

Expansion of Financial Ombudsman Service Australia Small Business Jurisdiction

Submission by Legal Aid Queensland



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Introduction

Legal Aid Queensland (LAQ) welcomes the opportunity to make a submission in response to consultation regarding the expansion of the Financial Ombudsman's Small Business Jurisdiction.

LAQ provides input into State and Commonwealth policy development and law reform processes to advance its organisational objectives. Under the *Legal Aid Queensland Act 1997*, LAQ is established for the purpose of "giving legal assistance to financially disadvantaged persons in the most effective, efficient and economical way" and is required to give this "legal assistance at a reasonable cost to the community and on an equitable basis throughout the State". Consistent with these statutory objects, LAQ contributes to government policy processes about proposals that will impact on the cost-effectiveness of LAQ's services, either directly or consequentially through impacts on the efficient functioning of the justice system.

LAQ always seeks to offer policy input that is constructive and is based on the extensive experience of LAQ's lawyers in the day to day application of the law. We believe that this experience provides LAQ with valuable knowledge and insights into the operation of the justice system that can contribute to government policy development. LAQ also endeavours to offer policy options that may enable government to pursue policy objectives in the most effective and efficient way.

Background

Legal Aid Queensland's Farm and Rural Legal Service (FRLS) was established in the mid-1990s. The FRLS provides advice and assistance to rural producers and rural small businesses that have severe debt related problems or are in dispute with their lenders, or are otherwise facing financial hardship directly related to their business of primary production. The service is free of charge. No income or assets tests apply.

The FRLS works closely with rural financial counsellors and professional advisors, such as agribusiness consultants, accountants and private legal advisors and represents rural producers in farm debt mediations as well as other debt negotiations with their financiers. The FRLS does not provide representation in court proceedings.

The service has one lawyer who travels throughout Queensland including to remote locations to give legal advice. The service assists rural producers on the farm, at a venue of the farmer's choice, at LAQ offices or by telephone.

The FRLS specialises in representing farmers and rural small businesses in negotiating settlement of financial disputes between primary producers and financiers.

FOS is conducting a review of their terms of reference (TOR) with a view to increasing eligibility thresholds for retail and small business customers. LAQ proposes to focus on the expansion of eligibility thresholds for small business and the impact of changes on rural producers and rural small businesses and will respond to proposals in paragraphs 1 to 4 of the consultation paper.

1. Expanding the jurisdiction of the Financial Ombudsman Service for small business credit facility disputes

1.1 Monetary limits

Rural producers and rural small businesses are currently unable to access the services of the FOS:

- if their credit facilities are for amounts in excess of \$2M;
- if the amount in dispute with the financial services provider is in excess of \$500,000; or
- if they have been offered and have accepted farm debt mediation.

The FOS jurisdiction set out in TOR 5.1(o) excludes claims exceeding \$500,000. TOR 5.1(r) further limits jurisdiction to exclude claims against a small business where the contract provides for a credit facility of more than \$2M.

LAQ submits that FOS's existing monetary limits are not reflective of current commercial reality for rural producers and rural small business.

It is quite common for rural producers and rural small business to have credit facilities well in excess of \$2 million and disputes relating to credit facilities in excess of \$500,000.

It is not unusual for our clients to have large overdraft facilities, many in excess of \$1.5M. These facilities do not include core debt which relates to the purchase, development, or expansion of the farming property and enterprise which are often well in excess of \$2M.

Overdraft limits are often reached annually. Generally, farming is a cost intensive business requiring significant inputs. The fluctuations in the overdraft facilities are dependent upon many things including seasonal conditions, commodity price fluctuations, timing of sales and harvest/picking regimes. Income is irregular and may only occur several times a year. Equipment required to operate a farming enterprise is also very sophisticated and expensive requiring large capital outlays which are often financed independently of the overdraft. Livestock operations can have separate funding facilities independent of the overdraft. It is quite common for the value of a farm's plant and equipment to be in excess of \$1M while livestock values reflect similar if not greater investments for farming clients.

The current financial capacity of FOS ensures that many rural producers and rural small businesses will not be afforded any protections offered by FOS and their only recourse in the event of a dispute is to take court actions.

Additionally, LAQ submits that commencing court action to enforce rights is beyond the financial capacity of many small businesses, in particular, rural producers and rural small businesses who are seeking legal assistance with financial distress.

Submission

LAQ supports an increase in the monetary jurisdiction of FOS but considers that the SBCF claim limit and compensation cap should be \$3M rather than \$2M as this is a more commercially realistic figure given the operational costs of establishing and maintaining small businesses and, in particular, rural producers and rural small businesses.

1.2 Dispute resolution processes

a. *Compulsory Conferences and third parties*

LAQ supports the proposals in paragraph 1.2 of the consultation paper.

It is effective for SBCF disputes to be resolved by a decision maker. This provides certainty for both parties because they are both bound by the decision. This is particularly relevant to rural producers and rural small businesses as they do not have the financial capacity to pursue a dispute through the courts. Also, issues relating to the provision of credit or the conduct of the bank are not satisfactorily addressed during a farm debt mediation because there is no mechanism available to compel the credit provider to provide documents and consider these issues during mediation. Our clients should have access to FOS compulsory conferences and dispute resolution to determine such issues if they are not addressed/disclosed at mediation.

LAQ considers the proposals contained in the consultation paper provide a fair, independent and cost effective means of compulsory conferences and dispute resolution. Additionally, access to compulsory conferences and dispute resolution should be available to rural producers and rural small businesses regardless of whether farm debt mediation has been offered, accepted or undertaken.

In the context of farm debt disputes it is not uncommon for a rural producer to have several financiers for parts of the enterprise. For example, Bank A finances the overdraft and credit facility, Bank B finances the crop, Bank C finances livestock and Bank D finances equipment.

Regarding compelling third parties to participate in a FOS dispute resolution process, it is a normal practice for a guarantor or other interested parties to attend farm debt mediations. When third parties are included a realistic resolution and a workable solution is more likely to be achieved.

However, it is not normal practice is for the bank to invite second and third mortgagees to farm debt mediations. Failure to include these additional parties creates difficulties for the rural producer and can prevent an effective resolution of the all matters in dispute.

Disputes relating to a specific financier can rarely be separated from the whole financial structure and obligations of the borrower and trying to mediate isolated disputes leave the rural producer exposed to other creditors who are not party to the negotiations and agreements. This can have significant impact on the capacity of the rural producers to meet commitments under the negotiated agreement as pressure is applied by other creditors.

Submission

LAQ supports rural producers and rural small businesses having access to FOS for compulsory conferences and dispute resolution. Access to compulsory conferences and dispute resolution should be available to rural producers and rural small businesses regardless of whether farm debt mediation has been offered, accepted or undertaken.

LAQ supports paragraph 7.3 of FOS TOR being amended to apply to SBCF disputes in a way that allows FOS, when considering such a dispute, to require a party to:

- attend a compulsory conference; and
- ensure that a relevant third party also attends the conference.

b. Access to FOS dispute resolution processes and farm debt mediation

The Queensland Farm Finance Strategy and other voluntary and legislative approaches throughout Australia provide that financial services providers must offer farm debt mediation before they take enforcement action.

If a rural producer/small business accepts an offer to mediate under any of the schemes, including the legislative schemes, the FOS will not consider the matter even where the farmer's complaint would otherwise fall within its jurisdiction. The FOS exercises its powers relying upon the discretionary exclusions provided in FOS TOR 5.2. that "*there is a more appropriate place to deal with the dispute, such as a court, tribunal or another dispute resolution scheme or the Privacy Commissioner.*"

Generally, farmers are unaware of their rights to refer matters to the FOS even if they fall within the current guidelines. Because of the time limits for accepting mediation, farmers often accept mediation before seeking advice, thinking their interests are being protected by accepting mediation.

It is common that, only after advisors take instructions to prepare for mediation, concerns regarding responsible lending, the provision of documents, the conduct of case management and collection processes, or bank maladministration become apparent.

There is currently no mechanism contained in any farm debt mediation process whether legislated or otherwise which requires a bank to produce documentation or information used to assess the suitability of the loan or later credit limit increases (see Clause 27 of the Code Of Banking Practice), or to provide all relevant communication between the parties which the banker relied upon to make decisions. However, the Farm Debt Mediation Bill 2016, currently before the Queensland Parliament, would require the provision of some documents.

Also, in the mediation process there is currently no obligation on the banks to take into account the effect of any breaches of the *Code of Banking Practice*. In one farm debt mediation, where there was an issue as to the appropriateness of the loan for the farmer's circumstances, the bank representative advised that he would not discuss or consider these issues as they should have been referred to the FOS. The farmer had attempted to raise these issues with FOS after accepting, but prior to the actual, mediation but was prevented by FOS.

Under the current TOR guidelines of the FOS, many rural producers and rural small businesses are excluded from accessing FOS to have breaches of the *Code of Banking Practice* considered in an independent and cost effective manner.

This can occur in two ways:

- a. the rural producer/business has accepted mediation and is excluded because of this regardless of whether they were within the monetary limits of FOS; or
- b. the rural producer/business has a genuine dispute regarding breaches of the *Code of Banking Practice* but they cannot be determined by FOS because of the current monetary limits.

In both cases the farm debt mediation process does not adequately address the issues and protect the customer in relation breaches of the *Code of Banking Practice*. The bank is aware that the customer is excluded from applying to FOS. This knowledge increases the power imbalance between the bank and its customer and reduces the fairness and effectiveness of the mediation.

The only avenue of redress for customers experiencing financial distress is court action which is costly and prohibitive for most rural producers and rural businesses. Private lawyers report that legal costs for a Supreme Court debt dispute can exceed \$200,000. These costs usually need to be paid by the client in advance. Banks can also seek orders for security for costs against the customer at the commencement of the action. These costs and litigation strategies by banks make it commercially unrealistic for a rural producer and rural small businesses to seek redress through the courts. There is no other avenue available if FOS will not consider these matters.

The Farm Debt Mediation Bill currently before the Queensland Parliament would require mortgagees to produce documentation. If this Bill is passed and, during the farm debt mediation process documentation is produced which raises issues relating to breaches of the *Code of Banking Practice*, the rural producer and rural business should not be excluded and should still be able to access FOS.

LAQ does not consider allowing access to FOS after acceptance and commencement of the farm debt mediation process will necessarily “open the flood gates” of customers seeking FOS determinations.

In LAQ’s submission to the Commonwealth Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Impairment of customer loans in 2015, it was stated:

“It is acknowledged that in most instances genuine attempts are undertaken by the banks to try to find a solution to issues. On many occasions there are no easy solutions. Neither the customer nor the banker is to blame for the problem. However, outcomes can often result in great financial and emotional loss for the farmer and sometimes significant loss for the bank. These circumstances are sometimes unavoidable.

Many of the FRLS clients’ financial difficulties arise as a result of circumstances beyond the control of either the client or the bank. There are many issues which can affect the financial well-being of a farming business, including flood, fire, drought, cyclones, product market collapse, market manipulations, over-supply, disease and financial market collapse.”

For the above reasons once the reality of the rural producer’s/small business’ situation is openly and fairly explained before or during mediation they are generally keen to have a quick resolution. LAQ supports the opportunity remaining available for referral to FOS in circumstances of genuine breaches of the *Code of Banking Practice* being identified and the client wanting to pursue this through FOS.

Submission

LAQ submits that:

- the FOS should have jurisdiction to consider a complaint about a financial services provider even where the financial services provider has offered to mediate the dispute and/or the client has accepted an offer to mediate the dispute and/or the mediation has been undertaken; and
- the FOS jurisdiction should be widened to provide that if during a mediation, the client considers that the financial services provider has failed to provide adequate documentation or has failed to adequately address genuine concerns raised during the mediation process relating to the conduct of the financial services provider, the rural producer can refer the matter to FOS should it fall within the extended jurisdiction.

1.3 Format of TOR

LAQ supports the proposals contained in paragraph 1.3 of the consultation paper.

2 Varying credit facilities

2.1 Jurisdiction and remedies

For reasons already outlined earlier in this submission, LAQ supports the proposals contained in paragraph 1.3 of the consultation paper.

We consider the proposals will have a positive impact on rural producers and rural small business.

The proposal that would enable the forgiveness or variation of an unregulated credit facility would have a significant and positive impact of rural producers and rural small business and would provide a fair, equitable, costs effective, independent and binding resolution of the dispute.

3 Improving consistency

Legal Aid Queensland supports the proposals contained in paragraph 3.1 of the consultation paper.

LAQ considers the proposals will have a positive impact on rural producers and rural small business.

4 Operating an expanded small business jurisdiction

4.1 Proposed operating model

Legal Aid Queensland supports the proposals contained in paragraph 4.1 of the consultation paper but submits that there should be a specialist unit for rural producers and rural small business.

Agribusiness is a specialised industry. Each type of industry within agriculture (i.e. dairy, viticulture, fisheries, sugar cane, beef, horticulture, broad acre farming, small crops etc.) also has its own specialised financial requirements. Any decision maker within FOS will need to have detailed knowledge, experience and understanding of multiple specialised rural industries.

Some rural producers and rural small businesses have been exposed to inappropriate banking practices due to the banks failure to understand the complexities of the industry. In these circumstances the rural producer and rural small businesses have had viable and efficient businesses financially impacted by inappropriate banking practices.

For example, it is important for bank managers to understand the funding needs of particular rural industries. It is not unusual for new bank managers to be placed into an area where a specialised rural industry is conducted and the new manager has no knowledge of or training in the funding needs of that industry. Many industries require large short term annual credit extensions to fund harvest, packing and transport costs and for the financing decision to be made in an efficient and timely manner. Failure to understand the financial needs and the impact of timeframes for a particular industry can be catastrophic for rural producers, their suppliers and local communities. It is important that FOS decision-makers understand the factors affecting rural debt including:

- industry practices and needs for each area of agribusiness including timeframes for planting, harvesting, transporting and marketing/sales;
- impact of weather conditions and natural disasters;
- impact of export and commodity price fluctuations;
- changing State and Commonwealth Government policy; and
- impacts of geographical and climate conditions on industries in different regional areas (e.g. the beef industry in Southern Queensland faces different issues and challenges to the beef industry in the Gulf.).

Submission

LAQ supports the establishment of a separate business unit within FOS's Banking and Finance Area staffed by case workers and decision-makers with strong expertise and experience in dealing with rural producers and small business disputes, including agribusiness specialists.

LAQ supports the proposed funding model and imposition of a "small business levy".

4.2 Commencement date for proposed changes

In addition to this review of the FOS's Terms of Reference, in the past 12 months the State and Commonwealth Governments have sought submissions in relation to the following:

- Commonwealth Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Impairment of customer loans,
- Queensland State Rural Debt and Drought Taskforce,
- Queensland State Department of Agriculture and Fisheries proposed Farm Debt Mediation Bill.

Submission

LAQ submits that FOS, when considering the commencement date of proposed changes to FOS's terms of reference, should take into account and compliment the legislative changes being considered by the Queensland and Commonwealth Governments. Rural producers and rural small business should have access to FOS notwithstanding that farm debt mediation has been offered or undertaken.