

Improving dispute resolution in the financial system

Consultation Paper

May 2017

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Consultation Process

### Request for feedback and comments

Interested parties are invited to comment on this consultation paper and accompanying draft legislation and regulations.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked as such in a separate attachment.

#### Closing date for submissions: 14 June 2017

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# Improving dispute resolution in the financial system

## Introduction

### A new dispute resolution framework

1. On 9 May 2017, the Government announced a new framework for dispute resolution in the financial system. The key element of this is a single external dispute resolution (EDR) scheme (a one-stop shop) — the Australian Financial Complaints Authority — (AFCA) that will deal with all financial disputes, including superannuation disputes.
2. The new EDR framework will be enacted via the Treasury Laws Amendment (External Dispute Resolution) Bill 2017 (the Bill) and the Treasury Laws Amendment (External Dispute Resolution) Regulations 2017 (the Regulations). Drafts of the Bills and Regulations have been released for consultation.

#### Review of the EDR framework

1. In April 2016, the Government commissioned the first comprehensive review of the EDR framework to be led by an expert panel chaired by Professor Ian Ramsay (the Ramsay Review).
2. The purpose of EDR in the financial system is to provide free and timely access to redress where a consumer or small business has a dispute with their financial service provider, credit provider or superannuation trustee.
3. There are currently three EDR bodies in the financial system: the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT).
   * The FOS and CIO are ASIC authorised ombudsman schemes: Australian Financial Services licensees and Australian Credit licensees are required to be members of one of these schemes as a condition of their licence.
   * The SCT is a statutory tribunal: its jurisdiction extends to the decisions and conduct of trustees, insurers and other decision-makers in relation to regulated superannuation funds (other than self-managed superannuation funds), approved deposit funds, annuities, life policy funds and retirement savings accounts.
4. The Review provided its final report to Government in April 2017. The Review found:
   * The existence of multiple EDR schemes with overlapping jurisdictions means: it is difficult to achieve comparable outcomes for consumers with similar complaints; it is more difficult for consumers to progress complaints involving firms that are members of different schemes; and there is an increased risk of consumer confusion. Multiple EDR schemes also result in duplicative costs for industry and for the regulator.
   * There are long-standing problems with the SCT’s current arrangements for resolving superannuation complaints, which can be attributed to: underfunding and a lack of flexibility in funding; outdated governance; and limited flexibility with regard to its dispute resolution processes.
   * While superannuation complaints are not subject to a monetary limit, the monetary limits and compensation caps applying to other complaints ($500,000 and $309,000 respectively) have fallen behind what is required to ensure access to redress for consumers, with the value of many financial products and services being higher than the current limits.
   * Small business does not have adequate access to EDR because the existing monetary limits of $500,000 for the value of the claim under dispute and $2 million in relation to credit facilities preclude many complaints from being able to be brought to the schemes.
   * Data on internal dispute resolution (IDR) outcomes is limited and inconsistent which means that it is difficult to determine the effectiveness of IDR and whether it is leading to improved consumer outcomes over time.

### The establishment of AFCA

1. A new single EDR scheme, AFCA, will replace FOS, CIO and the SCT.
2. The Government has announced that AFCA will be based on an ombudsman model and will be operational by 1 July 2018. It will be established by industry as a company limited by guarantee.
3. The new scheme will operate under a co‑regulatory framework. This means that while the AFCA board will make its own decisions regarding funding, staffing and dispute resolution processes, it must comply with legislative and regulatory requirements, as set by Government and ASIC. Such an approach will provide the scheme with flexibility and adaptability to respond to changes in the regulatory framework, user expectations and the overall economic context, but ensure that minimum standards and protections for users are retained.
4. Although in most instances the operational aspects of the scheme will be based on private law (contractual) obligations between the operator of the EDR scheme and its members, some statutory powers are required to manage superannuation complaints effectively. Where statutory powers are provided, it is important that the circumstances in which those powers can be used and accountability mechanisms are also included in the legislation. These issues are discussed in further detail in the Superannuation section.

## Legislative framework

### Ministerial authorisation

1. The scheme will be formally authorised by the Minister (proposed s 1046(1) *Corporations Act 2001* (Corporations Act*)*).
2. In making the decision to designate a scheme as the authorised EDR scheme, the Minister will have regard to requirements specified in the legislation (see especially proposed ss 1046(2) and s 1047 Corporations Act). Among other things, the Minister will have regard to whether the scheme will be: accessible, accountable, free for consumers, efficient, effective, able to deal with complaints in a timely manner and have the necessary expertise to effectively operate the scheme.
3. In making the authorisation decision, it is expected that the Minister will have regard to the proposed operational rules of the scheme (its ‘terms of reference’).
4. Consistent with the Government decision that there be a one-stop shop EDR scheme, the Minister will only authorise one scheme as the authorised EDR scheme.

### Membership will be compulsory for all financial firms

1. In order to ensure that its decisions are binding, financial firms providing services to retail clients, as well as regulated superannuation funds (other than self‑managed superannuation funds) and approved deposit funds, will be required under the Bill and Regulations to be members of the single EDR scheme as a condition of one or more of their licences and be contractually bound to comply with its rules.

### Strengthened regulatory oversight

1. The EDR scheme will be subject to enhanced oversight and monitoring.
2. The authorisation of the EDR scheme will be subject to conditions (see proposed s 1048 Corporations Act), including a condition that it complies with ongoing scheme functions set out in proposed s 1047 Corporations Act), and that it complies with any regulatory requirements set by ASIC. ASIC will be provided with a new power to issue such requirements, which will be legislative instruments (proposed s 1049 Corporations Act).
3. The EDR scheme will also need to seek approval from ASIC before the operator of the EDR scheme can make any material changes to its terms of reference (proposed s 1050 Corporations Act). ASIC will take into account the same matters the Minister considered when authorising the EDR scheme before approving the change.
4. ASIC will be provided with a general directions power that can be used where the scheme fails to meet a condition of its authorisation (proposed s 1051 Corporations Act), including conditions set out in proposed s 1048, a failure to perform the scheme functions set out in proposed s 1047, or comply with ASIC regulatory requirements made under proposed s 1049. Before issuing a direction, ASIC will be required to provide the operator of the EDR scheme with written advice that it intends to use its power and the reasons for that decision, as well as set out the specific measures the operator needs to undertake to comply with the condition of its authorisation.
5. Use of the directions power will be subject to merits review.

### Enhanced internal dispute resolution reporting

1. There will be enhanced transparency and accountability of the internal dispute resolution (IDR) activities of firms.
2. All members of the EDR scheme will be required to have IDR arrangements that comply with ASIC’s regulatory guidance and be required to report to ASIC in a standardised form (as determined by ASIC) on their IDR activity. For superannuation complaints, the above requirements will replace those contained in section 101 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)*.*

### Superannuation complaints

1. Superannuation is a compulsory, long‑term product and currently, superannuation complaints have an unlimited monetary jurisdiction. The Government agrees with the Ramsay Review recommendation that the EDR scheme should have appropriate statutory powers in relation to superannuation complaints. Superannuation complaints may have unique features that may require statutory provisions for effective dispute resolution.
2. In particular, unlike other financial system complaints, some superannuation complaints may not be able to be adequately resolved by relying on the contractual obligations between the EDR scheme and its members (as set out in the terms of reference). Superannuation complaints may involve third parties to a complaint, where a person is not a party to a contract between the complainant and the member of the EDR scheme but may have an interest in the outcome of a complaint; for example, beneficiaries to a death benefit.
3. The EDR scheme will have enhanced flexibility under the proposed industry-based model to resolve disputes. It will also be given sufficient powers to ensure that the rights parties currently have under the SCT framework are preserved in the new framework. Consistent with this, complaints handled by the EDR scheme will be covered by the statutory powers as defined in the draft legislation. The draft legislation defines a ‘superannuation complaint’ in proposed s 1052 Corporations Act in broad terms, intended to capture the same decision‑makers and types of complaints covered by the *Superannuation (Resolution of Complaints) Act 1993* (S(ROC) Act).
4. As noted above, superannuation complaints sometimes require the involvement of third parties who will not have contractual obligations to comply with the EDR scheme’s processes. Accordingly, the draft legislation provides the EDR scheme with equivalent powers to the SCT to obtain information and documents (with appropriate secrecy provisions) (see proposed s 1054 and s 1064 Corporations Act), to require attendance at conciliation conferences (proposed s 1055) and to join third parties to a complaint (proposed s 1053).
5. The draft legislation also preserves certain existing requirements around decision‑making processes for superannuation complaints. In particular, as under the S(ROC) Act, the EDR scheme will have all the powers, obligations and discretions conferred on the trustee or other decision-maker, and will only be able to provide remedies to remove the unfairness or unreasonableness of a decision (proposed s 1057 Corporations Act). This ensures that decisions made by the EDR scheme continue to be consistent with superannuation fund trustee duties and/or the duties of other decision-makers.
6. EDR determinations for superannuation complaints will come into operation immediately upon the making of the determination (unless otherwise specified) (proposed s 1059 Corporations Act) and will be legally enforceable as the original decision of the trustee or other decision-maker (proposed s 1059), in line with current provisions.
7. Consistent with current provisions in the S(ROC) Act, all parties to a superannuation complaint will have the right to appeal to the Federal Court on questions of law.
8. Many of the current provisions in the S(ROC) Act that relate to operational aspects of the scheme will be included in the terms of reference, rather than the Bill (see section on terms of reference).
9. In line with current provisions, superannuation funds which are not regulated superannuation funds under the SIS Act may elect to be members of the new EDR scheme. The policy intent is that these funds would then be subject to the relevant legislative and regulatory provisions and the terms of reference of the new EDR scheme, as well as the enhanced IDR requirements set out by ASIC.

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| **Question 1**  Are there other statutory powers the EDR body will need to resolve superannuation complaints effectively? |

## Terms of reference

1. A key element of the new framework is that AFCA is flexible and responsive to new developments.
2. For this reason, under the new EDR framework, the standards that AFCA must adhere to will be set in the legislation; however, the way in which it operates in order to meet these standards will be determined by the AFCA board and set out in AFCA’s terms of reference.
3. This approach will allow operational improvements to be enacted much more quickly than would be the case if legislative change were required.
4. To ensure that the new scheme fulfils its legislative obligations and delivers benefits to consumers and small businesses, the Minister will carefully consider the terms of reference when approving a company to be the authorised EDR scheme. The Minister will publicly outline the minimum requirements that would be expected to be included in a scheme’s terms of reference for it to be designated as the authorised EDR scheme at a later date.
5. The following sets out the matters that are expected to be addressed in the scheme’s terms of reference:
   * how the scheme is funded by its members (although the fact that it must be free for consumers will be a legislative requirement);
   * the governance structure of the scheme (and, in particular, that the Board will comprise an independent Chair and equal number of directors with consumer and industry backgrounds);
   * the monetary limits that determine which disputes can be heard by the scheme and how much compensation can be awarded;
   * the processes by which the scheme will manage complaints;
   * the approach the scheme takes to making decisions;
   * how the scheme uses panels to resolve complaints;
   * when the scheme will refer complaints back to the financial firm with which the consumer had the original complaint;
   * how and when the scheme will undertake periodic reviews of its operations; and
   * matters relating to the establishment of an independent assessor (Ramsay Review Recommendation 6), whose role will be to review the way in which disputes were handled by the scheme (but not the outcome of the dispute).
6. In relation to superannuation, the Government considers the following matters that are currently in the S(ROC) Act would be appropriate to include in the scheme’s terms of reference:
   * appropriate elements of the ‘claim-staking’ process for death benefit complaints, including who will be considered to have an interest in a death benefit and appropriate time limits for considering death benefit complaints; and
   * appropriate time limits for total and permanent disability complaints, which should be designed to ensure that consumers do not have to wait long periods of time to access these benefits.
7. The Government also expects that the terms of reference should include an unlimited monetary jurisdiction for superannuation complaints.
8. As noted above, material changes to the terms of reference will be subject to ASIC approval. ASIC will also have a power to issue enforceable directions if AFCA fails to comply with this, or other legislative or regulatory requirements.

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| **Question 2**  Do you consider that the Bill strikes the right balance between setting the new EDR schemes objectives in the legislation whilst leaving the operation of the scheme to the terms of reference?  **Question 3**  Are there any issues that are currently in the Bill that would be more appropriately placed in the terms of reference or issues that are currently absent from the Bill that should be included in the Bill? |

## Transitional arrangements

### FOS/CIO

1. Once the new body is operational, all new complaints will be heard by AFCA. It is proposed that all disputes that are lodged with the FOS/CIO prior to this date will be dealt with by the CIO/FOS. As such, it is anticipated that financial service and credit providers will be required to be members of the new EDR scheme and their existing EDR scheme as FOS and CIO work through their remaining complaints.
2. Although there would be no statutory obligation to remain a member of the FOS or CIO, financial service and credit providers with a complaint being heard by one of these bodies would continue to be bound by contract to adhere to the determinations of the scheme.

### Superannuation Complaints Tribunal

1. While all new superannuation complaints will be made to the new EDR scheme from the date the new body is operational, the SCT will continue operations until 1 July 2020 to resolve the current backlog of complaints. Consumers will have the option to refer complaints previously made to the SCT to the new scheme once it is operational.

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| **Question 4**  Are there any additional issues that should be considered to ensure an effective transition to the new EDR scheme? |

## Monetary Limits

1. The Government has accepted the Ramsay Review recommendations that the claim limits and compensation caps be raised for consumer and small business non‑superannuation complaints, as the existing limits are inadequate and no longer in line with the values of many financial products.
2. While the Ramsay review recommended that initially claim limits be set at $1 million and compensation caps be set at $500,000 for consumer complaints and non-credit small business complaints, the Panel also recommended that consultation be undertaken about:
   * whether complaints in relation to certain products, including mortgages and general insurance products, should move immediately on commencement to a compensation cap of $1 million; and
   * whether there are compelling reasons to retain the current sub-limits applying to different insurance products.
3. Superannuation complaints will have an unlimited monetary jurisdiction, in line with current arrangements.
4. The draft legislation notes that the Minister must take into account the accessibility and effectiveness of the scheme but does not prescribe the monetary limits for complaints, which will be specified in the terms of reference of the EDR scheme. The Minister will have regard to the monetary limits specified in the Terms of Reference when making the authorisation decision. Additionally, in the event that future monetary limits imposed by the scheme are considered ineffective in meeting the purposes of the scheme, ASIC will have a power to issue a direction that the monetary limit be increased (see proposed ss 1048(3) Corporations Act).

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| **Question 5**  Would moving immediately to a compensation cap of $1 million have significant impacts on the availability/price of professional indemnity insurance?  **Question 6**  Are the existing sub-limits for different insurance products still required? |

## Credit Representatives

1. Recommendation 11 of the Ramsay Review noted that in principle there is no reason why credit representatives should continue to hold EDR membership but that further work should be undertaken to ensure there would be no unintended consequences from removing the requirement.
2. 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.
3. 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.
4. 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.
5. Stakeholders are invited to provide any concerns that they would have with removing the requirement for credit representatives to be members of an EDR scheme.

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| **Question 7**  Are there any reasons why credit representatives should be required to be a member of an EDR scheme? |

## Regulatory Impact

1. Consistent with best practice, Treasury will assess the regulatory impact of the new EDR framework by costing the regulatory impact using the Government’s regulatory burden measurement framework.
2. Areas where there could be an increase in regulatory burden for industry include:
   * updating disclosure material;
   * training staff;
   * the obligation on superannuation funds to be members of a scheme;
   * firms dealing with an increased number of complaints as a result of increased claim limits; and
   * the cost of providing IDR data to ASIC.
3. Stakeholders are invited to provide feedback on the regulatory impact of the reforms, including the impact of the factors identified above, as well as any additional factors.

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| **Question 8**  What will the regulatory impacts of the new EDR framework be? |