7 March 2012

By email: disputeresolutionreview@asic.gov.au

Ai-Lin Lee
Consumers, Advisers and Retail Investors
Australian Securities and Investments Commission
GPO Box 9827
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Dear Ms Lee

ASIC consultation paper 172: EDR jurisdiction over complaints when members commence debt recovery legal proceedings

The following is a joint submission to on ASIC consultation paper 172: EDR jurisdiction over complaints when members commence debt recovery legal proceedings (**the consultation paper**). The Consumer Action Law Centre (**Consumer Action**), Financial Counselling Australia, the Consumer Credit Legal Centre NSW, the Financial and Consumer Rights Council, Financial Counsellors Association of Queensland, Paul O'Shea of the Law School at the University of Queensland and the Consumer Law Centre of the ACT have all contributed to or endorsed this submission. Information on the contributing organisations can be found in the appendix.

We welcome the opportunity to make this submission and we are grateful that ASIC has allowed us to submit this paper later than originally requested.

We continue to strongly support the requirement in ASIC regulatory guide 139 that external dispute resolution (**EDR**) schemes must hear complaints when members have commenced debt recovery proceedings against the consumer making the complaint.

We support retaining the jurisdiction because:

- removing the jurisdiction will erode access to justice by referring consumers to a court process which is demonstrated to be inaccessible;

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- retaining the jurisdiction is consistent with Government policy on dispute resolution and consumer credit;
- removing the jurisdiction would leave consumers with less access to dispute resolution than before the enactment of the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**), which is contrary to the purpose of that Act;
- removing the jurisdiction would allow traders to launch collection proceedings purely to avoid EDR complaints; and
- the jurisdiction is used widely and responsibly by consumers.

We have further argued that, if there is to be any amendment to the jurisdiction, it should be to extend it to allow consumers to lodge complaints against credit providers where a default judgment has been entered against them.

Our comments are detailed more fully below.

Support for retaining the jurisdiction—response to question B1Q1

B1 *We propose that the requirement in RG 139.77–RG 139.79 remains in its current form.*

B1Q1 Do you agree? If not, why not? We are particularly interested in statistics and feedback from EDR scheme users on this scheme jurisdiction, including examples or experiences that illustrate where the requirements may not be working so well and why: see paragraph 36.

We support retaining the jurisdiction, for the following reasons:

Removing the jurisdiction will erode access to justice by referring consumers to a court process which is demonstrated to be inaccessible.

It is in our view beyond debate that EDR is a more accessible and fairer venue for disputes between financial service providers and consumers than the court system.

Court processes are highly formal, procedural and intimidating, and in our experience, unassisted consumers find it very difficult to respond to debt recovery proceedings through the courts. Courts are in general much more costly than EDR processes, and also come with significant cost risks to the parties. Although section 199 of the NCCP Act provides some cost protections to plaintiffs, it does not provide complete protection and is limited by maximum amounts in some cases. The complexity of court process is also a significant barrier, meaning most consumers would need access to specialist legal assistance to make applications for hardship variations (or seek counter-claims that include hardship variation requests where a credit provider may have sued for payment of a debt). The combined complexity and risk of costs will deter many consumers from initiating or defending proceedings in a court.

The Department of Justice report *Courting Debt* found that, in 2005/06, 30,814 complaints for civil consumer debt matters were finalised in the Magistrates' Court of Victoria. Of these, an astounding 98 per cent (30,169) ended in default judgment.[1]

[1] Louis Schetzer (2008) *Courting Debt: The Legal Needs of People Facing Civil Consumer Debt Problems*. Department of Justice, Victoria, viii.

A significant portion of these matters were consumer credit debts. Firms in the GE group accounted for thirteen per cent of creditors for civil complaints less than $10,000 (3,258 complaints)[2], while Commonwealth Bank initiated 718 complaints, and Lion Finance (subsidiary of the debt collector Collection House) initiated 580 complaints.[3] Local government authorities, utility companies, and finance companies were also in the list of companies that initiated civil complaints.

This research demonstrates that the vast majority consumers are unable to respond to court proceedings regarding civil debt. This means that very few consumers will be able to defend themselves against debt recovery proceedings if the only venue open to them is the courts.

Conversely, the Financial Ombudsman Service (**FOS**) and the Credit Ombudsman Service (**COSL**) are procedurally simpler, and come with no cost risk (except that interest on outstanding debts continues to accumulate). Dispute resolution through the EDR schemes is also less intimidating, as much of the process is conducted at a distance and on paper. This ensures the processes remain informal and avoids some of the pitfalls of face-to-face dispute resolution where a power imbalance exists between the parties.

The EDR schemes have been demonstrated to be accessible to consumers and able to consider and settle consumer credit disputes following the initiation of debt recovery proceedings. Reporting by FOS shows that 1,890 complaints were received between 1 January 2010 and 30 June 2011 where debt recovery proceedings had been issued.[4] Ninety-six percent of these complaints related to credit products.

The FOS report also finds that the introduction of an expedited process has allowed most disputes to be settled relatively quickly,[5] meaning minimal delay is created for lenders while still allowing an accessible process for consumers.

This FOS data demonstrates that EDR is accessible to consumers and is capable of considering and settling complaints brought by consumers after debt recovery processes have been initiated. The earlier Department of Justice research establishes that courts are not accessible to consumers and so are largely unable to consider these kinds of complaints. If the EDR jurisdiction was removed, large numbers of consumers with legitimate hardship and lender misconduct complaints would be effectively denied access to justice.

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[2] This figure comprises complaints brought by GE Capital Finance Australia, GE Finance Australasia Pty Ltd and GE Personal Finance Pty Ltd.

[3] Figures on GE, Commonwealth Bank and Lion Finance are not stated in the Courting Debt report, but were provided by the Department of Justice following release of the report.

[4] Financial Ombudsman Service (2012) *Debt Recovery - Legal Proceedings Statistical Report: 1 January 2010 to 30 June 2011.* Accessed from http://fos.org.au/centric/home_page/publications/debt_recovery_legal_proceedings_statistical_report.jsp

[5] Financial Ombudsman Service (2012) *Debt Recovery - Legal Proceedings Statistical Report: 1 January 2010 to 30 June 2011*, explanatory note.

Retaining the jurisdiction is consistent with Government policy on dispute resolution and consumer credit

As the discussion paper points out, retaining this jurisdiction supports the Government's objective of requiring all financial service providers to be members of an ASIC-approved EDR scheme,[6] and that EDR be the forum of first choice for complaints against credit providers.

The rationale for this requirement is explained in the revised explanatory memorandum to the NCCP Bill:

> 4.9 Consequently, wherever possible, parties will be encouraged to resolve disputes without resorting to litigation. It is expected that courts would generally only be utilised where internal dispute resolution (IDR) and EDR processes have not resolved the matter, or where EDR is considered inappropriate.
>
> ...
>
> 4.11 This also recognises that in cases of hardship or other consumer credit issues, a facilitated or negotiated outcome can be more favourable to a debtor than if it had been formally heard and determined under law.
>
> 4.12 The key policy objective of the amendments is to maintain accessibility to dispute resolution in terms of location, procedural simplicity and costs...

The Regulation Impact Statement to the Bill notes in no uncertain terms why EDR is the preferred venue:

> 10.86 The importance of mandating access to an EDR Scheme is that they provide consumers who are unable to resolve a dispute directly with their provider with a free, fair and independent dispute resolution mechanism. The alternative is often the complex, time consuming and costly court process which is not particularly viable.

We are aware that some financial services providers have argued against retaining the jurisdiction on the basis that EDR is costly and inefficient.[7] This argument assumes that the courts are themselves an efficient option for handling consumer credit disputes. We have already demonstrated above that they are not. While the courts may provide a relatively cheap debt collection option for credit providers, they are not an efficient way to achieve just outcomes in these kinds of disputes. EDR is far more efficient in this regard.

We also note that retaining the jurisdiction is consistent with the existing approach to internal dispute resolution (IDR). ASIC's regulatory guide 165[8] requires traders to

> refrain from commencing or continuing any legal action, or other enforcement action (e.g. debt collection activity), while a dispute is being handled by the IDR procedures of the credit licensee and for a reasonable time thereafter.

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[6] Required by paragraph 47(1)(i) of the *National Consumer Credit Protection Act* 2009.

[7] For example, see the response to this consultation paper from the Australian Collectors and Debt Buyers Association at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/cp172-submission-ACDBA.pdf/$file/cp172-submission-ACDBA.pdf

[8] At paragraph 165.34.

The purpose of this requirement is to

> ..ensure that IDR procedures are effective and the consumer has an opportunity to complain to EDR...

We believe this reasoning is sound (that the IDR process should be allowed to run its course and resolve disputes wherever possible) and applies equally to EDR. We note also, that greater adherence to the IDR requirement on the part of financial service providers would reduce the time and cost spent at EDR.

<u>Removing the jurisdiction would leave consumers with less access to dispute resolution than before the enactment of the NCCP Act</u>

Prior to the enactment of the NCCP Act, the state based uniform consumer credit regulation gave state tribunals (where they existed) exclusive jurisdiction over applications for hardship variations and complaints regarding unjust contracts. This meant that, even after a credit provider had initiated recovery action in court, consumers could apply to a tribunal and request a stay on the court processes while their complaint was decided.

This raises two points. The first is that the risk that lenders will have to pause recovery proceedings in court has existed for some time. This risk, and the associated costs, should now be seen as a natural part of the debt recovery process and is not in itself an argument against the jurisdiction in RG 139.77-139.79.

Secondly, to remove the jurisdiction under RG 139.77-79 would mean that consumers in states that had tribunals will have less access to dispute resolution than before the introduction of the NCCP Act. Whilst the Federal Magistrates' Court has some jurisdiction in relation to these matters, to date they have not set up any specialised procedures or capacity to deal with this new jurisdiction with the result that this avenue has the limitations described above in relation to courts. Thus removing the EDR jurisdiction would reduce consumer access to dispute resolution This would be clearly contrary to the policy behind the NCCP Act and so inconsistent with the intent of Parliament.

<u>Removing the jurisdiction would allow scheme members to launch collection proceedings purely to avoid EDR complaints</u>

Removing the jurisdiction would effectively permit credit providers to block consumer access to EDR by initiating legal proceedings. This may occur before the consumer has had a chance to access EDR, or even knows of their right to do so. This would create a loophole which could further limit access to justice and create outcomes that are clearly contrary to the Government's policy objectives. Removing the jurisdiction will also limit the ability of consumers to bring legitimate complaints where the scheme member has acted unreasonably. This restricts access to justice for consumers and prevents genuine disputes from being ventilated.

Case study: Jenny

Jenny (name has been changed), a Centrelink recipient, obtained a personal loan. Jenny was required to move at short notice and got behind on her loan repayments by $400.

Jenny says that she received a letter from the lender giving her time to catch up on the outstanding payments. Jenny managed to get the money together to pay the arrears, but when she called the lender to arrange payment, she was transferred to a debt collector. The collector said that it had commenced legal action, it was now too late to pay the arrears, and Jenny would have to wait to be served with the complaint in the Magistrates Court.

Jenny says that she was not served with the complaint for weeks, and when it arrived the complaint was dated several days after the debt collector said it had already been issued. When she contacted the debt collector again, she was told that she could enter into a payment plan, but that the debt collector would seek judgement anyway.

On Consumer Action's advice Jenny lodged a complaint with an external dispute resolution scheme to stop the debt collection action. The lender contacted her almost immediately and offered a repayment arrangement.

Jenny's story suggests that both the lender and debt collector were unnecessarily heavy handed given the small amount in arrears and her stated willingness to repay. It is important that consumers be able to resolve relatively simple disputes such as these without having to proceed to court.

The jurisdiction is used widely and responsibly by consumers

Data noted in the consultation paper demonstrates that the jurisdiction has been widely used by consumers in complaints to FOS[9] and COSL.[10] This aligns with Consumer Action's experience. Consumer Action's legal advice service frequently receive calls regarding financial service providers initiating debt recovery proceedings and callers are advised to lodge an EDR complaint where they have arguable grounds for a complaint, such as a hardship variation or unjust contract.

Consumer Action's records show at least 19 advices given since 1 January 2010 where consumers reported that their lender had initiated proceedings to secure a writ of possession (that is, the lender was seeking permission to repossess property, usually a home) and the consumer was advised to lodge a complaint with an EDR scheme.

While 19 cases does not appear to be a large number, we note that each of these cases is significant as the potential outcome—loss of a home—is severe. Consumer Action has also handled many other cases involving proceedings other than a writ of possession (for example, relating to unsecured lending).

[9] See paragraph 21.
[10] See paragraph 24.

There are a number of legitimate reasons why consumers (and disadvantaged or vulnerable consumers in particular) may not make a complaint to EDR before proceedings are initiated. Many consumers are unaware that they have the ability to complain about lender conduct or seek a hardship variation. Those that do wish to complain may not know of the existence of the EDR schemes or know where to seek help. Many borrowers simply fail to seek legal advice until their situation reaches a critical point, such as when they receive court documents. This being the case, it is entirely reasonable that consumers should have the option of making a complaint to an EDR scheme even where lenders have taken all reasonable steps before resorting to court proceedings.

Case study: Emily

When Emily (name has been changed) first approached Consumer Action, she was in her 60s and had a chronic health condition which has interrupted her employment and put her future earning capacity at risk. She had two credit cards with one lender.

The credit limit of one of these cards had been increased over six years from $3,000 to $20,000. In each case, the increases were made after Emily received unsolicited credit limit increase offers. At all relevant times, the lender was on notice that Emily was struggling to repay her existing debt.

By the time Emily sought advice from Consumer Action, the total debt across the two cards was over $25,000, and the lender had issued proceedings in the Magistrates Court of Victoria to recover the debt. The only way Emily could have repaid the debt would have been by selling her family home.

With assistance from Consumer Action, Emily made a complaint to the EDR scheme asserting that the lender had made no attempt to assess Emily's ability to repay her debts before offering her more credit, and as a consequence had caused her to be financially overcommitted.

After making the EDR complaint Emily obtained a satisfactory outcome which allowed her to keep her home.

Finally, it is worth noting that it is unlikely that this jurisdiction will be abused by consumers as a delaying tactic. Despite EDR offering a low cost forum, default interest on debts continues to accumulate when a consumer brings an action in EDR, creating a financial disincentive to delay resolution of an unmeritorious claim. If unmeritorious or vexatious claims are made, both COSL and FOS can refuse to hear them, which will ensure that delay to members is kept to a minimum.[11]

[11] FOS Terms of Reference 5.2(d); COSL rules 10.1(t).

Argument to extend the jurisdiction—response to question B1Q2

B1Q2 If you disagree with Proposal B1, what refinements do you consider necessary to improve RG 139.77–RG 139.79, and why?

<u>If any change is made, it should be to extend the jurisdiction to allow EDR schemes to consider complaints even where a default judgment has been made</u>

There are sound arguments that consumers should still be able to lodge EDR complaints against credit providers in cases where default judgment has been entered.[12]

We acknowledge that, generally, if the complaint has been dealt with, or has been the subject of a decision of a court, then EDR should not re-consider the matter. However, we do not accept that a default judgment means that a matter has been dealt with or considered by a court. A default judgment is a binding judgment in favour of a plaintiff (the financial service provider) where a defendant (the consumer) has not responded to the complaint or appeared before the court. Default judgments are generally made 'on the papers', with very limited if any consideration by the court about whether the debt is owed, whether the defendant has a defence, or whether they may have rights relating to making a hardship variation.

There are many reasons why a default judgment might be issued despite the consumer having a valid defence. These relate not only to the vulnerability of the consumer who may not understand the court proceedings or their rights to complain to EDR and such does not enter a defence, but also the practices of those seeking default judgments and the nature of the default judgment process itself.

In our view, it is reasonable to allow EDR schemes the discretion to investigate complaints after a default judgment has been entered, given that the issues covered in the default judgment have not yet been genuinely considered. This would not displace the ability of the EDR schemes to refuse to hear cases if the issues have been considered or if the complaint is without substance.[13]

We note that currently COSL goes further than FOS in its rules when it comes to default judgments. Pursuant to its Position Statement Issue 3, COSL will, where it considers that a borrower has valid grounds for seeking a stay of execution of a default judgment, ask or order the lender to stay execution for a particular period of time. In its position statement, COSL notes:

> Despite the fact that borrowers are able to apply to the Court to stay execution of a default judgment, we have observed that often they do not exercise their right. The precise reasons are not clear, but are likely to include that borrowers:
>
> (a) are not aware that they can apply for a stay;
> (b) are not legally represented;
> (c) may not be able to afford the cost involved in seeking a stay; or
> (d) may be located in a remote or rural area and face practical difficulties in bringing matters to Court.

[12] Arguably the COSL rules already allow such complaints under 10.1(n)(i)
[13] FOS Terms of Reference 5.2(d); COSL rules 10.1(t).

> Given the relative certainty of the way in which Courts will grant stays of enforcement in the situations ..., COSL will exercise its jurisdiction in specific situations with the aim of achieving the same result (or a comparable result) to that which a borrower could reasonably be certain of achieving if they applied to the Court.

We strongly support this extended jurisdiction, and note that COSL's position about the reasons a borrower might not apply to a court to seek a stay of execution of default judgment equally applies to all court processes that require consumers to take an active step in the proceedings (such as issuing a defence). For these reasons, we think RG 139 needs to be refined not only to make it clear that EDR schemes must, where appropriate, require lenders to stay execution of default judgment. It must also be refined to make it clear that EDR schemes are able to reconsider default judgments as well.

Proposed changes to the National Credit Act—response to question B1Q3

Question B1Q3: Do you consider any refinements necessary to RG 139.77–RG 139.79 given proposed changes to the National Credit Act? If so, how and why?

We do not believe that any refinements to RG 139.77 – RG 139.79 will be necessary following the proposed amendments to hardship procedures in the National Credit Act.

We understand that the proposed amendments will broaden access to hardship by removing a ceiling preventing claims where the credit provided is above $500,000, allowing consumers to seek hardship variation requests verbally, and reducing the restrictions on reasons for requesting hardship. The proposed amendments will also require licensees to delay commencing debt recovery proceedings until 14 days after a credit provider has refused a request to a hardship variation.

We welcome these amendments. However, they do not make the jurisdiction provided by RG 139.77 – 139.79 any less necessary because they:

- will not reduce the likelihood of credit providers or debt collectors initiating debt recovery proceedings in court; and
- will not improve the ability of consumers to defend themselves against those proceedings, or bring hardship claims in the courts.

Responses to comments in paragraph 36 of the consultation paper

At paragraph 36 of the consultation paper, ASIC says:

We may be persuaded to refine our requirement in RG 139.77–RG 139.79 if, for example, we receive sufficient information to suggest that:

(a) debt recovery legal proceedings relating to certain scenarios for other financial products are not able to be appropriately handled at EDR and would be more appropriately addressed in court. We may update RG 139.77–RG 139.79 to clarify that such scenarios are excluded from scheme jurisdiction;

(b) certain court processes and procedures prevent a scheme member from being able to reasonably comply with FOS and COSL's requirements on this jurisdiction, which leaves the scheme member open to being reported to ASIC for serious misconduct. We may update RG 139.77–RG 139.79 to accommodate these court processes and procedures; or

c) a class of complainants is being allowed access to EDR under this jurisdiction when EDR can do little to resolve the complaint and the complaint would be more appropriately handled in court. We may update RG 139.77–RG 139.79 to refer to a class of complainant that may be excluded from scheme jurisdiction in limited situations.

We would be very concerned with any proposal to exclude particular products, scenarios or groups from EDR jurisdiction under RG 139.77-139.79. The danger with this kind of carve-out is that it may arbitrarily deny access to EDR based on the form of a product, even though the substance of a complaint is meritorious. We are not aware of any evidence that supports the suggestion that particular situations should be excluded from jurisdiction, or that they could be excluded without also excluding meritorious claims.

We are particularly dubious that the risk suggested by paragraph 36(b) will eventuate. The risk envisaged is that scheme members who have court proceedings on foot will be forced by the court to take further 'steps' in those proceedings, which would breach the member's obligations under RG 139.77-139.79.

This is unlikely to occur because very few of the rules of court in Australia are self-enforcing, rather, are only enforced on application of one of the parties to the action. For instance, the requirement to deliver a List of Documents and other forms of Discovery within a fixed time after the close of pleadings will only be acted on if the party who has not received discovery makes an application to the court for an order. As the consumer will be the other party and it is the consumer who has taken the matter to EDR, they will be uninterested in applying to force the member to take the next step. The only time an action "rolls on" without the parties making such application is where cases are "supervised" or "managed" and a judicial officer periodically calls up a matter and makes directions for parties to take certain steps. This is rare in consumer cases.

As noted above, our experience and the available data suggests that many consumers are making use of this jurisdiction to resolve genuine complaints against the conduct of scheme members. We have also demonstrated that the courts appear to be unable to provide an accessible forum for these disputes for the overwhelming majority of consumers. We cannot see how closing off access to this jurisdiction will create more just outcomes than leaving access open.

Even if it appears to ASIC that a particular type of product or scenario is not being handled appropriately at EDR, this is not a sound argument for closing off EDR jurisdiction given the inability of courts to hear these matters. At most, this is an argument for EDR schemes to retain their existing discretion to refuse to hear complaints if they are not suited to EDR and would be better suited to consideration by the courts.[14]

[14] FOS Terms of Reference 5.2(a); COSL rules 10.1(p).

Thank you again for the opportunity to provide input. Please contact David Leermakers at Consumer Action on 03 9670 5088 or david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

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Appendix - About the Contributors

Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

We also operate MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians experiencing financial difficulty.

Consumer Credit Legal Centre NSW

Consumer Credit Legal Centre (NSW) Inc (CCLC) is a community-based consumer advice, advocacy and education service specialising in personal credit, debt and banking law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We provide legal advice and representation, financial counselling, information and strategies, and referral to face-to-face financial counselling services, and limited direct financial counselling. CCLC also operates the Insurance Law Service, a national service assisting consumers with disputes with their insurance company.

A significant part of CCLC's work is in advocating for improvements to advance the interests of consumers, by influencing developments in law, industry practice, dispute resolution processes, government enforcement action, and access to advice and assistance. CCLC also provides extensive web-based resources, other education resources, workshops, presentations and media comment.

Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. Financial counsellors assist consumers in financial difficulty by providing information, support and advocacy. Their services are free, confidential and independent. The majority of financial counsellors work in non-profit community organisations.

Financial Counselling Association Queensland

FCAQ is the peak body for the Financial Counselling sector in Queensland. The association has 72 members located from Cairns to the Gold Coast and west to Roma.

Our membership's client base (depending on funding agreements) ranges from wage/salary earners, gamblers, and Centrelink recipients; self funded retirees, small business owners and

primary producers. Financial Counsellors provide support to individuals or families experiencing financial difficulties. Support is tailored to each client and includes advocacy, budgeting, education, and empowerment. Referrals are made where necessary and appropriate to other services to further improve the situation of the client.

Financial and Consumer Rights Council

The Financial and Consumer Rights Council Incorporated (FCRC), is the peak body for community based organisations and individuals concerned with the rights of financially disadvantaged and vulnerable consumers in Victoria. The purposes of the FCRC are to advocate for vulnerable Victorian consumers who are experiencing financial difficulty and to support the financial counselling sector through its casework, advocacy and law reform, to adopt and maintain best practice.

Consumer Law Centre of the ACT

The Consumer Law Centre of the ACT is a free, independent, community legal centre funded by the ACT Government. It aims to provide legal assistance and advice to low to moderate income consumers, primarily in the areas of consumer credit, telecommunications and utilities, as well as general fair trading and consumer protection. The Centre also works towards improving legal protection for consumers, and raising awareness and understanding of consumers' rights in the ACT.