AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

The Treasury

Dear Sir/Madam,

7 February 2020

ARCA SUBMISSION – ESTABLISHING A COMPENSATION SCHEME OF LAST RESORT (CSLR)

Thank you for the opportunity to provide a submission in response to this Treasury discussion paper.

ARCA is the peak industry association for businesses using consumer information for risk and credit management. Our Members include Australia's leading banks, credit unions, finance companies, fintechs, and credit reporting bodies. Collectively, ARCA's Members account for well over 95% of all consumer lending in Australia.

ARCA provides the following observations in response to the discussion questions:

- *What is the appropriate coverage for the CSLR, beyond the provision of personal advice?*

  ARCA supports the narrow coverage approach, as the outcome recommended by the Ramsay Review, restricting the CSLR to financial advice failures. We note the Discussion Paper highlights there is no evidence of unpaid determinations relating to the provision of prudentially regulated banking, insurance and superannuation services to consumers and small businesses (page 8). It appears then the evidence does not exist to support a move to the broader coverage models proposed in the discussion paper.

  If (despite the position expressed above) a broader coverage model were to be adopted, we would urge caution in extending the model to NCCP-regulated credit

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providers generally, and, more specifically, Authorised Deposit-Taking Institutions (ADIs) engaged in the provision of credit.

The circumstances relevant to credit providers and their customers is entirely different to that applying to financial advice firms and their clients. Financial advisers are trusted with the wealth and money of the client and the client bears the risk if the financial adviser becomes insolvent. However, in a credit situation, the credit provider bears the risk of non-payment. On that basis, in respect of NCC-regulated credit providers (which will be members of AFCA), AFCA Rules D.2.1 already enable AFCA to apply a range of remedies in its determinations including forgiveness of a debt or variation to a debt. This means that, for credit disputes, in the case of insolvency of the credit provider, any unpaid determination is able to be applied against any liability that the customer owes under a credit contract, notwithstanding any terms and conditions in the credit contract to the contrary. This significantly limits the likelihood of a determination in a credit dispute remaining unpaid.

In respect of ADIs, given the strict prudential requirements which already apply, ADIs are highly unlikely to become insolvent and should always have the capacity to pay a determination amount (including by loan reduction). In fact, the application of the CSLR to an ADI would indicate that an issue exists with the Australian Prudential Regulation Authority's (APRA's) capital adequacy requirements, such that these requirements are insufficient to protect against the risk of an ADI becoming insolvent.

For those two reasons, we consider that the additional costs and regulatory burden of extending the CSLR to providers of credit cannot be justified.

- *Would there be any unintended consequences from initially excluding court and tribunal decisions or from excluding voluntary members of AFCA from the CSLR?*

  The exclusion of 'voluntary members' of AFCA, such as debt management firms and other non-AFSL/ACL holders, from the CSLR undermines any proposed coverage of the CSLR to the credit industry. As we have noted, NCCP-regulated credit providers (and, in particular ADIs) should not need recourse to the CSLR, given issues of solvency become less relevant given AFCA's powers and, for ADIs, would have been identified and addressed through APRA reporting.

  It is far more likely that non-regulated entities will seek recourse to the CSLR. It would then seem counter-intuitive that they are not subject to coverage by the CSLR on the basis it may provide a dis-incentive to their continued, voluntary AFCA Membership.

  Broadly, we would observe that this issue is due, in part, to the lack of regulation of certain sectors, including debt management firms. We note that, in February 2019, the Senate Economics Reference Committee in its report on credit and financial services targeted at Australians at risk of financial hardship recommended that: "*the government implement a regulatory framework for all credit and debt management, repair and negotiation activities that are not currently licensed by the Australian Financial Security Authority, including compulsory membership of the Australian*

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Financial Complaints Authority, giving clients access to an External Dispute Resolution scheme.[1]*"*

To our knowledge, no steps have been taken by the Government to give effect to this recommendation.

ARCA's strong view is that if the intent is to provide adequate coverage to consumers who are at risk of both adverse treatment and, subsequently, an unpaid determination issued against an insolvent financial firm, then the establishment of the CLSR must occur in conjunction with improved regulation of those sectors of the financial services industry most at risk of both adverse consumer treatment and insolvency. This includes the regulation of debt management firms, as recommended by the Senate Economics Reference Committee.

Finally, an additional concern with the proposal to exclude voluntary AFCA Members is the potential for consumer harm suffered by consumers who use these particular financial firms, under the misapprehension that they are protected in dealing with a financial firm who is an AFCA member. That is, consumers will be led to believe that using an AFCA member to provide services includes the protection of being able to go to AFCA for disputes and having any determination 'guaranteed' through the CSLR. At a minimum, there must be a manner in which voluntary members clearly tell the customer the limits of their members *before* providing services.

- *Funding arrangements – assessment of risk model, compared to 'firm's ability to pay' model*

  ARCA considers that the assessment of risk model is preferable to the 'firm's ability to pay' model. This is because, if the matrix to the risk model is based on risk of business versus risk of service provided, and the unit rate is based on percentage of sales/turnover/assets – then it becomes unnecessary to consider the 'firm's ability to pay'.

  ARCA further considers the setting of the minimum contribution level may, in itself, provide a means to gauge risk. That is, if minimum fee is set at a material level (for example, $2,000), and the business cannot afford to make this contribution, this then provides a clear indication that the financial firm lacks sufficient capital to pay an adverse determination.

- *Funding arrangements – unexpected costs and maximum caps*

  ARCA considers that maximum caps on unpaid determination amounts must be applied, within the current AFCA maximum caps.

  In terms of managing unexpected costs, ARCA's view is that the CSLR would best be designed to cater for a moderate level of unexpected costs. However, it does not seem feasible to fund the CSLR to cater for a significant industry wide event, simply

[1] Senate Economics Reference Committee, Final report – credit and financial services targeted at Australians at risk of financial hardship, 22 February 2019, Recommendation 1.54

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because the likelihood of this occurring appears remote and this may place an unnecessary burden on the operation of the CLSR. Further, if an unexpected significant industry wide event occurs, an immediate levy imposed via the CSLR may exacerbate industry's ability to recover from the event. If unexpected costs do arise from significant industry wide events, then it should be expected that some funding for unpaid determinations may need to be provided by the Federal Government.

If you have any questions in relation to this submission please contact ARCA's Legal and Regulatory Affairs Manager, Elsa Markula.

Yours sincerely,

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