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28 September 2017

Senate Standing Committees on Economics
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Dear Sir or Madam

MFAA Response to the Senate Standing Committee's Inquiry into Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Bill 2017

On behalf of the Mortgage & Finance Association of Australia (MFAA), we welcome the opportunity to respond to the Senate Standing Committee's Inquiry into Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Bill 2017 (AFCA Bill).

With over 13,000 members, the MFAA is Australia's leading professional association for mortgage and finance brokers. The aim of the MFAA is to help MFAA members to be recognised as trusted professionals and to be their client's first choice. To achieve this aim, the MFAA promotes and advances the broker proposition to consumers as well as external stakeholders including governments and regulators, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development.

The mortgage and finance broking industry is relatively new in Australia but continues to demonstrate growth. Mortgage and finance brokers have filled a clear gap in the market, being viewed as providers of comprehensive, and convenient credit advice to clients. Usually representing a panel of lenders, they offer customers a range of products and tailor mortgages to specific needs. Generally, these factors have contributed to demand growth in the industry.

Mortgage and finance brokers provide a distribution network right across the country, often in areas where there are no bank branches. As mainly small businesses or sole operators, each mortgage and finance broker accesses on average 1,000 customers per year, and it is conservatively estimated that the industry as a whole directly engages with over 1.9 million customers every year. Mortgage and finance brokers are strong drivers of competition in the mortgage lending market, providing

many small lenders and originators with a 'shop front' to compete against the larger bank branch networks.

It is estimated that around 17,000 mortgage and finance brokers operate in Australia.[1] In September 2016, *Comparator Business Benchmarking* found that local brokers' market share then stood at 53.6 per cent for home loans written compared with 70 per cent for the UK (in 2016)[2], 27 per cent for Canada, less than 40 per cent in the US and 25 per cent in New Zealand. Industry participants[3] agree that within five years, brokers will account for 60 per cent market share in Australia based on prevailing growth trends.

MFAA Commentary on the EDR reform process

The MFAA has made a number of previous submissions to Federal Government, including to the previous Review into External Dispute Resolution and Complaints Framework (Ramsay Review) on the issue of establishing a single scheme environment for EDR. The MFAA has been highly sceptical from the start of this review process, some eighteen months ago, about the merits of establishing a single EDR scheme. We strongly believe that the case for change was not made by the Ramsay Review, and that the suggested benefits of a single scheme do not outweigh the risks associated with such a move.

That said, should the Parliament pass the AFCA Bill, the MFAA is keen to work with the Government to try and ensure that the benefits provided by a multi-scheme environment are not lost through the mandating of a single scheme. The MFAA has already engaged with the transition team established by the Treasury, and will continue to engage in good faith to ensure that the rights of our more than 13,000 members are protected under the proposed AFCA regime.

MFAA position on EDR

The MFAA rejected key elements of the Ramsay Review's reports into EDR, including the interim report's principle recommendation *"that there should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO";* and the final report's recommendation that "*There should be a single EDR body for all financial disputes to replace FOS, CIO and SCT."*

The current AFCA legislation seeks to implement the recommendations of the final report. As such, the MFAA comments relate to the principle of a single scheme environment, and the implications this has for EDR as a method for successfully resolving mortgage and finance broker disputes. The MFAA does not address the provisions of the legislation directly, as it believes that the entire premise on which it is written – the establishment of a single scheme for EDR – remains an ill-advised one.

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[1] IBISWorld, *Mortgage Brokers in Australia: Market Research Report*, August 2016, p. 1, http://www.ibisworld.com.au/industry/default.aspx?indid=1821

[2] IRESS, *Intermediary Mortgage Survey 2016*, p. 7, https://www.iress.com/files/1214/5995/3077/UK_IRESS_IMS_2016_FINAL.pdf.

[3] Ernst & Young, *Observations on the Value of Mortgage Broking*, May 2015, p. 2, https://www.mfaa.com.au/IndustryInformation/Documents/1527742_MFAA_Broker%2020Study_final_email.pdf#search=observations%20on%20the%20value.

The MFAA believes that its position is best articulated through its submission in response to the interim report of the Ramsay Review lodged in December 2016. Given that the final recommendations of this review were only substantively varied through the addition of superannuation complaints, which do not impact MFAA members, we believe that the arguments made, and conclusion held in this submission remain entirely relevant, and not adequately addressed through the AFCA Bill.

The MFAA will however comment further on the provisions in the legislation to remove the obligation for credit representatives to be members of an EDR scheme, as this was not covered in our previous submission, relates solely and directly to the activities of MFAA members, and it is built on the somewhat inaccurate premise that it will lower the regulatory burden on industry without impacting on consumer's ability to access redress.

The Ramsay Review assessed the merits of a single scheme for EDR on seven key criteria: *Efficiency; Equity; Complexity; Transparency; Accountability; Comparability of outcomes; and Regulatory cost.* Through our submissions to the Ramsay Review, the MFAA made the following observations on each.

Efficiency – *A complaints resolution framework should provide outcomes in an efficient manner*
The Ramsay Review did not make the case that either the Financial Ombudsman Service (FOS) or the Credit and Investments Ombudsman (CIO) were inefficient in the application of their EDR functions. Nor did it provide any evidence that the creation of a monopoly EDR regime will lead to greater efficiencies. The Review claimed that jurisdiction overlaps lead to delays in resolving some disputes. The MFAA can only support the evidence provided by both the CIO and FOS that where there is overlap, the current MoU and operating principles ensure that delays are minimised. Equally, there was no evidence provided that establishing a single EDR monopoly will improve efficiency. It is assumed that the single EDR scheme will have several divisions. Its establishment will therefore simply move the jurisdictional overlap from between schemes to between departments, with no guarantee that they will be more efficiently resolved. Of a more worrying nature, one of the claimed benefits of a monopoly is that the scheme will have "the capacity to reallocate resources as priority areas shift". Given the profile nature of the large bank disputes, and the influence they will have over scheme strategy, this 're-allocation' is only likely to go one way – away from smaller financial service provider (FSP) disputes, to the disputes of big banks.
Equity – *Complaints should be treated fairly*
The Review Panel pinned its equity argument on the alleged consumer confusion between the current schemes (FOS and CIO). The MFAA contended that no significant confusion exists. It also contended that where it does exist, it is resolved quickly and at no detriment to the customer. Even the Ramsay Review's Interim Report claimed that "it is difficult to measure consumer confusion", and acknowledged the effectiveness of the current MoU between CIO and FOS. Therefore, the MFAA did not believe that there was any equity benefit from the recommendation to establish a single scheme. Moreover, the MFAA believed that there could be an equity detriment to many financial service providers, including mortgage and finance brokers, if resources were 're-allocated' away from the resolution of their disputes in favour of the big banks.

Complexity – *Given individuals can possess low levels of financial literacy and behavioural biases, a complaints resolution framework should have minimal complexity*

The Ramsay Review claimed the most significant complexity benefit came from the removal of confusion. The MFAA contended that this was both simplistic and inaccurate. There was no evidence of genuine customer confusion or detriment, and as such the Ramsay Review should not have contended that there was any inherent complexity from the existence of two schemes. The MFAA also believed that the establishment of a large, monopolistic bureaucracy was more likely to lead to increased complexity, because the efficiencies produced by the competitive tension inherent in the current market for EDR would be removed.

Transparency – *A complaints resolution framework should be transparent and open.*

The Ramsay Review contended in its interim report that the "presence of competition between schemes may provide incentives to minimise financial disclosure (due to price competition), which reduces financial transparency". However, there was no evidence presented in the interim report to support this statement, nor was there any evidence that the alleged practice occurred. The MFAA argued that if it were to occur, it could easily be resolved through ASIC, acting against breaches due to the lack of such statutory disclosure, as part of its oversight role.

The MFAA also contended that a monopoly provider could actually be less transparent, as it does not have to compete for business. This has been seen in almost all monopoly industries. The advent of competition means that the appetite for information amongst customers is heightened as they desire comparative data to support their purchase decision.

Accountability – *A complaints resolution framework should ensure decision makers account for their actions to users and the wider public*.

The Ramsay Review claimed that the lack of consistency in reporting between the schemes made it difficult to compare the schemes and monitor their effectiveness. Again, the MFAA argued that there was no evidence to support this claim. The MFAA also argued that one does not fix reporting and accountability problems by abolishing competition and establishing a less accountable monopoly. The MFAA also argued that any issues of accountability under the current EDR model could easily be resolved by empowering ASIC to establish consistent reporting standards.

The MFAA believed that accountability should be measured in terms of responsiveness to both the complainants (customers) and member FSPs. The MFAA believed that a monopoly could be less accountable because, regardless of outcomes, all FSPs would be forced to join, and remain members of the scheme. It is entirely reasonable to assume that once the competitive pressure of members being able to switch between schemes is removed, a scheme could become much less responsive to their needs.

Comparability of outcomes – *A complaints resolution framework should ensure that consumers receive comparable outcomes*

The Ramsay Review argued that due to a differing approach and criteria for decision making between FOS and the CIO, this compromises comparability of outcomes. The MFAA contended that this differing approach reflected the different nature of the disputes covered by CIO versus those handled by FOS. It also reflected the differing impact of such disputes on members. While a minor financial dispute involving a big bank handled by FOS has little impact on the bank should the decision go against them, a similar dispute handled by the CIO in relation to a mortgage or finance broker could end the broker's business should it go against the broker. This therefore increases the risk to a broker should the dispute be incorrectly dealt with. This means that the

CIO needs to be much more focused on due process, and demonstrating such due process to its members.

The MFAA argued that a monopoly scheme was likely to apply a single 'one size fits all' approach to dispute resolution processes. While such an approach could resolve the comparability of outcomes issue, it could mean that the processes suitable for dealing with a big bank are likely to be applied to small businesses including mortgage and finance brokers. This could undermine mortgage and finance broker confidence in EDR processes generally, and, more specifically, undermine the effectiveness of the mediation process.

Regulatory costs – *The regulatory settings for a dispute resolution framework should, as appropriate, utilise market forces and avoid creating moral hazards.*

The Ramsay Review claimed that the removal of duplication in regulating, and indeed running, two schemes would reduce supervision costs for ASIC and costs to members. The MFAA believed that such an assertion did not reflect the common practice of monopolies, and ignored the Ramsay Review's core principle that regulatory setting should utilise market forces and avoid creating moral hazards. The creation of a monopoly would likely remove all market forces including downward pressure on member costs and more likely, in our view, would lead to member cost increases which a competitive scheme would constrain.

In terms of the creation of moral hazards – or irresponsible risk taking – the MFAA argued that the removal of choice would make such hazards more, rather than less, prevalent. Such moral hazards could be reflected in poor decision making, poor outcomes, or both. As under a single scheme environment FSPs would not be able to 'vote with their feet', the monopoly EDR provider could make risky or 'creative' decisions without impacting their business. This could undermine member confidence in decision making and the wider confidence in the EDR environment.

Removal of the obligation for credit representatives to be members of an EDR scheme

The AFCA Bill proposes to remove the obligation on credit representatives to be members of an EDR scheme, with potential disputes relating to them being handled through their credit licensee. The Government's consultation paper, "Improving dispute resolution in the financial system", of May 2017, makes the following observations on the current and proposed treatment of credit representatives.

> 48. Under the National Consumer Credit Protection Act 2009, both credit licensees and credit representatives are required to be members of an EDR scheme, even though the licensee is responsible and liable for the conduct of their representatives.
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> 49. This requirement is in contrast to the financial services licensing regime where only the licensee is required to be a member of an EDR scheme. The rationale for the financial services approach is that making financial services licensees responsible for the conduct of their representatives, combined with compulsory EDR membership for licensees provides adequate consumer protection.
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> 50. Removing the obligation for credit representatives to be members of an EDR scheme could potentially lower the regulatory burden on industry without impacting on consumer's ability to access redress, as the licensee ultimately retains responsibility for the conduct of their representatives.

The MFAA is in favour of reducing the regulatory burden on credit representatives, however, is concerned that this measure may simply transfer that burden to the credit licence holder. Whilst the obligation to be a member of an EDR scheme may be removed, the activity of credit

representatives will still be subject to EDR, with the cost of this activity now being borne by the credit licence holder. In many respects, this may not result in a reduction of the regulatory burden, but rather a transfer of the burden and associated costs.

Equally, the AFCA will need to recover the shortfall in membership fees from the removal of a substantial number of credit representative members, or face a significant funding gap, and a resultant reduction in services. This shortfall will most likely need to be recovered through an increase in the membership cost to credit licence holders, or through the application of complaint fees for consumers. In any case, it is likely that these cost imposts will then be passed from credit licence holder to credit representative, significantly negating the benefit of the removal of the EDR membership requirement.

Conclusion

The MFAA was disappointed by the findings of the Ramsay Review, and believes that the current AFCA legislation does not adequately address industry concerns with a single EDR scheme. The Ramsay Review was established to assess EDR as it interacts with both complainants (customers) and member financial service providers. Unfortunately the Ramsay Review largely based its findings on the agendas of, and evidence given by, a small number of consumer representative organisations, and not the customers they represent. More importantly, the Ramsay Review, and current AFCA legislation has ignored almost all of the evidence and views provided by EDR members.

The MFAA does not support the establishment of a monopoly EDR scheme. The Ramsay Review, and the Federal Government, have not adequately made the case for change, and has pinned the need for this reform to alleged customer confusion – which the Ramsay Review acknowledged was difficult to measure. Equally, no analysis was provided to suggest that the alleged confusion was leading to customer detriment, or that a single scheme environment would be in any way less confusing to customers – as cases are shifted internally between departments.

The MFAA believes that the only effective EDR system is one which has the support of its members. EDR reform which is not supported by members, or is forced upon them, will only lead to the degradation of successful mediation principles.

As we previously mentioned, should the Parliament pass the AFCA Bill, the MFAA continues to remain willing to work with the Government to try and ensure that the benefits provided by a multi-scheme environment are not lost through the mandating of a single scheme.

The MFAA would like to thank you again for the opportunity to respond to the Senate Standing Committee's Inquiry into Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Bill 2017, and should the Committee have any questions regarding this submission, please do not hesitate to contact me.

Yours sincerely

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CEO