legal precedent:

- on 26 August 2019 ASIC approved the naming of financial firms by AFCA in published determinations.³ This poses potential material reputation risk for members if a determination has not been made on a question of law (AFCA only has to have regard to legal principles, applicable industry codes of practice or guidance, good industry practice and previous relevant determinations of AFCA or predecessor schemes)
- it would reduce the occurrence of the current practice of adopting a practical/commercial approach to resolution rather than a strictly legal position, because this will avoid the potential for a formal determination to be found against a member
- it would ensure that more natural justice prevails and a greater alignment with AFCA's Rules occurs around procedural fairness to all the parties⁴ involved in a complaint
- AFIA members note AFCA's commentary that an AFCA Determination is specific to the particular facts that underpinned the decision and its ability to 'act as a precedent' for future compliance settings does not automatically flow. However, determinations can have a far broader application. For example, contracts that have the same or similar facts to those that AFCA has determined to not be 'fair' in all the circumstances become the benchmark against which future complaints will be assessed. This means that other members, who operate with similar product constructs:
 - revise their compliance settings to meet AFCA's guidance or risk having a future complaint with similar facts determined in favour of the customer (with systemic ramifications) and
 - consider amending their credit policy settings, potentially excluding cohorts of customers due to concerns about the reputational risk of a determination going against them or the compounding nature of costs, which can at times be close to original debt levels.
- there would be improved trust in the legal and regulatory framework that AFCA uses; which underpins access to funding for many of the smaller members in the industry
- there would be improved understanding and integrity of the NCC law itself, along with supporting regulatory guides
- members would feel more confident in the process. The financial outcomes that flow from damage to a member's brand may significantly outweigh compensation awarded in an AFCA determination
- new and existing financiers who are not part of AFCA may decide to join and launch products captured under its rules. This would also increase AFCA's revenue streams
- members who joined AFCA 'voluntarily' (i.e. it was not based on a pre-requisite of holding an AFSL or ACL), will remain and not consider exiting the scheme.

While our preference is that a mechanism to appeal a determination is implemented, we appreciate the operational complexity this may pose and the timeframe it may take to deliver a timely outcome. As a result, in parallel to this being considered, we have suggested a series of changes to AFCA Rules that, if adopted, may reduce the number of determinations needing an appeal.

1. *Investigate and see if the grounds for appeal that currently exist for superannuation issues can be replicated for non-superannuation issues.*

³ ASIC (2019). [ASIC approves AFCA rule change enabling the naming of firms](#). Media release, 26 August 2019.

⁴ AFCA Rules A.2.1 c ii

AFCA Rules outline that a Determination of a Superannuation Complaint comes into effect immediately it is made, unless the AFCA Decision Maker states a later effective date in the Determination.⁵

Each party to a Superannuation Complaint has a right of appeal to the Federal Court on a question of law within 28 days after the day when a copy of the determination has been given to the party (unless the Federal Court allows a further period).

This process could be replicated for non-superannuation issues.

2. *Broaden the role of the Independent Assessor to review the merits or substance of a Determination*

AFCA's Independent Assessor is appointed by the AFCA board as part of their quality assurance and accountability framework.⁶ The primary role of the Independent Assessor is to identify, address and respond to complaints received about AFCA's complaints handling service and performance and make necessary recommendations about significant issues.⁷

Consequently, an Independent Assessor does not have the ability to review the merits or substance of a Determination.⁷ Rather, all the Independent Assessor considers is whether AFCA's provided service was satisfactory and recommendations to address the issues found.

There could be merit in broadening this role to review the merits or substance of a Determination.

3. *Broaden and increase the use of test cases*

AFCA Rules outline the process whereby a test case can be considered by a court.⁸ Members note that AFCA does not have to agree to a request for a test case but needs to take into account a number of factors. Members also note that they need to comply with undertakings as required by rule 2.2(f).

There could be merit in broadening the use of test cases to allow for a review of a Determination.

4. *Consider the introduction of an own motion review*

An ombudsman's own motion or on application by a party within 28 days after the date on which a determination or award was sent to that party, may allow the ombudsman to review the decision and assess if there is a clerical mistake; or there is a material error, oversight or omission; or there is a material miscalculation of figures or a material mistake in the description of any person, thing or matter; or there is a defect in form; or the terms of the determination or award do not reflect the scheme's or the ombudsman's actual intentions.

The result of this could be that the ombudsman may re-open the complaint; or make whatever amendments to the determination or award he or she thinks appropriate; or re-issue the determination or award; or give such directions as he or she thinks appropriate (including directions about times for compliance) in connection with the determination or award.

⁵ AFCA Rule 15.1

⁶ AFCA Rules A.16.3.

⁷ AFCA Rules A.16.4

⁸ AFCA Rules Page 147